US and OTHER SANCTIONS REVIEW

Presented by: Dennis Ansbro and Zoya Faynleyb
ACAMS Greater Philadelphia Chapter
December 10,2015

AGENDA

- Sources and Types of Sanctions
  - OFAC / HMT / EU / UN
- US Sanctions Key Concepts
- 2015 Recent Sanctions Developments
  - SSI / Cuba /Iran /Myanmar
- Increasing Attention to OFAC Compliance
- Common Challenges and Omissions
- 2015 Challenges
- Creating a Sustainable Sanctions Program
- Future Changes to Sanctions
- Q&A

Sources and Types of Sanctions

- Sources of sanctions:
  - United Nations (UN)
  - Other multi-national organizations, such as the European Union (EU) or Arab League
  - Individual countries, such as the United States (Office of Foreign Assets Control, OFAC) or United Kingdom (Her Majesty's Treasury, HMT)

- Types of sanctions:
  - Targeted sanctions against individuals, entities or organizations ("designated persons"), vessels and aircraft;
  - and now targeted industries like oil and gas sectors with SSI regulations
  - Sanctions against countries can be full, limited and partial

US Sanctions – OFAC

OFAC

US sanctions can have multiple legal bases:

- The President may impose sanctions by issue of Executive Orders (EO), usually based on powers provided by the International Emergency Economic Powers Act (IEEPA)
- Congress may pass legislation imposing sanctions

- Sanctions are then codified in detailed regulations in the Code of Federal Regulations
- US sanctions apply in the US to US nationals and permanent residents and to legal entities incorporated under US law. Certain US sanctions also apply to non-US incorporated subsidiaries of US incorporated entities
- US sanctions can be divided into two categories:

  - Targeted sanctions aimed at particular parties ("Special Designated Nationals", SDN's)
  - Country sanctions, aimed at whole countries (Iran, Syria, North Korea, Sudan, Cuba, Burma)

US Sanctions – OFAC

- US sanctions, targeted and country, usually provide that all SDN property, and interests in property, in the US or the possession or control of US persons are blocked (i.e. frozen) and may not be transferred, paid, exported, withdrawn, or otherwise dealt in
- US country sanctions add further restrictions, usually including:
  - Prohibitions on new investment in the sanctioned country by US persons
  - Prohibitions on the exportation, re-exportation, sale, or supply, directly or indirectly, from the US, or by a US person, wherever located, of any services to the sanctioned country

    It is this prohibition which prevents many US banks from undertaking payments and other transactions involving persons in US sanctioned countries – doing so would constitute the export of a financial service to the sanctioned country

  - Prohibitions on any approval, financing, facilitation, or guarantee by a US person, wherever located, of a transaction by a foreign person where the transaction by that foreign person would be prohibited if performed by a US person or within the US

US Sanctions – OFAC

OFAC

- Consequences for breach of US sanctions:

  - OFAC may impose civil monetary penalties on a strict liability basis (i.e. no intent to breach is required);
  - Willful commission of sanctions breaches can lead to criminal penalties, such as imprisonment or fines
  - Reputational damage and damage to relationships with regulators

- In addition to the standard sanctions described above, the US also utilizes '<u>secondary boycott</u>' measures (CISADA, NDAA, ITRA). These allow the US to cut off from US markets non-US companies who deal with certain Iranian parties or sectors.

<u>*Example: Elf Bank, Part 561 List*</u>

UK Sanctions – HM Treasury

- The UK introduces sanctions regulations to implement UN and EU sanctions. It can also introduce sanctions on its own initiative, which may go further than UN and EU sanctions

- UK sanctions apply to:

  - conduct in the UK; and
  - UK nationals and companies, wherever located

Example: all branches of Standard Chartered Bank, a UK incorporated entity, are subject to UK sanctions. Subsidiaries of Standard Chartered Bank, incorporated outside the UK, are not.

* UK sanctions are administered by HM Treasury (HMT)

UK Sanctions – HM Treasury

HM Treasury

- UK sanctions regulations usually provide that it is a criminal offence for a person ("P") to:
  - deal with funds or economic resources belonging to, or owned or controlled, directly or indirectly, by a designated person (this effectively "freezes" assets)
  - make funds available, directly or indirectly, to or for the benefit of a designated person
  - make economic resources available, directly or indirectly, to or for the benefit of a designated person

  If P knows, or has reasonable cause to suspect, that P is dealing with such funds or economic resources or making them so available.

- It is usually also an offence to intentionally participate in activities knowing that the object or effect of them is (whether directly or indirectly)—
  - to circumvent any of the prohibitions in regulations 3 to 7, or
  - to enable or facilitate the contravention of any such prohibition

* *UK sanctions regulations typically include provisions allowing HM Treasury to license activities that would otherwise be prohibited*

European Union (EU) Sanctions

- The EU implements UN sanctions by adopting a Common Position. An EU regulation directly applicable to member states is then introduced
- The EU may also introduce sanctions on its own initiative, going beyond UN sanctions
- EU sanctions are usually targeted at particular parties or activities and generally provide for:
  - The freezing of all funds and economic resources belonging to, owned, held or controlled by designated parties
  - A prohibition on making funds or economic resources available, directly or indirectly, to or for the benefit of designated persons
  - A prohibition on participation, knowingly and intentionally, in activities the object or effect of which is, directly or indirectly to circumvent the sanctions
- EU sanctions regulations apply within the territory of the EU, to any person who is a national of a Member State, to any legal entity incorporated under the law of a Member State and to any legal entity doing business within the EU
- EU sanctions regulations generally require EU Member States to legislate to introduce penalties for breach of sanctions.

United Nations (UN) Sanctions

- The UN Security Council imposes sanctions through Security Council Resolutions.

UN sanctions are always targeted at particular parties or activities. Typical measures include:

  - Arms embargoes
  - Travel bans on designated individuals
  - Financial sanctions on designated individuals (assets freezes)

- These sanctions are not themselves legally binding – Member States must implement them into national law
- Some jurisdictions have standing legislation to implement UN sanctions automatically, while other adopt specific legislation to implement each set of UN sanctions
- Some jurisdictions may delay implementation or fail to implement, for administrative or political reasons, leading to inconsistencies in application between Member States

US Sanctions – Key Concepts

- **Block**: Freezing of a payment or other transaction

- **Reject**: Where a US bank cannot undertake a payment or other transaction due to US sanctions, but there is no obligation for it to block the transaction, it must reject the transactions

- **Reporting**: US banks must report both blocks and rejects to OFAC

    - Blocked and Reject reporting
    - Annual reporting

- **Self-disclosures**: Where a US bank becomes aware that it has breached sanctions, industry practice is to self-report the breach to OFAC. Should OFAC decide to impose a fine in such a case, the penalty amount may be reduced due to the self-disclosure.

2015 Recent Sanctions Developments

- Designation and Changes to Sectoral Sanctions Identification (SSI)
  - Russia and Ukraine; marginalized areas around Svestanpol
  - Issuance of 4 Directives
  - Issuance of General Licenses

- Amending Cuba Sanctions
  - May 2015 – Removed as a State Sponsor of Terrorism
  - Removal of several entities and individuals from the SDN List
  - Numerous provisions and General Licenses authorizing activity

- Amending Iran Sanctions
  - Joint Comprehensive Plan of Action (JPoA)
  - Global change in applying Iran Regulations; HMT

SSI Sanctions

- In response to the protracted crisis in Ukraine, the Obama administration authorized traditional and innovative economic sanctions against Russian and Ukrainian persons through Executive Orders 13660, 13661, 13662 and 13685.
  - Novelty of Sectoral Sanctions
    - Involves new debt and equity
    - Issuance of Directives
    - Focused on the energy, gas sector and Crimea region
  - Due Diligence of the Ownership Structure of Targeted Entities
    - Applies to any entity 50% more by a sanctioned persons; direct or indirect ownership in the aggregate
  - SDN involvement in Management and Board Representation of Non-Sanctioned Entities
    - Several individuals designated as SDN’s who hold leadership positions
  - Different Sanctions Across Jurisdictions
    - US has imposed sanctions as have the EU, Canada, Australia and other jurisdictions
    - However, the lists of sanctioned parties are not identical and their scope varies

Cuba Sanctions

January 15, 2015 – OFAC revised the CACR and Export Administration Regulations (EAR) to implement President Obama's Cuba policy changes; FAQ's April 2015 with 3 tranches of removals:

1. Impact on the Embargo
2. Commercial Exports and Donations – New commerce license exemption for exports of certain items to Cuba w/o application for DoC specific license
3. Telecommunications – Export/Re-export of certain sold or donated telecommunications
4. Financial Services – Authorized travellers can use their credit or debit cards in Cuba
5. Travel – Eased travel restrictions; 12 categories of travel with no specific license
6. Travel Services – New GL to provide travel services in support of authorized travel
7. Importation of Items from Cuba – Permits $400 USD worth of Cuban merchandise
8. Remittances – Increased from $500 to $2,000 per quarter to Cuban nationals
9. Third-Country Dealings with Cuban Persons – New GL for US owned foreign entities
10. Official US Government Business – New GL to provide goods and services to Cuban official missions and employees in the US

Iran Sanctions

July 14, 2015 US jointly with China, France, Germany, Russia and the UK agreed to the JPCoA with Iran aimed at “verifiably preventing Iran from acquiring a nuclear weapon and ensuring their nuclear program will be exclusively peaceful”.

Ratified in July 2015 and Adoption Day was October 18, 2015

Participants start taking steps to implement their JPCoA commitments.

Most Importantly – Iran begins taking the nuclear-related measures set forth in the JCPoA and the US and EU begins their additional work for the implementation of their commitments.

* **<u>Not all Iran Sanctions will be lifted</u>**

Myanmar Sanctions – *Hot off the Press*

New Myanmar General License issued December 7th authorizing certain trade related transactions otherwise prohibited by the Burmese Sanctions Regulations (BSR). Note: Asia World Port Terminal (AWPT); owned by a SDN

- GL permits individuals, companies, and financial institutions to conduct most transactions otherwise prohibited by the BSR ordinarily incident to the export of goods, technology, or non-financial services to/from Burma – including participating in trade finance transactions and paying port fees as well as shipping and handling charges associated with sending goods to/from Burma.
- Authorizes certain transactions ordinarily incident to exports to/from Burma involving Specially Designated Nationals (SDNs) and SDN-owned entities involved in the exportation of goods to/from Burma; however, it does not authorize any transactions to, from, or on behalf of an SDN, or any other person whose property or interests in property are blocked, including any entity in which SDNs own, whether individually or in the aggregate, directly or indirectly, a 50 percent or greater interest.
- Does not authorize a U.S. financial institution to advise or confirm any financing by SDNs or blocked persons.
- Does not impact other prohibitions in the BSR; the ban on new investment involving the Ministry of Defence, state or non-state armed groups, any entity in which any of the foregoing own a 50 percent or greater interest, and SDNs or other blocked persons remains fully in effect, as does the prohibition on the import into the US of Burmese-origin jadeite, rubies, and jewellery containing them.

New GL is good until June 7, 2016.

Increasing Attention to OFAC Compliance

- OFAC environment changed drastically in the last two years
  - Multiple lists
  - More selective sanctions
    - lending and amount thresholds
  - Regional vs. country sanctions
- Focus of the regulatory exams and independent testing
- To date – 15 OFAC CMP/Enforcement Actions for $599,705,997
  - U.S. banks
  - Foreign Financial Institutions (FI's)
  - Insurance Company

Common Challenges and Omissions

- Lack of testing of own Sanctions vendors
  - Best practice – quarterly internal testing of OFAC/Sanctions systems
  - What is the lag between OFAC action and the list update?
  - System sensitivity to typos and concatenation
  - Hyphens, commas, parenthesis, sequential numbers and other additions can change the matching score
  - Are all entities and all lists being added?
  - OFAC systems may be different for business lines

Common Challenges and Omissions

- Sanctions lists
  - Reference only to OFAC SDN in policies and procedures
  - Assuming that all OFAC lists are included in your sanctions process
    - Read your contract
    - Periodically request lists from vendors
    - Follow OFAC announcements and be proactive with the system providers
  - Country sanctions – not included with SDN or Consolidated lists
  - Regional sanctions – most systems don't consider municipalities in the process
  - PATRIOT Act Section 311 List
    - Administered by FinCEN
    - If the contract with system provider is for OFAC, Section 311 list will most likely be absent
    - Not only for correspondent banking

Common Challenges and Omissions

- Sanctions compliance across business lines
  - Deposit operations
    - Accounts – onboarding and periodic
    - Monetary instruments
    - "On-us" check cashing
    - Transactions with non-customers
  - Lending system of records can be different, and some parties may bypass the general OFAC scrub process
    - Acceptance of good faith deposit
  - Other business lines
    - Specifics of trade finance – ports, vessels, masters, etc.
  - Vendors
  - Employees

Common Challenges and Omissions

- International transactions
  - SWIFT is not subject to OFAC requirements
    - Large number of Iranian banks and Iranian branches of foreign banks are active in SWIFT
    - OFAC lists in 90% cases don't include SWIFT BICs for sanctioned banks
    - Deutsche Bank OFAC penalty in 2013 – SWIFT code was not on SDN list
      - "a settlement in this case would demonstrate the necessity of including the BICs of financial institutions on the Specially Designated Nationals and Blocked Persons List in interdiction software"
  - CUSIP – not on OFAC lists
  - International ACH transactions (IATs)
    - Gateway would mark OFAC suspect, but not stop the transactions
    - Need to review OFAC Indicator in IAT
    - Both ODFI and RDFI are responsible for IAT OFAC compliance

Common Challenges and Omissions

- Risks of “White” or “Good Guy” lists
  - Need to be reviewed periodically; ideally – with every OFAC update or risk-based
  - OFAC “False Hit List Guidance” of 10/21/15
  - Documented policies and procedures; segregation of duties for parties involved in the process to show independence

Common Challenges and Omissions

- Sanctions compliance risk mitigation
  - Subscribe to OFAC updates
  - Internal testing of the systems
  - System verification and validation
  - Tailored subscription to sanctions lists
  - Institution-specific training on OFAC
    - Special attention to system deficiencies
    - Training on own policies and procedures
    - At a minimum, annual training to ALL staff; including senior management

2015 Challenges

- Navigating Change
  - Sanction programs continually evolve; ensure OFAC compliance considerations are included in developments and introduction of new products and services
  - Failure to monitor changes can lead to risks
- Handling Expanded Sectoral Sanctions
  - Be mindful of OFAC's definition of debt and the necessity to evaluate transactions for potential violations; especially with Trade finance

  For example, a risk assessment may require closer scrutiny of individual transactions given the sanction prohibitions of debt longer than 90 days maturity or new equity with SSI's
- Establishing a Culture of and Responsibility for OFAC Compliance
  - Ensure your Sanctions Program has the support from company's leadership
  - Continue with on-going ad-hoc training and dialogue

2015 Challenges

- Conducting A Risk Assessment
  - Assess potential risk exposure not only across the entire organization but also in dealings with business partners such as your vendors and suppliers
- Implementing Information Technology
  - Is a **CRITICAL** component in OFAC and sanctions compliance in checking vendors, customers and even employees against respective sanction lists
  - IT carries certain limitations such as generating extremely large volumes of false positives; know your systems and utilize it's functionality to the maximum by creating auto false positive rules

Creating a Sustainable Sanctions Program

- To ensure your financial institution is protected, you should:
  - **Identify** which sanctions changes apply to your organization
  - **Ensure** sanctions staff have the requisite knowledge of your sanctions program
  - **Update** your respective sanctions procedures
    - Is a Global Policy required?
  - **Communicate** with relevant staff accordingly
    - ALL staff should be aware of sanction regulations
  - **Ensure** you have enough information about your customers to be able so you can identify any potential sanctions matches including sufficient transactions monitoring in place for relevant payment systems such as SWIFT:
    - Have adequate resources and escalation processes in places to ensure any potential sanctions matches are identified and managed as quickly and efficiently as possible
    - Have confidence in your systems and controls through appropriate oversight and testing

Future Changes to Sanctions

- The change in the dynamic of the SSI Program leads everyone to believe we will start seeing more OFAC sanctions programs based on specific industry sectors rather than the traditional Country Embargo Programs
- Globally, other sanctions regimes HMT/UN/EU will relax their sanctions towards Iran more than the US; for global organizations pay attention to developments and tailor your programs to ensure they adhere to requirements
- Pressure will be placed on decreasing weapons of mass destruction support regimes
- **Regulatory fines will continue to drive the costs of sanctions compliance!!**

QUESTIONS ?

THANK YOU

REFERENCE

OFAC – http://www.treasury.gov/

HM Treasury – https://www.gov.uk/government/organisations/hm-treasury

United Nations – http://www.un.org/

European Union – http://europa.eu/

US Department of Commerce – https://www.commerce.gov/

US Bureau of Industry and Security Export Control – http://www.bis.doc.gov/