

# **FOREIGN ASSETS CONTROL REGULATIONS AND THE INSURANCE INDUSTRY: APPLICABILITY OF OFAC RULES TO INSURANCE PRODUCERS, MANAGING GENERAL AGENTS AND PROGRAM MANAGERS**

Frederick J. Pomerantz, Esq.  
212-490-3000

## **Introduction**

U.S. insurance carriers, responding to the foreign needs of clients, routinely offer international insurance to their domestic clients. U.S. insurers form alliances with foreign companies to gain footholds in countries where client bases are rapidly expanding. U. S. underwriters are dramatically increasing their involvement in lucrative international reinsurance markets. Everywhere one turns, traditional barriers, as well as protections, are being dismantled.

It is critical that the insurance industry gain a better understanding of the economic sanctions and embargo programs of the United States. The programs are a front line defense against foreign threats to our national safety, economy, and security. Libya, Sudan, and Cuba are all the focus of full-fledged trade embargoes, including the blocking of assets in U.S. jurisdiction. There are restrictions on 1) imports from Burma and North Korea; 2) new investments in Burma; 3) imports from and exports of goods and services to Iran; 4) exports to Iraq; 5) imports of goods, technology, or services produced or provided by foreign persons designated by the Secretary of State as promoting the proliferation of weapons of mass destruction; 6) imports of rough diamonds from Liberia; 7) imports of uncertified diamonds; 8) the receipt of donations in the form of gifts or charitable contributions from the governments of Syria or North Korea; 9) and prohibitions against transactions with designated international narcotics traffickers, terrorists, foreign terrorist organizations, parties named in or pursuant to Executive Order 13304 relating to persons who threaten international stabilization efforts in the Balkans, and certain individuals tied to the regime in Zimbabwe.

Although the proposed USA Patriot Act regulations will not, if enacted, apply to property/ casualty insurers and their agents and brokers, there are other rules promulgated through the Office of Foreign Assets Control of the U.S. Treasury Department (OFAC), wholly unrelated to the USA Patriot Act, which that apply to the business of insurance producers, managing general agents (MGAs) and program managers. Those obligations are summarized in the questions by the insurance industry that appear in the OFAC website, which are reproduced as part of this article. Whether or not a particular producer or managing general agent's business, in the ordinary course, encounters issues of this nature, it behooves the producer or MGA to be aware of the laws applicable to all insurance companies, service providers including brokers, and insurance related businesses.

## ***Summary Of OFAC Requirements***

The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") administers and enforces sanctions policy, based on Presidential declarations of "national emergency," under nine basic statutes: the Trading With the Enemy Act, 50 U.S.C. App. §§ 1-44 ("TWEA"); the International Emergency Economic Powers Act, 50 U.S.C. §§ 1701-06 ("IEEPA"); the Iraqi Sanctions Act, Pub.L. 101-513, sees. 586-586J, 104 Stat. 2047---55 ("ISA"); the United Nations Participation Act, 22 U.S.C. § 287c ("UNPA"); the International Security and Development Cooperation Act ("ISDCA"), 22 U.S.C. 2349 as-8 and -9; the Cuban Democracy Act ("CDA"), 22 U.S.C. § 6001-10; the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act, 22 U.S.C. 6021-91; the Antiterrorism and Effective Death Penalty Act (enacting 8 U.S.C. 219, 18 U.S.C. 2332d, and 18 U.S.C. 2339B), and the Foreign Narcotics Kingpin Designation Act, 21 U.S.C. 1901-1908, 8 U.S.C.1182. All U.S. citizens and permanent residents, companies located in the U.S., overseas branches of U.S. companies and, in the case of the Cuba and North Korea programs, overseas subsidiaries of U.S. companies, are subject to OFAC jurisdiction. All U.S. insurance companies, and U.S. citizens and permanent resident aliens who are employees, officers, or directors of U.S., or foreign, insurance companies, need to be aware that they may be held accountable for sanctions violations.

OFAC's basic requirements are best summarized as follows: A producer or MGA cannot remit or receive monies from individuals or entities on the OFAC list or the list of specially designated nationals (SDNs) or transact business in a country that is blocked, without a special license. In particular, individuals and entities with underwriting and/or claims paying ability on behalf of insurers, which pay a claim to a person or entity on the list, could be in violation of the OFAC regulations. The insurer on whose behalf the individual or entity acts would also risk being in violation. Anyone with these authorities for insurers is contractually bound to comply with all laws and regulations applicable to their respective businesses.

Although not explicitly stated in the federal laws, there is enough support in the federal laws, the United States Treasury Department regulations and the OFAC interpretations, to support the view that to the extent an insurance producer, MGA or program manager receives or remits premiums in excess of \$10,000 in one transaction (or two or more related transactions) on behalf of an insurer must comply with the OFAC requirements.

It would be particularly onerous and impractical for smaller insurance brokers, agents or MGAs to scrutinize every insurance placement as they do not always have the resources or the staff to do so, unlike large alphabet house brokers. However, the OFAC rules and the Presidential Executive Orders and U.S. Treasury Regulations which they interpret, some of which were promulgated after September 11, 2001, paint a broad brush, probably intentionally so, and every broker, producer and MGA, regardless of size, must comply and show good faith efforts to comply.

OFAC does issue licenses for certain types of transactions, such as the sale of food or medicine to targeted countries. As a general rule, U.S. insurers are authorized to insure licensed shipments, but should request a copy of the shipper's OFAC license prior to agreeing to any transaction.

#### *Penalties*

Depending on the program involved, criminal violations of the statutes administered by OFAC can result in corporate and personal fines of up to \$1 million and 12 years in jail. OFAC also has authority to impose civil penalties of up to \$1,075,000, depending on the sanctions program.

#### *Applicable Laws, Regulations And Executive Orders*

Executive Order 13224 dated September 23, 2001, entitled "Blocking Property and Prohibiting Transactions With Persons Who Commit, Threaten to Commit or Support Terrorism" states at Section 1:

All property and interests in property of the following persons that are in the United States or that hereafter come within the United States, or that hereafter come within the possession or control of United States persons are blocked:

- (a) foreign persons listed in the Annex to this order;
- (b) foreign persons determined by the Secretary of State, in consultation with the Secretary of the Treasury and the Attorney General, to have committed, or to pose a significant risk of committing, acts of terrorism that threaten the security of U.S. nationals or the national security, foreign policy, or economy of the United States.

\* \* \* \*

Section 2 of Executive Order 13224 sets forth the broad application of the new rule, as follows:

- (a) any transaction or dealing by United States persons or within the United States in property or interests in property blocked pursuant to this order is prohibited, including but not limited to the making or receiving of any contribution of funds, goods, or services to or for the benefit of those

persons listed in the Annex to this order or determined to be subject to this order;

- (b) any transaction by any United States person or within the United States that evades or avoids, or has the purpose of evading or avoiding, or attempts to violate, any of the prohibitions set forth in this order is prohibited; and
- (c) any conspiracy formed to violate any of the prohibitions set forth in this order is prohibited. (Emphasis added.)

31 C.F.R. § 594.202 (Effect of transfers violating the provisions of this part) also blocks transfers, stating, in relevant part, as follows:

- (a) Any transfer after the effective date that is in violation of any provision of this part or of any regulation, order, directive, ruling, instruction, or license issued pursuant to this part, and that involves any property or interest in property blocked pursuant to § 594.201(a), is null and void and shall not be the basis for the assertion or recognition of any interest in or right, remedy, power, or privilege with respect to such property or property interests.

\* \* \* \*

- (b) Unless otherwise provided, an appropriate license or other authorization issued by or pursuant to the direction or authorization of the Director of the Office of Foreign Assets Control before, during, or after a transfer shall validate such transfer or make it enforceable to the same extent that it would be valid or enforceable but for the provisions of the International Emergency Economic Powers Act, this part, and any regulation, order, directive, ruling, instruction, or license issued pursuant to this part.

31 C.F.R. § 594.309 (property; property interest) includes in the definition of “property” money, checks, bank deposits and all other financial instruments. 31 C.F.R. § 594.312 defines “transfer,” in relevant part, as follows:

The term *transfer* means any actual or purported act or transaction, whether or not evidenced by writing, and whether or not done or performed within the United States, the purpose, intent, or effect of which is to create, surrender, release, convey, transfer, or alter, directly or indirectly, any right, remedy, power, privilege, or interest with respect to any property and, without limitation.... (Emphasis added.)

§ 594.203 (Holding of funds in interest-bearing accounts; investments and reinvestments) sets forth the requirement to hold blocked funds in interest-bearing blocked accounts in the United States.

Clearly, the rules on due diligence with respect to doing business with SDNs apply not only to financial institutions, but to all persons, as defined in the regulations, including insurance brokers and agents, MGAs and program managers, regardless of size.

### *Limiting The Company's Exposure*

Before committing a company to insurance risk, examine applications, proposals, slips and any other documents available from prospective clients and their brokers for clues of possible sanctions exposure. Are any parties involved in the contract (named insureds, underwriters, brokers, etc.) currently considered "Blocked Persons?" If so, and the firm has not yet been given a payment, decline the business.

If the firm has already received a payment, the firm must block it. Could potential losses involve property located in, goods originating from or destined for, or persons or commercial activity in target countries? Again, decline the business or structure the policy to exclude risks within the geographical limits of embargoed countries and losses

related to prohibited business involving those countries. Make sure the firm's foreign associates fully understand the restrictions under which the firm, as a U.S. person, must operate. U.S. underwriters should communicate their sanctions constraints to the foreign brokers with whom they regularly deal. Before entering into a syndicate or pooling arrangement, make it clear to the foreign members that the firm will not be able to participate in risks that would expose the firm to sanctions violations. Let international clients know that they must seek coverage elsewhere with regard to "sanctions-sensitive" items and factor the possibility of sanctions into the firm's international political risk analyses.

It may be helpful for a firm to designate a "Compliance Officer" responsible for monitoring compliance with OFAC programs. Internal auditing departments can assist in the development of a corporate compliance policy and verification that procedures, once established, are being followed. An effective internal communication network is critical for regulatory compliance. Firms might consider including regulatory notices and explanations in staff newsletters. Compliance training programs will help prevent violations. There are available software programs and procedures which enable an insurance producer or MGA to argue, in good faith, that it has attempted to use all practical measures to comply with OFAC, notwithstanding that any procedures of this nature will be viewed as time consuming and inconvenient, at a minimum.

Other useful measures would include reviewing regulations in staff meetings, incorporating compliance requirements into operating procedures, and sponsoring industry compliance seminars.

### *Summary*

Before committing a company to insurance risk, it is appropriate to examine applications, proposals, slips and any other documents available from prospective clients and their brokers for clues of possible sanctions exposure. Are any parties involved in the contract (named insureds, underwriters, brokers, etc.) currently considered "Blocked Persons?" If so, and the producer has not yet been given a payment, consideration should be given to declining the business. If the producer has already received a payment, it must be blocked. Could potential losses involve property located in, goods originating from or destined for, or persons or commercial activity in target countries? Again, declining the business or structuring the policy to exclude risks within the geographical limits of embargoed countries and losses related to prohibited business involving those countries is the prudent course of action. Making sure foreign associates fully understand the restrictions under which the producer, as a U.S. person, must operate is vital. U.S. underwriters should communicate their sanctions constraints to the foreign brokers with whom they regularly deal. Before entering into a syndicate or pooling arrangement, it is important to make it clear to the foreign members that the producer will not be able to participate in risks that would expose his firm to sanctions violations. Letting international clients know that they must seek coverage elsewhere with regard to "sanctions-sensitive" items and factor the possibility of sanctions into the firm's international political risk analyses is also a vital step.

What follows below are excerpts from the OFAC website with information specifically addressed to insurance companies, producers, MGAs, program managers and other players in the insurance industry:

### *Frequent Questions Asked By The Insurance Industry*

- State insurance statutes regulate an insurer's ability to withhold claim payments, cancel policies or to decline to enter into policies. In some cases, insurers must commit an ostensible violation of state insurance regulations to comply with OFAC regulations. Does OFAC have a position as to whether OFAC regulations preempt state insurance regulations in this context?

OFAC's regulations under the Trading with the Enemy Act and the International Emergency Economic Powers Act are based on Presidential declarations of national emergency and preempt state insurance regulations. OFAC regulations are not federal insurance regulations, they are regulations promulgated under the President's exercise of foreign affairs and national emergency powers.

- At what point must an insurer check to determine whether an applicant for a policy is an SDN?

If the firm receives an application from an SDN for a policy, the firm is under an obligation not to issue the policy. Remember that when the firm is insuring someone, the firm is providing a service to that person. The firm is not allowed to provide any services to an SDN. If the SDN sends a deposit along with the application, the firm must block the payment.

- What should an insurer do if it discovers that a policyholder is or becomes an SDN: cancel the policy, void the policy ab initio, non-renew the policy, and/or refuse to pay claims under the policy? Should the claim be paid under a policy issued to an SDN if the payment is to an innocent third party (for example, the injured party in an automobile accident)?

The first thing an insurance company should do upon discovery of such a policy is to contact OFAC Compliance. OFAC will work with the firm on the specifics of the case. It is possible a license could be issued to allow the receipt of premium payments to keep the policy in force. Although it is unlikely that a payment would be licensed to an SDN, it is possible that a payment would be allowed to an innocent third party. The important thing to remember is that the policy itself is a blocked contract and all dealings with it must involve OFAC.

- A workers' compensation policy is with the employer, not the employee. Is it permissible for an insurer to maintain a workers compensation policy that would cover a person on the SDN List, since the insurer is not transacting business with the SDN, but only with his/her employer?

If an insurer knows that a person covered under the group policy is an SDN, that person's coverage is blocked, and if he or she makes a claim under the policy, the claim cannot be paid. If an insurer does not know the names of those covered under a group policy, it would have no reason to know it needed to block anything unless and until an SDN files a claim under that policy. At that point its blocking requirement would kick in.

- How frequently is an insurer expected to scrub its databases for OFAC compliance?

That is up to the firm and its regulator. Remember that a critical aspect of the designation of an SDN is that the SDN's assets must be frozen immediately, before they can be removed from U.S. jurisdiction. If a firm only scrubs its database quarterly, it could be 3 months too late in freezing targeted assets. The SDN list may be updated as frequently as a few times a week or as rarely as once in six months. See [Automating Compliance](#) on OFAC's website for suggestions on how to keep current.

- Is it sufficient if my company screens life insurance policies only prior to policy issuance?

That's up to the firm and its regulators. Conducting screening only before policy issuance is critical but would not likely achieve the desired level of compliance. After the policy issuance, the U.S. Government may designate an existing policyholder or a named beneficiary as a Specially Designated National or Blocked Person ("SDN"), or it may expand sanctions with respect to a particular country, or impose sanctions against a new country. If an existing policyholder or a named beneficiary became an SDN or otherwise subject to U.S. sanctions, the insurer might be required to "block" the policy, report such blocking to OFAC within 10 days of the SDN designation, place any future premiums into a blocked, interest-bearing account at a U.S. financial institution, and seek an OFAC license before making any payments under the policy. Consequently, routine screening of all policies in force against OFAC's SDN list, as frequently updated, would enable the insurer to comply with the applicable OFAC regulatory requirements. It also is important to screen the policyholder and beneficiary prior to paying a claim.

- If my policyholder, which is a U.S. person, requests a change of beneficiaries and designates a cousin living in Cuba as a beneficiary under the life insurance policy, what shall I do?

In general, an insurance policy is considered "property" and a beneficiary's interest in the policy is considered an "interest in property" that may require blocking under the applicable regulations. The Cuban Assets Control Regulations, however, contain a general license that deals with transactions involving blocked life insurance policies. 31 C.F.R. § 515.526. In this case, the only blocked interest is that of a beneficiary, so the general license

would authorize the insurer to accept premium payments and interest on policy loans as well as to pay loans to the insured or process the insured's request for a change of beneficiary. Also, the insurer would be authorized under the general license to deduct premiums from cash surrender value, if any, or accumulate dividends or otherwise increase cash surrender value on the books of the insurer, pursuant to the terms of the policy. However, the insurer usually cannot pay an entire claim (the face amount of the policy) to the beneficiary without a specific license from OFAC. Recent amendments to the Cuba regulations authorize by general license remittances to a Cuban beneficiary of up to \$300 per quarter from a blocked account at a U.S. banking institution if the funds in that account were deposited there as a result of a payment from a life insurance policy triggered by the death of the policyholder. If the firm has a blocked policy, the firm should seek legal advice or contact OFAC for further guidance regarding the handling of that particular account.

- If my screening efforts uncover a policyholder who became an SDN after policy issuance, can I notify the policyholder that the policy is "blocked"?

Yes, the insurer may notify the policyholder that the policy is blocked, without obtaining a specific license from OFAC.

- In my letter to the policyholder whose policy is "blocked," may I also instruct the policyholder not to send any more premium or that we will not accept additional premium under this account?

The insurer may instruct the policyholder as follows: "If you send any more premium, we are required under applicable U.S. laws and regulations to place such funds in a blocked account. If the firm has any questions, please contact the U.S. Department of Treasury's Office of Foreign Assets Control."

### ***Specially Designated Nationals***

U.S. sanctions go beyond the borders of target countries. OFAC has identified and named numerous foreign agents and front organizations, as well as terrorists, terrorist organizations, and narcotics traffickers, as "Specially Designated Nationals and Blocked Persons," with a master list containing over 5,000 variations on names of individuals, governmental entities, companies and merchant vessels located around the world. To assure that illicit transactions involving target countries and SDNs are not processed, funds transfer departments in most U.S. banks as well as major corporations which are not banks have turned to sophisticated "interdict" software to automatically flag questionable transactions for review. Some of the filters contain every name on OFAC's list along with geographical names for embargoed countries and cities.

U.S. underwriters, brokers, agents, primary insurers, and reinsurers and U.S. citizen employees of foreign firms in the insurance industry are prohibited from engaging in transactions not licensed by OFAC that in any way involve:

- Individuals, entities, or vessels appearing on OFAC's SDNs and Blocked Persons list;
- Governmental entities and officials of Libya, Sudan, or Cuba;
- Companies located in Cuba;
- Companies, wherever located, organized in or controlled from Cuba;
- Individuals, regardless of citizenship, currently residing in Cuba;
- Cuban citizens, wherever located (except those legally residing in the United States, or unblocked by OFAC license).

### ***What Property Is Blocked***

All property, including insurance contracts, in which there is a direct or indirect interest of any of the above is considered blocked or "frozen." Premium payments, policy loan interest payments, and repayments of policy loans related to blocked insurance contracts must be credited to an interest bearing blocked account established on the books of a U.S. financial institution. Proceeds due under blocked policies may not be set-off against past due policy receivables or other claims and must also be paid into an interest bearing blocked account. Rights in blocked policies

may not be transferred without authorization from OFAC. Changing a beneficiary or assigning or pledging an insured's interest under a blocked policy would be considered illegal transfers involving blocked property under OFAC jurisdiction.

Blocked policies and policy payments must be reported within 10 days to OFAC's Compliance Programs Division by fax at 202/622-2426.

### ***Examples Of Blocked Insurance Transactions***

The following are examples of insurance transactions which would be prohibited or blocked because of the interest of a blocked person:

- A health insurance policy issued to a citizen of Cuba;
- A life insurance policy naming a resident of Havana, Cuba as beneficiary;
- An aviation policy, issued to a non-blocked foreign airline, which names the Arab Bank for Investment and Foreign Trade, Abu Dhabi, a Specially Designated National of Libya, as an additional insured because the bank holds a mortgage on the aircraft;
- A marine hull policy covering potential damage to the Pinecone, a Cypriot-flag merchant vessel which has been named as a Specially Designated National of Cuba;
- A cargo policy in which Valleta Shipping Corp. of Panama, a Specially Designated National of Cuba, is a named insured;
- A liability policy covering the pharmaceutical operations of Laboratorios Blanco Pharma S.A. of Bogota, Colombia, which has been named as a Specially Designated Narcotics Trafficker;
- A reinsurance contract for policies underwritten in whole or in part by the Arab Commercial Insurance Company of the Channel Islands, a Specially Designated National of Libya;
- Return of a premium overpayment to a Cuban resident in France.

### ***Illegal Facilitation And Other Prohibited Services***

The following are examples of insurance transactions that, while not necessarily blocked, would violate U.S. sanctions law because they would involve the provision of prohibited services:

- A property insurance policy written for an international hotel chain which covers hotels in Tehran, Iran;
- A marine cargo or "goods in transit" policy insuring a shipment of Iranian crude oil shipped from Egyptian ports to a Spanish buyer;
- An aviation liability policy known to cover scheduled stops in Havana, Cuba by a foreign air carrier;
- A liability policy covering a private oil exploration company's operations in Libya.