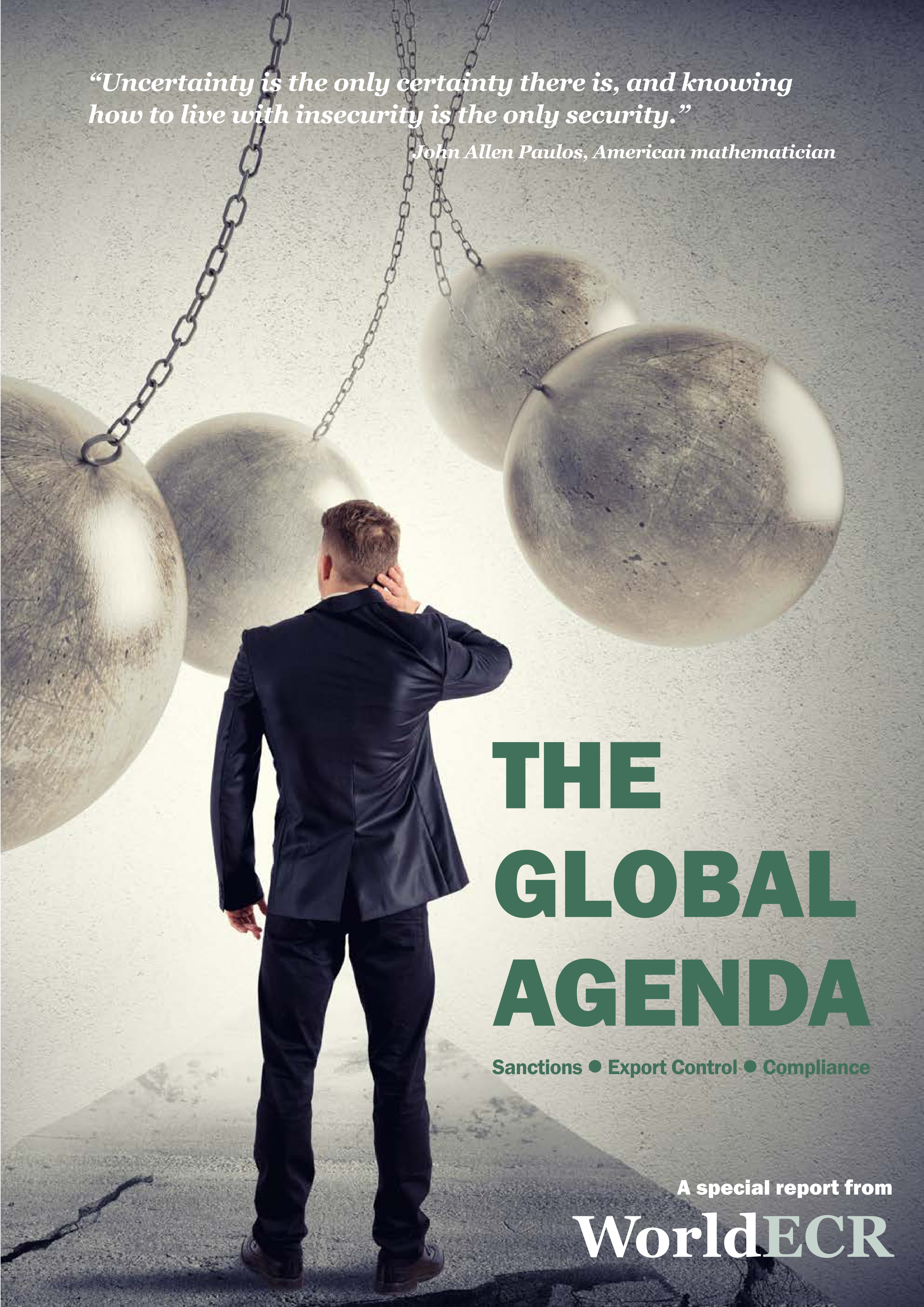


"Uncertainty is the only certainty there is, and knowing how to live with insecurity is the only security."

John Allen Paulos, American mathematician

THE GLOBAL AGENDA

Sanctions ● Export Control ● Compliance

A special report from

WorldECR

SANCTIONS: WHAT NEXT, NOW?

If it wasn't totally clear before, the past few years have demonstrated without doubt that politicians like sanctions and embargoes. And it's not just traditional regimes imposed on the usual suspects that have captured the headlines. Sanctions are changing and approaches to compliance with them will have to change as well.

'From a compliance perspective generally, this has been a challenging year, riven with uncertainties that promise to continue into 2018.'

That's one trade professional's assessment of 2017 and, *WorldECR* can report, it's a commonly shared sentiment. As the geopolitical risks become more complex, an increasingly divided world is attempting to address them – and sanctions are the current weapon of choice.

The stance of the nation that has long held *primus inter pares* status has changed almost over night and this is providing the backdrop for a period of uncertainty in global trade and its regulation. US president Donald Trump has shown little regard for the spirit of multilateralism encouraged by his predecessor, threatening to back out of the Joint Comprehensive Peace Agreement ('JCPOA'), pulling his country out of the Climate Change Treaty, recognising Jerusalem as the capital of Israel, and making statements about North Korea that others consider incendiary. At the same time, the imposition of sanctions against Russia for its alleged interference in the US presidential election highlights both the strangely surreal nature of current geopolitics, and of the relationship between the branches of government.

In Europe, the United Kingdom's peeling away from the European Union raises both fundamental questions about the future of the Common Foreign and Security Policy ('CFSP') and nuts and bolts ones about sanctions regulation and enforcement. Amidst the confusion, the assertion of global influence – economic, cultural, and regulatory, by new players (China especially) – seems inevitable.

All of which has enhanced the importance of trade compliance. 'Can I export to or do business with that country? Or with those people?'

Margaret Gatti of the DC office of law firm Morgan Lewis notes, 'Iran continues to be a concern, especially given the current administration's commentary regarding the JCPOA which relaxed some US sanctions on Iran effective January 2016. The Russia/Ukraine situation is also evolving. Then there's Venezuela and the restrictions recently implemented against Venezuelan individuals and entities. The sanctions against North Korea are being tightened continuously for obvious reasons. We've seen changes to the Cuba embargo and the removal of sanctions against Sudan. That's a lot of activity in a relatively short period of time.'

As ever, in the midst of uncertainty, some things are certain, a key one being that lawmakers make laws. CAATSA (Countering America's Adversaries Through Sanctions Act, see further below) marries Donald Trump's pugnacious stance against Iran with Congress's concerns about Russia and North Korea. In the United Kingdom, a new financial sanctions bill is on the table. Sanctions measures in Washington and the EU are affecting transactions with Venezuela, as they are in Canada, which, like the US before it, has introduced 'Magnitsky'-type sanctions designed to enable the authorities to target individuals they believe guilty of violations of human rights. Secondary sanctions, sectoral sanctions, proposed embargoes against countries which 'do not respect democracy'... 2017 has seen a long list get longer and 2018 will likely see it longer still.

Against such a swirl, international businesses need to have their antennae tuned to changes in mood music which are not always subtle. 'The sanctions landscape is changing all the time,' says DJ Wolff of Crowell & Moring. 'In the past, when I made presentations, I used to put the dates on the slides. Sometimes now, I think I should change those to actual times of the day – everything is becoming obsolete so quickly.'

What a difference a day makes, goes the popular song. In economic sanctions, the arrival of President Donald Trump on the world stage proves the rule. As we move toward the new year, what can we expect of the Global Agenda?

The Global Agenda: Impact of the JCPOA

In January 2016, the EU and the US lifted most of their economic and financial sanctions on Iran, after the International Atomic Energy Agency ('IAEA') confirmed that Iran had taken the required steps to dismantle its nuclear programme under the 2015 Joint Comprehensive Plan of Action ('JCPOA') between the P5+1 (China, France, Russia, the UK, the US plus Germany and the EU) and Iran. This was widely seen as good news for exporters looking to open up for trading opportunities.

'Implementation day has certainly been a milestone for German exporters,' says Georg Pietsch, Director General at the Federal Office for Economic Affairs and Export Control in Germany ('BAFA'). 'It has facilitated civil trade and cooperation with Iran, especially in the gas, petrochemical, banking and insurance sectors that was subject to economic sanctions before.'

Exporters doing business with Iran still need a robust export compliance management programme, however. The EU sanctions list still includes entities such as the Islamic Revolutionary Guard Corps ('IRGC') and others linked to the missile and conventional weapons sector, and there is a complex system of export bans and authorisation requirements for dual-use items.

Pietsch provides an example: 'Companies may export nuclear dual-use items for civil purposes, if the United Nations Working Group and the Procurement Working Group has given its approval upon consultation by the national licensing authority...Items that are not covered by the annexes of the Iran embargo regulations or by the EU dual-use regulation can be subject to control over their concrete end use. Exporters need to make an individual end-use assessment under the EU's catch-all clause.'

Regulators have expressed some frustration with the Procurement Channel, operated through the Procurement Working Group. This aims to ensure that single and dual-use items with possible nuclear application cannot be diverted to any nuclear programme in Iran, or stockpiled for future use. As a highly complex mechanism without precedent, its first year or so of operation has left some open questions. Concerns include the extent to which commercial confidentiality could be compromised by the disclosure of information, the possibility of corruption – as the Iranian government has to provide attestation for end-use undertakings – and the compliance burden on participating states.

Iran matters

Twelve months ago, *WorldECR* was reporting that the fate of the Joint Comprehensive Plan of Action ('JCPOA), touted then by its supporters as one of the great diplomatic breakthroughs of the age, was very much in the hands of the soon-to-be-next president of the United States. The deal provides for the lifting of all nuclear-related economic and financial sanctions that had been imposed by the United Nations (see box, left). For its part, the US maintains its primary sanctions, but suspends the application of secondary sanctions. The deal meant that for the first time since 2012, transfers of funds to and from Iran and the European Union, and the establishment of corresponding banking relationships, were permitted.

Donald Trump shared with his

fellow Republican candidates a strong distaste for the deal which provides Iran limited sanctions relief in return for a nuclear programme which is transparently for civilian purposes only.

Under the Iran Nuclear Review Act of 2015, the President of the United States is required to certify each 90 days that Iran is complying with its obligations under the JCPOA. By refusing to do so in October this year, President Trump has neither quashed the JCPOA nor pulled the United States out. Meanwhile the other members of the P5+1 have been vocal in saying that the deal should continue.

Where does that leave the situation from an operational perspective? Baker McKenzie partner Nicholas Coward characterises the status quo as a 'permanent state of stable uncertainty', observing, 'We're actually in a similar situation to where we were a year ago. The fact that nothing very significant has happened since then does create a kind of stability. There's huge uncertainty, but people navigate as they can.' This means, says Coward's colleague, Stockholm-based Mattias Hedwall, that from the EU side at least, 'There's been a huge amount of activity – especially in low and mid-risk business sectors.'

Undoubtedly, some companies have been able to take advantage of the relaxing of sanctions against Iran, and EU stats show a hike in trade: 'The EU exported over €8,2 billion worth of goods to Iran in 2016. EU exports to Iran are mainly machinery and transport equipment (€3,8 billion, 46,2%), chemicals (€1,8 billion, 22,2%), and manufactured goods (€0,7billion, 8,8%). The EU imported almost €5,5 billion worth of goods from Iran in 2016.' (Source: European Union.)

But has the recent noise around Iran – and Donald Trump's refusal to recertify – had an overly dissuasive impact on that growth curve?

Anthony Woolich, a lawyer at London's HFW, says that for many businesses, the mood around Iran remains pretty much unaltered from the state of affairs before Implementation Day, 16 January 2016. 'US enforcement authorities have fined non-US companies so heavily that many are still dissuaded from taking part in deals that would be perfectly compliant with sanctions regulations. Risk thresholds depend very much on a company's identity, whether or not it's publicly listed, its location, etc.'

Woolich's colleague, Daniel Martin believes there remains a misalignment between commercial operations

> ***'We have a number of clients who are having to forego or restructure deals which are entirely lawful, purely because of the attitude of their financiers, who are concerned with what's happening in the United States and the fear that the US government will renege on the JCPOA.'***
>
> **Daniel Martin, HFW**

involving Iran and banks involving Iran: "We have a number of clients who are having to forego or restructure deals which are entirely lawful, purely because of the attitude of their financiers, who are concerned with what's happening in the United States and the fear that the US government will renege on the JCPOA and are imposing additional restrictions on customers as a result. We also see clients adopting a "wait and see" approach to trade with Iran.'

London-based sanctions lawyers at international law firm Norton Rose Fulbright sense the same hesitancy on the part of companies with regard to Iran. 'Certainly on the corporate side we've seen more companies willing to walk away from deals, concluding that it's more trouble than it's worth to continue,' says Jason Hungerford, who has seen clients proceed with deals, only to 'pull out of contracts and prepare for arbitration' as a result of bank reticence to receive funds or provide export finance.

And it's not just on the European shores of the Atlantic that the ripples of President Trump's actions are being seen. 'Yes, there's been a bit of a chilling effect under the Trump Administration,' observes DC-based Steptoe & Johnson partner Brian Egan. 'We still see companies trying to figure out whether they can proceed under the terms of General License H, but often they find that it's more complicated than they thought, because of the remaining connection with the insurance system, US software, backroom support, financial system, etc. Lots of SMEs have said, "This is too much work, money and time and thus not worthwhile." Others are taking a longer view. Some of those are in the higher reward sectors, but there are also companies with a history of doing business in Iran who want to get back in before their competitors take the market over.'

Egan's colleague, Meredith Rathbone, a US lawyer based in the firm's London office, does not lay the blame for the uncertainty solely at the feet of President Trump. Rathbone notes that the remaining EU restrictive measures – designation of individuals for human rights abuses – also figure in the analysis: 'It is a real challenge to do thorough due diligence. Figuring out ownership structures and beneficiaries is complicated. That's why compliance hurdle for many companies is just not worth the cost.'

'With all these things, you have to be able to distinguish between rhetoric and reality.'

Steven Brotherton, Sandler, Travis & Rosenberg

Steven Brotherton, a partner at Sander Travis & Rosenberg ('STR') in California, points out that 'With all these things, you have to be able to distinguish between rhetoric and reality,' and that while the challenges, such as the prevalence of the sanctioned Iranian Revolutionary Guard Corp ('IRGC') in Iranian business, difficulties in interpreting General License H, and the reluctance of banks to put up trade finance, are ever present, they don't have to be showstoppers.

Consequently, Brotherton and his colleagues are busy with Iran-related business. 'There is a significant medical device market in Iran,' he says. 'We represent some of the largest companies in the sector, advising on their ability to utilise the general licences available. Outside of that, we're advising US-owned foreign entities operating under General License H, in establishing compliant mechanisms and structures for engaging with their parent companies [as well as] foreign entities with no US presence who are entering Iran – for example, in the automotive sector. They need to know whether and how they can remove themselves without significant financial consequences, if there's a snapback for example. They also need to know where the potential touchpoints with the United States lie. It might be a financing issue, or relate to parts and components. Another area to watch out for is technology – such as the software and updates that now go into cars and trucks.'

'It is a real challenge to do thorough due diligence. Figuring out ownership structures and beneficiaries is complicated. That's why the compliance hurdle for many companies is just not worth the cost.'

Meredith Rathbone, Steptoe & Johnson

Unchecked, potential violations will lie in wait.

Challenging times

Meanwhile, for those who find themselves the unwanted subject of authorities' attention and designation, the future, likewise, looks tricky.

Guy Martin, a partner at law firm Carter-Ruck in London, has a track record of making delisting applications for clients designated by the EU, UK and even by US authorities. Indeed, Martin led on the famous *Kadi* cases, which gave rise to the establishment of the Office of the Ombudsperson to the ISIL (Da'esh) and Al-Qaida Sanctions Committee in the UN Security Council, as a means of providing some independent oversight of Security Council designations. There continues, says Martin, to be a steady stream of applications for annulment of sanctions – he's currently working on cases for clients from Ukraine, Egypt, Tunisia, Syria and Saudi Arabia.

Already as things stand, typically parties seek relief both in the UK and EU courts. In the *Kadi* case, the EU regulation in which he was designated was issued by the Council of the EU and there was a separate domestic UK regulation by statutory instrument. It meant that in the UK High Court, the challenge had to be by way of judicial review and in the EU, by bringing proceedings before the General Court in Luxembourg.

After Brexit, of course, EU sanctions

regulations will not be binding on the UK. The recently published Sanctions and Anti-Money Laundering Bill is an attempt to ensure the regime will be fit for purpose, and generally aligned with EU regulations. But in some aspects, it goes further than the EU regulations – possibly too much so, thinks Martin: 'Clause 11 of the Bill allows for designation by description. Under EU law, a person must be named – in the interests of certainty. The Bill envisages a three-year review period for sanctions, which is very lengthy. But, perhaps most important, this is legislation which includes no right for an individual who has been sanctioned to be told that they have been or on what grounds. And that undermines the very important jurisprudence established by *Kadi*.'

OFAC specialist Erich Ferrari of Ferrari & Associates is also no stranger to the vicissitudes of challenging designations. Since 2016, Ferrari has been representing Reza Zarrab in a now high-profile trial which may yet prove to be critical to US-Turkish relations. He also represents clients in licensing applications. 'I've noticed a more restrictive licensing policy from OFAC in the past year,' says Ferrari. 'Things that were once seemingly sure to be granted are now being denied. For example, we were recently denied a licence for a US lawyer to appear as an expert witness in an arbitration occurring in Europe in which an Iranian entity was a party to the arbitration. In the past, we would have been sure it would be granted.'

Interestingly, on the enforcement side, Ferrari says: 'I think there's more interest from OFAC in going after facilitation of sanctions breaches, and not just the straight breaches themselves. It's also apparent that in the post-JCPOA environment, OFAC is keen to show that it's enforcing the law strictly [i.e., not letting breaches of historical sanctions "slide" just because of the deal].'

'[The recently published Sanctions and Anti-Money Laundering Bill] is legislation which includes no right for an individual who has been sanctioned to be told that they have been or on what grounds. And that undermines the very important jurisprudence established by Kadi.'

Guy Martin, Carter-Ruck

Overall, says Ferrari, 'There are more designations, but the programme of dealing with delisting applications has slowed down – partly because so many of the key positions needed to deal with them during the interagency review process are unfilled.'

Neither in the US nor in Europe does it seem that the appetite for imposing sanctions (or challenging them) is at all diminished.

CAATSA among the pigeons

In August, barriers to business with Iran, Russia and (though arguably it's a more academic point) with North Korea were raised somewhat higher when the US president (without the gusto that attends many of his actions) signed into law the Countering America's Adversaries Through Sanctions Act ('CAATSA').

Among its various effects, CAATSA imposes additional sanctions in response to Iran's ballistic missile programme. It also imposes terrorism-related sanctions respecting the Iranian Revolutionary Guard Corp (which it accuses of 'implementing Iran's international program of destabilizing activities, support for acts of international terrorism, and ballistic missile program'). Ironically, this may actually help President Rouhani in his reported efforts to tackle corruption in the IRGC and trim down its sprawling role in the Iranian economy.

But it is perhaps as regards Russia that CAATSA threatens to most significantly disrupt the flow of dollars and deals. And it is, in a sense, something of an oddity, as Debevoise & Plimpton partner Satish Kini notes: 'CAATSA is different to other sanctions legislation in that it became law not because of any particular events in Russia, or directly related Russian events, but for domestic political reasons. Traditionally, when you're trying to interpret sanctions, you look to the facts on the ground. In this case, the facts may actually be related to the US Congress.'

CAATSA commences by stating that the President shall impose sanctions upon any 'Foreign Person if the President determines' that that person violates a relevant executive order or undertakes a 'significant transaction or transactions' with persons sanctioned under US law, or 'any child, spouse, parent, or sibling' of such a person.

'People have a lot of questions,' says Kini. 'Partly because its scope is so ambiguous in many of its provisions: How do the secondary sanctions apply? How are the relevant sectors defined? What is a "significant transaction"? Yes, there has been some guidance from OFAC and the State Department, but not all of it provides a great deal of clarity.'

One provision which is leading to consternation – both amongst foreign businesses with Russian interests and in Russia – is that relating to the so-called 'Oligarch List'. Section 2.41 of CAATSA which directs the Treasury Secretary along with Secretary of State and Director of National Intelligence to submit in the new year a report on 'senior political figures and oligarchs in the Russian Federation,' assessing their net worth, 'closeness to the Russian regime', their respective relationships to Vladimir Putin 'or other members of the…ruling elite', and the known sources of income of those individuals and family members.

Kini says that when the firm hosted a seminar in Moscow on CAATSA in general, including the implications of this provision, 'We had to move the

'I've noticed a more restrictive licensing policy from OFAC in the past year. Things that were once seemingly sure to be granted are now being denied.'

Erich Ferrari, Ferrari & Associates

venue – the number of people interested – both US business people in Russia and Russians – was extraordinary.'

Ginger Faulk is a DC-located partner at Baker Botts, a firm which, true to its Texan roots, has a long tradition of representing the energy and related sectors. Many of her clients have questions about CAATSA: 'It has the potential to have a sudden and significant impact. Because it is so targeted and complex, it's going to make it hard for businesses in the energy, mining, pipeline and other sectors to navigate this web. Of course the secondary sanctions themselves are not new, but what is different is that, in the CAATSA context, they're so potentially broad and amorphous that companies and banks are very nervous about how it might apply in a wide range of transactions.'

'Secondary sanctions themselves are not new, but what is different is that, in the CAATSA context, they're so potentially broad and amorphous that companies and banks are very nervous about how it might apply in a wide range of transactions.'

Ginger Faulk, Baker Botts

Further, CAATSA puts a subtle wedge between the US and EU approaches to Russia (originally engineered for effective alignment). 'CAATSA puts the Russia sanctions on the statute books (rather than in executive orders as previously); that formalises them and makes them very much harder to remove,' says Roger Matthews of the London office of Dechert. 'It also upends the alignment with the European Union which reviews the appropriateness of maintaining its Russian restrictive measures every six months (in contrast to the 12-month review periods it applies for most sanctions regimes). Clearly in this respect we're going in different directions.'

Matthews, who frequently advises on sanctions-related issues typically with an EU dimension, says that ambiguity is not the sole preserve of US sanctions and similar issues seen through both lenses lend further complexity. 'Banks and others are seeing ongoing ambiguities in the EU's restrictive measures against Russia (Regulation 833/2014 as amended) especially around the capital markets aspects – and these were flagged by the *Rosneft* case.' And even where the EU and US measures are aligned (for example on the prohibition on making loans to certain entities), there are differences: for example, in the EU version, payment terms beyond 30 days would not constitute a loan – but they would in the United States.

In August this year, in light of the *Rosneft* decision, the European Commission released revised guidance on the Russia sanctions addressing, amongst other questions, when and whether certain kinds of activity constitute 'financial assistance' for the purposes of the Regulation, and how to distinguish between prohibited loans and other kinds of (legitimate, non-prohibited) commercial activity.

'The point is that the capital markets measures and oil restrictions haven't been developed through other sanctions regimes,' says Dechert's Matthews – the implication being that there is very much less material available which might guide compliance with these complex sets of rules.

'[CAATSA] upends the alignment with the European Union which reviews the appropriateness of maintaining its Russian restrictive measures every six months (in contrast to the 12-month review periods it applies for most sanctions regimes). '

Roger Matthews, Dechert

But Matthews emphasises that the EU sanctions on Russia only prohibit certain activities: 'There are 11 or 12 energy companies and banks to which EU entities are prevented from providing loans or share capital. But that's not to say that all business with them is prohibited. It just needs patient untangling.'

David Harris, a partner at Norton Rose Fulbright, points to the practice on the part of banks to maintain a policy of prohibiting all transactions which may involve Iran, particularly given the continuing risk of US sanctions, and as a result will frequently demand provisions in facility agreements which go beyond the scope of the sanctions regimes.

Fire and fury

If trade compliance has been losing sleep because of Russia and Iran, the man on the street's night sweats are more likely diagnosed as caused by Kim Jong-un, strangely coiffured leader of North Korea, the regime whose increasingly feverish acts of pugilistic defiance become ever more terrifying.

Each new intercontinental ballistic missile ('ICBM') launch and nuclear test demands a response, and bar the use of force, the imposition of tighter sanctions is inevitable – to the point that there's little left to sanction; only China is in a position to apply more meaningful pressure.

In August, UN Resolution 2371 put the squeeze on North Korea's revenue-generating ability by prohibiting joint ventures with UN member state companies, and prohibiting sales of seafood, iron ore and iron and lead. The United States has also applied secondary sanctions against Chinese and Russian entities. (As at time of writing, President Trump has urged his counterpart in Beijing to cut off the supply of crude oil to North Korea in retaliation for the launch of the Hwasong-15 missile.)

CAATSA also addresses North Korea, imposing blocking sanctions on US and non-US persons that 'knowingly' engage in certain activities, such as purchasing 'significant' amounts of copper or other metals; transferring to North Korea 'significant' amounts of rocket, aviation or jet fuel; and insuring or registering vessels owned or controlled by the government of North Korea.

It also prohibits some financial, shipping, and labour transactions and imposes mandatory sanctions against foreign persons who 'knowingly' employ North Korean labourers.

There are clear risks for some companies with a Chinese component in the supply chain. 'We've seen US Customs issue requests to companies with activities in the Chinese provinces bordering North Korea,' says STR's Steve Brotherton. 'They've been going down the list seeing who's importing from those regions and asking, "What is your policy on the use of forced labour?" So far, they haven't been detaining goods but they are asking questions.'

Inevitably there's more to come, thinks Debevoise's Satish Kini: 'I think we'll see Congress pushing for more pressure against Chinese banks in 2018 – it won't be abating soon,' he says.

Fracas in Caracas

In late August 2017, the US President issued Executive Order 13808 'Imposing Additional Sanctions With Respect to the Situation in Venezuela, which prohibits US persons from participating in transactions involving:

- new debt with a maturity of greater than 90 days of state oil company, Petroleos de Venezuela, S.A. ('PdVSA');
- new debt with a maturity of greater than 30 days, or new equity, of the government of Venezuela, other than debt of PdVSA covered by subsection (a)(i) of this section;
- bonds issued by the government of Venezuela prior to the effective date of this order; or
- dividend payments or other distributions of profits to the government of Venezuela from any entity owned or controlled, directly or indirectly, by the government of Venezuela; and
- 'The purchase, directly or indirectly, by a United States person or within the United States, of securities from the Government of Venezuela.'

'I think we'll see Congress pushing for more pressure against Chinese banks in 2018 – it won't be abating soon.'

Satish Kini, Debevoise & Plimpton

On 13 November, the European Union announced it was following the lead of the United States in imposing sanctions against Venezuela, expressing its 'deep regret at the decision of the Venezuelan authorities to continue with the election of a Constituent Assembly, a decision that durably worsened the crisis in

Venezuela and risked undermining other legitimate institutions foreseen by the Constitution, such as the National Assembly.'

The resulting measures, Regulation No 2017/2063 and Decision 2017/2074 include an arms embargo and prohibition on supply of equipment that could be used for internal repression, and financial sanctions (at this stage comprising simply the framework for an asset-freeze list, but this may be expanded in time). In some respects – and certainly in their intended message – the measures correspond with the US sanctions, although for now they do not go as far.

Little surprise that an energy-focused law firm like Baker Botts should also be fielding questions on Venezuela. Washington DC partner Ginger Faulk notes how the Maduro government's attempt to restructure Venezuela's debt has in effect been stymied by sanctions which prevent the country and PdVSA from refinancing because US institutions are now barred from acquiring new debt. The cocktail of sanctions, Venezuela's track record of default and current financial and political woes create, she says, 'a Catch-22' for creditors of PdVSA: 'They now have to consider whether they should accelerate the process of repayment – or wait to see if they can get paid on the existing debt. Meanwhile, US persons are prohibited from transacting in new, long-term debt by the executive order. And, of course, there are more routine issues, such as, what might the consequence be of a specially designated national being involved in a debt transaction.'

If a handful of sanctioned countries dominate the compliance agenda, that's not to say that others don't generate enquiries. Roger Matthews says he's been advising banks and charity sector clients on the ongoing challenge of ensuring humanitarian aid gets through to Syria, thus '...squaring a bank's legal obligations with the ability of NGOs to get money and equipment through to those that need it...' (highlighting the irony that sanctions don't always ameliorate the fortunes they're intended to help, despite the best of intentions).

'The sectoral sanctions defy automation and require real analysis by experienced personnel.'

Jason Hungerford,
Norton Rose Fulbright

Future-proofing compliance

The strategies that corporations, banks and other organisations adopt to manage the kaleidoscope of diverging, sometimes conflicting, compliance frameworks depend on risk appetite, global footprint, touch points, and industry sector.

'A lot of companies are asking

themselves – and their legal advisers: “What’s the future landscape of sanctions?”’ says Crowell & Moring’s DJ Wolff. ‘Clearly, policy makers love sectoral, limited list-based regimes because it means they can apply focused pressure while limiting repercussions elsewhere. But they’re an enormous pain in the [proverbial] for compliance professionals.’

Wolff thinks the way that most sanctions programmes are now structured demands close attention to the underlying facts of a transaction and analysis as to whether it’s ‘caught’ rather than just who is involved. ‘The face of compliance is going to have to change for a lot of institutions. Their systems need to evolve, and the ability of staff to analyse risk needs to improve,’ he says. ‘It isn’t just about numbers. Historically, banks, for example, put an emphasis on the volume of people in their compliance teams. But there aren’t 1,500 people in the world who properly understand, say, the Venezuela sanctions. The fact that you get a “true hit” in your screening doesn’t necessarily mean you can’t do the deal. De-risking – simply not doing business with certain people or places – was the natural reaction if you don’t have the right people with the right expertise.’

Uncertainty in sanctions regulations – and in their application to complex financial arrangements – is a source of sharply increased workload on in-house legal and compliance teams, says Jason Hungerford. ‘The sectoral sanctions defy automation and require real analysis by experienced personnel.’

Likewise, Harris points out, taking a blanket approach to sanctions in contractual documentation can yield ‘absurd results’. We often see sanctions clauses which are not fit for purpose, for example, it is impractical and overly prohibitive to say, “You will not deal with sectoral sanctions targets in any capacity.”

Coming of age

The holiday season is a time for giving some thought to what the next year may bring. And even from the admittedly narrow window of sanctions, there’s a rich and varied agenda in store – geopolitically, but also as regards some interesting case law and the impact of regulation. (NB: the following does not purport to be exhaustive!)

At Baker McKenzie, Mattias Hedwall and Nicholas Coward point to the General Data Protection Regulation

‘There are a lot of watchmen out there now. Freight-forwarders and brokers are also making sure they don’t facilitate violations… so there’s a whole vanguard of checks and double-checks.’

Margaret Gatti, Morgan Lewis

('GDPR') as a potential headache for businesses with EU operations. The GDPR marks a huge overhaul in the way that EU law will regulate personal data. 'As things stand, it is already difficult in some EU Member States to undertake sanctions screening without being in breach of domestic data protection regulation. In the Nordic countries, you need special permission to, say, screen against the OFAC list. It isn't quite clear how the GDPR is going to impact in this area, but it certainly will,' says Hedwall.

One lawyer points to the high-profile *Zarrab* case (upon which, some say, hinges the future of US-Turkish relations). The case, which has been much covered in the mainstream press, involves a colourful cast including a 30-something gold trader with a playboy lifestyle (Reza Zarrab), banker Mehmet Hakan Atilla, and no less a personage than the President of Turkey himself, Recep Tayyip Erdogan. 'There are some interesting enforcement theories at play. One that the government may likely pursue is that Zarrab and Attila can be criminally prosecuted for evading secondary sanctions. That could have a major bearing on sanctions compliance.'

Morgan Lewis's Margaret Gatti predicts ever more sophisticated screening by financial institutions and others – with the private sector also becoming more self-policing. 'Partly it's the banks that, acting on behalf of their customers, are making or receiving payments, screening for countries, parties, SDNs, deemed SDNs and those on the SSI (sectoral sanctions identification) list as well as deemed SSIs – the banks are really sharpening and fine-tuning their screening capabilities,' says Gatti. 'We had a client who recently made a sale, the terms of which were 90 days. There was a delay in payment, and that transformed the account receivable into a debt that was prohibited under the Sectoral Sanctions program. And that was caught by the bank. There are many additional watchmen that play a role in ensuring sanctions compliance. Freight-forwarders, brokers and couriers are also making sure they don't facilitate sanction violations and thereby entangle themselves in a sanctions violation, so there's a whole new vanguard for sanction checks and double-checks.'

Sanctions compliance as a competitive advantage in 2018 – the challenge and opportunity of increasing complexity

Today's complex sanctions require a smarter approach to compliance and that, in itself, can put a company more than a step ahead of its competitors, write DJ Wolff and Michelle Linderman.

In 2018, successful compliance programmes will be those that see themselves less as a fixed cost imposed on the business, and more as a partner to help drive competitive opportunity where less developed programmes cannot. The rapidly changing nature of economic sanctions has always challenged compliance professionals, a challenge compounded in recent years by the increasing complexity in sanctions requirements. Those familiar with, and compliance programmes designed to handle, 'old-style' sanctions – comprehensive embargoes or full asset-blocking list-based programmes – are often ill prepared for the subtle nuanced determinations required by these newer programmes. The net result is often a defensive 'No' from compliance. De-risking is an impulse: avoid risk by going nowhere near it.

That is one solution, but it is one that is as blunt an instrument as the sanction itself. Smart compliance discerns opportunities others don't even see. The 'cost' of an unsophisticated defensive 'No' may have been low in a world in which most list-based sanctions targets are commercially irrelevant. That becomes substantially less true with bigger targets: can you afford to decline all business with Russia's major corporate actors (Sberbank, Rosneft, Gazprom, etc.), Petróleos de Venezuela S.A. (PdVSA), or Citgo?

The challenge is that the justification to reflexively de-risk increases in a world of ever-more complex requirements. Historically, sanctions required most compliance personnel to conduct a two-step assessment: (1) Is the transaction subject to the relevant country's jurisdiction? and (2) Is the transaction a true match to a sanctioned geography/person? If the answers were 'Yes' and 'Yes', then the transaction is generally prohibited (unless a licence applies), a determination that can be reached without a close analysis of the underlying facts.

The rise of 'limited list-based sanctions' programmes has added a third, more challenging, question. Now, even if the answer is 'Yes' (there is jurisdiction)

Smart compliance discerns opportunities others don't even see.

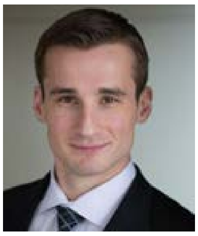
and 'Yes' (it is a true match), compliance needs to assess (3) Is the type of activity undertaken the type of activity targeted by the relevant restriction? That is not a question that screening systems can answer and it is often not one that level-one compliance personnel are trained to address.

Unfortunately, they may need to be, because these more sophisticated limited-list-based sanctions programmes are likely here to stay; they solve a problem which had previously confronted policymakers. If the only policy tool is a comprehensive embargo, or a full asset-blocking programme, there are some targets you effectively cannot sanction due to the collateral consequences. What would have happened to energy markets in Eastern Europe, or in the United States, if the United States had designated Gazprom or PdVSA respectively as SDNs? But, for the same reason – the size of these actors – if you exempt them from sanctions entirely, the target of your programme has an enormous loophole through which to operate.

Policymakers have recognised the benefits. As Assistant Secretary for Terrorist Financing, Marshall Billingslea testified to the House Committee on Financial Services on 30 November 2017, the United States had 'found these types of targeted, sophisticated actions to be highly effective at imposing specific, selective consequences on regimes that pose a threat to national security.' This is just as true in Europe, and globally as it is in the United States. For example, the Russian sectoral sanctions were modelled to a substantial degree by the European Union, Canada, Australia and, to certain extents, Japan and Switzerland.

Unfortunately, we cannot (yet) rely on technology to manage these risks. Technology may one day provide a solution, but until then the investment in human talent is a differentiator. Most screening systems will generate a hit; clearing that hit requires a trained reviewer, capable not just of reviewing the 'who' or 'where' of a transaction, but now to understand the 'what', 'how', and 'why'.

Looking at this landscape, some compliance professionals in 2018 will choose to de-risk all sanctions targets. But, that comes at a higher cost and with less justification than it has before; the more limited scope of these sanctions makes de-risking increasingly overbroad, while the commercial size of the targets increases the opportunity cost. Compliance teams that make the investment – not just in technology and headcount, but in training existing resources and developing efficient decision-making and escalation processes – will be able to identify, mitigate, and manage the risk fast enough to enable their business to exploit opportunities others cannot in 2018.

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Links and notes

[1] https://financialservices.house.gov/uploadedfiles/hhrg-115-ba19-wstate-mbillingslea-20171130.pdf

Targeted sanctions and the obligation to self-disclose dealings with potentially sanctioned individuals: UK, US, Japan

By Guy Martin and Magali Sharma, Carter-Ruck

Targeted sanctions are used by governments and institutions such as the UN and EU to influence foreign policy and discourage criminal activities such as financing of terrorism. They include asset freezing and prohibitions on making available funds or economic resources to sanctioned individuals and entities. This article will examine some salient points of UK sanctions law, and contrast it with the US and Japan.

UK developments

There have been two major developments in the UK this year alone. The Policing and Crime Act came into force in April 2017, granting the UK Treasury wider powers to impose penalties for breaches of financial sanctions. The UK enforces these powers through the Treasury's Office of Financial Sanctions Implementation ('OFSI'). The Act extended criminal penalties, and created monetary ones. This new civil penalty is easier for companies to fall foul of as there is a lower burden of proof. Monetary penalties may go up to £1 million or 50% of the estimated value of the funds or resources, whichever is the greater value, taking into account several factors, including the frequency and value of the breach, and the harm or risk of harm to the sanction regime's objectives.

A key aspect of OFSI's approach is to encourage voluntary disclosure of known and suspected breaches. OFSI's Financial Sanctions Guidance says it will consider prompt and full disclosure of a breach as a mitigating factor when determining its enforcement approach, but still encourages early disclosure with partial information on the basis that 'you are still working out the facts and will make a further disclosure shortly'.[1]

Then, in August 2017, the EU Financial Sanctions (Amendment of Information Provisions) Regulations came into force and extended the reporting requirement that previously only applied to certain financial service providers to other businesses, including auditors, estate agents, external accountants, tax advisors and 'independent legal professionals'. These organisations must inform OFSI if they know or have reasonable cause to suspect that someone is a 'designated person' (i.e., targeted by sanctions) or has committed an offence under the financial sanctions regimes as soon as reasonably practicable. If they fail to inform OFSI, they commit an offence themselves, punishable by a fine or a maximum of three months' imprisonment.

US and Japan

OFSI's emphasis on voluntary disclosure follows the approach adopted by the US sanctions enforcement regime, enforced mainly by the Office of Foreign Assets Control ('OFAC'). Self-disclosure is also considered a mitigating factor in US proceedings, although this is construed strictly. If a third party is required to and does notify OFAC of an apparent violation, disclosure by the subject company of its violation will not be considered voluntary, regardless of when OFAC receives such notice from the third party and regardless of whether the subject company was aware of the third party's disclosure. Voluntary self-disclosure does not apply where OFAC would have learned of the apparent violation in any event.[2] As a result, some companies have not been able to receive voluntary disclosure credit after making extensive disclosures which are more complete than the third party's disclosure. In the UK, the Guidance provides that the mere fact that another party has disclosed first will not necessarily lead to the conclusion that later disclosure has any lesser value.

Multiple agencies in the US exercise authority to enforce financial sanctions (DDTC,[3] BIS,[4] and CES[5]) and have overlapping jurisdiction to address potential violations. Companies need to make parallel voluntary self-disclosures to both the applicable regulatory agencies and CES, increasing the number of cases reviewed by CES for possible criminal prosecution and preventing efficient and effective administration of sanctions.

By contrast to the UK and US, Japan does not provide a legislative mechanism enforcing United Nations Security Council resolutions domestically, and it has its own sanctions framework for the Democratic People's Republic of Korea ('DPRK').

Japan does not provide a formal voluntary disclosure mechanism for the violation of financial sanctions. However, some statutes provide credit for self-reporting to the government. According to article 6 of the Terrorist Financing Suppression Act,[6] if a person who has been involved in financing a planned terrorist activity reports on the activity before it is executed, the penalty may be reduced or waived. The court or the regulatory authority has the discretion to consider self-disclosure as a mitigating factor.[7]

Sanctions violations have led to increasingly large civil and criminal penalties in the US, UK and Japan, and at the same time granting wider powers to enforcement bodies. Clear sanctions and voluntary disclosure regimes are essential for companies to avoid falling foul of these rules.


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Links and notes

1. OFSI's Guidance on Monetary penalties for breaches of financial sanctions
2. Appendix A to Part 501 – Economic Sanctions Enforcement Guidelines
3. State Department Directorate of Defense Trade Controls
4. Commerce Department Bureau of Industry Security
5. Counterintelligence and Export Control Section
6. Act on Punishment of the Financing of Criminal Activities for the Purpose of Intimidation of the General Public and of Governments, Act No. 67 of 2002
7. http://thelawreviews.co.uk/edition/the-international-investigations-review-edition-6/1136375/japan

Coping with the US secondary sanctions tsunami

US secondary sanctions seek to target and restrict the activities of non-US persons. Meredith Rathbone and Brian Egan explain how best to deal with them.

US secondary sanctions are designed to discourage non-US persons from doing business with a sanctions 'target' disfavoured by the US government for national security or foreign policy reasons. 'Targets' can be specific individuals, entities, or organisations (for example, designated narcotics traffickers), sectors of an economy (for example, the Russian 'frontier' oil exploration and production sector), or business activity (for example, trading North Korean coal).

No US nexus – such as a connection to the US financial system, US economy, or US person – is required to trigger US secondary sanctions restrictions. Given the lack of a US jurisdictional nexus, secondary sanctions do not 'prohibit' conduct by a non-US person or impose fines or similar penalties on a non-US person for 'violations'. Instead, those engaging in activity that is 'sanctionable' are potentially subject to restrictions on access to the US economy, ranging from targeted (for example, prohibitions on US government export assistance) to extensive (for example, placement on the Specially Designated Nationals list).

US secondary sanctions are not new. The Iran and Libya Sanctions Act of 1996 included secondary sanctions related to significant investments in Iran or Libya's petroleum industries. Since 9/11, numerous Presidential executive orders authorise restrictions against those who provide material or other support to various Specially Designated Nationals.

But over the past decade, the US Congress has dramatically expanded the scope of secondary sanctions. Between 2010 and 2013, Congress passed four secondary sanctions laws on Iran alone. Most recently, the 'Countering Americas Adversaries Through Sanctions Act' ('CAATSA') identified dozens of additional categories of Russia, North Korea, and Iran-related activity for secondary sanctions. The US executive branch – traditionally lukewarm to secondary sanctions for foreign policy reasons – also has been more willing to impose these restrictions in recent years. Even more dramatically, an ongoing prosecution of a former Turkish bank executive in New York may reflect a willingness by US prosecutors to seek criminal penalties for secondary sanctions 'evasion'.

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Companies outside the United States often ask what they should do to reduce risks related to US secondary sanctions. Understanding those risks can be daunting. The sanctions 'triggers' – for example, a 'significant' or 'material" 'investment' or other business activity with a sanctions target – are unclear, often by design. The interpretation or application of these triggers may vary based on a number of factors, from the identity of the sanctions target and the applicable restrictions, to the identity and nationality of the non-US person who may be subject to secondary sanctions restrictions.

One also needs to assess how aggressive the US government might be in implementing the secondary sanctions under consideration. OFAC and the State Department exercise substantial discretion and frequently appear to make decisions in a 'black box'. It is important to consider whether it is better to approach OFAC or the State Department to raise questions or discuss contemplated transactions up front, or to be prepared to defend a company's actions against possible secondary sanctions measures after the fact.

The policy consequences of secondary sanctions should also be part of an informed risk-management calculation. Use of secondary sanctions by the US government is not 'cost-free'. US secondary sanctions present significant foreign policy issues – particularly when they are propounded unilaterally, without the support of the UN Security Council or US allies. The run-up to the passage of CAATSA saw EU objections to proposed secondary sanctions on Russian gas export pipelines, leading Congress to amend the law to require this sanction be implemented 'in coordination with allies of the US'. Overuse of secondary sanctions could lead countries to decide to avoid the US economy altogether, or encourage closer cooperation between US rivals. And there is the practical reality of sanctions implementation – with dozens of sanctions programmes, the US government may not have the resources to aggressively implement them across the board, even for 'mandatory' secondary sanctions passed by Congress.

What to do in response to this 'tsunami' of US secondary sanctions? Don't exasperate over what appears to be an indiscernible morass. The specific language of relevant sanctions provisions should be reviewed and analysed; factors relating to the discretion of those administering these sanctions can be identified and evaluated; 'costs' on both sides of the ledger should be considered; documenting the rationale for a course of action will help mitigate risks; and engagement with government officials may be appropriate in some circumstances.

All of these factors are susceptible to an informed assessment. Internal or external experts can help make reasonable and defensible risk assessments and lead to informed management decisions.

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US sanctions: Adapting compliance programmes to address new challenges

Increased complexity appears to be an ongoing feature of new US sanctions programmes. Satish Kini, Carl Micarelli and Robert Dura offer advice on how to manage the challenge.

Historically, many sanctions programmes maintained by the US Treasury Department's Office of Foreign Assets Control ('OFAC') have been list-based, meaning US persons are prohibited from dealings with designated persons. Other sanctions programmes involve complete embargoes of a country or territory. In each case, the primary approach for US persons involve screening counterparties against lists of sanctioned persons and reviewing their information to determine whether a prohibited jurisdiction is involved. Financial institutions and other companies that encounter larger volumes of higher-risk transactions commonly rely on automated processes for this screening.

New sanctions programmes present new challenges. Increasingly, they involve more nuanced restrictions that may restrict only specific activities. For example, the sectoral sanctions against Russia apply only to certain financing activities and related financial products, or support of specific oil-related activities with designated persons or their majority-owned subsidiaries. US persons are also now prohibited from engaging in certain financial transactions with the Venezuelan government, including any of its political subdivisions, agencies or instrumentalities, (e.g., Petroleos de Venezuela, S.A. ('PdVSA')), but there are many carve-outs from these restrictions.

This complexity is not limited to US persons but also extends to foreign companies facing US-imposed secondary sanctions. Potentially sanctionable activity related to North Korea now includes many types of commercial transactions, including undertaking at least one 'significant' import from or export to North Korea. Additionally, non-US persons engaging in a variety of Russia-facing activities may now face consequences under US sanctions. These activities include facilitating a transaction for a sanctioned Russian person, or facilitating 'unjust' privatisations of Russian state-owned assets.

Ensuring compliance with these provisions is not simple. The financial restrictions against Venezuela require US persons to ensure they do not deal in any new debt of an entity directly or indirectly owned by the Venezuelan government. This includes the many subsidiaries of PdVSA doing business throughout the world. Moreover, OFAC interprets 'debt' for this purpose to encompass dealings that, in other circumstances, would not commonly be considered debt (e.g., payment terms). Just understanding a US company's risk exposure under these sanctions, let alone maintaining ongoing operational awareness to ensure compliance, may be difficult.

So what to do? Companies should focus on accurately evaluating their risk exposure. A longstanding cornerstone of compliance with US sanctions is that compliance programmes should be risk-based. Companies must, of course, comply with all of their mandatory sanctions obligations. But before tweaking policies and procedures in response to new sanctions risks, a company should consider its overall exposure and review the adequacy of its existing sanctions policies and procedures.

Companies should then evaluate existing controls in light of their new risk exposure. For example, regarding the new Venezuelan financial sanctions, a US financial institution with many energy customers or many correspondent customers in Central or South America would face different expectations for tailoring its sanctions compliance programme than a financial institution that lacked such exposure.

If there is appreciable new risk, new controls may be necessary, such as screening counterparties for ownership by the Venezuelan government. One approach would be to continue with a list-based screening approach and devote efforts towards assembling a comprehensive list of every entity that falls within the new sanctions. Some service providers are compiling such lists. We saw, however, in the case of the sectoral sanctions on Russia, that similar efforts produced lists including thousands of entities. Wading through these lists was a drain on resources and, as the number of complex sanctions programmes expands, developing and maintaining such comprehensive lists may prove challenging. Another approach would be to diligence ownership structures on an ad hoc basis, though this could delay the opening of accounts and the processing of transactions.

Another approach, which complements rather than supplements other efforts, is creating new screening methodologies that assess data points for a customer or counterparty rather than screening against a list. This may be unfamiliar terrain for sanctions compliance teams, but financial institutions may be able to construct a workable template from anti-money laundering ('AML') processes. For example, a sanctions team looking to screen for Venezuelan state-owned entities, may look to AML processes for identifying so-called 'politically exposed persons', which are a category of banking customers that pose greater money-laundering risks because of their positions of influence in foreign governments. Identifying such persons in a company's management could be one signal that there is a need for further diligence.

No matter the final controls adopted, though, a robust risk assessment is an essential element to maintaining a sanctions programme in the face of new and complex requirements that challenge traditional approaches, particularly as efforts to maintain comprehensive screening capabilities show their downsides. To do this, companies should ensure that new sanctions requirements are promptly reviewed and assessed against ongoing business activities; failure to appreciate the compliance challenges may be a recipe for inadvertent violations.



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KEEPING IT ALL MOVING

While sanctions may have stolen the headlines in 2017, the ongoing and planned evolution of export control regulation under the United States ECR initiative, the EU's dual-use recast, and a host of standalone national changes seeking international harmonisation, will continue to provide the foundations of the trade compliance challenge.

One could conclude – given the slew of sanctions developments in the past year – that, if anything, the trade compliance agenda is currently weighted more heavily in that direction than toward export controls and that the key export controls questions that remain outstanding pertain more to the world of intangibles than that of widgets.

It wasn't always thus. During the latter years of the second Obama presidency, Export Control Reform ('ECR') generated headlines, as, on an ongoing basis, long-established categories on the US Military List ('USML') were redefined. ECR represented a steep learning curve for many companies, especially those with defence-related activities, both in the United States and beyond. By the end of the administration, BIS Assistant Under Secretary Kevin Wolf and colleagues had achieved much of what they had set out to – barring the single agency and control list. In theory at least, all business now has to do is comply.

'It's true,' says Baker McKenzie's Nicholas Coward, 'that [the first wave of] export control reform is mostly done and dusted. But while the rules are now in place, that's not to say that they're easily followed.'

ECR, says Coward, has yielded the greatest benefits to companies with finite product ranges. 'Those kinds of businesses, once they've undertaken the analysis as to how the controls apply, can come out better. But for companies with a really broad range of products, it can be really difficult. I never before thought that I'd hear a client say, "What can I do to prevent my products being removed from the ITAR list?" But increasingly, that's what they want. Under ITAR, they know the routine: they apply for a licence and, if granted, export in accordance with the terms of that licence. It requires a more complex analysis when the same item is placed on the Commerce Control List.'

Coward points out that if you now look at the Export Administration Regulations ('EAR'), there have been almost no changes whatsoever this past year, with a very significant exception: 'The Commerce Department has got into the habit of putting OFAC specially designated nationals ('SDN') on the Entity List, so that even if an item is EAR99, it may need a licence to be exported.' It's a change, he says, from when the list constituted a small handful of names (and blurs the line between export control and sanctions compliance).

Steven Brotherton of STR believes it will take 'years before industry is familiar with ECR. And some people are simply never going to get their heads around it. Even simple things, like using the STA (Strategic Trade Authorisation, which authorises the export, reexport and transfer (in-country) of specified items on the Commerce Control List ('CCL') to destinations posing a low risk of unauthorised or impermissible uses) – people aren't doing it!'

Brotherton predicts that 2018 may see enforcement actions around products that have been transferred from the USML to the 600 Series of the CCL – a political gesture as much as anything 'to counter the erroneous impression that the Department of Commerce is lax in enforcement as compared to the State Department.'

Non-proliferation

Momentum for more profound change isn't wholly absent – albeit that progress has been slowed both by reduced staffing numbers in the Department of State, and by efforts to reduce the proliferation of regulation (including White House guidance that any new regulations to be published must be approved by a presidential appointee or their designee).

Over the summer of 2017, Joshua Fitzhugh, formerly head of export controls at BAE Systems in the UK, joined law firm Clifford Chance. He says: 'It's been a really interesting transition. At BAE, I was focused intensely on the corporate mission. But now as a legal adviser, I'm seeing the missions of various clients.'

It's a more constrained lens into each client, he says, but one that facilitates a broad picture of industry concerns. Amongst those is the continuing playing out of export control reform. 'You'll find that many defence industry clients are looking at similar issues,' says Fitzhugh, 'and as outside counsel you can draw on that experience to see trends that may be hard to discern otherwise.'

Amongst the issues on the agenda are the revision of remaining categories including I, II and III (Firearms, Close Assault Weapons and Combat Shotguns; Guns and Armament; and Ammunition/ Ordnance); potential changes to other categories in the light of public comments, agency concerns and the regular review cycle; and a compliance focus on technical data handling and non-US companies.

Very first steps, says Fitzhugh, should be greater clarity on key definitions, in particular, those of defence services, and technical data. 'How do we apply defence services in relation to US Persons employed abroad, for example, or for services that are not inherently military in nature but still have an ancillary military benefit, such as changing dual-use tires on a military aircraft? The policy direction in these areas is not entirely clear. Likewise, how companies define "technical data" is often inconsistent between US and non-US industry. There's a lot of uncertainty and too much scope for

The Global Agenda: US Export Control Reform

Since 2009, the US export control system has been subject to a comprehensive overhaul, with the goal of simplifying the multi-agency structure which was described by former Secretary of Defense Robert Gates as a 'byzantine amalgam of authorities, roles, and missions scattered around different parts of the federal government.'

The licensing of dual-use and certain military items is controlled by the Department of Commerce, munitions by the Department of State, sanctions by the Department of the Treasury, and the Nuclear Regulatory Commission and Department of Energy for certain nuclear materials and technologies. Each arm of government operates under varying statutory authorities and enforces different regulations.

Reform is being implemented in three phases. The first and second phases, which include reconciling definitions, regulations and policies for export controls, were reported as being nearly complete in the summer of 2015. There should be an update on progress towards the third and final phase – creating a single control list, a single licensing agency, unified information technology system and enforcement co-ordination centre – in 2018. A recent Congressional report into ECR suggests that President Trump may request the movement of the Department of Commerce's Bureau of Industry and Security's Office of Export Enforcement to Immigration and Customs Enforcement so as to remove overlaps in agency authority.

'I never before thought that I'd hear a client say, "What can I do to prevent my products being removed from the ITAR list?" But increasingly, that's what they want. Under ITAR, they know the routine.'

Nicholas Coward, Baker McKenzie

interpretation. Going forward [defence contractors] need to see a honing of those definitions.'

'Generally,' Fitzhugh adds, 'companies are appreciative of the intention behind ECR and the progress that's been made, but in many cases it has made compliance more complex and expensive... It was originally cast [by former Secretary of Defense, Robert Gates] as a way to enhance NATO inter-operability, reducing the incentive to go ITAR-free for non-US companies. That has not been achieved. EU companies are not spending less on compliance or facing less risk.'

'Generally, companies are appreciative of the intention behind ECR and the progress that's been made, but in many cases it has made compliance more complex and expensive.'

Joshua Fitzhugh, Clifford Chance

Expanding horizons

As sanctions are evolving, so, too, is the remit of many export/trade compliance professionals as they are charged with tackling new and wider supply chain compliance needs. This widening of the remit looks likely to be one of the key compliance challenges for 2018.

Export control advisers at global professional services firm Deloitte say that against the backdrop of ever-increasing globalisation of trade, they're dealing with many more examples of the intersection between export control and other areas of compliance – in the defence sector, particularly.

'We're seeing a continued convergence of non-compliance with both trade controls and anti-bribery and corruption regulations,' says Stacey Winters, who heads up Deloitte's Regulatory Risk practice. 'Typically, issues arise at the border, where companies are dealing with numerous agents and customs officials. If you don't have good controls over your import and export compliance, you may be exposed to greater risk in your anti-bribery and corruption programme.'

Convergence of diverse trade compliance obligations is a common theme. Norton Rose Fulbright's David Harris says they continue to see cross-over with sanctions and anti-money laundering, particularly in financial services. 'Sometimes it can be difficult, when reviewing transactions, to divorce the two. You find examples where everything may seem fine from a sanctions point of view, but there are unexplained payments that flag a potential AML issue. In this context, there is inevitable overlap between the sanctions regimes and applicable money laundering regulations, and it gives rise to complexities when balancing the legal obligations which arise under both. So we find that you need to look at these issues very much in the round.'

Meanwhile, another rich seam for the team at Deloitte is advising compliance functions on dealing with the wider 'digital transformation' within a company. 'The risk,' says Winters, 'is that a company undertakes ambitious digital change in every sphere of operation – and the trade compliance function is still filling in pieces of paper!'

Tangible intangible issues

Away from the world of widgets, important elements of the control of cyber products and technology remain unresolved. As is well known, in 2013, the Wassenaar Arrangement adopted controls on 'intrusion software' and carrier class surveillance tools with the aim of protecting, for example, political opponents of authoritarian governments who might be the targets of such technologies.

A consortium of US technology companies and others, baulking at the controls on 'intrusion software' which, they said, were overly broad to the extent of being self-defeating – as well as potentially putting a huge dampener on the development of cybersecurity tools – lobbied the US government to firstly not implement the Wassenaar controls without significant

The Global Agenda: Developments in Asia-Pacific

Singapore implemented its Strategic Goods Control legislation in 2003 and since then has regularly updated its list of strategic goods and technology, most recently on 1 September 2017. The Strategic Goods Control Order ('SGCO') 2017 brought Singapore's strategic goods control list up to date with the 2016 Wassenaar Arrangement Munitions List, and the 2016 European Union list of dual-use items. The Strategic Goods (Control) Regulations 2004 was also updated to expand the scope of strategic goods subject to transhipment controls to include two new category codes, and also a technical amendment to the Strategic Goods (Control) Brokering Order 2007.

Australia's membership of core multilateral regimes controlling the export of arms and dual-use items, such as the Wassenaar Arrangement, Arms Trade Treaty and the Australia Group, is reflected in recent updates to its export control lists. A key development in 2017 was the Defense Export Control's launch of a public consultation on its proposed amendments to regulation 13E of the Customs (Prohibited Exports) Regulations 1958. The changes are designed to harmonise regulation 13E with the more recent Defense Trade Controls Act 2012, and propose measures such as a new personal use exemption for the physical export of technology; legislative clarification that the physical export of controlled software and technology stored on an uncontrolled good (such as a computer) will require an export permit; and enhanced powers to revoke a permit concerning an export that would prejudice the security, defence or international relations of Australia. The consultation closed in September 2017 and a response is expected in early 2018.

amendments, and also to work with the Wassenaar Arrangement to revisit the controls

'The US appears to have achieved significant progress on this issue during 2017,' observes Richard Tauwhare of the London office of Dechert. 'The Participating States in the Wassenaar Arrangement have recently agreed to create carve-outs for authorised software updates and for transfers of technology for vulnerability disclosures or cyber incident responses. But there has been little movement towards relaxing or simplifying the encryption controls – a key area of frustration for many businesses.'

Of course the Wassenaar debate is intertwined with the European Commission proposals for a recast dual-use regime – and indeed, existing controls under the current Regulation (428/2009). The new regime, as imagined by Brussels, envisages changes pertaining to almost every aspect of export controls: introducing a catch-all for human rights considerations, imposing tighter restrictions on the export of surveillance technology, licensing architecture and encryption.

'[Regarding proposed new Chinese export control laws] You could foresee very complex situations where businesses will have to run de minimis tests under two sets of regulations – where most systems can barely cope, doing it under one.'

Pablo LeCour, Deloitte

'The Commission's proposal is still very much in the throws of discussion,' says Tauwhare. 'The lead committee in the European Parliament, INTA [the International Trade Committee] recently voted through a number of

The Global Agenda: Things to watch for in 2018

Bank of Tokyo Mitsubishi takes on the NYDFS Back in 2013/2014, Bank of Tokyo Mitsubishi paid out nearly $600m to the New York Department of Financial Services ('NYDFS') for its improper handling of transactions relating to sanctioned countries. Now the bank is biting back. In November 2017, the bank got the go-ahead to convert branches from being regulated at state-level, to operating under federal supervision – and is suing the NYDFS to stop it continuing to supervise it. If successful, this could free other banks to pursue a similar path.

Zarrab and Halk Bank In Turkey, following the Zarrab case has become a national obsession. Did senior government ministers take bribes from playboy gold dealer (and defendant-turned-witness) Reza Zarrab, or are the allegations a Gulenist plot? And what did the Turkish president know or not know about the proceeds of sanctions busting through Halkbank? The drama being played out in a New York courtroom could have a major bearing on sanctions jurisprudence: for example, is it criminal to circumvent secondary sanctions, the breach of which would not be criminal in itself?

Exxon versus OFAC It takes something to take on OFAC (hence the dearth of OFAC-related case law). But Exxon has deep pockets, and its former chairman happens to be the Secretary of State. OFAC fined Exxon for its involvement with state-run Rosneft, headed by Putin associate Igor Sechin. Should that have precluded Exxon and others from doing business with Rosneft? We should find out in 2018.

Not a Rich List you'd want to be on If the relevant government agencies adhere to the CAATSA schedule, the end of January should see the publication of the 'Oligarch's List' – a *dramatis personae* of Russia's rich, Putin associates, and others. Will it become a de facto sanctions list by default? Its publication is certain to be met with some trepidation by those included, their associates, relatives, and business partners in Russia and beyond.

OFSI to bare its teeth The UK's new mini-OFAC (the Office of Financial Sanctions Implementation or 'OFSI') has kept a low profile since springing from the loins of HM Treasury. But there are rumours afoot that, armed with new powers to impose penalties (including against breaches by non-UK companies 'with a British nexus') OFSI will be making its presence felt in 2018. (A recent freedom of information request in the UK revealed that it is currently working its way through more than 60 'live cases'.)

Cyber insecurity The future regulation of controls of cyber surveillance tools is figuratively – arguably, literally – up in the air right now. The EU is looking for them to be included in the new recast dual-use regulation; the United States is pushing the Wassenaar Arrangement to refine their inclusion in the dual-use lists, citing unworkability concerns raised by the tech industry. Can we expect greater clarity in 2018?

The Saudi conundrum continues With the war in Yemen creating a continuing (if under-reported) humanitarian disaster, EU lawmakers are feeling pressure to impose an embargo on arms to Saudi Arabia. Were the EU to do so, that would be very much at odds with Britain's determination to license such exports to Saudi: a huge money-spinner for the UK arms industry.

Chinese export control reform could, say some, become a real headache for exporters. Japanese industry, in particular, is concerned at how it could impact on the reimportation of Japanese-made components assembled in China. And there are concerns that the driver for the new law is less related to non-proliferation, than it is to counter perceived over exertion by the US of extra-territorial jurisdiction. Possibly one of the biggest export control stories in years.

substantive amendments and the proposal now goes to a vote in the Parliamentary Plenary in January. But the Council [the 28 Member State governments] has not yet completed its first reading, so a final text looks unlikely to be agreed before the end of 2018. Meanwhile, there appears to be no early prospect of agreement in Wassenaar to expand international controls on cyber surveillance in the way that the EU is proposing to do unilaterally.'

Amongst the areas of agreement of MEPs so far are:

- the Commission should publish a handbook for both Member States and exporters, with practical recommendations on the implementation of the controls;
- the proposed new catch-all controls on items that may be used to violate human rights should be limited to cyber surveillance and there should be no formal obligation for exporters to conduct due-diligence;
- new risks and technologies should be swiftly included in revisions to the Regulation by the Commission;
- creating a level playing field among Member States, by, for example, introducing similar penalties for non-compliance, along with greater transparency of national authorities' export control decisions.

As things stand, HFW's Anthony Woolich notes, there's a mild irony that while the US has the reputation as the heavy enforcer, 'Some US companies get caught out because US law offers greater exemptions than EU law on encryption. It means that they're fairly relaxed – and they don't always appreciate that they need to check against the EU regulation.'

'Strong compliance creates opportunities. If you have the right team in place, you can say, "We can do this because we understand and can manage the risks, and our peers can't, or won't." That's a market advantage.'

DJ Wolff, Crowell & Moring

Crystal ball gazing

EU export control reform comes at a time when the United Kingdom, which has a reputation for being one of the most active Member States in the export controls arena, is planning its getaway from the European Union. And it remains a moot point as to which will come first: Brexit, or the EU recast regulation. Either way, says Woolich, 'UK companies most likely to be hard hit are those that currently only export [dual-use goods] within the EU. Many of these don't understand the export control licensing system, because they don't need to.'

Other pinch points, he predicts, will become clearer as the UK hurtles closer toward its 'freedom' from the yoke of regulation, and all the bureaucratic trappings that liberation will necessitate.

Further shores

Beyond the United States and European Union, global businesses will need to get to grips with the coming of age of new regulatory frameworks, in Asia, Latin America and the Middle East. For example, India's SCOMET regime has been overhauled in the past 12 months and it has very recently become a Wassenaar Arrangement participating state. Meanwhile, China has proposed a reformed export control regime, closely modelled on the US system – to the extent that it includes prohibitions on re-export and deemed exports.

'That's definitely one to watch,' says Pablo LeCour of Deloitte. 'I think it could be the most significant change in this space hitting companies – especially if it's applied as [the Chinese government has] stated. You could foresee very complex situations where businesses will have to run *de minimis* calculations under two sets of regulations – where most systems can barely cope, doing it under one.'

Of course, it could be argued that companies that are proud of the strength of their compliance capability welcome the greater challenge that ever more complex layers of regulation present.

'Look,' says Crowell & Moring's DJ Wolff', 'Strong compliance creates opportunities. If you have the right team in place, you can say, "We can do this because we understand and can manage the risks, and our peers can't, or won't." That's a market advantage.'

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The lawyers on our international trade, national security, and economic sanctions team represent and advise clients on economic sanctions, investigations associated with export and import issues, due diligence, licensing, compliance matters, enforcement settlements, and national security matters. Working with defense, high-tech and other global businesses, universities, and nonprofits, we counsel on regulatory compliance and enforcement related to Export Administration Regulation (EAR) and International Traffic in Arms Regulations (ITAR); US government national security and Committee on Foreign Investment in the United States (CFIUS) reviews; import laws; Office of Foreign Assets Control (OFAC) sanction programs; and anti-boycott regulations.

We regularly interact and communicate with government agencies, such as the Directorate of Defense Trade Controls (DDTC), US Bureau of Industry and Security (BIS), US Customs and Border Protection (CBP), the Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF), and the OFAC.

Our team conducts classified and non-classified investigations and, where appropriate, guides clients through the OFAC, EAR, and ITAR voluntary and directed disclosure procedures. We also determine export jurisdiction and classification on behalf of clients. Our lawyers prepare commodity jurisdiction and classification requests, and develop licenses, agreements, and technology control plans. We also create and review compliance policies, manuals, and procedures, and conduct compliance training for employees.

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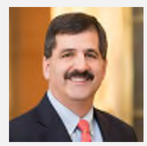

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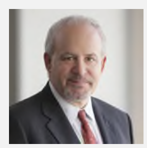

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The Global Agenda: What next for the EU and UK?

Throughout 2017, the European Union has pushed ahead with plans to overhaul EU export controls for dual-use items, with the aim of establishing an EU-wide regime for the control of the export, transfer, brokering, technical assistance and transit of dual-use items in place of Regulation (EC) No 428/2009. The new regulation will incorporate key technological advances, such as the export of certain information and communication technologies ('ICT'); address security risks over the proliferation of weapons of mass destruction; and attempt to create a 'level playing field' among EU Member States.

The European Commission's proposals, published in September 2016, have now been actively examined by EU Member States. The new concept of 'human security', which seeks to prevent the abuse of cyber-surveillance technologies by regimes with poor human rights records, has proved controversial. A progress briefing released in August 2017 revealed division amongst stakeholders over the inclusion of human rights considerations, which some industries – such as the tech industry – feel will create new obstacles to business and lead to them losing work to non-EU competitors. The Finnish government, for example, has expressed concerns that the greater emphasis on human rights will increase the administrative burden for businesses and create uncertainty, and is critical of extending export control beyond EU borders. Poland supports tighter control of the export of computer surveillance technology, but is concerned that unregulated non-European competitors will step in to fill any gap. Slovakia called for a 'fine-tuning' of existing EU export controls for dual-use items, rather than an overhaul.

Georg Pietsch, Director General at the Federal Office for Economic Affairs and Export Control in Germany ('BAFA') welcomes the strengthening of 'human security' in the EU's draft regulation, but points out that it is important not to compromise the established, 'field-tested' dual-use export controls currently in existence. In particular, he considers that the non-binding guidelines over major aspects of the regulation are not sufficient: 'The Commission's draft contains many more new substantial provisions that will turn out to be labour-intensive for industry as well as authorities,' he says.

Until now the way in which Member States choose to implement a regulation has been the responsibility of each Member State, under the principle of subsidiarity set out in Article 5 of the Treaty on European Union. 'Particularly challenging is the fact that the draft foresees the Commission's interference in procedures and practices to implement the regulation on a national level,' says Pietsch. 'This is an enormous challenge for Germany and German exporters, as a large share of the exports from the European Union is in fact administered in Germany.'

A spokesperson for the Commission commented that the debate has now evolved considerably, showing that 'most – if not all – the stakeholders recognise that emerging technologies and their trade must be consistent with our security and foreign policy interests and values.' They point out that the debate has 'moved on' to focus on parameters of control such as the advantages of list-based controls versus end-use controls, and 'the necessity to introduce an EU autonomous capacity for decision and action in this area.'

Switzerland has already introduced a similar concept to the one proposed in the EU's draft dual-use regulation to ensure that surveillance technologies that could be used for human rights abuses are not exported. This means that requests to export internet and mobile surveillance technologies must be rejected if there are 'reasonable grounds to believe' that the items could be used for repression in the destination country. This is up for review in 2018. 'We have been using this provision for the past year,' says Erwin Bollinger, Head of Export Controls and Sanctions at the State Secretariat for Economic Affairs Switzerland. 'Because this control order has a limited duration, until 2019, the Swiss Government intends to propose to Parliament to integrate it into formal law.'

The prospect of Brexit also needs to be factored into the process, as underlying legislation will have to be adjusted as well as licensing procedure – such as national general licences – for both the EU and the UK. 'While conducting the review of the dual-use regulation, it would undoubtedly be sensible to already integrate Brexit into the process at some point,' says Pietsch.

The European Parliament's international trade committee ('INTA') – as co-legislator with the EU Council – adopted a report supporting an 'ambitious' modernisation of EU export controls on 23 November 2017, and Parliament is expected to finalise its position in the first half of 2018. The next stage will be 'trilogues' between the Parliament, Council and Commission with a view to concluding the legislative process later in 2018.

In the UK, 2017 was the first full year of operation for the government's new Export Control Joint Unit ('ECJU'), which was established in July 2016. The ECJU co-locates Department for International Trade ('DIT') staff in the Export Control Organisation and export licensing teams from the Foreign and Commonwealth Office and Ministry of Defence. The government claims that, 'The creation of the ECJU has centralised expertise and removed duplication, helping us to provide a high-quality service to business.'

The Export Control Organisation remains the UK government's regulatory body for military and dual-use exports, with the Secretary of State for International Trade, currently Liam Fox, responsible for decisions to grant or refuse export licences. Arms export requests are assessed on a case-by-case basis against the Consolidated EU & National Arms Export Licensing Criteria. This process came under scrutiny in a judicial review brought by civil society group Campaign Against the Arms Trade ('CAAT') concerning arms exports to Saudi Arabia, which was defeated in the High Court in July 2017. CAAT is pursuing an appeal against the decision.

The government has confirmed that until leaving the EU, the UK will continue to abide by the Council Common Position 2008/944/CFSP defining common rules governing control of exports of military technology and equipment, implemented in the UK through the Consolidated EU & National Arms Export Licensing Criteria.

As the UK is a member of all the relevant multilateral regimes controlling the export of military goods and dual-use items – such as the Wassenaar Arrangement, the Nuclear Suppliers Group, the Missile Technology Control Regime, the Australia Group and also a member of the Arms Trade Treaty – the general consensus from regulators is that Brexit will not substantially affect export control policy. 'We will certainly watch the process with the UK, but we do not envisage any real change,' says Bollinger 'There is much co-operation between Swiss and UK industries and certainly that will not change.'

US Export Control Reform: Where are we headed?

The achievements of ECR are significant – and with smart thinking and commitment they can be even greater, write David DiBari, Josh Fitzhugh, Wendy Wysong and Hena Schommer.

Export Control Reform ('ECR') was launched almost eight years ago with bold aims, including strengthening US national security by focusing compliance resources on more sensitive items; increasing inter-operability with US allies; and promoting US exports by reducing incentives for non-US companies to avoid US-origin content. ECR pursued these objectives by shifting less sensitive military items from International Traffic in Arms Regulations ('ITAR') to Export Administration Regulations ('EAR') control; establishing new EAR licence exceptions; removing ambiguities from the regulatory text; and harmonising key concepts and definitions.

Much of that ECR campaign has been delivered. In a monumental effort, many less sensitive items previously subject to ITAR regulatory requirements have been shifted to the EAR. Many items moved to the EAR may be exported and re-exported under new license exceptions such as STA, authorising eligible exports to allied governments without a licence. These regulatory clarifications have helped industry identify the classifications for their products, understand their compliance obligations and open new markets for their products. Some of the grander visions for ECR – a single control list, single licensing agency and single licence application – have not yet happened, but that does not undermine what ECR has achieved.

Partial success

ECR appears successful in its tactical aims. Many transactions previously requiring ITAR licensing no longer do. Companies may also be better equipped to self-classify products, and may have more options for structuring their production. That flexibility comes with cost, however, including reclassifying products, retraining staff and managing complex licensing decisions. Healthy debate continues in US and European industry as to how best to balance the benefits of ECR's reduced licensing burden against the costs of its additional complexity.

Success on ECR's underlying aims, including improving alliance inter-operability and enhancing US exports, is harder to quantify. Many programmes with ITAR content before ECR still have ITAR content afterwards, meaning they still have to apply a full set of ITAR controls including jurisdiction/classification assessment; inventory tracking; employee nationality screening; subcontractor management; technical data segregation; retransfer controls; tracking of repair, replacement and support activity; recordkeeping; etc. ECR offers benefits for those able to manage its complexity, but elements of the ITAR regime still disincentivise exports of controlled material to US allies.

Thoughts for improvement

Assuming continued interest in enhancing exports to and inter-operability with US allies, we offer a few thoughts below on furthering those aims without undermining other US interests.

Some ideas for improvement are already under consideration at the State Department. Clarifying the definition of defence services would help. So, too, would a practical regime for managing US persons employed abroad, ideally including employer-managed registration and authorisation for US persons employed in allied countries, as well as official clarification that non-US defence articles do not become ITAR controlled simply because US persons contribute to their development. Finally, a clarified definition for technical data would enhance consistent compliance by industry. To a greater or lesser extent, all these topics are on the Defense Trade Advisory Group ('DTAG') agenda or are the subject of existing efforts at the Directorate of Defense Trade Controls ('DDTC').

A few equally meaningful changes not yet under discussion could enhance exports without undermining US national security. Borrowing from ITAR §§126.15-16, DDTC could empower allied governments to submit lists of intermediate consignees for incorporation by reference into licences and agreements supporting those governments' activities, allowing licensees to use anyone on the list when choosing freight-forwarders, painting shops and IT support. This would provide flexibility to non-US companies and defence ministries and avoid the need for frequent licence updates while retaining DDTC's control over who has access to ITAR material.

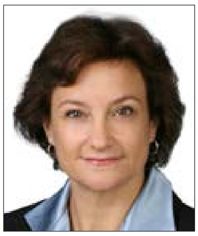
The ITAR could update the definition of 'regular employee' to remove length, location and exclusivity of service as requirements. Instead, any appropriately screened employee with authorised nationality acting on behalf of an entity and subject to its control could be covered by its authorisations and responsibilities under ITAR §127.1(c), including the responsibility not to share controlled material with any unauthorised third party.

DDTC could create additional incentives for US exports and alliance inter-operability without the need for regulatory changes. Enhancing clarity on commercial support for foreign military sales ('FMS') activities would encourage participation in the FMS programme. Expanded company engagement and outreach, paired with voluntary disclosure treatment for mistakes uncovered during such engagement, could further demystify ITAR compliance for non-US companies and reduce anxiety over ITAR procurement.

Final thoughts

ECR demands a more sophisticated compliance strategy but offers important opportunities for companies to reduce compliance cost and risk. It also presents a chance to enhance US national security and export promotion through additional regulatory simplification. We encourage industry to avail itself of the existing benefits, and government officials to consider further improvements.



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Preparing for BREXIT

When the UK leaves the EU, most businesses will still have to comply with EU requirements. But on top of this, they will have to comply with new UK rules. While there may be a broad political aim to ensure close alignment, businesses need to keep aware that the UK framework will be different from that of the EU, and understand the potential implications of that for them, write Roger Matthews and Richard Tauwhare.

Sanctions and export controls are complex areas; but businesses have had until now the advantage that the rules are essentially the same across the EU. This article considers how that might change after Brexit.

Sanctions

Brexit will lead to significant changes – both to the legal framework in the UK, and to the nature of the UK's influence on European sanctions policy. It is too early to say whether or not this will lead to significant differences between the UK and the (remaining) EU's substantive positions as regards particular sanctions regimes, but the impact for businesses will be felt nonetheless. In particular:

- *The UK has recognised that, after Brexit, the UK and EU may not always coordinate their positions:* the UK has urged that it and the EU should 'remain close partners in foreign policy', and proposed that they should have 'regular close consultations' with the 'option to agree joint positions', including on sanctions listings, and 'aligning policy where appropriate'. There will likely be a good degree of coordination, but these proposals implicitly recognise that alignment will not always be appropriate – i.e., the possibility of substantive divergence from time to time between UK and EU sanctions is real;
- *The actual sanctions restrictions, licensing powers etc. that will apply in the UK after Brexit will only become apparent when the individual UK sanctions regimes are set out in regulations:* the Sanctions and Anti-Money Laundering Bill, currently going through parliament, proposes to give the minister(s) power to establish UK sanctions regimes through secondary legislation (regulations). The Bill would give the relevant minister(s) a very broad discretion as to the types of measure, the basis for targeting a person or entity, and the scope of OFSI's and EJCU's licensing powers, with only a minimal role for parliament;
- *The proposed UK approach is different from the EU approach on some points:* The UK government is already proposing some departures from the EU position, albeit in areas less likely to impact businesses directly. For example, it is proposed that sanctions measures be reviewed only every three years (EU reviews every year), and that a UN-designated person's ability to challenge their UK designation (which they have now under EU law) will be reduced;
- *Even where there is alignment, the operational details are likely to vary:* UK and EU sanctions laws will be made using different legal frameworks, different wording, and subject to separate judicial systems. Even substantively similar provisions will likely evolve to have different application, scope and operation.

Export controls

UK and EU traders and governments have a strong mutual interest in minimising any additional administrative burdens from export controls on trade between them. Reasonable assumptions (with the caveat that nothing is guaranteed) include that:

- The UK will remain a member of the international export control regimes and continue to use their control lists with minimal national revisions;
- EU regulations in force at the time of Brexit will be retained into UK law and that there will be no hurry to revise these;
- The UK will continue to apply the current 'Consolidated Criteria' in assessing licence applications;
- For military items, changes will be minimal given that trade is already subject to licensing, except possibly for the transit of military items; and
- For dual-use items, a simple way forward is available, through the EU adding the UK to its EU001 general licence and the UK creating a new open general licence covering exports to all the EU Member States.

But there remain some key areas of uncertainty, in particular:

- If a transition period is agreed, how far it will maintain the status quo with respect to export licensing and how long it will remain in effect;
- Whether licences for dual-use exports to third countries issued before Brexit will remain valid in both the UK and EU until they expire;
- Whether the UK will continue to be able to issue licences to UK companies to export from an EU country to a non-EU country;
- Whether the likely new UK dual-use open general licence for exports to the EU would waive the standard requirements of open licences for annual reporting and compliance audits, which impose significant administrative burdens on users;
- Whether the UK will adopt all elements of the revised EU Dual-Use Regulation if it is not approved before Brexit and, in the longer term, in what ways the UK may diverge from EU export control regulations and how far industry will be consulted.

For most businesses the introduction of a new, separate, UK framework will add to the trade compliance burden. They will likely want the government to minimise the differences and new administrative requirements. But since many businesses will operate in both the UK and the EU, their procedures will need to adapt to take account of new UK measures in addition to their existing EU compliance obligations.

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Advanced economies tighten inbound investment screening regimes

Among the headlines, a new research report from Baker McKenzie has found that seven out of nine advanced economies have strengthened or are proposing to tighten their foreign investment review procedures in recent years.

Most advanced economies are focused on increasing foreign direct investment ('FD'I) to promote jobs, innovation and economic growth. But the investment policy landscape is getting more complex in the face of new risks, and in the last few years many governments have enacted new legislation to broaden the scope of review of cross-border investments to address expanding notions of national security protection.

Baker McKenzie has examined the shifting foreign investment review landscape in nine of the world's key FDI jurisdictions – Australia, Canada, France, Italy, Germany, Spain, the UK, EU and the US. In its report, *Rising scrutiny: Assessing the global foreign investment review landscape,* the firm finds that seven of these nine have recently tightened or are proposing to tighten their foreign investment review frameworks to allow governments more leeway to block deals or impose conditions on their completion.

The report identifies three drivers of this enhanced scrutiny:

- Record levels of Chinese investment
- Increased activity by state-owned enterprises and sovereign wealth funds
- Changing ideas about national and economic security

While most cross-border transactions still have a high likelihood of approval, those in sensitive sectors may now encounter more scrutiny and face a prolonged approval process. The report identifies the following sectors as most at risk of review by host governments: Agriculture; Homeland Security; Critical Infrastructure; Information Technology; Defence; Media Energy; Telecommunications; Gambling.

Deals are being impacted around the world. In 2016, Chinese investors walked away from 10 deals for US companies, worth $59 billion. In Europe, 20 Chinese deals worth $16.3 billion were cancelled or withdrawn. Greater regulatory and political scrutiny was a contributing factor.

The US government investigated 389 foreign investment transactions from 2009 to 2016, and formally rejected or forced divestitures in three deals.

The Australian government considered 43,013 foreign investment applications in 2015-16, up from 13,322 in 2012-13. In all, five deals were rejected, and 14,491 approved with conditions.

And Canada's government has reviewed 3,445 notifications and applications since 2012 and ordered thirteen national security reviews. Eight deals have been blocked or subject to divestiture.

In the last year alone, several developed countries have expanded government review of foreign investments in strategic sectors. For example, in July 2017, Germany extended the duration and scope of examination for investments in defence and other highly sensitive sectors following public and political debate over a number of Chinese acquisitions. The UK government has also signaled plans to increase scrutiny of investments that could impact national security, including foreign ownership of companies controlling critical infrastructure. Investors need to be mindful of the impact of these changes, not only on transaction viability, but also on timetables, and develop appropriate strategies.


For assistance in inward investment in protected industries, contact Rod Hunter in Baker McKenzie's DC office and Dr. Thomas Gilles in the firm's Frankfurt office.

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US developments: The Cornyn Bill

The proposed Foreign Investment Risk Review Modernization Act ('FIRRMA') would significantly expand the jurisdiction of the Committee on Foreign Investment in the United States ('CFIUS') to reach, for example, joint ventures and other arrangements between US critical technology companies and foreign investors, even when such JVs or other arrangements are outside of the United States.

While CFIUS would have authority to exclude certain investments from allied countries, the bill's changes would encompass many transactions not previously within the ambit of CFIUS, including US investments in China, Indonesia, and other emerging markets that impose technology transfer obligations and even largely financial transactions in the US.

'CFIUS is increasingly becoming a technology control regime, and the Cornyn bill would continue that trend. Indeed, the legislation would direct CFIUS to work with allied governments to develop similar regimes aimed at controlling the flow of cutting-edge technologies with security implications, a response to policies of major emerging markets such as China,' says Rod Hunter, a partner in Baker McKenzie's Washington, DC office. 'FIRRMA would also create a mandatory declaration procedure for certain foreign investments by state-owned enterprises and investments in certain US technology companies, including those with emerging technologies.'

Download the report at:
http://www.bakermckenzie.com/en/insight/publications/2017/11/rising-scrutiny

AND FOR MY NEXT TRICK…

The geopolitical and legislative developments of 2017 set up compliance teams for a year of juggling unpredictable and sometimes novel regulatory change. But it doesn't stop there – as one new challenge is met, expect another to take its place.

Consider just a few of the major changes that legal and trade compliance departments have faced over the past 18 months: the Brexit referendum vote for the UK to leave the European Union without any prior government strategy to achieve an EU exit; the arrival of the European Union General Data Protection Regulations ('GDPR') with an implementation timeline of just 21 months; a US presidential election that resulted in a new administration whose campaign largely centered on promises to pull the country out of or renegotiate the majority of trade agreements, sanctions programmes, and bilateral agreements.

On top of these landmark developments, compliance has continued to go about its daily business dealing with ongoing US export control reforms and the classification and licensing issues arising, the JCPOA and potential opportunities and conflicts, cyber security, cloud computing and other intangible transfers compliance, revisions and amendments in Russia-Ukraine-Crimea sanctions, Cuba rethinks, proposals to reform the regulation of dual-use exports in the EU… *plus ça change*.

More than just in a day's work

In the normal course of business, compliance departments manage the matrix between global and local concerns, and the balance of internal and external business decisions. In an atmosphere where sanctions, export controls and regulatory regimes are well established, usually lean teams tend to establish efficient, effective practices that benefit the business, but in times of uncertainty and aggressive change, efficient compliance and legal departments can become a competitive advantage to the business functions they support.

Bjorn Uggala, Vice President Export Compliance for Swedish defence contractor Saab AB, says that 'Industry wants long-term, clarity, predictable and transparent,' when it comes to regulations and sanctions. In the current atmosphere of uncertainty, companies such as Saab have faced an administrative onslaught on a multitude of fronts.

Increasingly, companies with design and product specifications understand that the business must adapt to treating export-controlled information, not just products, as classified information. Many trade departments leveraged their team to identify and determine a process to deal with the GDPR changes on a short timeline in 2017 and without a previous mandate to manage network classified information. Accenture's Managing Director, Global Trade Compliance, John Pisa-Relli says his team has noticed a different dynamic from recent EU regulatory changes. 'The EU's changes with GDPR are very aspirational, and while still a hodge podge, export controls are becoming more assertive and more formal,' he says.

The flip side to new and more assertive export control and data protection regulations, however, is the appetite for a business or industry with high compliance requirements to develop new products, acquire businesses and expand their supply chain. Compliance departments' day-to-day work, became more challenging for global companies in 2017 due to the uncertain environment with regulatory changes.

Saab Kockums' Export Control Director and Head of Trade Compliance, Susanna Sjosten notes that 'On top of regulation changes, there is a need to track in-house development of new products to see if we are developing products that are affected by existing or new legislation.'

'The EU's changes with GDPR are very aspirational, and while still a hodge podge, export controls are becoming more assertive and more formal.'

John Pisa-Relli, Accenture

One bright spot in all the uncertainty has been the reform of US export controls under the Department of Commerce's EAR, which receives favourable comments on its role out by compliance professionals. According to Brian Cochran, Vice President of Global Trade Management for Eaton Corporation, 'During the reforms, there was lots of outreach to industry that made it easier to comply with regulations once they were announced,' which, Cochran says, resulted in smoother changes in process controls and establishment of a leadership attribute of complying with regulations for his company's management team.

Outreach and planning are comforting when the social media habits of certain world leaders can result in quick changes in sanctions, as they did with North Korea due to US President Trump's war of words with that country. While those sanctions don't affect many businesses, the continued turmoil in the US, particularly around Russia, is a cause for concern for businesses with interests there.

'The unpredictable nature of the US administration has made it more challenging to predict how sanctions might evolve, and how enforcement might evolve,' says Zahra Kitson Frimor, Senior Legal Compliance Officer at Maersk Drilling. Kitson Frimor draws a distinction between complying with US sanctions (which often impact the energy industry with fast changes and sanctions, like the quick roll-out of Venezuela sanctions in November) and EU sanctions. She posits that EU sanctions are simpler, and quite binary in comparison. For the most part, the EU has also had a longer timeline from announcement of regulation changes to expected compliance, making it easier for trade departments to ramp up.

'The unpredictable nature of the US administration has made it more challenging to predict how sanctions might evolve, and how enforcement might evolve.'

Zahra Kitson Frimor, Maersk Drilling

Then there's Brexit. For companies with significant manufacturing in the UK, like Eaton, Cochran says his main concern is 'What that fall-out might look like. Eaton manufactures a lot of dual-use in the UK and there is nothing laid out yet.' For Cochran, the customs changes might be easy, but the tension comes in getting staff trained and third parties certified, which is much more complex. Cochran notes in particular the impact of GDPR, and of Authorised Economic Operator ('AEO') impact on supply chain and logistics teams where there are currently not enough staff trained with knowledge in those areas or third-party suppliers to cover predictable backlogs at customs clearance.

Staying ahead of the game

Well-run compliance departments show their competitive advantage in the ability to adapt to times of high change and high risk through aligning resources and scaling to cover new events while maintaining existing compliance programmes.

Defence industry supplier Meggitt's Vice President of Group Trade Compliance, Bruce Jackson says that his main focus in 2017 has been on internal structures such as 'developing career paths and professionalism on the team, and finding better ways to measure key performance indicators.' Jackson says he prioritises 'right resources' in order to be able to deal

Baker McKenzie.

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Baker McKenzie covers the core areas of International Trade, such as export controls and sanctions, encryption issues, customs compliance, anti-bribery and anti-corruption, as well as offering significant expertise in relation to WTO rules and free trade agreements. Our market-leading team is widely recognised by leading multinationals and regulatory authorities as the leading advisers for international trade work. We are increasingly appointed by clients with strong in-house teams to assist with high-profile export controls, sanctions, and anti-bribery matters.

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Our global coverage and structural integration is unmatched. We offer a 200-plus team of International Trade specialists who are strategically situated across more than 40 markets, including most of the world's key financial and policy centres such as Washington DC, London, Amsterdam, Frankfurt, Stockholm, Barcelona, Sao Paulo, Mexico City, Hong Kong, Singapore, Beijing, and Sydney.

Multinational clients appoint us because of our unsurpassed ability to resolve multi-jurisdictional trade matters involving US, EU and other national regulatory regimes and authorities such as Germany, UK, China, and Australia.

Industry Focus

Our practitioners have a particular focus on industries that are most impacted by the introduction of new trade regulations, including major industrial manufacturers, energy, IT, telecommunications and financial services companies. We have a vast amount of experience advising many multinationals within the Fortune 100 and FTSE 100 communities.

Global Thought Leadership

Our annual International Trade conferences in London, Amsterdam and Santa Clara are among the largest and best-attended trade seminars in the world. Clients also hail our regular globe trade webinars as an integral component of their trade compliance training.

Keep ahead of the curve on the latest economic and trade sanctions developments – visit the Baker McKenzie Sanctions Blog: www.bakermckenzie.com/sanctionsnews.

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with the external issues his industry faces.

Accenture's Pisa-Relli echoes the sentiment, saying that 'putting the needle in the right place to provide right guidance to the business function' is the key to managing people resources.

The use of automation in compliance functions has helped compliance teams innovate in their response to 2017's challenges, for example, implementing an escalation process, to simplifying and penetrating with specific messaging to the business via online, and creation of compliance and ethics frequently asked questions to assist in scaling and harnessing the knowledge of the compliance department.

Best foot forward

Overall, 2017 has been a year of reassessing priorities and balancing the challenges of new or changing regulations, virtualisation, and aligning with business functions. In 2018, compliance departments will not shrink, but could see continued reorganisation depending on the outcomes of Brexit, export control and data protection initiatives, and ongoing unpredictability in the US overall.

Regional concerns will remain an area compliance departments track closely. Some industries will have unique challenges related to local regulations that apply extraterritorially to their business. In Sweden, for example, updated dual-use regulations will require Swedish companies to apply a 'democracy criterion' for export licences in the defense industry. This regulation will create more tracking issues for global companies. Saab Kockums' Sjosten says her team is 'getting more requests from suppliers about our supply chain and end customers, so there is more screening and more administration for the team.'

'People are getting apprehensive [about Brexit]... We have to plan for chaos at ports because there is not enough storage. It will affect logistics. Customs itself is understaffed, and there is no guidance.'

Brian Cochran, Eaton Corporation

Should such a criterion become widespread within the EU, it will undoubtedly impact compliance well beyond 2018. Meanwhile, the energy industry faces similar administrative challenges with tracking how sanctions in Venezuela and Russia will evolve, and creating a framework for enhancing due diligence in countries where that task takes longer and is not efficient or transparent.

Also top of mind for all the trade compliance leaders is the Cloud and implementation of GDPR in addition to EAR requirements related to technical data security that require changes in access, personnel and physical processes. Eaton's Cochran notes: 'When you work in a company with controlled data and products, it becomes hard to strike a balance between being too strict and catching everything needed without overloading the system.'

While compliance departments appear to be maintaining vigilance in light of continued capriciousness by the US administration, the big cloud hanging over many compliance teams is Brexit. 'People are getting apprehensive,' says Eaton's Cochran. "Apprehensive about getting the team trained up. Staffing issues and third-party relations could all become more complex. We have to plan for chaos at ports because there is not enough storage. It will affect logistics. Customs itself is understaffed, and there is no guidance.'

In an era where the range of trade compliance issues have become more territorial and more unforeseeable, it looks like the only risk compliance departments will not face is job insecurity.

Crowell & Moring LLP

Crowell & Moring LLP is an international law firm with more than 500 lawyers in offices in the US, the EU and the Middle East. Our International Trade Group includes 30 practitioners, located mainly in Brussels and Washington, DC, who advise clients ranging from local SMEs to the world's largest multinational corporations on all aspects of international trade, customs, and regulatory laws.

Our core practice areas are export controls and sanctions, WTO law, trade remedy procedures and litigation, customs and duty recovery, anti-corruption, investment and market access rules, and preferential trade agreements. Our clients are active in a wide range of industries, including aerospace & defence; information technology; financial services; automotive; semiconductor; construction; aluminium, iron and steel; consumer products; agriculture and food products; sports and leisure; chemicals; and pharmaceuticals.

The International Trade Group provides clients with a range of services, from straightforward licence applications and training programmes to responding to government investigations and counselling on difficult commodity jurisdiction or regulatory compliance issues. We counsel traditional financial institutions and designated non-financial businesses and professionals on how to successfully navigate anti-money laundering laws and regulations.

Our US and Brussels teams are consistently ranked among the world's leading practitioners by *Chambers USA* and *Chambers Global*, including for export controls and economic sanctions.

Our services include:

- Advising on licensing requirements and preparing licence and agreement applications
- Performing internal investigations and assisting with voluntary disclosures
- Performing compliance audits
- Designing and implementing compliance programmes
- Performing jurisdictional assessments and preparing requests for commodity jurisdiction determinations
- Assisting in self-classification of products and preparing requests for commodity classification requests
- Performing export control/sanctions/anti-money laundering/ anti-corruption/import due diligence reviews related to proposed mergers and acquisitions
- Representing clients in civil and criminal enforcement proceedings
- Training on export controls, anti-money laundering, sanctions, anti-corruption/anti-bribery, import procedures and requirements

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