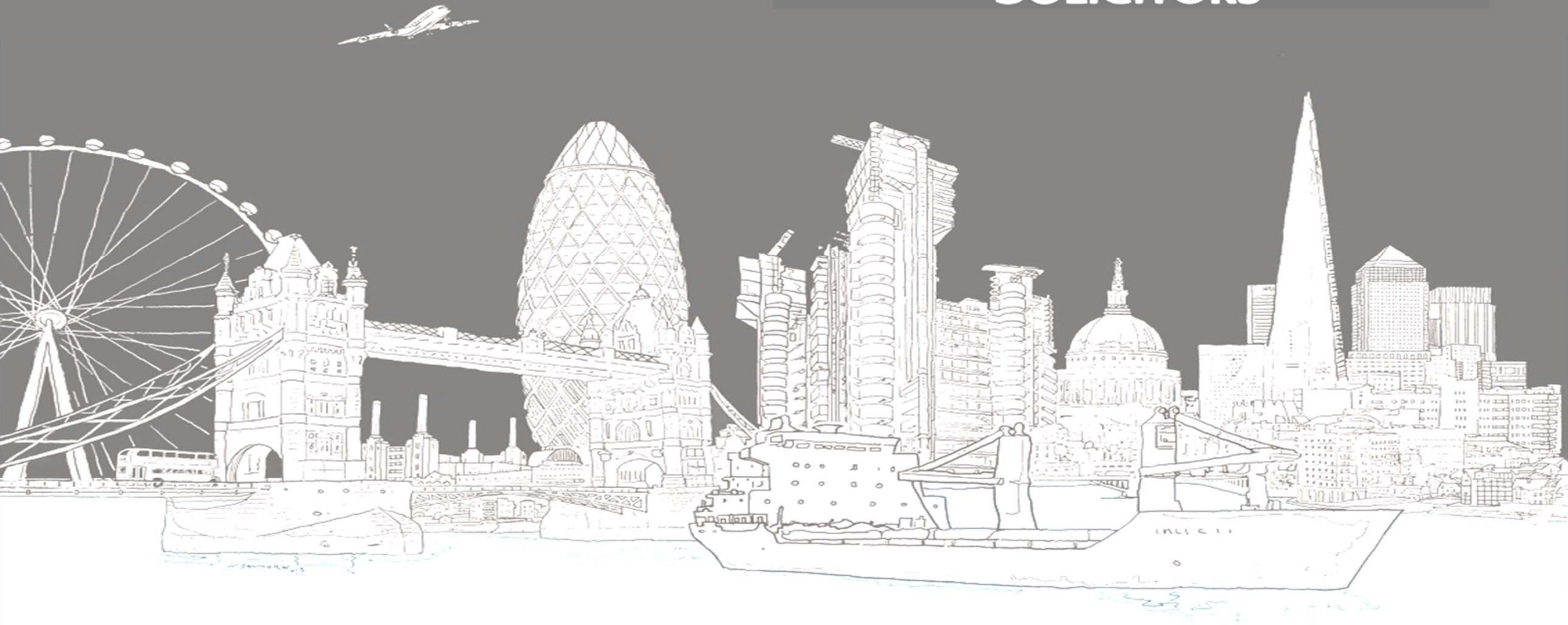


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Practical sanctions - what are the pitfalls in claims handling

Does the lifting of sanctions relating to Iran make things easier or more complicated?

29th September 2016

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Agenda

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2. Implementation Day
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A few interesting facts about Iran...



- Iran is the second largest economy in the Middle East, after Saudi Arabia, with an estimated nominal GDP of approx. \$390 bn in 2016.
- It has the second largest population in the Middle East, after Egypt, with around 80 million people, of which over 60% are estimated to be under 30 years old and its workforce is highly educated.
- EU trade with Iran currently stands at around \$8bn-which is expected to quadruple in the next 2 years.
- Iran has the second largest gas reserves and fourth largest oil reserves globally.
- Iran has proven oil reserves close to 160 bn barrels, equivalent to more than 100 years of production at the current rate of extraction. Petrochemical production is the second-largest industrial sector after oil and gas.
- The Iranian government has set to boost the nation's oil production by 20 percent by 2021 from 3.8 million barrels a day to 5 million. Iran's oil exports have progressively risen the last 7 months currently reaching approximately 2 million barrels a day.
- Iran shares the world's largest gas reserves with Qatar and has the potential to become a leading LNG exporter, subject to accessing the right technology.

Implementation Day declared on 16th January 2016

Implementation Day marks the day on which *Yukiya Amano*, the General Director of The International Atomic Energy Agency (IAEA), confirmed that Iran had implemented its nuclear-related commitments, as described in sections 15.1-15.11 of Annex V of the JCPOA.

Following the IAEA's verification report that Iran had met its commitments, the European Union and the U.S. took all necessary actions to lift sanctions as set out in sections 16 and 17 of Annex V of the JCPOA.



EU position

- EU restrictions on Financial and Banking activities, Insurance and Reinsurance services, Petroleum and Shipping activities to and from Iran, have now been removed as part of the sanctions relief triggered on Implementation Day.
- A number of Iranian individuals and entities, including many (but not all) Iranian banks, have been delisted.
- This now allows financial transactions to go ahead with Iran, provided that no listed entities or individuals are involved.



U.S. position

U.S. primary sanctions remain in place:

U.S. persons, companies, citizens, permanent resident aliens, wherever located- largely, anyone in the territory of the U.S.-continue to be prohibited from engaging in transactions or dealings with Iran, the Iranian Government and Iranian financial institutions with the limited exception of transactions that are exempt or authorised by U.S. Treasury's Office of Foreign Assets control (OFAC).



U.S. Primary Sanctions- General Licensing

The U.S. Government provides licensing on a case-by-case basis:

- OFAC has issued “General License H” which authorises foreign subsidiaries of U.S. companies to engage in most Iran-related transactions to almost the same extent that a non-U.S. company can now engage in them, without triggering the imposition of U.S. sanctions. “General License H” also authorises U.S. persons to establish or alter policies and procedures to enable their foreign subsidiaries to engage in Iran-related transactions as long as such activity does not trigger the general prohibition on approval or facilitation by a U.S. person that would violate U.S. sanctions.
- In addition, there is a general licence now available for U.S. persons authorising the importation into the U.S. of certain Iranian origin foodstuffs and carpets and a favourable licensing policy has been established by OFAC under which U.S. persons (as well as their foreign subsidiaries and non-U.S. persons) may request a specific license to engage in transactions for the sale of commercial passenger aircraft and related parts and services to Iran.
- OFAC does have an informal policy of entertaining “requests for interpretative guidance” regarding transactional matters. That is distinct from a formal request for a license because: (a) a specific license seeks authorisation to do something which is otherwise prohibited; while (b) a request for interpretative guidance seeks confirmation that an action would not be in violation of a sanctions regime. We suspect that requests for interpretative guidance may be similar to what can be described as a “comfort letter.” However, we do not see a statutory or regulatory basis for the “interpretative guidance” procedure. Thus, we do not know whether a resulting response to a request will be sufficient “comfort” that no action would be taken or whether a bank could rely upon a positive response for interpretative guidance.



U.S. Primary Sanctions- General Licensing (2)

There are some activities not covered by the licence that remain prohibited to foreign subsidiaries of U.S. companies such as:

- dealing with SDNs (persons appearing in OFAC's List of Specially Designated Nationals and Blocked Persons);
- exporting from the U.S. any goods or service to the Iranian Government;
- any transfer of funds to or from a U.S. bank;
- dealings with military, paramilitary, intelligence, or law enforcement bodies of the Iranian Government, including the Islamic Revolutionary Guard Corps (IRGC) or its affiliates;
- engaging in any activity that remains subject to sanctions under U.S. Executive Orders relating to Iran's proliferation of weapons of mass destruction and their means of delivery, including ballistic missiles;
- activities connected to international terrorism; Syria; Yemen; or Iran's commission of human rights abuses;
- any nuclear activity involving Iran that is subject to the UN procurement channel (put in place further to the JCPOA) but that has not been approved through that procurement channel process.



Secondary U.S. Sanctions

The U.S. has lifted the nuclear-related “secondary sanctions” (i.e. sanctions with extraterritorial reach, directed toward non-U.S. persons) described in sections 4.1- 4.7 of Annex II and 17.1-17.2 of Annex V of the JCPOA by:

- Issuing waivers of certain statutory sanctions provisions;
- Committing to refrain from exercising certain discretionary sanctions;
- Removing certain individuals and entities from OFAC’s sanctions list; and
- Revoking certain Executive orders and specified sections of an Executive order.

* Non-U.S persons continue to be prohibited from knowingly engaging in conduct that seeks to evade U.S. restrictions on transactions or dealings with Iran that occur entirely outside U.S. jurisdiction.



U.S. delisted over 400 individuals and entities from:

- 1) OFAC's List of Specially Designated Nationals and Blocked Persons (SDN List);
 - 2) The Foreign Sanctions Evaders List (FSE List); and
 - 3) The Non-SDN Iran Sanctions Act List (NS-ISA List),
- pursuant to sections 4.8.1 of Annex II and 17.3 of Annex V of the JCPOA.

The names of those individuals and entities are set out in Attachment 3 to Annex II of the JCPOA.

- Most importantly, entities including the Central Bank of Iran (**CBI**), Iran Insurance Company (**Bimeh Iran**), the National Iranian Oil Company (**NIOC**), the Islamic Republic of Iran Shipping Lines (**IRISL**), the National Iranian Tanker Company (**NITC**) and the Naftiran Intertrade Company (**NICO**) have now been removed from the SDN (and EU) lists.



Non-U.S. persons will no longer be subject to sanctions for conducting transactions with any one of the more than 400 individuals and entities, including CBI and other specified Iranian financial institutions.

However,

secondary sanctions continue to apply to non-U.S. persons for conducting transactions with any one of the more than 200 Iranian or Iran-related individuals and entities who remain, on the SDN List, notwithstanding the lifting of secondary sanctions.



Financial and Banking services (EU Position)

The following are now permissible:

- Transfers of funds between non-sanctioned Iranian and EU persons, entities and bodies, including financial and credit institutions.
- The opening (or re-opening) of subsidiaries, branches or representative offices of non-listed Iranian banks in EU Member States.*
- The supply of specialised financial messaging services, including SWIFT, for Iranian persons, entities or bodies, including the CBI and other financial institutions that are no longer the subject of restrictive measures.
- Joint ventures and opening of bank accounts with Iranian financial or credit institutions.
- Provision of export credit and guarantees, insurance and other financial assistance.

*Melli Bank PLC and Persia International Bank PLC have been given the regulatory go-ahead to resume their operations in the UK and the EU.



Financial and Banking services (U.S. Position)

Non-U.S. persons, including foreign financial institutions, can engage in financial and banking transactions with the CBI or other financial institutions from Implementation Day without risk of exposure to sanctions.

U.S. persons, however, continue to be prohibited from engaging in transactions or dealings with the Iranian Government and financial institutions, including the CBI, with the exception of transactions that are exempt from regulation or authorised by OFAC.

US dollar-denominated transactions are broadly prohibited. Foreign and US financial institutions cannot use US dollars for any transaction in relation to Iran.



The Energy Sector (EU Position)

The following are now permissible:

- The import, purchase, transportation and swap of Iranian crude oil, petroleum products, natural gas and petrochemicals.
- The supply and export of equipment or technology as well as the provision of technical support, including training to any Iranian person, in or outside Iran, or for use in Iran.
- The investment in the Iranian oil, gas and petrochemical sectors by the provision of financial loans or credit to, participating in or creating joint ventures with any Iranian person engaged in the oil, gas and petrochemicals sectors in or outside Iran.

At present:

- More than 25 European and Asian-owned supertankers with capacity to carry more than 25 million barrels of light and heavy crude and fuel oil have either loaded in recent months or are about to load at Iran's Kharg Island and Bandar Mahshahr terminals to ship to international buyers.



The Energy sector (U.S. Position)

- The U.S. is no longer pursuing efforts to reduce Iran's sales of crude oil under the National Defense Authorization Act for Fiscal Year 2012 (NDAA);
- The restriction on the use of the proceeds of sales of Iranian petroleum and petroleum products for bilateral trade with Iran, which previously applied to the 20 jurisdictions with a so-called “significant reduction exception” under the NDAA, no longer applies (sections 4.3 of Annex II and 17.1 of Annex V of the JCPOA);



The Energy sector (U.S. Position)

The following activities by non-US persons are no longer the subject of sanctions:

- Investment, including participation in joint ventures, supply of goods, services, information, technology and technical expertise and support for Iran's oil, gas and petrochemical sectors;
- The purchase, acquisition, sale, transportation or marketing of petroleum, petrochemical products and natural gas from Iran, provided the transactions do not involve persons on the SDN List;
- The export, sale or provision of refined petroleum products and petrochemical products to Iran;
- Transactions with Iran's energy sector including with NIOC, NICO and NITC;
- The provision of associated services for each of the categories above.

*Transactions related to the above-mentioned activities are prohibited from transiting the U.S. financial system.



Shipping, shipbuilding and transport (EU position)

The following are now permitted:

- Sale, supply, transfer and export of naval equipment and technology for shipbuilding and maintenance to Iran or Iranian persons.
- Construction, design or participation in the construction and design of Iranian cargo vessels and oil tankers.
- Supply of oil and petrochemicals transport and storage vessels to Iranian persons.
- Provision of flagging and classification services to Iranian-controlled tonnage.
- Access to EU airports by passenger and cargo flights operated by Iranian carriers or originating from Iran.
- Provision of fuel, engineering and maintenance services to Iranian cargo aircrafts.
- Cargos to and from Iran of previously prohibited items will no longer be subject to inspection, seizure and disposal by EU Member States.



Shipping, shipbuilding and transport (U.S. position)

The U.S. have lifted the secondary sanctions on Iran's shipping and shipbuilding sectors and port operators in Iran, including sanctions related to:

- the sale, supply or transfer to, or from, Iran of goods and services used in connection with Iran's shipping and shipbuilding sectors, including port services such as bunkering, inspection, classification, and financing;
- transactions with entities that are part of the shipping or shipbuilding sectors of Iran (including IRISL, South Shipping Line, NITC and port operators of Bandar Abbas, provided that such persons are no longer controlled by a person on the SDN List); and
- the provision of associated services for the foregoing.



Insurance & Reinsurance (EU position)

- As of Implementation Day, the provision of insurance and reinsurance to Iran and any non-listed Iranian person, entity or body is permitted.
- The majority of the insurance and reinsurance providers and brokers, who have no U.S. connection, can provide their services with regard to activities consistent with the JCPOA (sections 4.2 of Annex II and 17.1 of Annex V).



Insurance & Reinsurance (US Position)

- The provision of underwriting services, insurance, or reinsurance by non-U.S. persons for activity that is consistent with the JCPOA (including in connection with activities in the energy, shipping, and shipbuilding sectors of Iran, for NIOC or NITC, or for vessels that transport crude oil, natural gas, liquefied natural gas, petroleum and petrochemical products to or from Iran) is no longer subject to secondary sanctions, as of Implementation Day, provided that the transactions do not involve persons on the SDN List. *
- OFAC will not impose penalties on a non-U.S. person for payment of insurance, or reinsurance claims, arising from an incident that occurred prior to Implementation Day, provided that the underlying activity would not be subject to sanctions at the time of payment and the transaction does not involve persons on the SDN List.
- To the extent that a claim payment involves a U.S. person, the payment remains prohibited and requires authorisation from OFAC prior to payment.

*Note: U.S. persons continue to be barred from providing insurance services to Iran. Similarly, non-US insurers who employ U.S. nationals still risk exposing those individuals if they write unlicensed Iranian business.



Insurance and reinsurance services to NITC or IRISL vessels

- Non-U.S. persons are now permitted to provide underwriting services, insurance, or reinsurance to NITC and/or IRISL vessels or vessels owned by non-U.S. persons when chartered by NITC or IRISL, provided that the transactions do not involve persons on the SDN List.*
- U.S. persons continue to be prohibited from providing underwriting services, insurance, or reinsurance to NITC or IRISL, including extending insurance coverage to, or paying claims involving, NITC or IRISL.

*Note: a certain number of NITC tankers and IRISL dry cargo vessels have already regained IG P&I cover.



P&I insurance – Fall Back cover



- By virtue of the continuing U.S. primary sanctions, the U.S. domiciled reinsurer participation on the General Excess Loss (GXL) reinsurance programme remains affected. This has a further impact upon the ability of U.S. affiliated or subsidiary reinsurers to pay a claim which their U.S. domiciled parent or affiliate would be prevented from paying causing a significant shortfall in recovery under the GXL programme.
- Since the lifting of the Iranian sanctions the IG Group has hold discussions with OFAC with regard to the issue of licence to the US-domiciled reinsurers which will allow them to participate on the Group and Hydra reinsurance programmes. Securing a formal licence will provide a long-term solution to the problem of ensuring the availability of full and global P&I coverage for shipowners.
- In the meantime, as an interim solution to facilitate the resumption of lawful trading with Iran, the Group has gained approval from OFAC for a "fall-back" reinsurance coverage programme, for non U.S. reinsurers that bridges either fully or partially any GXL programme shortfalls. This allows some flexibility to the Iranian seaborne trade and especially the sale of Iranian crude to the world market. On 14th April 2016 the IG increased the cover amount from 70 to 100 million EUR. The Group aims to have a permanent solution in place for 2017.



P&I insurance – Fall Back cover (2)



- The cover offered is an annual cover in respect of P&I liabilities providing indemnity in respect of claims which would otherwise have been recoverable under the first and second layers of the Group GXL reinsurance programme, U.S. domiciled private placement and the Hydra reinsurance programme, but for an inability to pay by U.S. domiciled reinsurers due to the continuing U.S. primary sanctions.
- We understand that the American Club (US–domiciled) has now been granted a licence and would, therefore, be able to contribute their share of any pool claim involving Iranian interests in most circumstances and for very large claims which impact upon the IG's Group Excess Loss programme.
- The risk is that the cover could be exhausted by several very significant Iran-related liability claims, or an aggregation of smaller claims up to the overall current policy limit (100 million euros). The costs which are not covered by the “fall-back” provision will remain with the shipowner.



EU & U.S. Sanctions still in place

The EU and U.S. have retained the sanctions in connection with activities outside the scope of the JCPOA including:

- arms embargo, missile technology and weapons of mass destruction (WMD) sanctions (the restriction will continue to be in place until 'Transition day' in October 2023);
- human rights, support for terrorism, regional destabilisation;
- restrictions regarding the trade control licensing requirements for export credit and(re)insurance for export to Iran of certain goods and technology related to nuclear items, graphite, metals and software designed for use in nuclear and military industries;
- a number of Iranian persons and entities continue to have their assets frozen under the sanctions regime;
- there are still travel restrictions in place that prohibit the admission into the EU of certain listed persons.



The “Snapback” Provisions

The snapback provisions are in place to ensure that Iran continues to abide by the terms of the agreement in the longer term. It is not meant to act as a disincentive for companies looking to do business in Iran.

The snapback of sanctions will be considered only when the Dispute Resolution Mechanism set up under the terms of the JCPOA has been exhausted. This mechanism aims to resolve any disputes between the E3+3 and Iran so that the snapback of sanctions will only be considered as a last resort.

However, in the event of significant non-performance by Iran of its JCPOA commitments such that cannot be resolved through the Dispute Resolution Mechanism, the snapback of sanctions will be considered by the other JCPOA participants.

In the event of a snapback, these provisions would not apply with retroactive effect to contracts signed between any party and Iran or Iranian individuals and entities prior to the date of application, provided that the activities contemplated under and execution of such contracts are consistent with this JCPOA and the previous and current UN Security Council resolutions.



Points to consider when dealing with Iran-related matters

A number of points need to be considered and practical steps taken to avoid pitfalls when dealing with Iran or Iran-related matters and/or claims:

- Seek legal advice on the residual EU and US secondary sanctions, especially as regards non-US subsidiaries of US persons considering Iran-related business under “General License H”, to ensure there is no risk of facilitation by a US person; Refer delegated underwriting or claims on any Iran-related business to your compliance officers; a financial institution should ensure that it has the appropriate procedures in place to identify, report and interdict transactions that are in violation of sanctions regulations.
- Conduct stringent and efficient assessment on a case-by-case basis and robust due diligence vis-à-vis counterparts; Consideration of money laundering and bribery risk;
- Consider amendments in contracts and policies, such as the use of exclusion and termination clauses (taking into consideration the snap back provisions);
- Payments to Iran-related entities concerning claims under covers legally bound after Implementation Day are no longer subject to sanctions. Likewise, payment obligations arising after Implementation Day in respect of a cover legally bound prior to Implementation Day may also be honoured, even if the payment is to an entity previously subject to sanctions. However, the sanctions relief implemented from Implementation Day does not have retroactive effect, and the payment of claims in connection with covers which were bound prior to Implementation Day in breach of the sanctions at the relevant time may still be illegal and legal advice should be sought as to whether such payment is permitted;
- Payments for Iran-related business should not (and cannot) be made/denominated in USD where they relate to activities which are or would be prohibited under U.S. primary sanctions against Iran. Regardless of whether or not the bank is U.S. domiciled, owned or controlled, companies intending to engage in transactions involving Iran should liaise with their banks to determine whether they are willing to process the relevant transactions. The underwriting of Iran-related risks is impossible if banks keep refusing to process financial transactions, either due to legal constraints or internal compliance policies.



Conclusion

Perhaps the biggest issue is that, despite nuclear-related sanctions being lifted on Iran, the most prominent European banks such as the big UK banks; BNP Paribas; Deutsche Bank; UBS and Standard Chartered, remain wary of dealing with payments relating to Iran for fear of falling afoul of the secondary U.S. sanctions on Iran's economy and banking sector. It is also our experience that many clients, hoping to be involved with Iranian business since the lifting of sanctions have been prevented from doing so as their banks are refusing to allow Iran-related transfers (although reports have emerged that certain smaller European banks in Germany, Belgium and Austria and Norway's Nordia have already started to re-engage with Iran). As such, whilst theoretically, there should be no barrier to trade, from a sanctions standpoint, the present practicalities mean that things are much less than straightforward. For the time being, questions remain, not least:

- Will these restrictions have similar chilling effects on players in the shipping, energy and insurance sectors?
- Will the risks associated with investing in and engaging with Iran be worth the reward?

The answers remain to be seen, but they may be just around the corner...

Useful links

- Europa: http://europa.eu/index_en.htm
- U.S. Department of the Treasury: <https://www.treasury.gov/Pages/default.aspx>
- HM Treasury guidelines: <https://www.gov.uk/guidance/sanctions-on-iran>
- British-Iranian Chamber of Commerce: <http://www.bicc.org.uk/>
- UK Export Finance (UKEF): <https://www.gov.uk/government/organisations/uk-export-finance>
- Foreign and Commonwealth Office: <https://www.gov.uk/government/organisations/foreign-commonwealth-office>



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