US Economic Sanctions Regulation, Enforcement and Compliance Risk for Today, Tomorrow and Beyond

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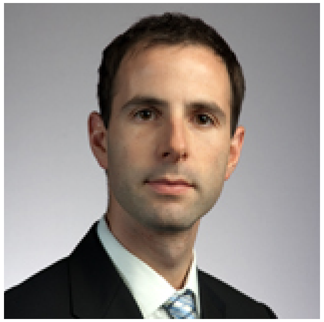

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Webinar Guidelines

- Participants are in listen-only mode
- Submit questions via the Q&A box on the bottom right panel
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Overview of Sanctions Trends

- Sanctions: the go-to tool of US foreign policy, evidenced by US policy towards Iran and Russia

- Shift from traditional trade embargoes (e.g., Iran, Cuba) to targeted sanctions: limits collateral harm, focuses on points and parties of concern and enhances prospect for multilateral support

- Shift from unilateral tool to harmonized approach:
  - With international partners (EU, Canada, Japan, Australia)
  - Across US agencies (Treasury Department (OFAC sanctions)), Commerce Department (dual-use export controls) and State Department (exports of defense articles/services)

- Increased use of general licenses to authorize "wind-down" activities and permit activity that is consistent with US foreign policy (e.g., social media, people-to-people contact, humanitarian trade)

Overview of Sanctions Trends, con't.

- New frontiers of sanctions:
  - Sectoral sanctions (Russian energy, defense, financial services sectors)
  - Cyber sanctions (North Korea, E.O. 13694)
  - Human rights sanctions (Magnitsky Rule of Law Act)

- Changing role of Congress:
  - Original concerns about unfettered Executive Branch power have been transformed into push for stronger sanctions
  - This has led to inter-branch disputes about authorities to impose or waive sanctions

- Increased importance of sanctions-related "risk management" considerations, particularly involving the willingness of financial services firms to proceed with transactions

Iran Sanctions

- Since 1979: approximately 25 Executive Orders and 10 statutes have led to nearly complete embargo against Iran
- Since 2008: sanctions made more extraterritorial and multilateral, focusing on energy, defense and financial sectors
- 2014 Joint Plan of Action (JPOA): limited sanctions relief for non-US persons and certain activity in petrochemical, automotive, precious metals, civil aviation, crude oil sectors
- July 2015: Joint Comprehensive Plan of Action (JCPOA)
  - Suspension of “nuclear-related” sanctions after IAEA certification (2016)
  - Principal easing will be of “secondary sanctions” applicable to non-US firms’ activities with Iran (financial, energy, petrochemical, insurance, mining and other sectors)
  - Some relief for US-owned/controlled foreign subsidiaries (exact scope remains unclear)
  - Most restrictions remain on US firms (e.g., “U-Turn transactions” and “facilitation” by US persons of otherwise prohibited transactions)
  - UN arms embargo lifted after 5-8 years

Russia Sanctions

- 2014: Russian annexation of Crimea, invasion of Ukraine
- Traditional blacklisting: separatists, Russian military and political leadership and Kremlin “inner circle”
- “Sectoral” sanctions: target specific Russian banks, energy firms and defense firms by prohibiting (1) US persons’ involvement with new “debt” or “equity” issued by the firms, and (2) provision of goods or services to firms active in unconventional oil projects
- Crimea embargo
- Expansion of the “50% Rule”: any entity that is 50% or more owned, individually <u>or in aggregate</u> (including beneficial ownership), by a sanctioned party becomes sanctioned itself by operation of law
- Compliance challenges:
  - “Debt” interpreted broadly (e.g., terms of payment, corporate credit cards)
  - Diligence into beneficial ownership, shell companies

Cuba Sanctions

- US embargo in place since 1963; some easing in certain periods, but further ratcheting up after Cuba shot down two US aircraft in 1996
- Statutes, regulations and Executive Orders prohibit virtually all US commercial/financial dealings with Cuba or its nationals
- 2014: Prisoner exchange negotiations led to broader opening of US-Cuba diplomatic relations
- Sectors opened (slightly) in 2015:
  - Travel, telecommunications, consumer communications, media, construction and others
  - Authorized travelers to Cuba may open bank accounts for use in Cuba, use credit/debit cards in Cuba
  - Opening of correspondent bank accounts in Cuba authorized
  - Certain Cuban nationals resident in US may participate in US financial system
- Instruments: expanded “license exceptions,” new license exceptions, general licenses, removal of Cuba from State Sponsor of Terrorism List

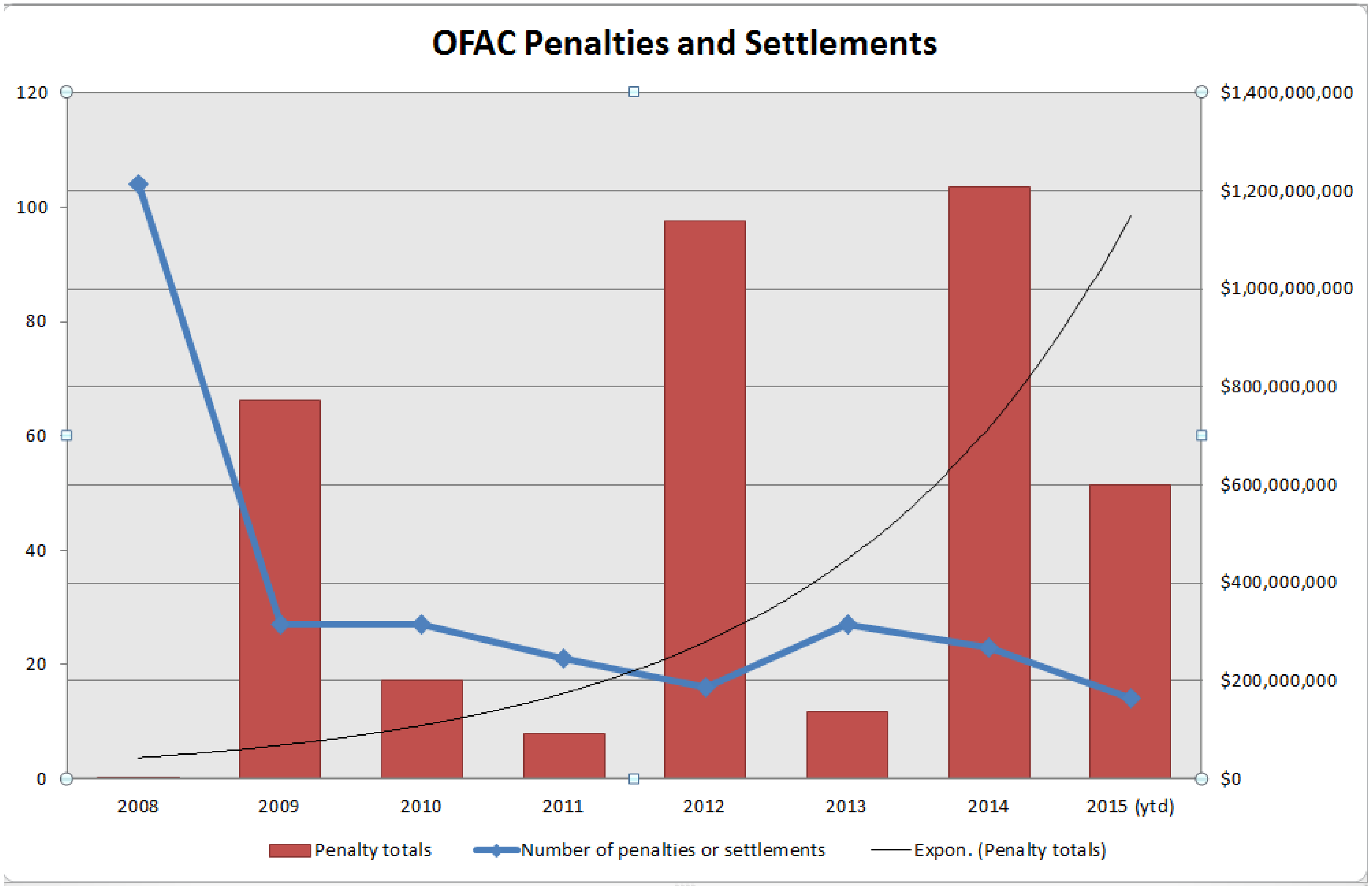
Anticipating Regulatory Change in 2016

- Iran sanctions (JCPOA)
  - IAEA must certify that Iran has dismantled certain nuclear infrastructure
  - Certification could occur in Q1 or Q2 of 2016
  - Most EU sanctions against Iran will be lifted
  - Most US sanctions will remain in place, except for “nuclear-related” sanctions applicable to actions of non-US persons vis-à-vis Iran and some licensing for US firms’ foreign subsidiaries
  - Limited specific licensing (e.g., civil aviation) available for US firms
  - Hundreds of Iranians will be removed from sanctions lists
- Cuba
  - Administration looking for further ways to ease sanctions, consistent with the statutory embargo against Cuba that remains in place
  - Possible avenues: further revisions to Cuban Assets Control Regulations, reinterpretation of certain provisions of embargo (e.g. “cash in advance”)
  - Congress may use authorities to block funding for new embassy personnel, hold up ambassadorial nominations for Latin America

Anticipating Regulatory Change in 2016, con't.

- Russia
  - US and EU sanctions linked to Minsk II ceasefire over eastern Ukraine, which expires at the end of 2015
  - International community will review Russian compliance – potential easing of certain sanctions
  - Crimea embargo likely to remain in place
  - Further sanctions possible for Russian action in Syria
- Other sanctions regimes
  - Cyber sanctions – nearly utilized before Chinese President visit in 2015
  - Further sanctions against Iran for regional activities and support for terrorism
  - Further sanctions re: Syria, ISIS, Yemen

Enforcement Trend: Fewer OFAC Cases but Larger Penalty Amounts



Complex Sanctions Enforcement

- Civil and criminal
- Multiple state and federal jurisdictions
- Some entities (DFS) impose individual liability for an institution's sanctions violations

Example of Complex Enforcement

- Commerzbank AG (2015) – $1.45 billion in total penalties
  - From 2002 to 2008, Commerzbank moved $263 million through the US financial system on behalf of Iranian and Sudanese entities subject to US economic sanctions, using numerous schemes designed to conceal the true nature of the illicit transactions from US regulators
  - DOJ: $563 million forfeiture and $79 million fine under deferred prosecution agreement
  - OFAC: $259 million fine
  - Board of Governors of the Federal Reserve: cease and desist order, required remedial steps to ensure compliance with US law, and civil monetary penalty of $200 million
  - New York County District Attorney's Office: deferred prosecution agreement
  - New York State Department of Financial Services: $610 million monetary penalty
  - IRS and FBI: key investigators

Recent Enforcement Highlights

- Credit Agricole (financial) – $787 million fine
  - Engaged in practice of removing, omitting or obscuring references to US-sanctioned parties in 4,297 financial and trade transactions routed to or through banks in the United States between 2003 and 2008 on behalf of Sudanese, Iranian, Burmese and Cuban entities
- PayPal (financial) – $7.7 million fine
  - Failed to employ adequate screening technology and procedures to screen clients against US sanctions targets (e.g., ignoring six “hits” on same client)
- Schlumberger (trade) – $232 million fine
  - Systematically approved and disguised capital expenditure requests from operations in Iran and Sudan, directed the transfer of oilfield equipment from projects in non-sanctioned counties to projects in Iran and Sudan; and US persons “facilitated” business decisions specifically concerning projects in Iran and Sudan
- Blue Robin (trade) – $82,000 fine
  - Conducted 33 transactions in which it imported web development services valued at $205,650 from an Iranian company

Enforcement in 2016

- Continuing focus on non-US banks, particularly Asia and Middle East
- Iran sanctions:
  - Congressional pressure to maintain pressure on Iran
  - Many Iranian front companies to facilitate trade
  - Many non-US firms will engage in new business with Iran and unwittingly utilize US financial system
  - Beware of clearing dollar and “U-Turn” transactions involving sanctioned parties and countries
  - Hard-line on remaining sanctions (terrorism, human rights)
- Russia sanctions:
  - No enforcement cases to date – possible cases in 2016 based on situation in Ukraine or Syria
- Anti-terrorism, WMD and narcotics trafficking remain a priority
- EU enforcement:
  - Increasingly prominent tool but enforcement actions are rare – could change in the future

Compliance Challenges in 2016

- Ensure appropriate screening programs and use of any proprietary sanctions lists (e.g., “good guy” or false positive lists)
  - Banco de Brasil: Processed transactions that were not stopped because payment system cleared transactions due to inclusion of customer on “Good Guy Exception List”
  - BMO Bank: Highlights sanctions risks associated with failing to implement proper procedures and controls to ensure that internal proprietary sanctions lists are properly reviewed following changes to the SDN List and/or to the sanctions programs
  - Challenges associated with Russian sectoral sanctions screening
- Risk-based inquiries into beneficial ownership
- Consider additional controls for high-risk omnibus accounts
- Inventory all US persons in the organization to avoid prohibited “facilitation” of prohibited transactions

Questions?

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