Financial Regulation international

Worldwide regulatory developments and their implications for the financial services industry

The evolving financial sanctions landscape – UK and US perspectives

Financial sanctions have assumed ever-increasing importance in the international business landscape. For firms operating across financial boundaries the challenge of navigating the escalating and sometimes conflicting financial sanctions has increased in recent years. Now, along with the need to remain current with changing sanctions programmes imposed by domestic regulators, firms must focus on identifying which sanctions apply to their global business, and put in place the right systems and controls to ensure they comply with all relevant measures.

In this article, Emma Radmore, Thomas Laryea, Michael Zolandz and Peter Feldman of SNR Denton look at the evolving landscape of UK and US financial sanctions.

What is the purpose of financial sanctions?

Financial sanctions are legal measures designed to impose costs on countries, governments, entities or individuals with a view to influencing a change in policy or actions, or as an enforcement tool to align compliance with international legal or diplomatic standards. The international community uses sanctions, in particular, when there is a perceived risk to global peace and security, including terrorism and illicit financing.

Depending on the policy stance or actions the sanctions aim to address, they can include:

- An outright ban on any inward or outward funds transfer (or transfers permitted subject to notification and/or licences);
- An asset freeze;
- Limitations on trading;
- Investment bans; and
- Other restrictions, eg on international travel.

Financial sanctions could target any person or organisation in a given country, or they could be limited, for example, to governments, or to named entities and individuals designated by the particular sanctions regime.

Interaction between UN Security Council resolutions and national sanctions regimes

Within the international sanctions architecture, there is a hierarchy involving sanctions imposed by United Nations (UN) Security Council resolutions, which tend to be at a relatively high level of generality in terms of content. Below this are national sanctions regimes that incorporate UN Security Council resolutions and that sometimes expand or tighten the effect of these resolutions or introduce sanctions informed by specific national interests and with content unrelated to UN Security Council resolutions. The resulting complexity of these varying, overlapping and parallel tracks of sanctions can be a trap for the unwary.

Under the United Nations Charter, the UN Security Council can impose sanctions where there is a perceived need to keep or restore international peace and security. The UN Security Council can decide on the measures to take and call on UN members to apply them. These UN Security Council resolutions bind all UN member states. However, within states such as the UK and the US, which rely on a so-called dualist system of international law, the content of the UN Security Council resolutions apply to private parties only when incorporated into applicable domestic law.

EU sanctions and application in the UK

Sanctions imposed by the European Union (EU) have two main sources. The first comes from UN Security Council resolutions, whereby the EU sanction is a means of uniformly incorporating within the EU measures that have been adopted through UN Security Council resolutions. Second, the EU may impose sanctions under its own legal authority. For example, in implementing the EU Common Foreign and Security Policy, the EU can impose measures to interrupt or prejudice economic relations with third countries and measures against individuals and entities. Sanctions imposed by the EU are usually enacted by EU Regulation, which means that they are directly applicable in the UK and other EU member states without local law implementing measures (ie the UK introduces statutory instruments, which are a form of secondary legislation, to give UK regulators power to enforce sanctions compliance).

UK sanctions

Another component of the UK sanctions regime is sanctions that the UK Government makes. It usually does this by means of a statutory instrument that the appropriate government department (in the case of financial sanctions,

HM Treasury) can issue under the relevant primary legislation. This secondary legislation avoids the need for a full parliamentary debate and process. Consequently, UK sanctions imposed by statutory instruments can come into force very quickly, sometimes within hours, as a response to an emergency situation. HM Treasury's website sets out all updates to sanctions lists, including all the relevant UN, EU and UK measures, along with consolidated lists of "designated persons".

Given that statutory instruments can only impose sanctions within the limits and powers established by the relevant primary legislation, scope for legal challenge can arise. For example, in 2010 certain individuals whose names HM Treasury had added to the designated persons list in respect of the anti-terrorism measures claimed the UK Government had misused its powers. The relevant primary legislation enabled the UK Government to make an order giving effect to a UN Security Council resolution where 'necessary or expedient', but did not allow it to impose sanctions more broadly. The English Supreme Court held[1] the powers used in some terrorism orders were beyond what the primary legislation allowed and quashed the orders. The UK Government's response was to bring in the Terrorist Asset-Freezing (Temporary Supplies) Act 2010, which retrospectively validated any asset freezes under the quashed orders. The permanent Terrorist Asset-Freezing Act 2010 followed after one year, to give permanent effect to the changes.

Who is covered by UK financial sanctions?

Here, we are not considering the sanctioned entities or designated persons who are the subject of the sanctions – these can be anywhere in the world. This is about whom the UK has power to order to limit engagement with these sanctioned entities or designated persons. Broadly speaking, any British citizen, any company incorporated in the UK and anyone physically in the UK should work on the basis that the UK financial sanctions regime would apply to them. This covers British citizens working overseas (regardless of whether their employer is covered) and overseas branches of British businesses, but not foreign incorporated subsidiaries.

Who is responsible for administering UK financial sanctions?

The Foreign and Commonwealth Office is responsible for the overall policy framework for UK sanctions. However, the Asset Freezing Unit (AFU) within HM Treasury is the key unit that implements and administers financial sanctions. Accordingly, the AFU grants general and specific licences to deal with designated persons and is the first port of call for queries. The Department for Business, Innovation and Skills is responsible for export and trade controls and, within this, the Export Control Organisation deals with licensing issues. Coordinating the receipt of information and advice from these various sources can be daunting.

What do UK financial sanctions do?

UK financial sanctions impose the relevant international (or domestic) measure on UK businesses. Some will apply to all UK persons, while others (specifically those under the Counter Terrorism Act) only to defined financial institutions. But what they invariably have in common is:

- A ban on providing any funds or economic resources, directly or indirectly to any designated person;
- A requirement for financial institutions to report any accounts or other monies they hold for any designated person; and
- A possibility of seeking a licence to continue with a transaction that is otherwise outlawed.

Depending on the law in question, there may be extra requirements – for example, the current wide-ranging Iranian sanctions outlawing any involvement with certain industries and notification or requests for approval for transfers to non-designated Iranian persons.

What are the penalties for breach of UK sanctions?

Failure to comply with the UK sanctions regime is an offence and can lead to imprisonment and financial penalities. Moreover, it is a strict liability offence, which can be hazardous for firms and their compliance departments. The risk-based approach to compliance, which is embodied in UK financial regulation generally and in anti-money laundering and anti-corruption laws, has no place in sanctions compliance. Most sanctions legislation imposes potential liability on the UK corporate entity, or the individual involved in the breach, and creates senior officer liability for senior management concerned in the breach.

If an institution covered by the UK financial sanctions regime is also regulated by the Financial Services Authority (FSA) it must also take account of the FSA's enforcement powers. The FSA has no direct powers under sanctions legislation, but it does have:

- Powers to take action for criminal offences under the Money Laundering Regulations, which include failing to have in place appropriate procedures to combat the risk of terrorist financing as well as money laundering. The FSA has used these powers already; and
- A general objective under the Financial Services and Markets Act 2000 to take action to prevent financial crime. This means it can use – and, indeed, has used – its enforcement powers against authorised firms that it considers do not have in place adequate systems and controls to protect them against financial crime, citing a breach of its Principles for Business. As a number of regulated financial firms have found to their cost, the FSA need not prove the firm in question has conducted business with sanctioned entities. Rather, it is enough if the FSA shows the firm did not maintain adequate systems to safeguard

against transactions that would violate the sanctions programme. The level of regulatory scrutiny in this regard is set to increase. The FSA has set standards it expects regulated firms to comply with, which it includes in its handbook, *Financial crime: a guide for firms*. These relate to governance, risk assessments, screening of customers and dealing with matches and procedures for notifying authorities. The handbook emphasises the need for an integrated approach to financial compliance – for example, the regime for prevention of money laundering is separate to the sanctions regime, but they may at times be interlinked. A sanctions target may be (but is not necessarily) a money laundering suspect – so sometimes a firm may need to report a match or suspicion under both regimes.

Sanctions that apply in the US

As in the UK, sanctions imposed by the US Government may go beyond merely incorporating the content of UN Security Council resolutions. The legal bases for US sanctions vary by sanctions programme. Most US sanctions programmes are primarily based on the International Emergency Economic Powers Act of 1972, as amended (IEEPA) with the notable exception of US sanctions against Cuba, which are principally rooted in the Trading with the Enemies Act of 1917, as amended (TWEA). In addition to these baseline authorisations for sanctions, there are several programme-specific sanctions laws, regulations and executive orders. For example, the US sanctions against Iran are rooted in the IEEPA, and also in the Comprehensive Iran Sanctions, Accountability and Divestment Act, the FY 2012 National Defense Authorization Act, the Iran Threat Reduction and Syria Human Rights Act, the Iranian Transactions Regulations, and a few dozen executive orders.

A marked feature of the context of sanctions in the US is the politically charged nature of much of the discourse, which can affect the content of the sanctions, the design of the formal enforcement tools and the informal channels of enforcement, including risks to business reputation. Effective legal analysis and advice needs to be informed by an understanding of this context.

Who is covered by US financial sanctions?

Generally, US sanctions apply to "US persons", not to non-US persons. Under the relevant regulations, a US person is defined as any US citizen, permanent resident alien, or entity organised under the laws of the US or any US jurisdiction (including foreign branches) or any person actually within the US.

However, there are two notable exceptions. First, US sanctions against Cuba apply to "persons subject to the jurisdiction of the United States". This category includes any US citizen or resident, wherever located; any person actually within the US; and any entity organised under the laws of any US jurisdiction, or – importantly – its subsidiaries. Second, pursuant to recent legislation (the Iran Threat Reduction and Syria Human Rights Act), US companies are now liable for the Iran sanctions violations of their foreign subsidiaries.

In addition to this, the US also asserts extraterritorial application of certain sanctions against Iran. US extraterritorial sanctions target Iran's energy and financial services sectors, and assert jurisdiction over all persons, US and non-US. The actual enforcement of extraterritorial measures often involves a very complex and sensitive political and foreign policy calculation in addition to jurisdictional issues associated with foreign parties. Accordingly, there is no automatic exercise of extraterritorial sanctions in the US.

Extraterritorial sanctions authorise penalties on any person, regardless of nationality or location, who makes investments in or provides certain types of goods or services for Iran's energy sector. These sanctions are triggered by certain levels of economic activity and are applicable to individuals or entities that knew or should have known that their investments or commercial activities benefited Iranian parties. US extraterritorial sanctions also include provisions directed at foreign financial institutions that facilitate certain transactions for the Iranian Revolutionary Guard Corps and its agents and affiliates or for the purchase of petroleum or petroleum products from Iran.

Who is responsible for administering US financial sanctions?

The US Treasury Department's Office of Foreign Assets Control (OFAC) has principal responsibility for administering US financial sanctions programmes, including the system of general licenses and specific licenses that may be issued to authorise certain types of transactions or conduct in line with the sanctions programmes.

As a practical matter, and often pursuant to statutory direction to do so, the US State Department also plays a key role in the administration of US sanctions programmes, including determinations about enforcement and licensure. Given the global political and national security implications of sanctions, other US Government agencies may also be involved in the design, implementation and enforcement of financial sanctions. This so-called inter-agency process can include the Treasury Department, State Department, Department of Defense, National Security Council and other US Government agencies.

What do US financial sanctions do?

US financial sanctions generally prohibit or impose strict conditions on any transactions between or involving US persons and individuals, entities or countries that are subject to sanctions.

The OFAC administers a publicly available list of Specially Designated Nationals (SDNs) who are subject to US sanctions. Among other things, the several thousand entries on the SDN list include specially designated global terrorists, foreign narcotics kingpins and entities owned or

controlled by the Government of Iran. SDNs can be of any nationality and located in any jurisdiction.

SDNs are generally prohibited from engaging in or with the US economy. US persons typically must block and freeze any property and interests in property of an SDN that comes within the US jurisdiction. US persons may not engage in any transaction (direct or indirect) with a person on the SDN list, including anybody who is owned or controlled by a person on the SDN list – regardless of whether that person is themself named on the list. US persons may not facilitate any transactions for a third party that would be impermissible if they were performed in the US or by a US person.

In addition to the broad prohibitions with respect to SDNs, the US sanctions programmes that are country specific – for example, Burma (Myanmar), Cuba, Iran, Sudan and Syria – each have their own sets of restrictions. These sanctions can include prohibitions on imports into the US from sanctioned countries, bans on exports from the and US to sanctioned countries, asset freezes and US travel bans for top government officials.

What are the penalties for breach of US sanctions?

Penalties for violating US sanctions can be severe, and include a wide range of administrative and civil liability, as well as potential criminal liability for certain egregious and wilful violations.

The specific measures that can be imposed depend upon the sanctions programme involved, the nature of the violation and how the conduct came to the attention of US regulators. Penalties that can be imposed include substantial fines and possible jail time, restrictions on eligibility for US Government contracts ("debarment") and restrictions on access to the US financial system.

Additionally, sanctions issues expose individuals and entities to substantial degrees of reputational risk. Given the extraordinary focus on sanctions compliance by the US Congress, the media, shareholders and various stakeholder groups, any company implicated is likely to face heightened scrutiny of its business dealings, counterparties and other relationships, separate and apart from any legal or regulatory penalty.

Global sanctions compliance strategies

As business becomes increasingly global, active monitoring of the sanctions policy landscape is critical in ensuring that all applicable sanctions regimes are identified, understood and incorporated into an appropriate compliance programme.

Many international businesses' operations will be affected by the UK and US sanctions, as well as others. Operating a compliance programme that meets the needs of multiple sanctions regimes – and at the same time preserves legitimate business activity – is a challenge. While many of the sanctions regimes and designated persons or SDNs match some do not. Businesses must be aware of this and have a method for dealing with matches in an integrated system.

Increasingly, many commercial agreements and banking documentation will include warranties on compliance with sanctions laws. When negotiating these documents, businesses must be clear as to which laws they are obliged to comply with in any event, and the additional requirements that may potentially arise in light of the evolving direction of sanctions.

The process and outcome of navigating these complexities is optimised through proactive engagement between internal compliance teams and external advisors with expertise in the legal and policy dimensions of sanctions.

 Emma Radmore (Managing Associate) is a member of SNR Denton's Financial Services and Funds group. Contact her on +44 (0)20 7246 7206 (emma.radmore@snrdenton.com). Thomas Laryea (Partner), Michael Zolandz (Partner) and Peter Feldman (Managing Associate) are based in SNR Denton's Washington DC office. Contact them on +1 202 408 6400 (thomas.laryea@snrdenton.com, michael.zolandz@snrdenton.com, peter.feldman@snrdenton.com).

Endnote

1. *Ahmed and others v HM Treasury (Justice intervening); al-Ghabra v Same; R (Youssef) v Same* [2010] UKSC 2, [2010] WLR (D) 12.