Occasional Paper

Underwriting Proliferation
Sanctions Evasion, Proliferation Finance and the Insurance Industry

Emil Dall and Tom Keatinge
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Executive Summary

Securing insurance is key to North Korea’s ability to move sanctioned or restricted goods around the world. Recent high-profile cases of vessels involved in ship-to-ship transfers of diesel and crude oil to North Korean tankers, in violation of UN Security Council resolutions, highlight the importance of insurance coverage in facilitating these operations. The US Department of State, the UN and the Financial Action Task Force, the global standard-setter on government responses to financial crime, have all highlighted the role of insurance in implementing sanctions against North Korea.

As London is the home of global maritime insurance, it is increasingly expected to play a prominent role in global sanctions implementation and in the disruption of North Korea’s illicit commercial networks and activities. This paper argues that just as banks have begun to enhance scrutiny to anticipate the vulnerabilities of both their activities and their clients to abuse for proliferation purposes, so too should similar assessments feature on the financial crime and compliance agendas of insurers, brokers and their regulators. As sanctions requirements against North Korea are expanded to include new forms of restrictions, implementation requirements must also expand to new industries that are key to enforcing these restrictions.

However, this paper finds that the (re)insurance sector is currently hindered from fulfilling this role, due to three issues:

- First, the paper finds that while the industry has experience in countering other types of financial crime risk, such as money laundering, terrorist financing, fraud and corruption, there is less evident industry-wide understanding of how to effectively counter proliferation-related activity. This is mostly due to a lack of relevant government guidance and outreach to the insurance sector, which has left insurers with a false sense of security that proliferation finance transgressions do not affect their industry.
- Second, the paper finds that the unique structures of the insurance industry – such as the division of labour between brokers and insurers – mean that there is a heavy reliance on clients’ information being passed down from other parties, rather than compliance officers interacting directly with clients themselves. This limits the level of insight into the risk, and as a result, the ability to conduct further analysis into specific clients or due diligence concerns that may present a proliferation finance threat. While this paper finds stark regional differences in awareness and approaches, it is also true that London’s dominance in marine insurance and the open sharing of information within the Lloyd’s of London market offers the industry unique tools and opportunities to collaborate on efforts to counter North Korean sanctions evasion.
- Third, current responses are primarily focused on identifying designated entities and individuals, or voiding contracts retrospectively where sanctions exclusion clauses are triggered. However, as insurance acts as a key enabler of the movement of goods and
materials, this paper proposes a more proactive approach by (re)insurers to identify and exclude the underlying entities involved and their activities. Such an increase in effort will require support from governments in the form of offering guidance and information. It will also require greater engagement in due diligence by the supply chain that is supported by the provision of insurance, such as the transport sector. This paper finds, however, that the work undertaken in these related sectors is not sufficiently robust to prevent proliferation-linked activities, thus providing limited comfort to the supporting (re)insurers.
Introduction

PREVIOUS RUSI RESEARCH has highlighted how, despite international sanctions, North Korea’s ‘procurement of sensitive WMD-related goods is made possible by the international financial system’\(^1\) with the regime using ever-greater ingenuity in accessing formal banking channels\(^2\) to facilitate illicit commercial activities on the international market. Increased attention has been devoted to disrupting proliferation finance in recent years, both through new financial restrictions passed by the UN Security Council and the efforts of the Financial Action Task Force (FATF), the global standard-setter on matters of financial crime, which added proliferation finance to its global standards in 2012 and in February 2018 published updated guidance on counter proliferation finance (CPF).\(^3\)

The role of banks in countering proliferation finance has been highlighted in particular, and many banks around the world have begun to consider their exposure to proliferation networks and their operations.

However, this conversation about proliferation finance must also take place in the insurance sector: just as proliferators depend on banks to facilitate the movement of finance, insurance is an integral part of global trade and commerce, and it is often required for the movement of goods around the world. For example, RUSI’s research shows that North Korea’s extensive shipping network, including vessels operating on behalf of North Korea, is gaining access to insurance products that facilitate its operation – including via insurers based in London, where more than 40% of global speciality risks (marine, energy and aviation) are underwritten.\(^4\) This is key, as vessels often cannot leave or enter ports without valid insurance. Therefore, while sourcing insurance is not the end goal, it facilitates other illicit activities for North Korea, primarily the transport of sanctioned goods and materials, and thus represents a key potential choke point for North Korea.

With the world’s attention on North Korea’s rapid development of its nuclear and ballistic missile capability, the insurance sector is coming under increasing scrutiny as governments scramble to obstruct the various means by which this ambition is financed, and is being expected to play an increasingly prominent role in global sanctions implementation and the disruption of North Korea’s nuclear ambitions. International sanctions against North Korea seek to prevent the regime from procuring, shipping and acquiring illicit technology and dual-use items or materials which are needed to further develop its nuclear and missile capability. In addition, the UN Security Council has passed wide-reaching sanctions packages to restrict North Korea’s ability to trade licit goods on the international market. Restrictions have been placed on the export of small arms and light weapons; coal, iron and other key minerals; seafood, agricultural products, textiles and machinery; and North Korean labourers placed abroad. Strict limits have been placed on North Korean imports of crude oil and petroleum products.

Thus, as an increasing number of activities are restricted or move from the licit to the sanctioned space, the international community should expect that North Korea will redouble its efforts to evade sanctions. The expansion of sanctioned items and activities also means that a range of new industries – including commodity traders and insurers – must now consider North Korean sanctions implementation more carefully.

In a recent press briefing, senior representatives from the US Department of State said that as part of the enforcement actions pursued against vessels engaged in illicit North Korean trade, insurers who are providing insurance cover for those vessels will also be targeted.\(^5\) This position is underlined by UN Security Council Resolution 2397, adopted in December 2017, which also requires countries to prohibit the ‘provision of insurance or re-insurance services’ to any vessels involved in North Korea’s illicit activities.\(^6\)

It is thus important that, as sanctions requirements against North Korea are expanded to include new forms of restriction, awareness of risks and implementation requirements must expand to new industries that are key to enforcing these restrictions.

This expanded requirement is emphasised by the recently published updated guidance from the FATF that calls on countries to consider: ‘extending [CPF] monitoring to those sectors which do not fall under the definition of financial institution or DNFBPs [Designated Non-Financial Businesses or Professions] but are vulnerable to proliferation financing (e.g. maritime insurers or dual-use goods exporters)’, and ‘encouraging both financial and non-financial institutions to leverage on existing risk-based measures to identify potential customers and transactions that could be involved in sanctions evasions’.\(^7\)

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Just as banks have enhanced their own scrutiny to anticipate the vulnerabilities of both their activities and their clients to abuse for proliferation purposes, so too, therefore, should similar assessments feature on the financial crime and compliance agendas of insurers, brokers and their regulators.

This paper seeks to establish the baseline for a discussion on proliferation finance in the (re)insurance sector. The paper first assesses current insurance industry approaches to the risk of supporting the ambitions of proliferators, as well as the measures in place to mitigate this risk. Second, the paper outlines how proliferators, such as North Korea, might seek to evade sanctions and gain access to insurance products. Finally, the paper provides a range of practical recommendations to strengthen industry approaches to contributing to CPF efforts, and advice on how the industry can better integrate CPF measures into wider financial crime practices already in place in the industry.
I. Proliferation Finance in the Insurance Industry

When devising strategies to counter proliferators’ access to financial services, it behoves policymakers to look at the financial sector in its entirety, and not purely restrict consideration to the banking sector. Yet, the recommendations and guidance put forward by policymakers, international organisations and academic institutions often refer exclusively to the banking industry, rather than taking a broader view to include insurance. Differences exist between the banking and insurance sectors, which make their perceptions of proliferation finance and their potential responses very different. Based on interviews with insurance stakeholders, primarily in London, which is home to the majority of global maritime insurance, as well as in Europe and Asia, this chapter assesses what the CPF strategy in the insurance sector currently looks like and seeks to illuminate the related gaps and challenges that exist within the industry.

The risks posed by the ambitions of proliferators are not alien to the insurance sector. In the banking sector it is most often those that maintain global operations – including in the US – that have some form of policy for mitigating against proliferation finance risk. Similarly, larger insurers that operate globally, or those located in more sophisticated markets, demonstrate a level of awareness of the requirement to preclude providing financial services, including insurance, to proliferators.

However, while the insurance industry has experience in countering other types of financial crime risk, such as money laundering, terrorist financing, fraud and corruption, there is less evident industry-wide understanding of proliferation finance risks. This is a consequence of three issues that will be examined further in this chapter: a lack of government guidance on CPF to the insurance sector; the due diligence challenges presented by the structure of the insurance sector; and the industry-wide focus on the implementation of list-based sanctions, leading to a reliance on sanctions policy wording.

The limited study of the insurance industry which has already occurred has focused primarily on sanctions. Because of the lack of outreach, stakeholders in the insurance sector expressed that they are unclear about their responsibilities relating to CPF initiatives, short of simply implementing targeted financial sanctions as directed by the FATF’s Recommendation 7. As

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As a result, one insurance company in London expressed that while it is aware of proliferation finance risk, it ‘probably do[es] not do enough to counter it’. Similarly, among the broking community there is ‘no thinking about proliferation finance’, according to one broker interviewed for this paper.

Out of Sight, Out of Mind?

Throughout three years of research on the topic, RUSI researchers have found that awareness of proliferation finance risk is highly uneven between governments. In some jurisdictions, the subject features prominently on the agenda alongside other financial crime risks, although only a few of these governments currently understand proliferation finance as a distinct financial crime risk. In other jurisdictions, proliferation finance does not feature on the agenda of national financial crime priorities at all.

When and where direct government outreach and training on proliferation finance has taken place in the private sector, the focus has been almost exclusively on the banking sector. The same is true of academic and policy research into proliferation finance, and available typologies and red flags designed to help identify and disrupt proliferation networks are grounded in the banking sector and its practices. In addition, as one reinsurer stated, most government regulations relevant to proliferation finance have so far focused on goods and finance, rather than explicitly addressing insurance. This, however, could change following the attention devoted to insurance in recent UN Security Council resolutions and the updated FATF guidance.

In contrast to the banking industry, which has faced billions of dollars in penalties for breaching sanctions requirements, most prominently those against Iran, the insurance industry has not experienced the same enforcement-driven need to pause and review risk exposure to sanctions. The lack of focus on the insurance industry both from policymakers and enforcement agencies means that the need to understand and counter financial crime risks in general and proliferation finance risks in particular is not present to the same extent. This lack of policymaker- and

13. For example, in its assessment of Belgium in 2015, FATF evaluators found it ‘regrettable that the financial aspect of proliferation is not more emphasised’ in wider sanctions discussions. See FATF, ‘Anti-Money Laundering and Counter-Terrorist Financing Measures: Belgium: Fourth Round Mutual Evaluation Report’, April 2015, p. 79. In the more recent evaluation of Cambodia in 2017, FATF highlighted that the country does ‘not have adequate skills or resources to address PF risks’ and were ‘unaware of any [North Korean] presence in Cambodia’s [financial sectors]’, despite evidence proving otherwise. See Asia/Pacific Group on Money Laundering (APG), ‘Anti-Money Laundering and Counter-Terrorist Financing Measures: Cambodia Mutual Evaluation Report’, September 2017, p. 55.
enforcement-led scrutiny may leave insurers with a false sense of security that proliferation finance transgressions do not affect their industry.

The closest insurers have come to feeling the impact of policymaker proliferation finance concerns is through the US and EU sanctions requirements against Iran, which included a prohibition on the provision of (re)insurance services to Iranian entities, as well as specific prohibitions on the provision of insurance related to Iranian shipping firms or the transport of Iranian crude oil. However, while the Iran sanctions regime did cause insurers to think carefully about their exposure to sanctioned entities, along with their exposure to Iran more broadly, it did not necessarily steer them towards focusing on proliferation finance as an activity that can be carried out by non-designated persons acting on behalf of sanctioned individuals and entities. As a result, insurers seem to have a less nuanced understanding of proliferation finance risk than their banking colleagues.

Box 1: Voluntary Self-Disclosures for Potential Sanctions Violations

Insurers in London explained to the authors in interviews that they submit voluntary self-disclosures for potential sanctions violations to either the Office for Financial Sanctions Implementation in the UK, or the Office of Foreign Assets Control in the US. Since 2015, twelve self-disclosed cases relating to potential sanctions violations have been submitted, but insurers generally claim not to have received any feedback on their submissions, a complaint reflected across the private sector when filing such disclosures or suspicions with government agencies.

In the absence of feedback from government, insurers and brokers are unclear whether they are actually identifying proliferation finance-related activities, or other sanctions-related violations, and are unable to use these experiences as learning tools to improve practices. As a result, insurers and brokers have (understandably) determined that current practices are compatible with an effective CPF strategy. This is particularly concerning given the extent to which sanctions and CPF expectations have been raised and broadened by governments in recent years to cover industry sectors that have not traditionally been central to CPF and sanctions-enforcement activities.

Feedback loops between industry and government are important to build common knowledge of sanctions-related risks and increase capacity in the private sector to counter those risks.

Impact of the US

Regardless of how much attention is devoted to CPF by governments, most insurers are also motivated to avoid the extra-territorial reach of US sanctions. Just as banks with global operations

look towards jurisdictions where CPF is a priority, primarily the US, and strengthen their policies accordingly, so too have insurers adopted similarly cautious approaches towards dealing with US sanctions. For example, London-based insurers with a US parent company continue to have blanket bans on providing insurance to Iranian clients, despite those activities being permissible under the Joint Comprehensive Plan of Action (JCPOA). Furthermore, foreign subsidiaries of US insurers generally do not provide (re)insurance cover where there is knowledge of a link to Cuba, North Korea, Syria or Russian-occupied Crimea. Furthermore, currently, European-owned insurers also have to incorporate continuing Iran-related US sanctions restrictions in their compliance procedures. The US dollar is the dominant currency of the international (re)insurance market, and it is standard practice for US dollar payments to be processed through financial institutions based in New York. Any dollar-based premium or claims payment would therefore likely violate US primary sanctions against Iran.

However, as RUSI analysts have found during previous research focusing on banks, despite efforts to cease all dealings with certain countries, they may still do so indirectly. In fact, such blanket bans can result in a false sense of security. An over-reliance on simply screening for any mention of ‘Iran’ or ‘North Korea’, rather than investigating the possible presence of complex networks of front companies and middlemen on which those countries rely to obscure their involvement, leaves the private sector vulnerable. Without a deeper assessment of the client – which would include seeking to understand what their trading activities are, where they are operating and to whom they are connected – banks (and insurers) will have little way of knowing if a connection to North Korea or Iran exists.

National policymakers, as well as organisations responsible for international CPF obligations, should work to ensure that insurers better understand their obligations as well as the tools already at their disposal for countering proliferation finance. However, any examination of proliferation finance risk in the insurance industry should also consider how the insurance sector operates. Existing recommendations to banks on countering proliferation finance may not always be appropriate in the insurance sector, where risks often manifest themselves very differently. For example, as will be explained next, the different roles of brokers and (re)insurance underwriters mean their risk and client perspectives will vary considerably. It is thus important that policymakers craft their CPF guidance and expectations with these differences in mind, so that they are relevant for each different stakeholder within the insurance sector.

Structural Considerations

To make CPF obligations and recommendations relevant and actionable for insurance stakeholders, the unique features of the insurance industry must be considered. Some of these features – such as the division of labour between brokers and insurers – can result in a lack of ownership or leadership on CPF efforts. Others – such as the concentration of global speciality insurance in London and the open sharing of information within the Lloyd’s of London market

16. Subject to less than 50% US ownership or control.
– offers the industry unique tools and opportunities in terms of countering financial crime in general, and proliferation finance specifically.

Since the seventeenth century, Lloyd’s of London has been the world’s centre point for insurance. Lloyd’s is an insurance market where individual managing agents (insurers) come together (both in an organisational sense and physically in the same building) to insure often larger or specialist risks, such as marine hull and cargo insurance for vessels and their operators. In 2017, it was estimated that London accounted for more than 40% of global speciality risks (marine, energy and aviation). Furthermore, many risks underwritten by insurers elsewhere around the world are reinsured in London. This provision of insurance capacity facilitates the movement of goods around the world, and just as proliferators rely on banks for the movement of money, insurance cover facilitates their commercial activities.

London’s dominance in marine hull and cargo insurance means that insurance companies operating there are central to efforts to disrupt global proliferation finance activities.

The Lloyd’s of London insurance market, where risks are often complex in nature and require substantial availability of capital to cover against potentially large claims, is a subscription market. This means that insurers share the risk among themselves, facilitated by a broker. As shown in Figure 1, clients seeking insurance in the Lloyd’s (re)insurance market must deal through a Lloyd’s accredited broker, who will then bring the risk to individual underwriters operating at Lloyd’s of London. The broker will have direct interaction with the client (known as ‘the insured’) and pass on any relevant information about the proposed policy or the risk involved to the underwriters, who can also ask questions of the broker.

The lead insurer (generally with the highest percentage of risk assumed) will consider the key compliance questions or the handling of large claims investigations, although other insurers (however big their risk share) will also carry out their own due diligence. Thus, the credibility and jurisdiction of the lead insurer will provide varying degrees of comfort to the other insurers signing on to the policy. For example, given the scrutiny applied to sanctions and proliferation by US authorities such as the Office of Foreign Assets Control (the administering and enforcing agency of US economic and trade sanctions), if a US-domiciled insurer is the lead, others in the group will enjoy greater confidence that there is no exposure to US sanctions, before most likely conducting their own due diligence to consider US sanctions in accordance with their own risk appetite.

Once enough underwriters have signed up to insure the entire risk, the premium, as well as any potential claims made under the policy, is shared between them, according to the percentage of risk they agreed to. Some managing agents also seek reinsurance, the process whereby insurance companies insure other insurance companies against loss, further dispersing the carried risk. Insurance companies will often combine policies for the purposes of reinsuring them – for example, an insurance company may seek reinsurance for its entire portfolio of marine

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hull or cargo policies. Once again, a broker will play a facilitating role in approaching potential reinsurers. As a result, a reinsurer is normally far removed from individual risk and will rely on proportionate due diligence checks carried out by the brokers and insurers closer to the risk.

**Figure 1:** Relationship Between Clients, Brokers and (Re)insurers in the Lloyd’s of London Insurance Market

![Relationship Between Clients, Brokers and (Re)insurers](image)

*Source: Authors’ research.*

When it comes to certain risks, insurers have even less interaction with the client. This is often the case with third-party liability insurance for the operation of vessels, such as collisions, environmental pollution or liability for the crew in case of death or injury. Several (smaller) shipping companies pool their vessels together in underwriting associations called protection and indemnity (P&I) clubs. The International Group of Protection & Indemnity Clubs estimates that ‘approximately 90% of the world’s ocean-going tonnage’ is insured through one of the thirteen principal P&I clubs,¹⁸ which will seek further reinsurance in the London market, and since thousands of vessels are insured under each club, the level of detail available to the reinsurer is very limited (see Figure 2).

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Another example involves ‘cover holders’ or ‘delegated authority’, where insurance companies agree to delegate underwriting authority to a local agent, often based in markets far from London. The local agent can agree to risks within the conditions of the underwriting agreement on behalf of its parent insurer in London, who will as a result only have insight into the risk after it has been signed.

Because the insured are the clients of the brokers, not the clients of the managing agents, compliance officers of managing agents do not interact with the insured. The division of responsibility within the industry means that there is a heavy reliance on due diligence on clients being passed down from or carried out by other parties, rather than compliance officers interacting directly with clients themselves. This limits the level of insight into the risk, and as a result, the ability to conduct further analysis into specific clients or risks which may present a proliferation finance risk. For example, one reinsurer expressed that its insight into proliferation finance risk is ‘very limited’ and pointed out that because reinsurers are often twice removed from the risk at hand, with a broker and insurer dealing more closely with clients, any effort to better understand proliferation finance risk will be hindered by this.\(^\text{19}\) Insurers, who in theory are one step closer to the individual risks, also rely on relevant information being passed from

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\(^\text{19}\) Authors’ interview with global reinsurer in Europe, November 2017.
brokers. However, if brokers have not thought of proliferation finance as a distinct financial crime risk, they will not be motivated to gather the relevant information relevant.

These unique features of the London insurance market – which also define much of the global market because of London’s dominance in speciality risk – will impact how the industry responds to proliferation finance initiatives. It means that compliance procedures relating to the same risk are carried out to varying degrees by different actors, with different levels of insight into the risk. Policymakers should consider these insurance sector-specific features when devising new CPF initiatives and guidance in the insurance sector.

It is not only between brokers, insurers and reinsurers that interaction with proliferation finance risk differs. There are also stark regional differences in awareness and approaches. One broker stated that ‘areas like the Middle East and Latin America have little oversight, and they are not as tuned into the risk’ compared to its central compliance teams located in the UK, the US and financial centres in Southeast Asia, such as Hong Kong and Singapore.\(^{20}\) This broker had undertaken efforts to raise compliance capabilities by ensuring that knowledge about financial crime risks was disseminated to all local offices, with clear procedures for when major compliance cases should be referred to the central compliance team in Europe. Another reinsurer stated that regional teams are responsible for doing the necessary due diligence on risks that they underwrite in their respective region, but acknowledged that its European offices often had heightened experience while ‘regional offices are behind’.\(^{21}\)

These differences in regional capacity to detect and counter proliferation finance may not currently have a significant impact, as most specialist and marine risks are still handled through central compliance teams in London. However, in recent years market share has begun to shift away from London towards emerging markets, especially Asia, where local insurance companies have increasing financial capacity,\(^{22}\) meaning that ‘more complex risks do increasingly originate in emerging markets’.\(^{23}\) This shift will make regional differences more pronounced and will necessitate that efforts to raise compliance capabilities across regions are pursued across the industry.

**Opportunities**

While the division of labour between brokers, insurers and reinsurers can complicate compliance efforts, the industry also has unique opportunities for strengthening information flows as related to countering proliferation finance risk.

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An important consequence of London being the dominant centre for the underwriting of specialist insurance is that insurance companies can more easily, at least in theory, communicate and share information with each other. The subscription market, whereby no single insurance company is the sole insurer of a risk, means that insurance companies need to discuss complex risks with each other. In contrast to the banking sector, as all insurers have access to the same information about the client, as provided by the broker, there are few issues relating to the sharing of privileged information within Lloyd’s.

Compliance officers have found it useful to talk through potential financial crime risks with other insurers underwriting the same risk, and the same can apply when considering exposure to proliferation finance risk. As one insurer stated, information sharing has become an essential feature of compliance practices in the industry in order to ‘avoid an asymmetry of underwriting information’. This level of information sharing is unique to the insurance sector and provides insurers with an important tool that their banking colleagues lack, due to the prohibition of sharing customer data between banks.

Lloyd’s of London, an association of underwriting members, and regulator of the Lloyd’s Market, also undertakes initiatives to encourage cooperation on compliance between insurers (Lloyd’s and non-Lloyd’s underwriters), including the high-level Sanctions in Insurance Roundtable, where issues such as proliferation finance are discussed. One insurer stated that Lloyd’s of London has become critical in compliance and information-sharing efforts, stating that often ‘the market relies on Lloyd’s rather than the government’ for guidance.

Of course, there are also stakeholders outside the insurance sector who can be useful collaborators in the conversation about CPF. Banks and insurers may operate in different ways, but ultimately they face the same risk of exploitation by skilled proliferators seeking to evade sanctions. A broker stated that ‘the banking and insurance sectors already work much closer together than before on compliance, including on proliferation finance risk’. Insurers often have information on clients for which banks may benefit in their own assessment of potential proliferation-sensitive transactions, and vice versa. Insurers have a golden opportunity to seek out this information: companies depend on the provision of insurance to operate in global markets, and insurers can therefore demand answers to questions before providing insurance cover.

Still, the information flow between brokers and insurers needs to be strengthened and must consider proliferation finance risk as a priority concern. Outside the Lloyd’s of London environment, communication between insurers is not facilitated in the same way. It is important that all jurisdictions consider how information may flow from brokers to insurers and ultimately to reinsurers. If brokers are not considering exposure to proliferators in their discussions with

25. Ibid.
clients, insurers who are underwriting the risk will not have the information required to make an activity-based assessment of proliferation finance risk, short of implementing targeted financial sanctions.

**An Approach Rooted in Sanctions**

All those interviewed for the research for this paper said that their institutions used sanctions screening software prior to signing a new policy or renewing an existing policy. They also undertake ongoing sanctions screening, which automatically checks whether any insured parties subsequently become subject to sanctions during the lifetime of a policy. Some insurance policies, especially those relating to large construction projects, will provide coverage for many years and ongoing sanctions screening is therefore critical as sanctions restrictions could become relevant later in the lifetime of the policy.

The insurance industry stakeholders interviewed for the research for this paper acknowledged that designated entities and individuals would rarely be named on an insurance policy and thus be captured by screening. Rather, designated individuals use a complex network of front companies and middlemen to help conceal their involvement in the insurance policy. Those interviewed therefore acknowledged that automated systems that screen for sanctions will not pick up proliferation finance risk, although insurers also expressed that it is not immediately clear to them what controls the industry could adopt to disrupt wider proliferation finance activities, beyond implementing targeted financial sanctions. One insurer stated that ‘we rely on WorldCheck’ [a commonly used sanctions screening tool] and will do no further analysis of clients unless there is a ‘WorldCheck hit’.

All US and European insurance companies therefore protect themselves against exposure to sanctions evasion activity by including a ‘sanctions clause’ in their policies. The sanctions clause ensures that an insurer ‘is not contractually required to perform activities which will expose it to sanctions’. While sanctions clauses may vary between jurisdictions, with some insurers in emerging markets not using an equivalent of a sanctions clause at all, an example of a standard sanctions limitation and exclusion clause may look as follows:

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27. All those interviewed incorporated UN sanctions lists, as well as additional designations made by the EU and the US. Some also incorporated Swiss sanctions lists because many insurance companies are headquartered there.
29. It is important to note that this practice is not universal, particularly among insurance companies not regulated by Western jurisdictions.
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.\textsuperscript{31}

While this clause does not remove the need to carry out proper due diligence on clients and their activities prior to commencement of a policy,\textsuperscript{32} and does not remove the possibility of exposure to a sanctioned individual or activity, it protects the insurance company should it later become aware that the insured is subject to sanctions. Even in cases where the client itself is not sanctioned, but is found to be engaged in sanctioned activities, the sanctions clause excludes coverage of those activities. Of course, such exclusion language only has value if the insurance company becomes aware that an insured is subject to sanctions; until that time, the benefits of insurance (such as providing valid entry to ports) can be enjoyed.

The insurance sector relies on banks to process the payment of premiums and claims between an insurer and its insured client. Insurance companies are therefore themselves subject to the sanctions screening efforts by the banks who process payments for them, as banks are looking to ensure they are not inadvertently sending funds to or from a sanctioned entity or individual, or someone acting on behalf of a sanctioned entity.

\begin{footnotesize}
\begin{enumerate}
\item Lloyd’s of London has emphasised that sanctions clauses are only meant to ‘protect against matters which cannot reasonably be identified through pre-underwriting due diligence’. See Lloyd’s, ‘Lloyd’s Sanctions Guidance’.
\end{enumerate}
\end{footnotesize}
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Box 2: Steering Clear of US Sanctions: Xchanging

In 2001, Lloyd’s and the International Underwriting Association created partnerships with Xchanging,33 a provider of technology and business process services for the global insurance industry,34 to create a single ‘bureau’ for both the Lloyd’s and companies markets (insurers operating outside Lloyd’s) for premium and policy processing services. In addition to the services provided by Xchanging Ins-sure Services Limited, Xchanging Claims Service provides claims-processing services for the Lloyd’s Market.

Since 2016, Xchanging has been US-owned (and thus for US sanctions purposes is considered as a foreign subsidiary). Two banks, appointed by Lloyd’s, execute payment instructions from Xchanging: a UK-owned bank which processes payments in sterling, and a US-owned bank that covers thirteen other currencies, including US dollars. As a consequence, policies connected to Iran or (previously) Sudan, and therefore subject to US sanctions, are either made in sterling so the US bank is not involved, or they are processed outside the bureau.

In cases where insurers process payments outside the bureau, each insurer and broker participating in the risk will have to handle the premium and claims payments itself. While this may avoid potential issues within the Xchanging system, insurers still encounter the complication that many international banks remain unwilling to support Iran-related transfers, regardless of currency. As a result, insurers have instead had to seek out payment channels with the few banks in Europe willing to process payments connected with Iran. Some banks charge insurers an additional fee for considering the processing of those stand-alone payments to and from Iran – regardless of whether the payment is eventually carried out.

In turn, one insurer interviewed by RUSI stated that while it is accepting Iranian business – in line with the sanctions lifting provided by the JCPOA – it is often charging up to ten times the normal premium to reflect the additional complications posed by the payment process and fees charged by the banks. The withdrawal of the US by President Donald Trump from the JCPOA on 8 May is likely to put an end to what business there was being undertaken.

Due to the heightened attention paid to sanctions evasion risk by many larger international banks, insurers and brokers explained that they have experienced an increase in the number of questions asked and due diligence measures imposed by banks.35 For example, banks will request clarification from an insurer if transaction activity starts to differ from usual business practices: a surge in clients situated in China would therefore constitute unusual transaction activity warranting clarification, if the insurer has thus far had a limited footprint in this region.

35. Authors’ interviews with roundtable of insurance compliance professionals and brokers (respectively), London, November 2017.
These activity-based questions allow banks to review their relationships with certain clients or risks over time, in line with their own risk appetite.\textsuperscript{36}

In contrast, an insurer does not have the same freedom to discontinue relationships with clients it perceives as high risk. Whereas banks can undertake (and have undertaken) programmes of ‘de-risking’ to remove higher-risk clients from their books, an insurer – once a contract has been signed – can only terminate a policy early if the client becomes subject to sanctions restrictions, or if US secondary sanctions exposure puts the policy beyond the insurer’s risk appetite. In instances where the client is not designated, but certain aspects of the policy are found to be involved in sanctioned activities, it may be that only that asset or specific activity is removed from coverage. This means that insurers have two choices when it comes to high-risk clients not found on sanctions lists: either identify them through available due diligence before the policy commences, or, if necessary due diligence information is not available, rely on the sanctions clause later in the life of the policy. This has occurred in some instances. For example, in one case a US insurer removed itself from the renewal of a policy covering a consortium of airlines as one of the insured airlines was flying to Cuba, a jurisdiction still subject to comprehensive US sanctions at the time.\textsuperscript{37}

In the absence of clearer instructions from government, and due to reliance on the sanctions exclusion clause, most (re)insurers and brokers interviewed for the research for this paper felt they were already countering proliferation finance, or at the very least fulfilling their basic obligations by screening policies for the names of designated individuals and entities. The inclusion of these sanctions clauses may provide insurers with a sense of legal protection, but it is important that they understand that managing proliferation finance risk and the violation of sanctions should not only be a reactive exercise, where an investigation is triggered after the violation has already taken place. Rather, because insurance acts as a key enabler, facilitating the commencement of a voyage or the issuing of necessary permits, it is wrong to think that the sanctions exclusion clause automatically protects against engagement in proliferation finance activities.

**Activity-Based Assessments**

For underwriters, efforts to conduct an activity-based assessment of their clients rely on the information gathered by brokers. However, as one broker stated: ‘at the end of the day, the broker is not obligated to do anything [on activity-based screening], because they are not the

\textsuperscript{36} One insurer stated that because a bank will process transfers between insurers and their clients over the lifetime of a risk, the bank will continue to reassess its risk and exposure throughout that time. As a result, a bank’s view of the client relationship can change if the risk profile changes as well. Authors’ interviews with roundtable of representatives of insurance companies, London, November 2017.

\textsuperscript{37} Information disclosed to authors in a non-attributable interview.
ones ultimately signing [a legal insurance contract with] the insured’.  

Another broker stated that activity-based analysis into a client’s related businesses and contacts is ‘beyond our capabilities’.  

A related challenge is that if underwriters ask for further information from brokers, they may simply choose to take the policy in question to a competing underwriter with a more tolerant due diligence threshold. One insurer stated that brokers and insured parties ‘may threaten to remove you from the policy if you ask too many questions or ask questions that others are not asking’.  

Relationships are built up between brokers and underwriters over many years, and the risk of losing business to competitors as a result of attempting a detailed (and in the view of the client, unnecessary or aggravating) activity-based assessment of a client means that the appetite for undertaking such assessments is diminished. A related risk is that insured clients may also choose to seek insurance in emerging markets that are less regulated – this will become an increasing challenge as the capacity of insurers in emerging markets to insure large portfolios of risk increases.  

Reinsurance underwriters feel even further removed from being able to gain meaningful insight into the activities of the insured parties. One reinsurer described the position as ‘right at the bottom of the compliance chain’, meaning that if brokers and insurers have not conducted proper due diligence, it will ‘leave the reinsurer in the dark’.  

Nonetheless, from the interviews, the authors of this paper identified efforts by brokers to gain relevant information about clients, which could be exploited further to assess proliferation finance risk. These include the geographical areas where clients operate (although unless the client openly discloses movement into a sanctions-affected area, brokers will rarely conduct independent investigations), basic questions about beneficial ownership, or limited efforts to understand the goods being shipped on an insurance policy. Common to all is the fact that brokers rely on the information being disclosed by their clients, which will in turn rely on a certain level of trust between brokers and their clients.  

Basic due diligence regarding the client’s beneficial ownership and connected parties is occasionally carried out. One broker has implemented a risk-scoring system that picks up significant changes in the client’s behaviour every year when the policy is renewed, including changes in vessel ownership. However, due to the volume of clients and the effort involved in doing this, the broker admitted that any ‘activity-based assessment is really only possible once a year upon renewal’ of the policy.  

It also noted that such due diligence is voluntary and not

39. Ibid.
41. Authors’ interview with global reinsurer in Europe, November 2017.
mandated by regulation. Thus, while the broker is able to gather additional information from clients to create a fuller picture of the risk, it limits this due diligence to what is ‘reasonable’, due to the perceived protection provided by sanctions clauses, which brokers as well as insurers believe removes liability, if they have carried out ‘reasonable’ due diligence.\textsuperscript{43}

A related point is that while general industry-wide awareness of risk remains an issue, this is particularly acute for smaller players. Training seminars and education in this field tend to be focused towards larger companies, who have the necessary resources at hand, rather than the smaller companies with fewer resources, despite arguably representing a greater risk.

When it comes to determining whether certain goods are intended for proliferation purposes, insurers face the same difficulties as banks. While it is the insurance broker’s responsibility to ensure that any necessary export control licences, if relevant to the policy, have been obtained, only when a client openly discloses that the policy includes exposure to dual-use or military goods is a detailed due diligence investigation conducted. Underwriters and brokers do not typically have the technical expertise to determine whether goods are subject to export control requirements. Furthermore, the documentation provided to brokers and underwriters often does not go into a sufficient level of detail. It is also the case that proliferators often procure goods that are below control thresholds, further challenging the ability to identify potentially sensitive goods and materials in cargo manifests.

Otherwise, insurers and brokers stated that when it comes to facilitating the insurance of cargo in general, the sheer volume of goods being shipped and the number of territories involved in the crossing makes it too great an effort to conduct granular analysis into the specific activities – one insurer admitted that it relies wholly on the insured to ‘tell us the nature of the cargo we are insuring’.\textsuperscript{44} The insured is required to disclose all material facts to the broker and underwriters. The result is that insurers most often only undertake an examination into specific goods if there is a claim on the policy. However, as one broker rightly pointed out, even if proliferators require insurance in order to operate vessels and enter ports, ‘if you are a proliferator, you will most likely not make a claim on your insurance’ and draw attention to yourself.\textsuperscript{45} Many of those interviewed also argued that it is up to customs and port authorities, not the insurance brokers and companies, to interdict any goods that fall under export control requirements or are subject to sanctions.\textsuperscript{46}

\textsuperscript{43} See Lloyd’s, ‘Lloyd’s Sanctions Guidance’.
\textsuperscript{44} Comments made by participant during roundtable discussion with insurers, London, November 2017.
\textsuperscript{45} Comments made by participant during roundtable discussion with broker firms, London, November 2017.
\textsuperscript{46} Authors’ interviews with individual insurers, and roundtable interviews with insurance compliance professionals and brokers respectively.
The Transport and Shipping Sector

While insurers and brokers can conduct their own due diligence, they also rely on the due diligence practices of the shipping and transport companies they insure. However, the authors’ conversations with these sectors suggest that efforts in these sectors to do further work on preventing proliferation-related shipments is less than imagined and should provide limited reassurance. One transport expert interviewed stated that up until 2010, when sanctions against Iran became an international compliance priority, ‘export control was an unknown phenomenon’ for the transport sector at large.47 Before 2010, transport companies were simply moving goods around the world, relying on the due diligence of their clients. In many jurisdictions, including in Europe, there is limited liability for transport companies, and in most proliferation-related cases there has been a trend to prosecute the manufacturer or exporter, rather than the transporter who moved the goods.

Some limited measures exist in the transport sector to understand the goods and materials being shipped. For example, when starting a new client relationship, most transporters will conduct a comprehensive inspection of the first few shipments to ensure that the contents match the description on the shipping documents. However, due to the number of goods shipped around the world daily, transport companies simply cannot continue this level of due diligence into each individual shipment. One global shipping company that was interviewed stated that it ‘can only rely on the information that customers provide on what is actually in the container’.48 Containers are often locked and sealed by the customer or intermediate transporter, and the shipping company does not have the legal authority to enter the container during its voyage.

Many large shipping companies control their own supply chain (for example, by owning planes and vessels), whereas smaller transporters need to use the services of the larger companies. This adds a further hurdle for large shipping companies, as their due diligence must also assess the extent to which the compliance carried out by these smaller transport companies is sufficient. Although transport companies do carry out automated screening of those companies and individuals named on the shipping documents, those entities will rarely, if ever, show up by name on shipping documents, and it is therefore unlikely that simply screening for names will be enough to identify proliferation-sensitive shipments. In fact, the transport sector makes use of sanctions exclusion clauses, just like the insurance sector.

A global shipping company reported that the banks it deals with have become increasingly concerned about proliferation finance risk. In some cases, the shipping company has been required to answer additional questions or complete extra questionnaires before the bank is willing to proceed with the payment. As a result, the company now prepares background notes for banks detailing their areas of operation as well as the due diligence and sanction screening measures in place. When asked if it supplies this information to the brokers and insurers that

48. Authors’ phone interview with global shipping company, August 2017.
provide the insurance for the journey, the company stated it ‘[is] not asked for it by insurers’ but that ‘[it] could give it to them if they asked’.49

**Box 3: Shipping Goods to Dalian, China**

One shipping company interviewed has applied enhanced due diligence measures for shipments going to and from Dalian in China.

The company had made an assessment that goods shipped to Dalian ‘might ultimately end up in North Korea’. Even if earlier transactions related to the shipment appear perfectly legal and compliant with sanctions, the non-compliant actions can take place at the last stage of the shipment – also referred to as ‘last mile diversion’.

Thus, in cases where the shipping company will supply a container to a customer to ship its goods, that customer can normally hold on to a container for many weeks after it has been unloaded from a ship. However, when shipping to Dalian, the company requires its customers to return the container almost immediately in order to prevent onward shipping to North Korea using the company’s containers. Of course, the company is aware that goods can simply be unloaded into another container and shipped onwards, but feels that it has ‘little control over that’ and that this risk is the responsibility of customs agencies.

*Source: Authors’ phone interview with global shipping company, August 2017.*

In sum, awareness among the insurance and shipping communities of the practical manifestation of proliferation finance risk appears low and responses are primarily focused on identifying designated entities and individuals, or voiding contracts where sanctions exclusions are triggered. This is due in part to a lack of available guidance from governments; the structure of the industry itself, which leads to differing levels of insight into proliferation finance risk; lack of focus on the insurance sector to date from both policymakers and sanctions enforcement agencies; and an industry-wide approach to CPF that is rooted in sanctions compliance screening and exclusion clauses. The result is that initiatives to detect and counter proliferation finance activity that extend beyond sanctions compliance are lacking.

II. Exposure to Proliferation Finance

This paper has so far outlined how the insurance industry currently considers the risk of proliferators evading sanctions controls, and the limited practices – mainly confined to sanctions exclusion clauses – currently in place to mitigate against this risk. To further understand how the insurance industry can strengthen its response to proliferation finance and prevent proliferators gaining access to insurance products, it is important to understand the various ways in which proliferators may seek to exploit insurance.

As previously mentioned, while proliferation finance is often perceived to be solely connected to financial transactions, the CPF definition is drawn much wider by the FATF, to additionally encompass financial services that facilitate sanctioned activities, such as the shipping of prohibited goods. Insurers, just like banks, are therefore exposed to the activities of proliferators. For example, if North Korea can gain access to insurance products, it will more easily be able to conduct the illicit activities the regime and its nuclear programme rely upon to survive. It is for this reason that the recently updated FATF guidance urges member countries to also consider other actors outside the banking sector as vulnerable to proliferation financing risk, including the insurance sector.

In terms of thinking through the potential exposure to proliferation networks, those interviewed for the research for this paper had an extensive knowledge of their business and could therefore identify a range of insurance products that proliferators such as North Korea might seek to exploit. The provision of insurance is not the end goal, but it facilitates many of the illicit activities undertaken by North Korea, primarily the transport of sanctioned goods and materials. The transport of materials touches many separate insurance products, including the insurance of the hull and machinery of the vessel itself, the cargo on board, and the third-party liability insurance needed to cover operational risks such as collisions or oil spills (see Figure 3). Each of these risks is present when operating a vessel, but may be insured on different policies, by different clients, with different insurers.
As the case study on page 27 illustrates, the insurance industry’s exposure to proliferation finance may be greater than many insurance sector stakeholders have assessed. Even if the insured client is not directly embedded in North Korea’s illicit networks, it may still unknowingly be engaging in trade with North Korea. Thus, the insurer may be facilitating the transportation of materials and goods on behalf of North Korea or a North Korean front company, or enabling the charter of a vessel to a third party who engages in trade with North Korea. Any connection on paper to North Korea or North Korean illicit activities may therefore not be immediately obvious.

Of course, there are also other classes of business (the range of insurance products an insurer offers) where insurance companies might be exposed to proliferation networks and activities. This includes insurance for sectors where North Korean contractors or labourers might be involved, aviation and aviation cargo insurance, property insurance, or sectors specifically subject to sanctions (such as coal, oil or gas companies).

Only in a very few cases has the insurance sector been used for proliferation finance in its narrowest sense, namely for raising cash for proliferators, rather than facilitating another illicit activity. In 2016, the EU designated the Korea National Insurance Company (KNIC, North Korea’s...
state insurance company) for its role in ‘generating substantial foreign exchange revenue which could contribute to the DPRK’s nuclear-related, ballistic-missile-related or other weapons-of-mass-destruction-related programmes’. KNIC had previously been known for exaggerating insurance claims to generate income. For example, in 2008 the company received $58.2 million in a reinsurance claim from a range of European insurance companies for what is widely believed to have been a fabricated helicopter crash.

North Korea’s Shipping Networks and Evasive Tactics

International sanctions against North Korea seek to prevent the regime from procuring, shipping and acquiring illicit technology, dual-use items or materials needed to further develop its nuclear and missile capability. However, in the past two years the UN Security Council has also passed wide-reaching sanctions packages to restrict North Korea’s ability to trade licit goods on the international market. Sanctions now include full embargoes on North Korea’s export of small arms and light weapons; coal, iron and other key minerals; seafood, food and agricultural products; textiles and machinery; and North Korean labourers placed abroad – all of which have been significant revenue-generating activities for the regime. Sanctions also impose strict limits on the amount of crude oil and petroleum products that North Korea can import, resources considered vital to the daily operation of the state.

Key to North Korea’s trade with the world is its fleet of vessels, which is now subject to an asset freeze and global port entry ban under the UN’s North Korea sanctions package, requiring UN member states to seize any vessel in their ports and territorial waters for involvement in prohibited activities. International sanctions also target North Korea’s shipping networks by name to ensure that vessels supporting North Korea’s trading activities are not able to operate. For example, North Korea’s Ocean Maritime Management, the country’s state shipping company, and its vessels are subject to UN asset freezes, and several other vessels that have been involved in illicit North Korean trading activities are designated by the UN or by the US.

53. UN Security Council Resolution 2397.
However, despite the designation of vessels and introduction of maritime inspection provisions, North Korea has time and again demonstrated its ability to evade sanctions. The UN Panel of Experts on North Korea, responsible for monitoring implementation of UN sanctions, stated in its most recent report that from ‘January to September 2017, [North Korea] continued to export prohibited commodities to generate at least $177 million in revenue’ and underscored that this number does not include exports that went undetected or unreported.\(^{55}\) To continue its trading activities, the panel also noted that North Korea makes use of ‘a combination of multiple evasion techniques, routes and deceptive shipping tactics’, which, due to the consistency and similarity of the tactics employed, are ‘part of a centralized strategy on the part of the Democratic People’s Republic of Korea to evade the commodities ban’.\(^{56}\)

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**Box 4: Examples of Deceptive Shipping Practices Used by North Korea**

North Korea uses various tactics to hide its involvement with or ownership of vessels, the goods being shipped, or the origin or destination of vessels. These tactics include:

- **Physically changing the appearance of the vessel.** Large shipping vessels are required to display their International Maritime Organization (IMO) number – a unique code used to identify vessels – on their hull. North Korea has been known to paint over these numbers, or paint on alternative IMO numbers to conceal the vessel’s true ownership.

- **Ship-to-ship transfers.** North Korea has made use of transferring goods between vessels while at sea to conceal the involvement of a North Korean ship, or the origin or destination of the goods. These transfers often occur from designated ships to non-designated ships in waters close to North Korea. The US Treasury estimates that North Korea directly operates 24 oil tankers capable of ship-to-ship transfer of oil and refined petroleum. The case study on page 27 is an example of a ship-to-ship transfer.

- **Fraudulent shipping documents or falsifying descriptions of goods.** North Korea falsifies bills of lading, invoices or shipping documentation to obscure the country’s involvement in a shipment, thus enabling it to gain access to financial services to facilitate those shipments, including the provision of insurance.

- **Disabling or manipulating the Automatic Identification System (AIS).** An AIS system transmits the position of a vessel, and any vessel engaged in international voyages must have its AIS activated for the duration of its voyage. However, North Korean vessels, or vessels involved in illicit trade with North Korea, frequently turn off or manipulate their AIS systems to make it appear that the vessel is not sailing to or from North Korea.

- **Voyage irregularities.** North Korea makes use of indirect routing, detours to unconnected jurisdictions and trans-shipment through third countries to obscure the origin and destination of its vessels. As the UN Panel of Experts highlighted in its investigations into evasion patterns of North Korean coal vessels ‘route detours almost always involved manipulating Automatic Identification

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56. Ibid., pp. 16, 23.
System transmissions while loading coal in ports of the Democratic People’s Republic of Korea before rejoining the original route and reactivating the Automatic Identification System in time for delivery, to make it appear as if the coal has not originated from North Korea.

- **Flags of convenience.** North Korea uses front companies not linked to North Korea to register its vessels in countries offering ‘flags of convenience’ to obscure any link to North Korea. Many North Korean-linked vessels frequently change the flag under which they are operating to remain one step ahead of sanctions designations. For example, as highlighted in a recent *RUSI Commentary* article, ‘two North Korean-linked ships that Panama de-registered in February are now sailing under the Sierra Leonean flag’. Of the 27 vessels designated by the UN in March 2018, nine were operating under foreign flags. In some cases, North Korean front companies have even managed national ship registries on behalf of countries who outsourced their ship registries (including Kiribati, Tuvalu, Niue and Mongolia). A related challenge is the difficulty of tracking the re-flagging of North Korea’s fleet of vessels. Currently, flag registries do not notify each other when vessels are de-registered, thus allowing North Korea to simply seek alternative flags. Although flag registrations and de-registrations are communicated to the IMO, this information is not fed back to governments and the private sector, which would benefit from this knowledge as part of wider intelligence-gathering efforts.


### Case Study: Billions No. 18

The following case study demonstrates the linkages between North Korea’s evasive tactics, which allow it to carry on its shipping activities, and the insurance industry.

In October 2017, a tanker named *Billions No. 18* departed from Yeosu port in South Korea with a stated destination of Taichung in Taiwan. However, shortly after departure, *Billions* turned off its AIS tracking and conducted a ship-to-ship transfer of diesel to a North Korean-flagged vessel, *Rye Song Gang 1*, in violation of UN Security Council resolutions. On 28 December 2017, the UN designated the vessel for its involvement in a violation of UN sanctions requirements.

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At the time of the violation, *Billions* sailed under a Panamanian flag, and was owned by a company named Bunker’s Taiwan Group Corporation, registered in the British Virgin Islands. RUSI has since learned that *Billions* was reinsured through reinsurance companies in London, including the vessel's protection and indemnity coverage, which was provided by the West of England P&I Club, located in London.

While the sanctions screening software of London-based insurers would have detected *Billions* after its designation, and the vessel's coverage would have been immediately terminated due to the sanctions clause, the policy had already secured insurance coverage, thus enabling the vessel to operate up until the designation.

A further investigation by the UN Panel of Experts into the vessel and its ownership reveals that *Billions* was part of a larger network of vessels involved in illicit North Korean shipping and trading activities. The sole shareholder of the vessel's owner, Bunker’s Taiwan Group Corporation, is Shih-Hsien Chen, a Taiwanese citizen. Chen is also the shareholder of another company, Billions Bunker Group Corporation, registered in the Marshall Islands, which owns and operated the vessel *Billions No. 88*, which has also been suspected of engaging in illicit ship-to-ship transfer activities.

Chen is also the director of another Marshall Islands-registered company named Oceanic Enterprise Limited, which in September 2017 chartered a vessel named *Lighthouse Winmore*, sailing under a Hong Kong flag. In October 2017, the *Lighthouse Winmore* violated UN Security Council sanctions by conducting a ship-to-ship transfer of oil to the North Korean-flagged vessel *Sam Jong 2*.

Although the *Lighthouse Winmore* was chartered by Oceanic Enterprise Limited, it had a complex operational structure. It received operational instructions from Billions Bunker Group Corporation, the owner of *Billions No. 88*, but was managed by a third company named Lighthouse Ship Management/Development in Guangzhou, and owned by Win More Shipping.

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64. It cannot be verified with company records whether the company is named Lighthouse Ship Management or Lighthouse Ship Development. The UN Panel of Experts refers to the manager of the *Lighthouse Winmore* as Lighthouse Ship Management, while several news reports refer to the company name as Lighthouse Ship Development.
registered in Hong Kong. Lighthouse Ship Management/Development and Win More Shipping share a director, and Lighthouse Ship Management/Development has claimed the company had no knowledge of the activities carried out by the charterer.65

However, the owner of the vessel would still hold insurance for the hull of the ship, whereas a charterer usually takes out charterer’s liability insurance to cover itself against operational risks. Therefore, even if the owner was unaware of what the charterer was doing, the insurance cover for the ship would still be in its name. The UN has also discovered that Lighthouse Ship Management/Development was previously named Billions Great International Group Limited, suggesting a link to Chen’s other companies.66

Chen is therefore at the centre of a network involved with the operation of several vessels linked to North Korean sanctions evasion activities, and was able to operate these vessels due to the insurance coverage provided.

The case demonstrates several challenges for insurance companies: it shows how easily insurers may be caught up in proliferation finance activities, even if their clients are not themselves immediately part of proliferation networks. It also shows exactly why insurance companies have, rightly or wrongly, become so reliant on sanctions clauses to protect themselves, in the absence of deeper investigations into vessels and their associated networks.

A further challenge for insurers relates to the inability to ‘de-risk’ clients connected with sanction-violating activities. While banks can voluntarily discontinue relationships with clients with whom they no longer wish to do business, insurance companies continue to uphold policies that have already been agreed to, unless the insured party itself is sanctioned. In the case of Billions No. 18, this was not the case. Because Bunker’s Taiwan Group Corporation was not designated alongside the vessel, only the vessel might have been removed from the coverage under the policy, thus in theory allowing the rest of the policy to be active.

The case also demonstrates several red flags that insurers could have picked up on:

- The vessels involved are all registered under different ‘flags of convenience’, while the owner of the vessels is in Taiwan. While the presence of a flag of convenience is a common feature of global shipping, the combination with vessels operating in the ‘neighbourhood’ of North Korea raises red flags.
- The complex corporate structure, as well as the lack of due diligence into the third parties chartering vessels, should trigger further due diligence questions.
- Vessels insured could have been linked to previous sanctions-violating vessels, if basic network analysis had been carried out prior to signing the risk.

Figure 4: An Illustration of the *Billions No. 18* Case Study

Recommendations

As sanctions have expanded to cover trade activities that were previously permitted, and which generated significant revenue streams for North Korea, the international community should be prepared to adapt its disruption strategies as North Korea continues to endeavour to evade sanctions. To continue trading, and in particular, importing and exporting necessary commodities and technologies, North Korea relies on the provision of insurance for its vessels to be able to enter ports. The insurance industry can thus play a vital role in contributing to the successful implementation of international sanctions and wider counter proliferation efforts against North Korea, which goes beyond reliance on sanctions exclusion clauses.

With this goal in mind, this paper offers the following recommendations for strengthening the insurance sector’s response to the malign and evasive activities of North Korea, which should be of use to the range of relevant stakeholders.

Recommendations for Governments

- When devising strategies to counter proliferators’ access to financial services, policymakers should look at the financial sector in its entirety, and not restrict consideration to the banking and payments sectors. Both informal outreach as well as formal guidance and regulations should explicitly address insurance, to make it clear to the insurance sector where it fits into wider CPF initiatives.
- National policymakers, as well as organisations responsible for international obligations on CPF, should work to ensure that insurers better understand their obligations as well as the tools already at their disposal for countering proliferation finance.
- It is important that policymakers craft their CPF guidance and expectations with an understanding of how the insurance sector operates, ensuring relevance for each different stakeholder within the industry. Due to the structure of the subscription insurance market, compliance procedures relating to the same risk are carried out to varying degrees by diverse actors, with differing levels of insight into the risk. Policymakers should consider these sector-specific features when devising new CPF initiatives for the insurance industry.
- Governments should clarify the insurance industry’s obligations, as relates to conducting customer due diligence and activity-based assessment of clients.
- Governments need to aid the insurance industry in developing an understanding of proliferation finance-related red flags, promoting a public–private partnership approach to enhancing the CPF effectiveness of the insurance sector. For example, alerts could be provided by governments that draw attention to the risks inherent in certain ports or jurisdictions, groups of clients or components that are difficult for the insurance sector to identify and thus incorporate into their due diligence processes.
• Regulatory authorities should provide feedback, whenever possible, to the insurance sector on sanctions cases and voluntary self-disclosures to further the industry’s understanding of whether current practices are effective.

• More broadly, governments need to consider the at-risk supply chain as a whole: collaboration and information sharing between different stakeholders, including the transport sector, export control agencies and the insurance industry, would strengthen the integrity of the system and enhance the CPF effectiveness of all.

• Governments should also work with the IMO to improve communication of registrations and de-registrations between flag registries and governments, and ultimately feed this back to the private sector, who will benefit from this knowledge as part of wider intelligence-gathering efforts.

Recommendations for the Insurance Sector

• Insurers and brokers should understand that developing an effective proliferation finance mitigation strategy will go beyond simply implementing targeted financial sanctions via list screening or installing blanket bans on dealing with certain countries. Such a strategy must instead focus on seeking to identify the underlying entities involved and their activities.

• While the inclusion of sanctions clauses may provide insurers with a sense of legal protection, it is important that insurers understand that addressing proliferation finance risk and the violation of sanctions should not only be undertaken in hindsight when an investigation is triggered following an identified violation. Rather, because insurance acts as a key enabler, facilitating the commencement of a voyage or the issuing of necessary permits, it is wrong to think that the sanctions exclusion clause automatically protects against engagement in proliferation finance activities.

• Because clients depend on the provision of insurance to operate key areas of business, brokers and underwriters occupy a critical position in the supply chain. This allows them to demand adequate due diligence information before proceeding with underwriting a policy. Where proliferation finance risk is heightened, insurers should include specific due diligence activities in their underwriting processes.

• While London’s dominance in shipping and marine and cargo insurance means that insurance companies and brokers operating there are critical to global CPF initiatives, the steady shift of insurance towards emerging markets necessitates efforts to raise compliance capabilities across all regions. The industry as a whole should pursue efforts to raise compliance standards globally and share best practices with subsidiaries or counterparts in emerging markets.

• The level of information sharing possible within the Lloyd’s of London market provides insurers with an important tool that their banking colleagues do not have, and a unique opportunity to contribute more effectively to CPF initiatives. This should be exploited further by promoting more common consideration and discussion of proliferation finance in general, as well as working together on identifying specific risks.
• In the absence of guidance from governments, the insurance sector should be proactive in seeking to develop and shape industry guidance, and cooperate within the industry to establish industry-wide principles to counter proliferation finance.

• Insurers should work closely with other sectors:
  - Banks: insurers often possess information about clients that banks may benefit from in their own assessment of potential proliferation-sensitive transactions, and vice versa. Insurers have a golden opportunity to seek out this information: companies depend on the provision of insurance to operate in global markets, and insurers can therefore demand answers to questions before providing insurance cover.
  - Shipping and transport companies: insurers and brokers should learn from the approach taken by banks with shipping and transport companies and require them to answer additional questions relevant to CPF before proceeding with providing insurance coverage.
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