

## **New UK Financial Regulator Heralds Tougher Enforcement Era**

By **Mark Taylor**

*Law360, London (December 14, 2016, 9:08 PM GMT)* -- Britain earlier this year established the Office of Financial Sanctions Implementation, adding another enforcer to the list of names policing U.K. banks and signaling a more robust approach to fighting transaction violations.

The OFSI, which was established in March and is currently consulting on its powers, has been assigned the role of prosecuting violations of British financial sanctions law by countries and individuals, taking over detection from the Treasury in a bid to catch up with aggressive U.S. enforcement efforts.

Law360 spoke to attorneys for the lowdown on the OFSI: how it compares to its feared U.S. counterpart, the Office of Foreign Asset Control, and what financial institutions and their advisers need to be aware of. Here, they provide a handy primer on the latest financial watchdog on the block.

### **What is OFSI and where did it come from?**

The OFSI was created by former Chancellor of the Exchequer George Osborne to help maintain the integrity of, and confidence in, the U.K. financial services sector. But despite the fanfare, the OFSI is not an entirely new organization.

“OFSI was established at the end of 2015, but ultimately it is simply a rebranding of what was formerly the Treasury’s asset freezing department,” said John Forrest, head of international trade at DLA Piper.

Britain wanted to put more resources into tackling sanctions violations, and a debate began over what such a body should look like.

“The U.K. has historically been less aggressive than its U.S. counterparts, and this is an attempt to demonstrate the government is more committed and intends to invest more heavily in the enforcement of this type of regulation,” said Joanna Dimmock, white collar lawyer at White & Case LLP.

It is also an attempt to relieve some of the burden on HM Treasury, which has been pressured since sanctions regulations against designated entities and individuals began ramping up in 2011 involving areas like Syria, Libya and Egypt.

There were also political reasons behind its creation, experts believe, as the Office of Foreign Asset Control in the U.S. began to flex its muscles and slap eye-watering penalties on overseas banks for transgressions.

“Because we have had more than 10 years of incessant U.S. focus on sanctions, it has created an environment where other regulators were starting to come under local pressure to act,” said Zia Ullah, financial crime partner at Eversheds LLP. “This was particularly the case given that many of the banks being hit with massive penalties were U.K. banks.”

Ullah said this was an attempt by lawmakers to give HM Treasury extra teeth in regard to civil enforcement, which had been beyond any U.K. regulator until now.

### **What will it do?**

“It is set up to administer and enforce economic sanctions in the U.K.; these will be economic sanctions predominantly derived from U.N. security council resolutions, or EU sanctions regulations,” said Forrest. “It will police the U.K.’s administration and enforcement of economic sanctions.”

OFSI’s brief has been defined, and it is currently consulting on monetary penalties for breaching financial sanctions. However, detail has been scant on how it will go about this, and every legal expert Law360 spoke to referenced potential staffing issues as unclear.

“Treasury resourcing also needs to be considered; is the U.K. government serious about putting them into OFSI to get the big ticket type of investigations?” Forrest said.

During the initial announcements, Osborne said sanctions should be properly understood and implemented, and enforcement improved.

However, with resource levels unclear, whether it can do this remains up for debate, says WilmerHale white collar counsel Christopher David.

He says guidance from HM Treasury on sanctions breaches was already challenging for firms to deal with and unclear historically, and part of what the OFSI may do is to aid transparency and add clarity.

“Certainly, when applying for licenses involving sanctioned parties and sanctioned countries, it is not unreasonable to want to get help from the supervisory agency,” David said. “Sometimes it takes a very long time for sanctions imposed by the U.N. or the EU to be implemented in U.K. statutory instruments. Historically, it has not been done very well.”

### **What powers does it have and how will it use them?**

In forming the OFSI, the U.K. tweaked existing laws, adding the power to pursue civil penalties and chase out-of-court settlements.

“What is different is the proposed legislation, the Policing and Crime Bill 2017, seeks to give OFSI new extended powers, namely to impose civil penalties and deferred prosecution agreements,” said Dimmock.

These are powers that have always been available to the OFAC and are a big reason for the OFAC’s bite and aggression, she says.

“In the U.K., regulation has been light compared to the U.S., as sanctions have commonly only been dealt with at a criminal level and this power has been rarely used given the high burden of proof required to prove the criminal offense,” Dimmock added.

The U.K.’s Financial Conduct Authority is the existing lead financial regulator responsible for overseeing bank behavior. How it interacts with the OFSI will also be of interest, given any potential arbitrage between the pair.

“We may have an interesting ‘conflict’ between the Treasury and FCA in the future in relation to primacy but they have sought to work through these potential challenges in the consultation document,” Ullah said.

“The creation of OFSI and this extension of enforcement powers means that for it to have any force whatsoever there will have to be some enforcement action,” he said.

Currently, attorneys say, the Treasury has not prosecuted any single person for economic sanctions breaches, and historic cases reported have not resulted in enforcement action. This is likely to change.

“The new OFSI enforcement regime is purely civil — they will not have to take a case to a full trial and convince a jury beyond reasonable doubt that it was a criminal offense, which could make it much easier to achieve a result,” said Mark Compton, financial services partner at Mayer Brown International LLP.

### **How does this differ from history?**

The importance of being able to resolve sanctions breaches by way of alternative routes rather than going straight for criminal sanctions cannot be underestimated for financial services firms, David added.

When the new powers come into effect there will also be an amendment to Britain’s Deferred Prosecution Agreement legislation, which will also enable sanctions breaches to form part of an agreement not to prosecute.

“The ability to negotiate or agree a civil penalty, or if the conduct is worse, a DPA, is absolutely critical,” David said. “It is pleasing this is the route they have taken, and definitely mirrors the U.S. approach where financial institutions can engage directly with OFAC, and there is a matrix for coming to the size of the fines.”

It is a new approach in Europe, added Clif Burns, international trade lawyer at Bryan Cave LLP in Washington, D.C., and likely to be welcomed.

“OFSI used the OFAC guidelines as a template, even going down to the penalty matrix concept,” he said. “At one time the idea you would walk into a federal agency and say, ‘Hey, I violated your rules, please don’t beat me up,’ was unheard of. But the agencies and business liked the idea so agencies set this up, OFSI looked at it and thought it must be a good idea.”

He says agencies liked the idea as they can see patterns of violations outside of the disclosure which helps with other probes.

“It allows them to see broader patterns for investigation,” he said.

### **Is it a U.K.-OFAC, or an OFAC-lite?**

The OFAC is a component of the Treasury department and has two principle purposes: It administers, from a regulatory perspective, economic and trade sanctions based on foreign policy, against targeted foreign regimes, terrorists and other threats to the U.S., and also has enforcement powers."

"Where there are violations, OFAC steps in and imposes administrative penalties," said Matthew Schwartz, partner at Boies Schiller & Flexner LLP in New York.

For banks, the interest is mainly in enforcement activity, which, he says, "has ramped up incredibly over the past few years."

"The penalties have been extraordinary," he added. "Billions of dollars."

The OFAC has forged a reputation as a fearsome and brutal enforcement agency, capable of handing out crippling fines at levels unseen in the banking sphere.

BNP Paribas and Commerzbank AG paid \$8.83 billion and \$258 million, respectively, to resolve criminal and regulatory investigations regarding alleged "stripping," i.e. concealing or falsifying documentation regarding transactions involving sanctioned entities and countries.

The fine that landed on BNP in particular stunned white collar and sanctions practitioners, as the company pled guilty in federal and state court to charges including conspiracy and falsifying business records. The fallout resulted in soaring sanctions protection safeguards.

"Banks have invested billions in ensuring compliance with OFAC," Schwartz said. "When there are failings, which are inevitable, the potential consequences are significant.

In recent years, its powers to go after any firm trading in dollars has led it to target foreign banks that don't have a U.S. presence, and foreign institutions have paid heavily to resolve regulatory investigations.

Legal experts note the similarity of approach, given the U.K. can now seek to settle out of court, but the fine matrix will differ.

"One critical difference is the size of the fines. My mind continues to be blown by the extraordinary size of OFAC fines," David said. "To my mind, it won't be like-for-like. We are unlikely to see a U.K. enforcement agency leveling fines of billions on U.K. companies."

The potential for discounts in relation to self-reporting will also play a big factor in the size of any penalty, Compton says, adding that voluntary disclosure early on could reduce the damage.

"The proposed civil penalties under the new regime, while not in OFAC territory, are substantial, £1 million or 50 percent of the estimated value of the funds or resources, whichever is greater," said Dimmock. "This is, something corporates and financial institutions should be aware of and should have taken legal advice on in order to ensure compliance and assess any risk exposure."

The OFSI will also not have the reach of its U.S. counterpart, which has the benefit of both huge

resources and decades of experience, having started life in 1950 as the Division of Foreign Assets Control relating to U.S. involvement in the Korean war.

“The U.K. consultation talks about extraterritoriality, but the reality will most likely be that the U.K. authorities will not seek to replicate the U.S. model of enforcement, I can’t see it happening” Ullah said.

Through a legal and regulatory prism there are still some very wide-ranging U.S. sanctions targeting Iran and other jurisdictions, and how the OFAC handles them is one area the U.K. could learn from, Forrest says.

“They are similar at a high level but there are some fundamental differences,” Forrest said. “OFAC has issued some degree of interpretive guidance on the use of U.S. dollars in regard to such transactions, where they can and can’t be used; it is very good at issuing interpretive guidance, FAQs to try and assist the industry in compliance and perhaps this is something OFSI can adopt.”

--Additional reporting by Michael Lipkin, Evan Weinberger and Khadijah M. Britton. Editing by Rebecca Flanagan and Kelly Duncan.