FAQ: LMA5670 – General Sanctions and Financial Crime Documentation Clause

1. **What does best efforts mean under English/US law?**

In both jurisdictions, the application of best efforts in any given situation will be fact dependant.

With regard to English law, best efforts is likely to require the (re)insured to take all those steps in their power that they are reasonably capable of taking to achieve the intended outcome. In this case, the insured would likely be required to take such steps that a prudent determined and reasonable (re)insurer would take if they were acting in their own interest to produce documentation to demonstrate compliance.

Similarly, from a US perspective, we expect best efforts to mean the diligence undertaken by a similar person under comparable circumstances. Best efforts would have to be within the bounds of reasonableness. Reasonableness in this situation may consider the (re)insured's ability to gain access to those documents, means at the (re)insured's disposal, and the (re)insurer's justifiable expectations.

2. **Consider the situation of a UK reinsurer with a French insurer covering a Chinese shipowner where new sanctions are introduced requiring production of documentation by the reinsurer and the French insurer. The French insurer is unable to obtain the documents from the Chinese shipowner despite using best efforts. How would the clause respond versus the Chinese shipowner, and versus the French insurer.**

On the assumption that the French insurer has used best efforts to obtain the documentation from the Chinese shipowner and has been unable to do so, then the French insurer may be excused under the clause as this would fall within the category of being unable to obtain the information despite using best efforts. The UK reinsurer would not be discharged from the contract between the French insurer and the reinsurer.

The position between the French insurer and the Chinese shipowner will depend on the terms of their contract. If the French insurer has the benefit of this Clause, then the insurer may be discharged from their obligation to the Chinese shipowner if the Chinese shipowner has not exercised best efforts. If the insurance contract does not include this Clause, the French insurer would not have a remedy unless they can demonstrate that the sanctions clause, or some other remedy, in their contract applies. This is likely to be a more protracted and costly exercise than discharge under the documentation clause.

3. **Consider the situation where new sanctions are introduced requiring an insurer to obtain documentation from its insured, but the contract does not have this clause in it. What would the insurer have to do to obtain that documentation in the event that there has not been a claim?**

Where the insurer does not have any contractual right in its contract to gain access to documents in the event of sanctions, it may ask the insured to provide the documents voluntarily. If the insured does not provide the appropriate documentation upon request, the insurer will be in the position of having to demonstrate that the sanctions clause has been triggered or exercising some other contractual remedy. These would be dependent on facts and may involve additional legal expense to advise on options and potentially manage court proceedings. If the other party is in a different jurisdiction there may be numerous law firms involved.

4. **If the remedy for non-production is considered drastic in the circumstances (maybe generally good relationship and compliance historically and one bad actor as an employee), what is the ability to exercise a less draconian response?**

In the UK, where the remedy is considered to be too drastic given the circumstances, the contract would automatically terminate, but the (re)insurer could then look to reinstate the contract with the (re)insured if they were satisfied that this would not expose them to sanction, prohibition or restriction under any Sanctions and Financial Crime Laws and Regulations.

If there are multiple insureds the contract may only terminate against the insured that has failed to comply with the request. Considering a composite policy, therefore, the 'irrevocable discharge' due to the conduct of one insured may lead to a discharge of only that insured, and cover for the other insureds may remain in place.

From the US perspective, you could consider the doctrine of divisibility. The contract may be divisible if its performance can be separated into distinct parts and the breach of one part may not necessarily invalidate the entire contract. The availability of divisibility depends on the applicable facts, the intent of the parties, contract terms and rules of construction. In some US jurisdictions, courts will favour interpreting the contract in a way that avoids complete forfeiture.

5. **If the insurer is discharged from liability under the clause, how would this impact prior claims?**

This Clause does not provide any clawback mechanisms. This means that where any claim has been made and paid prior to the remedy being exercised, then there would be no impact on those claims.

However, in the event the (re)insured fails to satisfy the (re)insurer that its activities do not expose the (re)insurer to any sanction, prohibition or restriction under the relevant Sanctions and Financial Crime Laws and Regulations, the (re)insurer is irrevocably discharged of all obligations under this (re)insurance and shall have no liability to the (re)insured.

This would mean that if there are any outstanding claims which have been made but not paid prior to the remedy being exercised, then the (re)insurer would not be liable to pay those claims.

In at least one scenario in which sanctions regulations have required provision of information related to compliance, the UK government has indicated that where an actor "fails to provide information that they are obliged to provide; UK providers should cease doing business with them, unless satisfied that the relevant actor has used their best efforts to obtain and provide the relevant information…."[1]

The UK financial sanctions FAQ also confirms that ceasing to do business means claims cannot be paid, and unearned premium cannot be returned, even if the claim was received before the inability to provide itemised ancillary costs information upon request (Question 38).[2]

It should be noted that the remedy is only exercised where there is a reasonable request and the (re)insured has not exercised best efforts to provide the relevant documentation and cannot show that the reasons are outside their control.

6. **Why is there no time limit in the clause for producing the documentation? How would you make time of the essence?**

The circumstances of when the documentation is required will vary and be case dependant. It is for this reason the Clause does not set a time limit for producing the documentation, as this matter is better addressed as part of the request for the documentation and to be policed by the need for that request to be reasonable.

Where the (re)insurer makes the reasonable request in writing, it is expected that the (re)insurer will provide the time limit to provide the documentation. In appropriate cases, this request may be seen as making time of the essence for providing the documentation.

7. **How robust is the reliance on the clause in situations where new legislation requires the insurer to hold records but there is a wish to rely on the insured holding that information on the insurer's behalf?**

The main aim of the Clause is for the (re)insurer to be able to request documents from the (re)insured to provide documentation that "its activities do not expose any party to any sanction, prohibition or restriction under any Sanctions and Financial Crime Laws and Regulations." Whether this would enable a (re)insurer to demonstrate compliance with a statutory obligation to hold records is a matter for the (re)insurer to determine in light of the language and interpretation of any such law,

[1] UK Maritime Services Ban and Oil Price Cap Industry Guidance - GOV.UK
[2] UK Financial Sanctions FAQs - GOV.UK

The Clause does not explicitly require the (re)insured to maintain records to demonstrate compliance with the relevant laws and regulation, and indeed if the change to laws or regulations occurs during the course of the contract, the insured might not have been aware of the relevance of the documents prior to that law, so might not have retained the documentation and might not be in a position to provide it.

The (re)insurer may wish to add an additional provision to the Clause requiring the (re)insured to maintain complete and accurate records of activities subject to sanctions or to comply with any regulatory requirement to do the same. If so, the accompanying Guidance for LMA5670 sets out the wording that can be implemented into the Clause to put that obligation on the (re)insured.

However, irrespective of whether the additional wording has been added, if the documentation still exists at the time that the law takes effect, the clause will be protective of underwriters insofar as it will require that information to be provided upon request.

8. **How specific would the request for documentation to the insured have to be? i.e. could you ask for documentation generally and if only limited documents are produced, would you have a remedy?**

The Clause does not attempt to determine the specifics of the documentation that may be requested, as the documents required may vary depending on the transaction in question and the nature of relevant Sanctions and Financial Crime Laws and Regulations. The Clause merely provides that the request needs to be a reasonable one.

It will usually be beneficial for the (re)insurer's written request for documentation to be detailed and specific as to what they want the (re)insured to provide and how the (re)insured may demonstrate that their activities did not expose any party to the relevant laws or regulations.

A (re)insured may be able to show compliance in various ways, depending on the parameters of each sanction. The (re)insured does not necessarily need to provide a set list of documents, unless specific items are reasonably requested by the (re)insurer to demonstrate compliance.

Where the documents provided by the (re)insured do not satisfy the (re)insurer or broker, then the (re)insurer's response would be case dependent. The (re)insurer may request further documentation, or may consider that the insured has not exercised best efforts under this clause so that coverage may be discharged, or may consider that the sanctions clause has been triggered so that coverage could be suspended (if LMA 3100 A or 3200 are in the contract).

6. **Consider the situation where new sanctions are introduced requiring an insurer to obtain documentation from its insured. The insured has already destroyed the records. How would the clause respond?**

Part 2 of the Clause states that "unless the (re)insured has exercised best efforts to comply with the requirements of this Clause and been unable to do so for reasons outside of its control…"

The way the Clause responds will vary depending on the facts of the case looking at when the (re)insured destroyed the relevant documentation, under what circumstances the documentation was destroyed and the knowledge of the (re)insured when destroying the documents.

Where the (re)insured destroys a document as part of standard practice prior to the sanction being introduced or knowledge of the sanction, this may provide the (re)insured with a valid defence if the destruction was reasonable in all the circumstances.

10. **The Clause states "(re)insurers or any such broker to satisfy themselves". What is the requirement here to satisfy the insurer or broker?**

What documents satisfy the insurer will vary on a case-by-case basis. Satisfaction from the (re)insurer and broker perspective will depend on the sanction in question.

The Clause states the (re)insurer or broker may request documents which are 'reasonably required… to satisfy themselves.' This would mean, for example, that the request for documents has to pass the objective test of reasonableness and the (re)insurer cannot use the Clause to gain excessive numbers of documents which may be irrelevant or request documents which are not responsive to the law or regulation in question.

11. **The clause states "(re)insurers shall be irrevocably discharged of all obligations under this (re)insurance and shall have no liability to the (re)insured or any other party in connection with the same. Any premium and brokerage paid shall be deemed earned upon inception of this (re)insurance". How does this interact with the 'Insurance Act 2015'?**

The Insurance Act 2015 transforms insurance warranties into suspensory conditions. Although section 10(2) of the 2015 Act provides that "An insurer has no liability under a contract of insurance in respect of any loss occurring, or attributable to something happening, after a warranty (express or implied) in the contract has been breached but before the breach has been remedied", section 10(4) makes it clear that that section "does not affect the liability of the insurer in respect of losses occurring, or attributable to something happening … if the breach can be remedied, after it has been remedied."

In order to indicate that the Clause should not be regarded as such an insurance warranty, which section 10 of the Insurance Act 2015 would transform into a suspensory

condition, the remedy provided by the Clause in the event of breach is that the insurer is *irrevocably* discharged of all obligations and has no liability.

Given the substantial costs that may be incurred pursuant to Sanctions and Financial Crime Laws or Regulations, and the accompanying guidance provided by the government and regulators, individuals and businesses would be expected to be ceasing to do business if there is an inability to demonstrate compliance with those laws and regulations.

12. Is premium earnt upon inception in all jurisdictions

In the UK, the common law position is that premium and brokerage are earned at inception, but we would expect the (re)insurer to be able to deal with this expressly by contract. The clause is clear that it overrides any contrary provisions in the contract.

We would expect a similar outcome in the US. Typically, state courts would uphold the parties' freedom to contract and enforce the provision unless there is a countervailing public policy consideration. It should be noted that this Clause has been designed for the Surplus lines market and at the time of writing, is not registered for use of the US admitted market, which would be subject to applicable rate regulations.

We have not raised the question in other jurisdictions. We do consider that the provision is more likely to be enforced because the clause operates in circumstances where the insured has not used best efforts to respond to a reasonable request.