

IN THE MATTER OF

B E T W E E N

RUSSIAN SANCTIONS

COVERAGE ADVICE 3

INTRODUCTION

1. I am instructed to provide further urgent advice to the Lloyds Market Association (“**LMA**”) on coverage following the recent introduction of sanctions against Russia (“**Russian Sanctions**”). The specific questions are set out below and are dealt with in turn. I should make clear that although the focus of my advice is on AVN 111, the same advice applies to form LMA 3100, save for Questions 4 and 5 below which concern solely paragraph 3 of AVN 111.

AVN 111

2. Paragraph 1 of AVN 111 states:

“If, by virtue of any law or regulation which is applicable to the Insurer at the inception of this Policy or becomes applicable at any time thereafter, coverage to the Insured is or would be unlawful because it breaches an embargo or sanction, that Insurer shall provide no coverage and have no liability whatsoever nor provide any defence to the Insured or make any payment of defence costs or provide any form of security on behalf of the Insured, to the extent that it would be in breach of such law or regulation.”

3. Paragraph 3 of AVN 111 relevantly states:

“In the event of any law or regulation becoming applicable during the Policy period which will restrict the ability of an Insurer to provide coverage as specified in paragraph 1, then both the Insured and the Insurer shall have the right to cancel its participation on this Policy, in accordance with the laws and regulations applicable to the Policy provided that in respect of cancellation by the Insurer the minimum of 30 days notice in writing be given. In the event of cancellation by either the Insured or the Insurer, the Insurer, the Insurer shall retain

the pro rata proportion of the premium for the period that the Policy has been in force. However, in the event that the incurred claims at the effective date of cancellation exceed the earned or pro rata premium (as applicable) due to the Insurer, and in the absence of a more specific provision in the Policy relating to the return of premium, any return shall be subject to mutual agreement. Notice of cancellation by the Insurer shall be effective even though the Insurer makes no payment or tender of return premium.”

Question 1:

4. If, per the relevant policy, the full premium is not earned on inception, will insurers need to make a partial refund of the premium in respect of the period of time when they were not on risk due to the effect of AVN111 para 1 (and where cover was not cancelled under AVN111 paragraph 3 or otherwise). If so, when should the returned premium be paid and can it be paid during the currency of the sanctions (assuming the insured is not a designated asset freeze target)?
5. Whether or not it is necessary to repay premium for the period when insurers are off risk pursuant to paragraph 1 of AVN 111 will depend on whether the cover provided is severable or not.
 - 5.1 Where the policy is an annual insurance with an annual premium that is payable in instalments then the risk for the year is indivisible and the whole premium would be earned immediately the year began to run. In that case where some of the risk does not attach as to part of the insurance, but does as to the remainder, the insured cannot recover any part of the premium. This also applies where the insurance is legal at inception, but subsequently becomes illegal (as where war breaks out between states of which the insured and insurer are subjects): in this scenario the insurer is not liable to return any part of the premium because the insurer has been on risk and has earned all of the premium.
 - 5.2 The only circumstances where the premium would be repayable would be if on its proper construction the policy was divisible so that in fact there are separate identifiable risks being run for each period when the premium is due to be paid.

- 5.3 I also note that paragraph 1 of AVN 111 does not contemplate the refund of premium for the period when cover is suspended. This may reflect the fact that the policy remains in place, albeit that coverage is suspended to the extent the sanctions apply. Paragraph 1 is to be contrasted with paragraph 3 of AVN 111 which does provide for the refund of premium.
6. If the policy is severable then the premium should only be refunded once the sanctions under regulation 29A of the UK Sanctions have been lifted, or with the benefit of a licence/authorisation to make the payment. Regulation 29A is drawn very broadly. There is an argument that refunding the premium could be considered as “indirectly” providing insurance to a person connected with Russia or for use in Russia. The premium is the consideration for insurance, and its refund is linked to the supply (non-supply) of insurance services. There is also a counter-argument that the refund of premium of a cancelled policy is not the provision of insurance, as it is being made precisely because insurance is not being provided. My view is that this counter-argument is the more likely interpretation, but it is not clear cut given the intended breadth of regulation 29A of the UK Sanctions. Given this uncertainty, it would be a prudent step to obtain authorisation from the Government before making any payment to a Russian insured.

Question 2:

7. If sanctions are lifted / revised such that insurers can no longer rely on AVN111 paragraph 1 to exclude cover, is there an argument that the risk has materially changed from that which was first accepted and therefore insurers are no longer obliged to provide cover?
8. This question is dependent on the circumstances that prevail when sanctions are lifted / revised.
9. In my view if sanctions are lifted / revised so that paragraph 1 of AVN 111 does not apply, then in isolation (i.e. on the sole point that sanctions have been lifted / relaxed) there would be a reasonable argument that the risk had not materially changed. The purpose of AVN 111 paragraph 1 is to provide a suspension of cover whilst an embargo or sanction makes it unlawful. In the

present circumstances, AVN 111 paragraph 1 would have been engaged after inception of the policy. On this basis, the removal of sanctions would revert to the circumstances at inception.

10. However, the above answer is given in the abstract. Much will depend on the circumstances in which the sanctions are removed / relaxed, which may well lead to the conclusion that the risk has materially changed. For example if during the period when cover was suspended the property insured has significantly changed (i.e. an aircraft has deteriorated significantly because of a lack of maintenance) then there would be a material change to the risk and insurers would have the right to cancel future coverage. What amounts to a material change is a question of fact, but it is likely to arise where the nature or character of the aircraft has been changed to a degree that it is not what it was originally was, in other words the aircraft has lost its commercial or merchantable character.¹
11. To cancel future coverage in these circumstances it will be necessary for insurers to rely on an express contractual term that affords a right to cancel the policy prior to the expiry of its term, either because of a material change of the risk insured, or a more general right to cancel. In the absence of an express term permitting cancellation of the policy, it will be necessary to imply a term to that effect. However, there is uncertainty as to whether a court would imply such a term as it would have to be demonstrated that the proposed term is necessary to give effect to the policy.

Question 3:

12. If the sanctions are revised so that they prohibit payments to / from an insured but do not generally prohibit the provision of cover, can insurers rely on their rights to cancel the policy for failure of the insured to pay premium on time due to the sanctions? If insurers have already received the premium, are they obliged to adjust a claim in respect of an occurrence which happens during the currency of the sanctions and pay the claim after sanctions have been lifted?

¹ See *Asfar & Co v Blundell and Another* [1896] 1 QB 123: per Lord Esher M.R. at 128 and Kay LJ at 132

13. If sanctions are revised with the consequence that insurers can provide cover, but have not been paid premium because of sanctions, then in my view insurers would be able to cancel the policy because of the failure by the insured to pay the premiums. This assumes that the policy provides the insurer with the right to terminate if the premium (or an instalment thereof) is not paid. The fact that the insurer is unable to receive the payment because of sanctions will mean that the insurer has not been paid. The insurer as the creditor is entitled to require payment to be made to its chosen account in legal currency and the continuing sanctions preclude that payment from being made.
14. As to the second question, if the premium has been paid, and sanctions do not prevent the provision of cover, then insurers would be obliged to adjust the claim in relation to an occurrence that occurs during the currency of the sanctions. However, insurers would not be able to pay on the claim unless and until the sanctions are lifted to permit such payment. However, it may be possible for insurers to apply for a licence from HM Treasury for permission to make payment prior to sanctions being lifted.

Question 4:

15. If an insurer cancels the policy pursuant to paragraph 3 of AVN111 at a time when the insured is a designated asset freeze target, can the premium be returned to the broker as agent of the insured or can the broker legitimately reject tender of the premium on the basis that sanctions apply? Would insurers be prevented from returning premium to a Russian insured that is not a designated asset freeze target? If the return premium cannot be paid or is not accepted, will the Notice of Cancellation sent by insurers still be effective?
16. As to the first question, I do not consider that the insurer can return the premium to the broker, in the event that the insured is a designated asset freeze company. The broker is the agent of the sanctioned insured, and as such a payment to that agent could be said to be providing financial services (i.e. the return of premium) for the benefit of a designated person.

17. As to the second question, it is difficult to advise in the abstract, but a broker which has retained its mandate with the sanctioned insured, could reject tender of premium as again from its perspective it might be said to be providing financial services (brokering of insurance) to a sanctioned insured.
18. As to the third question, so long as regulation 29A of the UK Sanctions remains in place, I do not think that insurers could (without risk) return premium to an insured which is not a designated asset freeze target, as the refund of premium could fall within the broad language of indirectly providing insurance services to a person connected with Russia or for use in Russia (see paragraph 6 above). In such a situation, to avoid any risk of breaching regulation 29A insurers should seek authorisation that the premium can be returned.
19. As to the fourth question, if the premium cannot be returned, or is not accepted, then in my view the cancellation would still be effective. The final sentence of paragraph 3 of AVN 111 makes clear that a notice of cancellation is effective even where the insurer makes no payment of premium.

Question 5:

20. If insurers have exercised their right to cancel the policy (whether pursuant to AVN111 paragraph 3 or otherwise), does any claim that accrued prior to cancellation still need to be paid? Assuming yes, can this be paid during the currency of the sanctions provided that the insured / payee is not a designated asset freeze target?
21. As to the first question, insurers are liable to adjust and pay any claim that accrued prior to cancellation. Insurers were on risk when the occurrence occurred.
22. As to the second question, so long as regulation 29A of the UK Sanctions remains in place, insurers should not pay (without some authorisation) the claim. Payment of the claim would constitute the direct provision of insurance services, namely the performance of the obligation to indemnify an insured loss.

Question 6:

23. Assume a policy contains LMA 3100 and an ordinary cancellation clause requiring either party to give for instance 30 days' notice;

23.1 If underwriters anticipate sanctions and cancel the policy prior to sanctions and say sanctions take effect 15 days later is the notice of cancellation (“NoC”) still effective after 30 days?

23.2 Can underwriters give NoC while the policy is suspended in the absence of a specific agreement such as AVN111 that NoC can be given in the event that sanctions are in force? In other words although the sanctions clause suspends coverage does it suspend all the other operative clauses of the contract such as cancellation provisions or dispute clauses?

24. LMA 3100 provides

“No (re)insurer shall be deemed to provide cover and no (re)insurer shall be liable to pay any claim or provide any benefit hereunder to the extent that the provision of such cover, payment of such claim or provision of such benefit would expose that (re)insurer to any sanction, prohibition or restriction under United Nations resolutions or the trade or economic sanctions, laws or regulations of the European Union, United Kingdom or United States of America”

25. As to the first part of question 6: If insurers anticipate sanctions and give notice to cancel the policy prior to the imposition of sanctions,² but sanctions are imposed during the notice period, then, in my view the cancellation will be effective upon expiry of the 30 days. LMA 3100 reflects an agreement that no cover or other benefit is to be provided to the insured, to the extent that it would expose insurers to breach of any sanction. LMA 3100 does not suspend other rights available under the policy, and the right to cancel the policy would not be a breach of sanctions. It has to be recognised that if insurers did cancel, they may not be able to repay any premium until after sanctions are eased or lifted, or a licence is obtained from the relevant government authority.

² i.e. pursuant to a clause that permits insurers to cancel the policy on giving 30 days notice.

26. As to the second part of question 6: LMA 3100 suspends cover and the provision of other benefits which the insured may receive under the policy, but it does not in my view suspend the other operative clauses of the policy. This is evident from the language of LMA 3100 which confines the suspension to those aspects of the policy which might expose insurers to act in breach of the sanctions. Provisions of the policy which would not have that effect, such as the right to cancel the policy would not in my view be suspended.

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