GETTING TO GRIPS WITH GLOBAL SANCTIONS

Trade embargoes and other legal restrictions are an increasing concern for businesses operating around the world

FOR COMPANIES WORLDWIDE, international sanctions are a major compliance challenge. The regulatory risks associated with economic sanctions, asset-freezing measures and trade embargoes are not new, but their scope and complexity have increased greatly, particularly with regard to those imposed by the EU and the US.

The increased use of sanctions means that a vital market, preferred supplier, strategic partner or important customer may become off limits almost overnight.

Failure to comply with international sanctions can result in prosecution, large fines, reputational damage and imprisonment. With a growing appetite among regulators on both sides of the Atlantic to prosecute companies and individuals for violations of sanctions and embargoes, there has never been a more important time to get things right.

This article sets out some of the main compliance challenges and other factors related to sanctions that companies should take into consideration.

Three challenges

The wrong side of the pond

Rightly, many companies' main focus is on compliance with US sanctions. There are two reasons for this: US regulations in this area are generally broader and more wide-ranging than those of other jurisdictions and the US has a history of being a prolific prosecutor for sanctions violations. Another reason is the extra-territorial reach of US sanctions.

However, EU sanctions, like US sanctions, are also wide-ranging and extra-territorial in nature. As such, companies need to ensure that their sanctions policies and procedures not only take into account the US, but also the EU and wider applicable measures. The most important areas to consider are:

- The nationalities of key personnel
- Overseas branches or EU incorporated subsidiaries
- Holding companies incorporated under the laws of an EU member state (including those incorporated in overseas territories)
- Business activities carried out within the territory of the EU.

Getting into bed with the wrong person

Another common problem for companies is contracts that involve a party that subsequently becomes a sanctions target, or when it is later established that the contracting party has links to a designated individual or entity (sanctioned parties).

In other instances, companies may be required, as a result of local laws and regulations in the jurisdiction in which they are operating, to enter into joint ventures either with little known entities or state-controlled entities – for example, in sectors such as mining.

Nowadays, the need for comprehensive due diligence on potential business partners and customers is more important than ever. The rapidly increasing list of designated individuals and entities means that it is essential that companies know who or what they are doing business with.

There is no one-size-fits-all approach, or minimum level of due diligence required. Companies should carry out a level of due diligence according to the risk profile of the individual or entity with whom they are doing business.

Due diligence should not be limited to the individual or party with whom you are directly doing business – it is important to consider ownership and control structures to ensure that there are no sanctioned parties further down the corporate chain. If something goes wrong, regulators will expect to see evidence of a sufficient degree of due diligence, and all records should therefore be maintained.

If you find out that a party with whom you have a contractual relationship has been sanctioned or that a party you are working with has connections to a sanctioned party further down the line, it might be necessary to suspend, investigate and maybe even terminate the contractual relationship, so contracts and terms should provide for such actions to prevent a drawn out contractual dispute. While the use of such clauses is helpful, it is worth remembering that they only minimise, rather than mitigate, the risk to your business.

Where an emerging sanctions issue appears insurmountable and the relationship needs to be wound down, this can also be problematic. Sanctions restrictions prevent the dealing in stocks and shares as part of the asset-freezing provisions. As a result, a company may find itself stuck in a joint venture or committed to a joint venture with a designated entity, unable to develop its asset and unable to divest from it. In the absence of specific exemptions this may require a more strategic solution.

Not practising what you preach

It is vitally important that sanctions policies and procedures are kept up to date. All employees should be given regular training on sanctions and export control compliance and an option could be to carry out regular assessments of whether employees truly understand their roles and responsibilities.

Companies should also consider carrying out auditing to test the resilience of their policies and procedures. Such auditing exercises can also be helpful to identify problems or potential problems – in the best case, allowing these to be rectified before they become a violation and, in the worst case, providing an opportunity to investigate and consider self-disclosure to the appropriate authorities.

Other key considerations

Licensing strategies

Regulators recognise that businesses need time to adapt to new sanctions regimes and therefore many of these measures include time-limited exemptions for prior contracts and general or specific licensing arrangements.

These exemptions and licences can be particularly useful where there are outstanding payment obligations, or where guarantees or trade financing arrangements are in place.

Asset-freezing restrictions are aimed at preventing sanctioned parties from receiving funds and economic resources and are not there to prevent the settlement of legitimate contractual payment obligations owed to non-sanctioned parties.

Companies should examine whether general licences have been issued or whether a specific licence is required to take advantage of such exemptions. If a licence is successfully obtained or when there is a general licence, companies should ensure that they comply with any requirements specified by the authorities.

Penalties and risk of enforcement

The US has been a prominent enforcer of sanctions compliance for some time and there are many examples of significant fines that have been levied for sanctions violations.

While we've not seen the same level of fines or prosecutions in the UK and the EU, the tides are changing and the risk of prosecution is increasing. In the UK, the Financial Conduct Authority, the Serious Fraud Office, the Treasury, and Revenue & Customs have all made clear statements of intent and have shown a growing appetite to prosecute for sanctions violations. Several financial institutions, including a major high street bank, have recently been handed significant fines for failing to have adequate systems and controls in place to prevent breaches of UK financial sanctions.

Openness and transparency

If something goes wrong, it is important to investigate the matter thoroughly. If it is established that there has been a breach, or a potential breach of sanctions, then self-reporting can often help minimise and, in some instances, mitigate a company's exposure to fines and prosecution.

If you are opting to self-report, it is important you investigate fully the circumstances surrounding the breach or potential breach and engage openly and transparently with regulators. SR

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> *"Embargoes are awkward for global companies – sanctions and regulations change frequently, creating great uncertainty. We cannot identify every business relationship of our trading partners, especially with the BRIC countries planning their banking payment systems. Extreme due diligence is too expensive, if not impossible.*
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> *"Another concern for our companies is insurance. Although policies state that if coverage is contrary to public policy it will be null and void, insurers are anxious about penalties from the US, so felt obliged to include sanctions clauses in policies. Confusion has multiplied, as the many sanctions clauses are difficult to incorporate into global policies.*
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> *"The risk manager, insurance buyer and captive manager must work closely with legal officers to reduce the risk of inadvertently breaching sanctions or having a major uninsured loss."*
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> **Jorge Luzzi** president of Ferma and managing director of Pirelli Insurance and Reinsurance Company

Top tips

1 **Don't focus exclusively on US restrictive measures.** Ensure you consider all measures applicable either to the company or its employees.

2 **Know your customers and suppliers.** Always undertake sufficient due diligence that takes account of the risk profile of the individual or entity in question. Consider regularly rescreening customers and suppliers against sanctions lists.

3 **Consider including sanctions and export control clauses and warranties in your contracts and general terms and conditions** to minimise your risk of being affected by sanctions. Where there is doubt as to the ultimate end user in a given contract, and to minimise your exposure to third-party risk, consider including end-user undertakings and maintain these in your records.

4 **Make full use of exemptions and licences when there are embargoes or sanctions** – they are there to assist businesses. When using licences, ensure you understand the terms and fully comply with the specific requirements.

5 **Keep your sanctions policies and processes up to date** and ensure key personnel are fully briefed and trained in these policies. Regularly audit your processes to ensure they are working effectively and to identify any problems.

6 **In the event of a violation or potential violation, suspend related transactions and carry out a thorough investigation.** It is recommended that you seek external legal advice before you engage with regulatory authorities and consider self-disclosure.