

Sanctions and the Insurance Market

Putting in place
an effective compliance
programme

September 2016





Introduction

UK insurance market participants have a legal and regulatory requirement to comply with the UK's sanctions regime. With increased regulation, more complex sanctions regimes globally and an increase in enforcement activity (\$US 14 billion fines by UK and US enforcement against financial services companies since 2010) it is imperative that firms have an effective sanctions compliance programme in place.

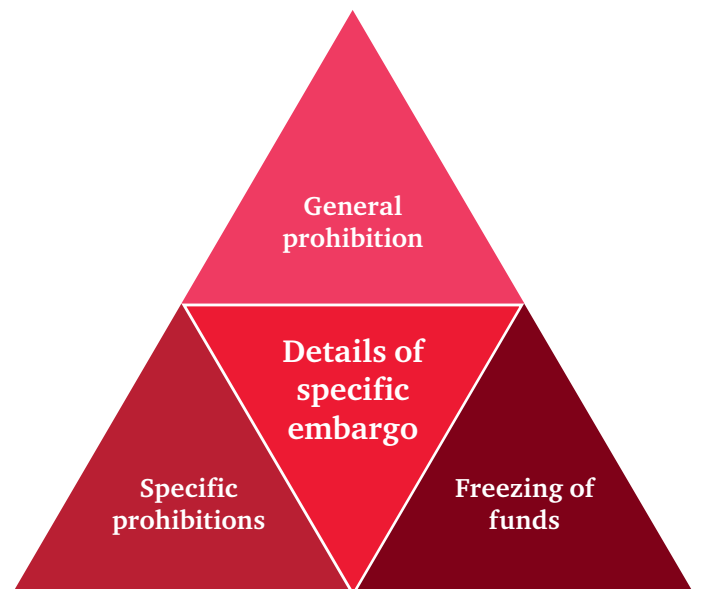
Sanctions: Legal requirements

Until the implications of Brexit are fully understood the legal framework of the UK financial sanctions regime is comprised of directly effective European Union regulations as well as UK domestic laws (primarily concerned with anti-terrorism). The competent authority for sanctions in the UK is Her Majesty's Treasury (HMT) with the newly created Office of Financial Sanctions Implementation (OFSI) the body tasked with enforcing the sanctions regimes from April 2016.

The UK sanctions regime has a range of implications for the insurance industry. Some sanctions are expressly addressed to the insurance sector (such as general and specific prohibitions of insurance activities) while some have only an indirect effect (such as the freezing of funds).

- **General prohibition of insurance business:** Prohibits firms from providing or brokering insurance or reinsurance to, for example: A country's government and its agencies, listed persons and entities persons acting on behalf of the country's government or listed persons.
- **Specific prohibitions on insurance business:** Prohibition to provide or broker insurance or reinsurance services related to a specific type of business or transport of certain goods or technology e.g. luxury goods to North Korea.
- **Freezing of funds:** Prohibits making economic resources available to listed persons, including payments (e.g. return of premium and claim payments). This does not limit the ability to receive premium and related income.

- **Details of specific embargo:** Trade Embargoes prevent the trade of certain goods (e.g. military goods) with certain embargoes placing requirements on insurance market participants (e.g. obtaining licenses).
- **Circumventions:** The instruments above are mostly supplemented by anti-circumvention prohibitions. Interpretations of the rules should always consider the spirit and purpose point of view.



Penalties (UK)

- Up to two years for breach of country specific sanctions and up to seven years for breach of terrorist financing legislation.
- Unlimited fines
- Regulatory action

Sanctions and reinsurance

It is a common misconception that compliance with sanctions regimes is unattainable for reinsurance services due to the complexity of the product and often distant relationship with the underlying risk. However, policy makers continue to place the same restrictions on both insurance and reinsurance. Both indirect (e.g. freezing of funds) and specific prohibitions apply to reinsurance activities with the only real difference between direct and reinsurance activities being the complexity of complying with the legal requirements.



In 2015 a US headquartered insurance company paid a US\$271,815 settlement to OFAC for providing Protection and Indemnity (P&I) insurance for North Korean vessels. They were also found to have been involved in disbursing claims payments relating to incidents occurring in, or involving, Iran, Sudan, and Cuba. The violations specifically relate to the actions of its London based branch.

Sanctions: Regulatory requirements

As well as having the aforementioned legal obligations, insurance market participants in the UK have a regulatory requirement to put in place adequate systems and controls, to manage the risks of financial crime, including ensuring compliance with the UK's financial sanctions regime.

Failure to do so may result in regulatory action by the Financial Conduct Authority (FCA) against the firm and its senior management. The liability of senior management for systems and controls failures should be particularly concerning for insurers, and reinsurers, as a result of the Senior Insurance Managers Regime (SIMR). SIMR increases the individual responsibility and liability of senior management for systems and control failures. Insurance brokers will continue to be governed under the FCA's approved person's regime.

Global business concerns

London is often viewed as the insurance capital of the world. This has resulted in a large amount of foreign investment in London to take advantage of the available opportunities, resulting in an increase of US backed, or listed, firms establishing a presence in London. These firms will have the UK legal and regulatory requirements of their competitors but will also have the added pressure of US sanctions compliance, as evidenced by recent OFAC enforcement action.

US sanctions apply to all US persons, wherever located, which also includes subsidiaries of US companies. US enforcement agencies are not afraid to pursue the activities of foreign subsidiaries for sanctions breaches and this is true in insurance.

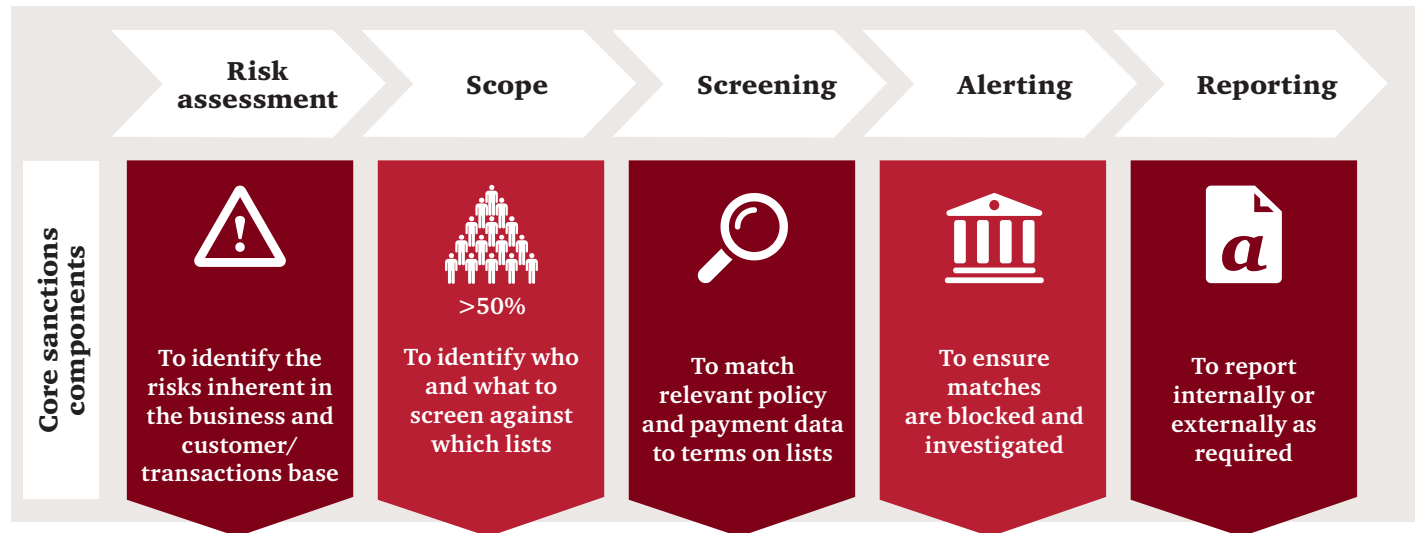
With differences in requirements between US and UK sanctions the risk for US subsidiaries shows no signs of abating. This is particularly true when the recent deal with Iran, the Joint Comprehensive Plan of Action (JCPOA), is taken into consideration. Under the JCPOA, EU companies will be allowed to provide various services, including banking and insurance involving Iran, whereas US companies will not without a valid licence. These differences between US and EU sanctions regimes, and considering the increase in enforcement actions, means companies will need to proceed with caution, particularly those operating in both the US and EU.

What do sanctions regulators expect from a compliance programme?

- Ensuring the effective configuration of sanctions screening filter (OFAC enforcement information July 2016).
- Having in place effective policies, procedures and processes in relation to the blocking and reporting of accounts (OFAC enforcement information March 2016).
- Ensuring alerts raised during sanctions screening are appropriately reviewed and acted upon (OFAC enforcement information March 2015).
- Taking remedial action when a sanctions issue is identified (OFAC enforcement information July 2016).

What are the key pillars of an effective sanctions compliance programme?

Outlined below are the key pillars of a sanctions compliance framework. The activities performed in each of these pillars should be fully documented and take into consideration all risks.



- **Risk assessment:** A sanctions risk assessment is the systematic process of evaluating the potential sanctions risks that are presented to the business. This should consider all risks including customer, third party, and business line risk.
- **Scope:** Firms should have clearly defined policies and procedures setting out the approach to sanctions compliance (as informed by the risk assessment). This should cover; who and what to screen, when to screen (e.g. pre binding/acceptance/claim payments), lists to be screened against and what trade control regulations are applicable.
- **Screening:** Firms should have effective, up-to-date screening systems and processes appropriate to the nature, size, and risk of its business. For insurance market participants this will often include elements of both automatic and manual screening as a result of the facilitation element of insurance services.
- **Alerting:** Firms should have procedures in place to effectively and efficiently review any potential 'hits' to sanctions lists generated through screening to allow a decision regarding the hit to be made.
- **Reporting:** Policies and procedures should be in place to ensure that appropriate action is taken when a 'true match' is identified. This may include – informing senior management, reporting to regulator and submission of a suspicious activity report to the appropriate authority. Firms should also have regular, relevant MI to report to senior management.

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