A transatlantic comparison: new UK civil sanctions regime and US sanctions enforcement

The Office of Financial Sanctions Implementation ('OFSI') was established in the UK in March 2016 to oversee the implementation and enforcement of domestic and international financial sanctions. Termed the 'Mini OFAC', just how OFSI will set about its business – and what lessons it will take from OFAC – must be of great interest to any international business with a UK nexus, write Mark Compton, Tamer Soliman, Alex Lakatos, Margaret-Rose Sales and Lauren Smith.

Companies whose business activities have a UK nexus should take note of the recently published HM Treasury ('HMT'), Office of Financial Sanctions Implementation ('OFSI') enforcement guidelines,[1] which signal an important new chapter in the UK's enforcement of international economic sanctions laws.

On 3 April 2017, OFSI, which was established on 31 March 2016 to oversee the implementation and enforcement of domestic and international financial sanctions in the UK, obtained for the first time authority to impose civil penalties for serious financial sanctions violations; previously, only criminal penalties were available. The new civil penalty authority is part of a broader package of newly enacted sanctions enforcement powers under the Police and Crime Act (the 'Act') that apply to offences committed after 1 April 2017. The new civil penalties for violations of financial sanctions bring the UK's enforcement closer in line with the sanctions enforcement regime administered by the US Treasury Department's Office of Foreign Assets Control ('OFAC').

In the US, OFAC has the authority to impose civil penalties upon individuals and entities that violate US economic sanctions, and may refer cases to the Department of Justice ('DOJ') for criminal prosecution. OFAC follows published economic sanctions enforcement guidelines (the 'OFAC Guidelines') to determine appropriate enforcement responses to violations of US economic sanctions. The OFAC Guidelines set forth the types of responses to apparent violations, general factors affecting administrative action in the civil penalties process, and the method of calculation for civil penalties. In this article, we examine the new UK enforcement regulations and compare them to the US approach to sanctions enforcement.

Changes in the UK

The new civil penalty system allows for an alternative to criminal prosecution. Previously, only criminal penalties could be imposed. That required the prosecuting authority to meet the criminal standard of proof and to establish the facts in question beyond reasonable doubt. Under the new regime, HMT can now impose a civil monetary penalty on a person if it is satisfied, on the balance of probabilities, that the person (1) has breached a prohibition or failed to comply with an obligation imposed under financial sanctions law and (2) knew or had reasonable cause to suspect that the person was in breach of the prohibition or (as the case may be) had failed to comply with the obligation. This lower standard of proof will therefore be an easier test for HMT to meet and could lead to more sanctions enforcement actions.

Conduct giving rise to liability

The most common types of financial sanctions currently in use or used in recent years in the UK are: (1) targeted asset freezes; (2) restricting access to UK financial markets and services; and (3) directions to cease all business of a specified type with a specified person, group, sector territory or country. Countrywide restrictions are rare. Penalties can be imposed not just on those who have breached these types of sanctions, but also on those that have committed information breaches, e.g., failing to provide specific information when requested by OSFI, which may request evidence relating to the commission of an offence or the extent of funds and economic resources owned, held or controlled by or on behalf of a designated person.

Similarly, under the OFAC Guidelines, failure to comply with a request to produce information during an investigation could also result in a penalty. In addition, OFAC can issue fines for the late filing of a required report or failure to comply with record-keeping requirements.

Mental state giving rise to liability

HMT must demonstrate that a person had reasonable cause to suspect that he or she was in breach of the prohibition or had failed to comply with an

obligation under UK sanctions law. According to the OFSI Guidance, this will be assessed by reviewing the factual circumstances from which an honest and reasonable person should have inferred knowledge or formed the suspicion that the conduct amounted to a breach of sanctions.

This knowledge requirement differs from OFAC's statutory penalty authority and evaluation of potential civil liability. The US sanctions laws provide for the imposition of penalties on a strict liability basis, which means that lack of knowledge or reason to know is not a defence to the imposition of civil penalties. As a practical matter, in evaluating whether and to what extent monetary penalties are appropriate, OFAC generally evaluates whether there is evidence that an individual or institution knew of, or should have known of, the prohibited conduct. However, OFAC asserts jurisdiction on a strict liability basis, and has imposed penalties accordingly. This is in contrast to the OFSI Guidance, which states the agency's position that if there is neither knowledge nor reason to know, 'we cannot impose a monetary penalty'.

Extraterritorial reach

In order to fall under the jurisdiction of OFSI, the sanctions violation must have a 'UK connection' or 'nexus'. UK sanctions legislation applies to:

- All individuals and legal entities who are within or undertake activities within the UK;
- All UK nationals and UK legal entities established under UK law, including their branches, irrespective of where their activities take place;
- Subsidiaries which are incorporated under UK law, irrespective of where their activities take place.

OFSI has said that its guidance and the Act do not extend or alter the reach of UK financial sanctions, but that a UK nexus might be created by such things as a UK company working overseas, transactions using clearing services in the UK, actions by a local subsidiary of a UK company (depending on the governance), action taking place overseas but directed from within the UK, or financial products or insurance bought on UK markets but held or used overseas.

The extraterritorial reach is similar to that of US sanctions, which apply to 'US Persons' defined to include US-incorporated entities and their foreign branches, US citizens and permanent residents, wherever located, and entities and individuals located in the United States. Under the Cuba and Iran sanctions programmes, entities owned or controlled by US Persons, such as foreign subsidiaries of US companies, are also considered US Persons.[2] Virtually any non-cash transaction denominated in US dollars is likely to be considered to be a transaction with a US Person, because a US financial institution almost always would be involved in processing the payment or other funds transfer. Over the past ten years, OFAC has increasingly imposed multi-million-dollar penalties on non-US banks for their role in dollar-denominated transactions that violated US sanctions laws.

OSFI may choose to impose a civil penalty on one officer and to prosecute another officer of the same corporation criminally.

Officer and professional facilitator liability

Under the OFSI Guidance, a penalty may be imposed on both individuals and legal entities. The Act states that separate penalties may be imposed on a legal entity and the officers that run the entity if OSFI finds, on the balance of probabilities, that the company's breach took place with the consent or connivance of the officer or was attributable to any neglect on the part of the officer. When deciding whether to impose a penalty and the level of the penalty, OFSI will assess individual officers separately from the corporation. Further, OSFI may choose to impose a civil penalty on one officer and to prosecute another officer of the same corporation criminally. The HMT guidance states that it will not normally impose a civil penalty on any person who has already been criminally prosecuted.

OFSI also considers circumvention of sanctions as a breach of UK sanctions laws. 'Circumvention' in this context extends not just to circumventing the sanctions prohibitions or requirements but also to enabling or facilitating the contravention of any such prohibition or requirement. The OFSI Guidance notes that individuals who act on behalf of or advise others may be considered 'professional facilitators' if through their representation of a client, they enable or facilitate a sanctions breach. Such professionals could include auditors and attorneys advising on sanctions. This signals that OFSI will focus on the conduct of individual officers and professional advisors in enforcement cases involving corporations. Such a focus is consistent with a trend in the United States where the role played by individuals in conduct resulting in sanctions violations is being increasingly scrutinised.

Deciding on the penalty

Under HMT's new powers, the permitted maximum fine for a breach is the greater of £1 million or 50% of the estimated value of the funds or resources for each transaction in violation of law. Total penalties, therefore, could reach even larger sums in cases with multiple unlawful transactions. HMT also has the power to change these caps. In addition, it has the discretion not to impose a penalty where it is not in the public interest. The maximum sentence for criminal prosecutions has also increased: from two to seven years.

OFAC's maximum penalty, in cases where it finds a violation to be egregious and where the institution did not self-report, is the statutory maximum. Under the Iran and most other sanctions programmes, this is the greater of $289,238 or twice the transaction value. Under the Cuba sanctions, this is $85,236.

When assessing what level or type of penalty to mete out, OFSI adopts a fact-specific approach, looking at a broad range of factors, such as whether the breach involved a designated person (one appearing on HMT's consolidated list), the value of the breach, a person's knowledge of sanctions and compliance systems, the number of breaches, the extent of self-reporting, the harm or risk of harm to the sanctions regime's objectives and the conduct of the individuals involved, including whether the circumvention of sanctions was deliberate.

HMT says it will ensure its response

is proportionate by looking at how severe or serious the breach is and the conduct of the individuals involved. HMT has said that mitigating factors will be taken into account when deciding how to proceed with a case, although some breaches will normally require a penalty or need to be referred for criminal investigation.

As well as imposing a monetary penalty or referring a person for prosecution, OFSI may also request details from parties on how they will improve compliance practices and refer regulated professionals or bodies to the relevant regulator. OFSI will work out the statutory maximum penalty it could impose given the breach and then decide what level of penalty is reasonable and proportionate on the facts. OFSI has said that it will make up to a 50% reduction on the final penalty amount if a person gives a prompt and complete voluntary disclosure of the breach.

Penalties can be challenged with written (and, rarely, oral) representations within 28 days from the date of an OFSI letter giving notice of the penalty. Persons will have a right to appeal to the economic secretary to the Treasury and a final right of appeal to the upper tribunal.

Similar to OFSI, OFAC employs a fact-specific analysis when determining what type of enforcement action to take and the amount of any civil money penalty for sanctions violations. The primary drivers of any penalty amount are the number and value of the violative transactions, whether the violations were voluntarily self-disclosed to OFAC, and whether the case is 'egregious'. Those three factors yield a starting penalty number (the 'base amount'), which OFAC may then increase or decrease based on its consideration of various factors.

The OFAC Guidelines provide substantial incentives for voluntary self-disclosures (base penalty amounts no greater than 50% of the base amount for comparable cases that are not self-disclosed) and substantial enhancement for egregious cases (keyed off the statutory maximum penalties for the violations at issue). The OFAC Guidelines provide that in determining whether a particular case is 'egregious,' OFAC will give substantial weight to (1) whether there was a wilful or reckless violation of law, (2) whether there was awareness of the conduct at issue, (3) the harm to sanctions programmes objectives, and (4) the individual characteristics of the person who committed the violation (such as their commercial sophistication, size of operations, volume of transactions, and sanctions compliance history).

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OFAC will issue a pre-penalty notice with an amount of the proposed civil penalty before imposing any penalty. The recipient of such a notice may provide additional evidence related to the underlying conduct of the violation and OFAC may adjust the penalty amount based on such evidence. In addition, OFAC often enters into settlement agreements with parties that have committed or are suspected of committing sanctions violations, either prior to or following the issuance of a pre-penalty notice. Under settlement agreements, OFAC does not make a final determination that a violation has occurred and in exchange, the party that committed or is suspected of committing the violation pays a settlement amount negotiated in accordance with the principles contained in the OFAC Guidelines.

Impact of the UK enforcement regime

The creation of OFSI last year suggests that there will be an increased focus on sanctions enforcement in the UK. Moreover, the Act coincides with a growing trend in UK legislation that is focused on penalising businesses that may facilitate economic crime.

However, it is too early to say the extent to which the new legislation will affect the UK sanctions enforcement climate. The new legislation marks a significant change in the UK's approach but OFSI will need to be well resourced to give the regime impact.

Although the UK's new civil enforcement regime has many similarities to the one administered in the US, it remains to be seen if OFSI will follow OFAC's lead with regard to the frequency and scope of enforcement actions. The threat of civil penalties and the lower standard of proof alone may encourage companies to review their sanctions policies and procedures. Significantly, the financial sanctions breaches are now offences within the scope of deferred prosecution agreements ('DPAs') and serious crime prevention orders ('SCPOs'), giving an alternative to prosecution for sanctions offences.

The availability of DPAs and SCPOs will clearly impact companies debating whether to self-report breaches, but it must be remembered that UK DPAs operate differently to those available in the US. For example, a UK DPA needs to be agreed to by independent judges in the UK courts who must decide if it is in the public interest and meets the requirements of justice.

To prevent potential criminal and civil exposure, more than ever, businesses that have a UK connection will need to monitor their own internal systems, assess the sanctions risk of those with whom they form business relationships, and monitor up-to-date lists of designated persons. Businesses should also respond promptly to any requests for information from OFSI, given the penalties that may be imposed for information breaches.

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Links and notes

1 OFSI's Monetary Penalties for Breaches of Financial Sanctions Guidance ('OFSI Guidance'), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/605884/Monetary_penalties_for_breaches_of_financial_sanctions.pdf

2 Under the Iran sanctions programmes, foreign subsidiaries of US companies are permitted to engage in certain Iran-related business, provided that it is not facilitated by the US parent company.