

Anti-Money Laundering and International Sanctions guidance for Coverholders

Introduction

The purpose of this document is to provide general high-level guidance in relation to anti-money laundering (“AML”) and international sanctions compliance and Lloyd’s expectations of coverholders to fulfil their obligations. Coverholders should take steps to understand the precise obligations that apply to them (and the obligations of those on behalf of whom they underwrite) and take steps to implement and document a robust and comprehensive compliance policy and procedure.

Coverholders are obliged to have proper/adequate systems and controls in place to ensure AML/international sanctions compliance and, in addition, managing agents have separate legal responsibility to ensure this. Coverholders are therefore expected at all times to be compliant with the AML/international sanctions requirements that apply to them.

Coverholders will also be required by managing agents to ensure that business they underwrite on managing agents’ behalf is compliant with the AML/international sanctions that apply to managing agents.

In order to ensure compliance, coverholders (and the managing agents who have delegated authority to these entities) will be expected to take all of the steps set out below in the AML and international sanctions sections.

However, it must be emphasised that there is an expectation on Managing Agents to ensure that the above requirements are enacted following a risk based assessment of the individual coverholder’s profile and that procedures are proportionate to the risk and clearly communicated and explained to the coverholder.

Anti-money laundering

Definition

- Money Laundering - “The process used by criminals to disguise the origin and ownership of the proceeds of their criminal activities in order to avoid prosecution, conviction and confiscation”

General Anti-Money Laundering Obligations

- In the UK, legislation covers most financial sectors which include:
 - Criminal offences around engaging in money laundering and/or assisting others to launder the proceeds of crime;
 - disclosure/reporting requirements in respect of suspicious activities/transactions;
 - tipping off offences: ensuring that law enforcement is not hampered in its investigations by the subject of the suspicion becoming aware of the allegations.
- Similar legislation with related requirements and offences will be in force within the jurisdiction that coverholders operate but the extent to which AML legislation will apply to intermediaries can vary.

What might be suspicious?

Activities that might trigger a suspicion are:

- Difficulty in obtaining information about, or doubts over the bone fides of, the policyholder or other parties involved
- Transactions set up and then quickly cancelled for no identifiable reason
- Transactions involving placements from, or the involvement of intermediaries, in different jurisdictions for no discernible purpose
- Return premiums, overpayments or Claim payments where a third party appears to benefit
- Transactions where insurance does not appear to be the primary object or make no economic sense
- Over inflated values (e.g. on jewellery/fine art).

Please note this is not an exhaustive list and the managing agent which has delegated authority to you may have other relevant examples for you to consider.

Expected minimum standards

It is expected that coverholders should adopt written procedures to cover the following:

- Recognition and reporting of suspicious transactions;
- Staff training and awareness; and
- Record keeping.

In order to devise a suitable policy, coverholders should identify and record their own business risks by assessing:

- The risks posed by the products they offer;
- The channels through which business is conducted; and
- The countries in which business is done – when relevant i.e. where the cover is multi jurisdictional.

A coverholder should also review its internal money laundering procedures (as applicable) but particularly in relation to:

- the extent of operational changes and their ML impact, if any;
- Ensuring recommendations from any previous reviews are implemented;
- Reviewing the level of understanding of, and compliance with, training issued to staff;

Reporting

In respect of reporting expectations, the following procedures should be regarded as a minimum standard-

- It is expected that coverholders will appoint a designated person within their company to receive; consider and report to the appropriate authorities any suspicions identified by company employees;
- Coverholders will ensure the reporting of any suspicions to a designated person within the coverholder firm and/or to their managing agent's MLRO in London for consideration (subject to compliance with local jurisdiction legislation);
- The coverholder will retain documentary evidence of the reporting undertaken;
- Coverholders will ensure procedures are in place for suspicions to be reported to a designated person to consider whether reports need to be made to local authorities and instructions issued to staff;
- The coverholder will retain documentary evidence of any decisions made not to report suspicions.

International Sanctions

Executive Summary – Compliance Requirements

Coverholders are expected to be aware of their obligations in respect of international sanctions and therefore expected at all times to be compliant with the international sanctions requirements that apply to them. Coverholders should note that the Franchise Board reserves the right to direct managing agents to terminate their binding authority in the event that they do not comply with this Guidance or Lloyd's Code of Practice for Delegated Underwriting.

As a result, coverholders will also be required by managing agents to ensure that business that they underwrite on managing agents' behalf is compliant with the international sanctions that apply to managing agents. If required by managing agents, coverholders will be expected to incorporate comprehensive international sanctions exclusions and warranties into the (re)insurance contracts that they underwrite under their binding authority. Coverholder breaching any such requirements may give their Managing Agent rights to cancel the binding authority agreement.

It should again be emphasised that there is an expectation on managing agents to ensure that the requirements are implemented as a result of a risk based assessment of the individual coverholder's profile and that procedures are proportionate to the risk and clearly communicated and explained to the coverholder.

In order to ensure compliance with international sanctions the following should be noted:

- (1) coverholders should, and should be able to demonstrate that they can, operate reasonable and proportionate sanctions due diligence and screening programmes in order to comply with the international sanctions that apply to the coverholder and those international sanctions that apply to managing agents for whom the coverholder underwrites,

as a bare minimum for international sanctions compliance, coverholders should be able to demonstrate that they:

- (a) conduct appropriate due diligence and screening against applicable financial sanctions target lists prior to underwriting (ie, the HMT Consolidated List, financial sanctions target lists applicable to the coverholder, and, if appropriate/necessary, the OFAC list¹) and have systems and controls in place to ensure that risks related to such persons/entities are not underwritten;

¹ This material can be found at:

HMT: http://www.hm-treasury.gov.uk/fin_sanctions_index.htm

US Treasury: www.ustreas.gov/offices/enforcement/ofac/programs/

OFAC: www.treas.gov/offices/enforcement/ofac/

- (b) have systems and controls in place to prevent payments being made to persons/entities on such lists - these systems should ensure that additional screening against these lists takes place prior to the payment of claims, return premiums and all other sums (so as to address the risk of mid-term sanctions designations) and should take place on the person to whom, or for the benefit of whom, payment is being made;
 - (c) conduct appropriate due diligence and screening to ensure that they do not underwrite Iranian risks (as defined in Market Bulletin Y4409) and, in particular, any other risk where applicable sanctions prohibit the underwriting of cover;
 - (d) conduct appropriate due diligence and screening for trade sanctions purposes and have systems and controls in place to prevent their participation in activities which would place them and/or the managing agents on behalf of whom they underwrite in breach of applicable trade sanctions²;
 - (e) are able to, and do, follow strictly at all times all sanctions compliance instructions and/or requirements of the managing agents for whom they act (including deploying sanctions exclusionary wording, where appropriate, and in accordance with the underwriting authority and instructions granted to them); and
 - (f) ensure that their sanctions compliance procedures are properly recorded, regularly audited and updated and that their staff are fully and regularly trained in how to comply with these procedures;
- (2) Managing agents and coverholders are expected to include financial crime compliance wording within each binding authority as set out in Market Bulletin Y4510 and ensure that they operate robust and comprehensive AML/international sanctions procedures in accordance with those provisions;
- (3) Lead managing agents will be expected to take steps to ensure that each coverholder knows about and adheres to all laws and requirements applicable to (i) the coverholder; and (ii) the managing agent; in relation to the business that is the subject of the binding authority – however, Lloyd's expects coverholders to be proactive in understanding which international sanctions apply to them and which international sanctions will apply to any business that they propose to underwrite (this may require the coverholder to liaise with managing agents to understand the procedures that the Managing Agent requires the coverholder to follow when underwriting on its behalf);
- (4) coverholder audits undertaken by managing agents will have specific and measurable questions relating to AML/international sanctions referable to these contractual obligations;

² In the UK, this is controlled by the Department for Business Innovation and Skills: <http://www.bis.gov.uk/exportcontrol> and <http://www.businesslink.gov.uk/bdotg/action/layer?topicId=1078151991>

- (5) coverholders will be expected to demonstrate that they are able to operate robust and comprehensive AML/international sanctions procedures as a condition of obtaining and maintaining Lloyd's approval and that they understand the international sanctions which apply to their activities (and how to mitigate the risk that arises from them);
- (6) coverholders should take note of all AML/international sanctions Market Bulletins and other market guidance issued to the Lloyd's Market (and ensure that they implement these into their business practices) **all of which are available on Crystal**; and
- (7) Lloyd's Code of Practice for Delegated Underwriting, so far as it is relevant to AML/international sanctions compliance, must be strictly complied with (by both managing agents and coverholders).

Background

Sanctions are used to bring about a change in another country's or individual's activities or policies particularly if breaches of international law or human rights have occurred, or democracy is under threat. Sanctions are also used to target the activities of terrorists and those involved in nuclear proliferation activities.

Coverholders should be aware that for various reasons including the ongoing and increasing threat of terrorism and increased global unrest, the scope of international sanctions is widening, with the consequent effect that the number of sanctions notices issued by governmental agencies in different jurisdictions in the last few years has increased exponentially.

Sanctions can take a number of forms, but the most relevant types of sanctions are (i) Financial Sanctions; and (ii) Trade Sanctions.

Financial sanctions laws can affect (re)insurers (including coverholders) either by directly prohibiting the provision of insurance or reinsurance to designated entities or individuals or in the form of funds and asset-freeze measures. Targeted or "smart" sanctions measures can prohibit indirect connections or dealings with designated entities or persons. Financial sanctions often also prohibit the provision of financing or financial assistance (which can include (re)insurance) connected to prohibited transactions.

Trade sanctions laws can affect (re)insurers since the provision of (re)insurance in connection with certain restricted trade or certain risks subject to sanctions can be prohibited and/or amount to a prohibited export of service or a prohibited promotional activity. In other cases, the provision of (re)insurance may specifically require to be licensed.

It is also broadly prohibited to engage in any activities, the object or effect of which is to circumvent international sanctions. The effect of this is that (re)insurers will not be permitted to structure transactions so as to sidestep the effects of international sanctions. Other sanctions regimes prohibit the facilitation of any activities that would amount to an infringement if performed by the (re)insurer themselves.

Breach of financial or trade sanctions law can result in the commission of a criminal offence punishable by imprisonment, a fine or both.

In the UK responsibility for the administration of sanctions falls to HM Treasury ("HMT") whilst other countries will have similar arrangements e.g. OFAC in the US.

In the UK, the Financial Services Authority also requires managing agents to ensure those to whom they delegate authority comply with international sanctions. Failure to implement adequate systems and controls to ensure sanctions compliance can result in regulatory censure (and fines) for managing agents.

Legal advice should be obtained on any transaction where there is a concern as to whether the transaction would breach sanctions.

All financial sanctions regimes regardless of jurisdiction create criminal liability in the event of their breach.

Who imposes sanctions?

There are a number of different bodies who impose sanctions:

United Nations

The UN Security Council decides and administers the sanctions regimes, which are binding on UN member states. UN member states are legally obliged to implement sanctions imposed by UN Security Council Resolutions.

Europe

In Europe, the European Union promulgates and administers financial and trade sanctions, which have direct effect in all EU Member States. Again, these sanctions are normally far broader than those imposed by the UN Security Council. The countries, regimes and entities currently subject to EU sanctions can be found on the EU's Europa website.

Individual Countries

Individual countries (such as the UK and the US) also promulgate and administer their own sanctions, which again may target additional entities, persons and activities beyond those targeted by the UN or EU. The countries, regimes and entities currently subject to UK sanctions can be found on the UK HM Treasury's website (and information on export control restrictions can be found on the UK Export Control Organisation's website).

Other countries/territories also impose their own unilateral sanctions which will be enforced by a specific body. For example in the US, The Office of Foreign Assets Control ("OFAC") of the US Department of Treasury administers and enforces financial and trade sanctions in the US. US Treasury maintains jurisdiction over all US dollar transactions, and its aims are to ensure no sanctioned countries, entities or individuals engage improperly in US dollar denominated transactions. OFAC is extremely proactive and diligent in enforcing US policy and coverholders do need to consider very carefully the impact of any US sanctions on their business activities. Most US sanctions are far more aggressive and far-reaching than the sanctions imposed by the UN Security Council or the EU.

The countries, regimes and entities currently subject to US sanctions are listed on US Treasury's website under the OFAC section.

Types of Sanctions

- Financial (including Country/Regime Specific Sanctions and SMART Sanctions)

Financial sanctions operate in a number of ways. These range from prohibitions on all transactions (including financial transactions such as (re)insurance) related to a particular country/region/government. Good examples of such regimes are those imposed by the US against Iran and Syria (similar regimes have been imposed by the EU and UK against these countries too).

Financial Sanctions often also impose prohibitions against making funds or economic resources available to certain entities or individuals. These sanctions are usually accompanied by requirements to freeze the funds and/or assets of governments, entities or individuals located in that region (and notify this to the relevant authorities).

Likewise, exports or investment transactions (and related financing including (re)insurance) may be restricted or not permitted with respect to certain countries.

SMART sanctions are restrictions against individuals or entities rather than against countries and include financial and/or travel ban measures. These sanctions are usually accompanied by requirements to freeze the funds and/or assets of those entities or individuals (and notify this to the relevant authorities).

Under US sanctions, designated entities/individuals are referred to as Specially Designated Nationals (or "SDNs").

- Trade

Sanctions against trading with a particular country may have a general application such as export/import bans (these are commonly closely linked to the financial sanctions that prohibit all transactions related to that country). Alternatively, dealing in particular commodities from certain countries such as oil, timber, diamonds or arms may be embargoed.

Trade sanctions also prohibit the trade in certain goods and items, and also all activities related to such trade. This means that the provision of (re)insurance in connection with certain restricted trade or certain risks subject to sanctions can be prohibited and/or amount to a prohibited export of service or a prohibited promotional activity. In other cases, the provision of (re)insurance may specifically require to be licensed before it takes place.

- Terrorism

There are specific sanctions in place aimed at preventing terrorism. A United Nations resolution in 2001 became binding on all UN member states to prevent acts of terrorism worldwide. The resolution denounces terrorism and requires member states to deny financial support for those involved in or supporting terrorism. Additionally, the resolution enforces the sharing of information about terrorists between governments.

- Al-Qa'ida and Taliban sanction regime

There is a separate Al-Qa'ida and Taliban sanction regime, where key terrorists and associated individuals and entities associated with terrorist activity are subject to separate specific measures imposed by the UN resolutions (and also measures imposed by individual countries, such as the US, EU and UK, for example).

- Diplomatic Sanctions

Diplomatic sanctions may be applied by one country against another (i.e. unilateral sanctions) and could include the expulsion of diplomats from a country, severing of diplomatic ties, suspension of official visits and less frequently, the boycotting of sports and/or cultural events.

- US narcotics regime

The US has imposed sanctions against targets thought to be involved in drug trafficking due to evidence that groups such as Al-Qa'ida are using narcotics trafficking to fund terrorism. These sanctions prohibit US persons from dealing with them and these persons are included on the list of SDNs.

How do sanctions impact on insurance?

In general, sanctions (irrespective of jurisdiction) will impose inter alia the following duties/requirements all of which should be taken into account by Managing Agents when undertaking their risk assessment and agreeing procedures with coverholders -

- Making funds or economic resources available

Making funds or economic available to a person or entity that is the target of international sanctions is an offence. The specifics of the offence are set out under your country's relevant statutory instruments, **but generally it is an offence to make funds, economic resources and financial services available, directly and indirectly, to any person listed under the sanctions regimes.**

Coverholders (and managing agents) have a duty to ensure that they are not making funds or economic resources available to those persons sanctioned. Coverholder activities, such as underwriting of (or agreeing to underwrite) (re)insurance contracts, or entering into endorsements or extensions of the same, on behalf of a managing agent could amount to an infringement of international sanctions.

Claims payments and return of premiums and all other funds to sanctioned persons/entities will amount to a breach of international sanctions. As such, controls and checks should be in place to ensure that monies are not paid to targets on sanctions lists, bearing in mind that policyholders can become targets after a policy has incepted. It should be borne in mind when implementing such checks that the prohibitions prohibit making available funds and economic resources to entities that are owned or controlled by designated persons (as well as to those that are directly listed on the relevant sanctions lists).

- Country-Specific Regimes

Under certain international sanctions, it is prohibited to engage in any activities with certain countries/regimes/regions. This will include all coverholder activities, including underwriting (or agreeing to underwrite) (re)insurance contracts on behalf of a managing agent (as well as the activities of the managing agents and syndicate concerned in relation to such contracts).

- Dealing in the Property/Funds of Designated Persons - Blocking Property and/or Freezing Funds

Where international sanctions prohibit the dealing with the property/funds of designated persons (as is the case for most financial/SMART sanctions), there are ancillary requirements to block/freeze the property/funds of these persons. This will mean that coverholders/managing agents will not be able to use, move or alter any property or funds of a designated person.

These restrictions are often accompanied by a requirement to notify the relevant regulatory authority of the matter including the blocked property and funds.

- Trade Sanctions

Certain comprehensive international sanctions regimes which target countries/regions, prohibit the export of any goods or services to that country. In these cases, and if these sanctions apply, this will include all coverholder activities, including underwriting (or agreeing to underwrite) (re)insurance contracts on behalf of a managing agent (as well as the activities of the managing agents themselves).

It is prohibited to enter into certain types of (re)insurance arrangement in connection with the export of certain goods/equipment (wherever located/destined). This will include all coverholder activities, including underwriting (or agreeing to underwrite) (re)insurance contracts on behalf of a managing agent (as well as the activities of the managing agents and syndicate concerned in relation to such contracts).

It is prohibited to provide (re)insurance in connection with the export of other goods/equipment dependent on their destination. Again, this will include all coverholder activities, including underwriting (or agreeing to underwrite) (re)insurance contracts on behalf of a managing agent (as well as the activities of the managing agents and syndicate concerned).

For some goods/equipment, it is prohibited to provide (re)insurance in connection with their export unless an export control licence has been obtained in advance. Again, this will include all coverholder activities, including underwriting (or agreeing to underwrite) (re)insurance contracts on behalf of a managing agent (as well as the activities of the managing agents and syndicate concerned in relation to such contracts).

- Disclosure of knowledge or suspicion of a transaction involving a sanctioned person / entity

There are a number of statutory instruments (SI) which implement the relevant sanction. The specifics of the applicable offences are covered in each SI but in general terms "failure to disclose knowledge or suspicion" of a transaction involving a sanctioned person or entity constitutes an offence.

- Circumvention and Facilitation

It is prohibited under all international sanctions to do anything which has as its object or effect the circumvention of international sanctions.

Under some international sanctions, it is prohibited for persons to facilitate or approve any activity which they could not have performed themselves under the relevant sanctions.

Penalties

Penalties for breaching sanctions involve a fine and, potentially, imprisonment.

It should be borne in mind that international sanctions breaches may also expose the coverholder (or the managing agent on whose behalf the coverholder underwrites) to regulatory scrutiny. For example, in the UK, it is expected that regulated firms will maintain adequate systems and controls to prevent themselves from being used for the furtherance of financial crime. If a regulated firm becomes involved in sanctions infringement, this may be evidence of defective systems and controls. This could result in additional fines from the relevant regulatory authorities and could result in the withdrawal of that authority's permission for regulated activities to be carried out by the firm concerned. In the most serious of cases, persons/entities infringing certain international sanctions regimes themselves risk becoming designated under international sanctions legislation.

Where those infringing international sanctions hold other offices (such as directorships), they risk being disbarred from performing such functions under the law that applies to the performance of those functions.

Conclusion

As stated at the beginning of this document, managing agents have the responsibility to ensure compliance by coverholders in respect of AML legislation/international sanctions. Coverholders, likewise need to understand their own individual responsibilities under relevant legislation (both international and local). Therefore, it is mutually beneficial for managing agents and coverholders to work together to ensure that adequate systems and controls are in place to fulfil the requisite compliance standards in respect of the class of business undertaken and the coverholders exposure to the applicable legislation.