NEWSLETTER NO. 2 / 16

IRAN TRADING - P&I COVER

The International Group of P&I Clubs

15th April 2016

Since the announcement on16th January of the lifting of certain EU and US sanctions in respect of Iran, the so-called Implementation Day , the International Group of P&I Clubs has been issuing circulars to Members which have addressed the implications on P&I cover resulting from a relaxation of some sanctions and the steps which the IG has undertaken and is undertaking to 'facilitate' Members P&I cover recovery certainty. This sequence of circulars has now culminated with news of the placement by the International Group of a 'fall-back' reinsurance to provide protection against US domiciled reinsurance shortfall.

Given the four months which have passed since 16th January, and the amount of information imparted by the Group to their Members on this issue, we have felt it helpful to provide a summary of the insurance cover issues arising for shipowners and the initiatives which have been and are being taken to address these.

16 January 2016 - Lifting of EU and US sanctions in respect of Iran following Implementation Day

Implementation Day under the Joint Comprehensive Plan of Action ("JCPOA") occurred on 16 January 2016.

This brought about;

(a) the lifting of most, but not all, of the previous **EU sanctions** and

(b) the lifting of most **US secondary sanctions**, which were those applicable to non-U.S persons and entities. **US Primary sanctions** (which are those applicable to US persons and entities) **remain largely intact**.

EU - sanctions relief has been provided in respect of a large number of trades previously targeted by sanctions, including Iran's oil, gas, petrochemical, shipping, insurance and financial sectors. Asset freeze measures imposed on a large number of entities were also lifted and it will no longer be prohibited to engage in otherwise lawful transactions with those entities. Full details of lifted restrictions are contained in the EU Council Decision 37/2016 and Notice 2016/C 15 I/01.

Restrictions remain however in relation to activities, goods and equipment connected with Iran's nuclear industry, and many dual-use goods. In addition there is no change to sanctions relating to anti-terrorism, alleged human rights abuses, and related designations for asset freezes, and restrictions on providing equipment for internal repression, military goods and associated services. There remain over 300 individuals and entities subject to designation under EU Human Rights and Nuclear Proliferation sanctions measures, including Tidewater Middle East, which may operate some port facilities in Iran, and a number of Iranian banks.

US - **lifting of secondary sanctions** applicable to non-US companies and persons, previously restricting dealings with various sectors of the Iranian Government and economy. The US has also lifted asset freeze measures against a large number of individuals and entities.

Not all secondary sanctions have been waived. **Restrictions remain** for example those in relation to the alleged support of international terrorist activities or human rights abuses remain in place as do those applying to non-US persons where, for example, they knowingly facilitate significant financial transactions with or provide material or certain other support to those Iranian or Iran-related persons that remain or are placed on the SDN List.

With regards to US asset freeze measures in respect of Iran over 300 remain including some banks and Tidewater.

US primary sanctions remain and continue to prohibit US persons from engaging in business with Iran. Prohibitions remain against export of goods, services, or technology directly or indirectly to Iran, including insurance cover to, or paying claims involving, Iran, with the exception of transactions that are exempt or authorised by the Office of Foreign Assets Control (OFAC). **Importantly, US dollar transactions in connection with Iranian business remain prohibited, the effect of which may be to continue to stifle lawful business conducted by non-US companies**.

Following these changes, the Clubs have issued a number of circulars on the implications of Implementation Day with respect to Club cover and indemnification.

Sanctions and IG Club P&I cover

The Rules of all of the International Group (IG) Clubs:

(a) contain provisions, under which the Member has no P&I cover in respect of activities or liabilities which would expose the Club as the insurer of such risks, to sanctions or to the risk of sanctions; and

(b) prohibit or limit (reduce) a Member's right of recovery from its club if, because of the application of sanctions, there is shortfall in recovery of club contributions under the IG Pooling Agreement, or **a shortfall in recovery under the club's individual or collective reinsurances** (the latter would include the IG General Excess of Loss (GXL) and Collective Overspill programmes) .

As US-domiciled reinsurers remain, under primary sanctions, prohibited from

paying claims relating to Iran trade or involving Iranian persons, this directly impacts on the club cover available to Members.. The Group clubs further note that the potential reinsurance shortfalls could apply to liabilities incurred by vessels trading anywhere in the world (if for example a vessel was involved in a collision with an Iranian owned vessel) as well as vessels that trade to/from Iran, and Iranian-owned vessels.

OFAC does operate a general license (General License H) which permits non-US entities owned or controlled by US persons to engage in Iran-related transactions that would otherwise be prohibited. The license appears also to allow a US person to alter policies and procedures between it and a US owned or controlled foreign entity to allow that foreign entity to benefit from the licence.

How could this impact on recoveries under Club Cover?

The effect of sanctions on Pooling and the GXL programme and possible shortfall in recovery under the club's reinsurance.

1. For the 2016/17 Policy Year each club individually covers, for own account claims, between zero and US$ 10m (the club retention). Within the individual club retention layer, there could be a risk of a reinsurance shortfall under a Club retention reinsurance if, although this is considered unlikely, US domiciled reinsurers participate in such reinsurance/s

2. For claims between USD10 million and USD80 million, liabilities are shared between all 13 IG clubs (the Pool). If any of the 13 IG clubs is prohibited (by sanctions applicable to that club) from contributing their share of any Pool claim, the individual Member will bear that shortfall in accordance with the applicable club's rules. The only IG club domiciled in the US (the American Club) and therefore still subject to US Primary sanctions against Iran, which we understand now benefits from a general license which in most circumstances would enable it to contribute its full share of any pool claim notwithstanding the involvement of an Iranian entity or person (other than an Iranian SDN).

3. In excess of US$ 80m liabilities fall within the GXL and Collective Overspill reinsurance programmes.

The US domiciled reinsurer participation on the Group GXL reinsurance programme, the US domiciled private placement and the US domiciled reinsurer participation on the Hydra reinsurance programme remains directly affected by US Primary sanctions.This could result in a shortfall in recovery under such reinsurances. As at 2.above, the individual Member will bear that shortfall in accordance with the applicable club's rules.

A significant further proportion of the programme has a US nexus, which may impact upon the ability of non-US domiciled but US affiliated or subsidiary reinsurers to pay a claim which their US domiciled parent or affiliate would be prevented from paying by virtue of the continuing US Primary sanctions. It is understood however that the licencing process introduced by the US referred to above (General Licence H) has largely resolved the concerns on this front.

Step 1 - The immediate response of International Group in January 2016

At the time clubs introduced their sanctions rules in 2011, the IG addressed the possible reinsurance shortfall implications (arising from excluded sanctions risks) on liabilities which could arise under an approved certificate or guarantee e.g. a CLC, Bunker Convention or Wreck Removal Convention Blue Card, the STOPIA/TOPIA agreements (**the so-called "certificated liabilities"**). In this respect the 13 IG **clubs agreed to re-pool** an eventual reinsurance recovery shortfall by means of the Group Supplemental Pooling Agreement (without separate reinsurance protection). This, again subject to individual clubs being permitted by applicable sanctions to contribute. If an individual club cannot contribute, then that club's shortfall would be borne by the Member.

Supplemental pooling of excluded sanctions risks did not however extend to non-certified liabilities e.g. collision/FFO liabilities, **with the result that any reinsurance recovery shortfalls** would be borne by the Member under the applicable club's rules.

The Clubs remain committed to finding better and broader solutions to the reinsurance shortfall exposure, and have been engaged in discussions with US authorities with a view to achieving this objective.

Step 2 - Finding a solution with US authorities

Given the potential extent of a reinsurance shortfall, both in scope and amount, the IG has engaged directly with the US authorities (State Department and OFAC).

In an effort to find an interim solution in respect of Iran, the Group has asked OFAC for confirmation that **"fall-back" insurance** (i.e. insurance to bridge either fully or partially any GXL programme shortfalls) would be non-objectionable.

Contemporaneously with approaches to the US State Department and OFAC, the Group started investigating the possibility of placing a "fall-back" reinsurance programme.

What is "fall-back" insurance?

The "fall-back" programme is designed to respond to reinsurance recovery shortfalls resulting from the inability of US-domiciled reinsurers on the Group GXL reinsurance programme, the US domiciled private placement and US domiciled reinsurers participating on the Hydra reinsurance programme, to make payments due to the continuing application of US Primary sanctions.

Subscribing underwriters to such a programme would necessarily be confined to non-US domiciled reinsurers.

Following extensive engagement with OFAC, the Group was successful in obtaining confirmation/comfort for non-US reinsurers potentially interested in participating on such a programme.

Following further engagement by the Group's brokers, a **"fall-back" programme has now been put in place**. The reinsurance placed has a limit of recovery of Euro 100m per event and in the annual aggregate and is further limited to two full paid reinstatements. The "fall-back" insurance protects against reinsurance shortfall in the GXL, the US domiciled private placement, and in the Hydra reinsurance programme, and will respond to both certificated and non-certificated losses.

Step 3 - What cover is currently available to the Owners after the placement of the "fall-back" insurance?

The "fall-back" cover is an annual cover in respect of P & I liabilities valid up to 20th February 2017.

It provides indemnity in respect of reinsurer contibutions which would have been recoverable under the first and second layers of the Group GXL reinsurance programme, from US domiciled reinsurers under the US domiciled private placement, and from the US domiciled reinsurers participating on the Hydra reinsurance programme, but which are not recoverable by virtue of continuing US Primary sanctions.

A key feature of the "fall-back" cover is that it not only provides reinsurance protection for a failure in reinsurance recovery in relation to **certified liabilities** (arising under approved certificates e.g. Blue Cards and guarantees) but also provides reinsurance protection in respect of other **non-certified liabilities** (e.g. collision, damage to property, etc.) in respect of which, as noted above, the risk of re-insurance shortfall previously rested with the Member.

Specifically with regards to **non-certified liabilities** the International Group has now agreed to re-pool the shortfall, **but only within the limits and to the extent that the " fall-back" cover is available / has not been exhausted**. Consequently, in respect of non-certified liabilities, the cover is not a "like for like" replacement of the cover currently available under the Group GXL and Hydra reinsurance programmes.

The fall-back cover itself contains a sanctions clause which could be engaged in the event of future sanctions or prohibitions constraining the subscribing reinsurers.

Snap – back

Under the terms of the JCPOA the EU and US reserve the right to "snap back" sanctions on Iran, if Iran is found to have violated its obligations, and care will need to be taken when negotiating contracts to protect against this possibility going forward. Historically however the approach of the US authorities has been to "grandfather" existing arrangements when new measures are introduced.

The Clubs' Managers recommend that all the usual due diligence be carried out in relation to cargoes carried to/from Iran and their end-use, and all parties to Iranian trade/transactions. Reliance on statements made by trading partners as to their due diligence will not necessarily provide a defence should trade or transactions result in a breach of sanctions.

Step 4 – Further Group discussions

The "fall-back" reinsurance is only a temporary solution. Efforts and engagement on the part of the International Group will continue with the US administration with a view to ensuring that a permanent long-term solution can be engineered and put in place for 2017 at the latest.

Depending on the outcome of those discussions, the Group will, for the next policy year, also review the on-going participation of US-domiciled reinsurers in the Group and Hydra reinsurance arrangements. We will continue to monitor the situation and will inform on developments as they occur.

We remain at your complete disposal for any further information or advice on this matter.

This Newsletter, and our information archive, can also be accessed at www.plferrari.com

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