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Prohibitions on insurance by EU sanctions: securing insurance coverage for major overseas projects

1. INTRODUCTION

In 2010 and 2012, the European Union (EU) issued sanctions against Iran[1] and Syria[2], which among others contained prohibitions on insurance. These prohibitions on insurance prohibit or complicate the co-insurance of affiliates or subcontractors of German companies in Iran or Syria.

Major projects such as plant constructions are especially affected of the insurance ban. Gapless insurance coverage for all companies involved in a project is not possible anymore.

Major overseas projects of German companies usually take several years from the planning until full finalization. Reasons for the long duration are for example administrative, legal, technical or logistic barriers in the target country. Long project durations make it more difficult to foresee political developments and possible EU sanctions against the target country. Thus, policy holders need to take possible future prohibitions on insurance into account when planning long-term projects abroad.

The following article demonstrates the scope and consequences of prohibitions on insurance by taking the example of Iran and discusses possible solutions to ensure gapless insurance coverage for major projects abroad.

2. DIRECT PROHIBITIONS ON INSURANCE ON THE BASIS OF SANCTIONS OF THE EUROPEAN UNION

Sanctions limit the freedom of foreign trade towards individual countries by banning the trade of specific goods and prohibiting the provision of specific services.

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1 Regulation (EU) 961/2010 of the Counsel of 25th October 2010 about restrictive measures against Iran and about annulment of regulation (EG) No. 423/2007, Article 26; replaced by Regulation (EU) Nr. 267/2012 of the Counsel of 23rd March 2012, Article 35.

2 Regulation (EU) No. 36/2012 of the Counsel of 18th January 2012 about restrictive measures in the view of the situation in Syria and about the annulment of Regulation (EU) No. 442/2011, Article 26.

Sanctions (embargoes) are issued by the EU as an instrument of foreign or security policy. The political goal is essential. This has to be considered when interpreting the legal consequences.

2.1 Example: Prohibition on insurance on the basis of Iran sanctions

As a reaction to the continuing dispute about the Iranian nuclear program on 25th October 2010 the European Union for the first time issued a prohibition on insurance through Regulation (EU) 961/2010 (Art. 26). The regulation came into force on 27th October 2010.

The regulation 267/2012 of 23rd March 2012 meanwhile replaced regulation 961/2010. The prohibition on insurance is regulated by Art. 35 of regulation 267/2012 (in the following: Art. 35). Art. 35 explicitly prohibits the provision and brokering of insurance or re-insurance for

a) Iran or its Government, and its public bodies, corporations and agencies;
b) an Iranian person, entity or body other than a natural person; or
c) a natural person or a legal person, entity or body when acting on behalf or at the direction of a legal person, entity or body referred to in (a) or (b).

The prohibition has to be interpreted broadly. The insurance ban applies independent of the goods or services to be insured. It bans (under consideration of a few exemptions, see 2.1.1) all kinds of insurance cover for Iranian risks.

Direct insurers, re-insurers, captives and brokers are affected by the prohibition. Policy holders are affected directly as well. They, for example, cannot co-insure affiliates located in Iran or Iranian contract partners. Policy holders are not allowed to renew or extend existing contracts which might violate sanctions.

2.1.1 Exemptions from the prohibition on insurance

Art. 35 allows for strictly limited exemptions from the prohibition on insurance.

2.1.1.1 Unpolitical natural or legal persons

According to para. 2 and 3 of Art. 35, the prohibition on insurance does not apply to the provision or brokering of insurance or re-insurance for natural persons, unless they are listed in the annexes of the regulation or act by order of Iranian bodies. The prohibition on insurance does also not apply for compulsory or liability insurances of Iranian natural persons, entities and bodies based in the EU (this includes for example the diplomatic service of Iran).

2.1.1.2 Transport industry

Art. 35 para. 3 also allows for strictly limited exemptions for companies of the transportation industry.

2.1.1.3 Provision to safeguard existing contracts

Art. 35 para. 4 allows to comply with agreements concluded before the sanction was issued on 27th October 2010. Art. 35 para. 4 does though also determine that the contract parties are not allowed to extend or renew existing contracts. Such contracts become subject to the prohibition in case of renewal or extension.

2.1.2 Evasion of the prohibition on insurance

The regulation explicitly forbids to evade the embargo, including the prohibition on insurance. Art. 41 says:

„It shall be prohibited to participate, knowingly and intentionally, in activities the object or effect of which is to circumvent the measures referred to in Article 2, 5, 8, 9, 11, 13, 17, 22, 23, 30, 34 or 35.“

The explicit prohibition to evade the embargo underlines the political goal of the regulation.

2.2 Consequences of the prohibition on insurance

The prohibition on insurance has consequences for insurance contracts which are subject to the sanction, as well as possibly consequences for insurance premiums already paid.

2.2.1 Consequences for the insurance contract

Art. 35 is a prohibition act in the meaning of sec. 134 German Civil Code (BGB). An insurance contract violating Art. 35 is entirely void, unless one can assume according to sec. 139 BGB that the insurance contract would have been concluded even without the void part.

For those insurance contracts to be considered, the scope of nullity depends on the individual case. If a risk referring to the sanctioned country makes up the main part of the contract, an entire nullity has to be assumed. If a sanctioned risk forms only a small part of an extensive international insurance program, a rather partial nullity can be assumed.

2.2.2 Consequences for insurance premiums

The sanction does not say anything about the consequences for insurance premiums. The question is whether insurers, re-insurers or brokers are obliged to refund a part of or the entire insurance premium (including a possible brokerage) if a policy is affected by the prohibition. A prohibition eliminates the *causa* of the legal transaction and leads to an enrichment of insurers, re-insurers, and brokers.

Thus, claims for compensation are possible according to enrichment law. Claims for compensation though require that the enrichment can be proven and calculated.

2.3 Sanctions clause

Some insurers react to the prohibition on insurance of the Iran sanction by including an exclusion clause in new and often also in existing direct and re-insurance contracts. This clause shall prevent the risk of a violation of the sanction by the insurer. The sanctions clause recommended by the German Insurance Association (Gesamtverband der Deutschen Versicherungswirtschaft) says in the first paragraph:

"Notwithstanding other provisions of the insurance contract, cover shall be granted only insofar as and as long as not in contradiction to economic, trade or financial sanctions or embargoes enacted by the European Union or the Federal Republic of Germany that are directly applicable to the contracting parties."

According to the opinion represented here, this first paragraph of the sanctions clause is a declaratory wording. It only confirms that the insurance contract is subject to applicable law. Solely the wording "in so far and as long" may constitute an own regulatory content as it makes clear that a violation of the sanction does not necessarily infect the entire contract.

It should be noted that existing policies no longer are subject to the provision to safeguard existing contracts (Art. 35 para. 4) after a sanctions clause is included.

3. APPROACHES TO SECURE INSURANCE COVERAGE

With the issuing of the regulation 36/2012 of 18th January 2012 on restrictive measures to face the situation in Syria, the EU issued for the second time a prohibition on insurance regarding a specific country. The insurance ban with regard to Syria is similar to the prohibition on insurance against Iran as described.

The Syria embargo shows that the EU is willing to sanction negative political developments in third-party countries with embargos that comprise prohibitions on insurance. In view of that, the question arises how policy holders involved in long-term major projects can make arrangements to secure insurance coverage in case of possible insurance bans.

Example scenario: In country XY a German corporation realizes a multiannual construction project, supported by a local affiliate and a subcontractor. The affiliate and the subcontractor are insured via the project insurance contract of the German corporation.

Due to a changing political situation in XY, the EU imposes sanctions which comprise a prohibition on insurance. Depending on the scope of the prohibition and the design of the insurance contract, insurance coverage for the affiliate and the subcontractor might be omitted as soon as the sanction comes into force.

The corporation may examine the following options to maintain insurance coverage.

3.1 Financial Interest Coverage

The prohibition on insurance with regard to individual countries can at first sight be compared with the so-called “non-admitted” problem.

In “non-admitted” markets (e.g. Brazil, Russia, China, etc.), the provision of insurance by an insurer who is not registered locally is forbidden. For risks of affiliates or subcontractors arising in such a country, a German corporation must not provide insurance coverage via its international insurance program. Difference in Conditions Coverage (DIC) as a compensation for insufficient local coverage, is also inadmissible.

The insurance of affiliates or subcontractors in “non-admitted” countries via local insurers is usually no satisfying solution for German corporations. The corporation is not able to realize a unified international coverage level with local insurers.

A solution for risks in “non-admitted” markets is the insurance of the German corporation’s financial interest in the affiliate abroad. By so-called Financial Interest Coverage, the parent company as policy holder insures own financial consequences of a loss of the affiliate. Financial Interest Coverage is a common part of international insurance programs.

The question is whether such a solution may also serve to insure risks in countries on which prohibitions on insurance are imposed. Opposite to the “non-admitted” problem, the obstacle of a co-insurance of affiliates and subcontractors is in case of prohibitions on insurance not a legal regulation in the target country but a regulation of European law. The EU will probably handle evasions strictly: An insurance of the corporation’s interest like a Financial Interest Coverage will most likely be a forbidden evasion of the insurance ban. It might therefore, in case of intentional evasion, even have consequences under criminal law.

3.2 Retaining losses

The German corporation could realize the project without insurance coverage. In case of loss, the corporation bears the risk. The company can factor in the risk from the beginning within the project budget and thereby protects itself. In practice though, especially medium-sized companies often depend on purchasing comprehensive insurance coverage.

3.3 Conclusion of undated insurance contracts

The conclusion of undated insurance contracts for long-term offshore projects could be a practicable solution at the moment.

For its long-term project in a potentially crisis-hit country, the German corporation purchases comprehensive insurance coverage unlimited in time until finalization of the project. A later embargo then cannot eliminate insurance coverage since the policy would be subject to the provision to safeguard existing contracts. Prohibitions on insurance according to the Iran sanction prohibit the extension and renewal of existing contracts. The current sanctions do not prohibit complying with existing agreements. Future sanctions will most likely use the same wording.

It must be noted that the protection of existing contracts does not apply to insurance of a certain group of persons. According to EU regulations, natural or legal persons, organizations or institutions listed in the annexes must not be provided with money directly or indirectly. This prohibition does also apply to insurance benefits. Also, difficulties with payments of insurance benefits might arise from possible restrictions on money transfer between the EU and the sanctioned country.

4. CONCLUSION

EU prohibitions on insurance can complicate or prohibit the co-insurance of affiliates or subcontractors located in crisis-hit countries. Against the background of recently tightened sanctions against Iran and Syria, further prohibitions on insurance with regard to other countries seem likely. It cannot be foreseen which countries might in the future be subject to such sanctions.

Corporate policy holders should take the possibility of future prohibitions on insurance into account in the planning of long-term projects in potentially crisis-hit countries. It is advisable to draft contracts carefully including undated durations until the finalization of the project.

In the future, the question of consequences of revocations of existing sanctions (and thus prohibitions on insurance) has to be clarified. In the view of changing framework conditions expected in a formerly sanctioned country, new negotiations of insurance contracts might be necessary.

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