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A legal update from Dechert's Trade and EU Government Affairs Group

# Compliance With Financial Sanctions and Trade Embargoes: A Simple Matter of Minding Your "Ps" and Asking the Right "Qs"?

For corporate and financial services clients on both sides of the Atlantic, trade compliance represents a major compliance challenge. The complex, multi-jurisdictional network of regulatory obligations has given many a General Counsel, Compliance Officer or Chief Financial Officer a headache.

While undoubtedly presenting a complex set of regulatory issues, the management of regulatory risks associated with issues such as economic sanctions, asset-freezing measures and trade restrictions can be broken down into four key components — the four "Ps".

## Places Where the Transaction Takes Place

**Question:** Does the transaction involve a destination subject to a country specific sanctions programme?

This is often the easiest of the core "sensitive" elements to spot. All organisations, whether multi-nationals, or small start-ups should have implemented well-established systems and procedures for "flagging" transactions which directly involve a sanctioned destination such as, Belarus, Egypt, Ivory Coast or Zimbabwe.

However, restrictive measures and trade embargos often cover both direct and indirect supply to the sanctioned destination. Therefore, even a transaction which appears to be totally contained within the European Union or the United States may involve regulatory risks if there is any knowledge or suspicion that the transaction might lead to indirect supply to a third party in a sanctioned destination.

**Answer:** International sanctions measures target transactions which may lead to either a direct or indirect transfer of funds or resources to a sanctioned destination. Where there is any knowledge or suspicion that a transaction may indirectly involve a sensitive destination enhanced due-diligence should be considered. Wider mitigating actions include securing warranties or drafting appropriate contractual provisions to limit the transaction to non-sanctioned destinations or to restrict re-supply to third parties located in a sanctioned country.

**Key considerations:**

- Has due-diligence in relation to the acquisition of a target company considered the target's primary markets and potential re-supply to a sanctioned destination?
- Whilst the beneficiary and applicant to a letter of credit are located and incorporated in non-sanctioned destinations, does the underlying transaction involve a sanctioned destination?

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- Does a claim for breach or non-performance of obligations under a contract or guarantee stem from an inability to perform due to the involvement of a sanctioned destination?

## Parties to the Transaction

**Question:** Does the transaction involve a party listed under an international sanctions regime?

For most non-sensitive transactions, this will simply involve incorporating the screening of counter-parties against the relevant European Union and United States consolidated lists of sanctions targets (often referred to as "SDN", or "Specially Designated Nationals" Lists). This generally forms part of the wider customer take on, or general AML/KYC checks.

For more sensitive transactions, for example those which may involve a destination subject to restrictive measures (e.g. Iran, Syria, Sudan, Libya, or Cuba) enhanced due-diligence may be required to establish the ownership structure of a particular counter-party, or members of its board or wider corporate officers who are responsible for controlling or directing the counter-party.

In addition, it may be necessary to screen known third parties — such as, agents, shipping companies and financial institutions against SDN lists.

**Answer:** International sanctions measures target a broad range of bodies, entities and individuals located around the world, including many targets that are located in Europe and the United States. The measures often target wider entities that "owned" or "controlled" by the listed sanctioned party. Therefore, a wider investigation may be required to ascertain the corporate structure, or equity participation of the counter-party to establish whether a sanctioned party will benefit from the transaction.

**Key considerations:**

- Are customer deposits that you currently hold, and which may form a key component of your liquidity ratios, potentially subject to asset-freezing provisions?

- Are the assets which you hold under a Custodian agreement subscribed to by a sanctioned financial institution or wider listed party?

- Does a hire-purchase agreement provide financing for assets to be acquired by a company whose CEO is a sanctioned individual?

## Products Involved in the Transaction

**Question:** Does the transaction involve goods, software, or technology which is restricted for export under either export control or sanctions provisions?

Military products (i.e. any product specially designed or modified for military use) and so-called "Dual-use" products (i.e. high-tech products which have both a civilian and military application) are tightly controlled for export on both sides of the Atlantic. Such products are generally listed and classified either at a national, regional, or multilateral level.

Country specific sanctions regimes often control certain wider products, equipment and technology either of use in key sectors of the target country's economy, or which may be used for internal repression or torture. Key sectors include the telecommunications sector, the financial services sector, the oil and gas sector, the petrochemical sector, and the crude oil and petroleum sector.

Wider controls apply to "facilitating" the supply of controlled products, for example through the provision of financing or financial services or the provision of insurance and reinsurance.

**Answer:** International sanctions and export control provisions control a wide range of military and dual-use products. In addition, wider controls exist on ancillary services which may facilitate the transfer of controlled products such as financial services, insurance, or logistical support. Therefore, companies involved in cross-border supply or in providing support for export related activity should ensure that they are aware of the relevant product classifications and any applicable restrictions in the specific products supplied under the transaction.

**Key considerations:**

- Is a loan agreement or financing structure being used to underwrite the procurement controlled products?

- Does an investment strategy need to consider whether an investment target's growth markets are limited due to controls on the export of its product to certain destinations?

- Do the underlying goods covered by a standby letter of credit need to be assessed before a counter-guarantee is issued or a payment effected?

## Purpose of the Transaction

**Question:** Does the transaction involve the transfer of products or the provision of ancillary services for a sensitive purpose or "end-use"?

Sanctions provisions restrict the direct and indirect supply of ***any*** product to certain destination if there is a risk that the product may be use in conjunction with a prohibited "end use". Wide-ranging "catch-all" controls restrict the supply of any items which may be destined for use in sectors such as WMD programme, a nuclear development programme, any military capacity, the oil and gas sector, or the petrochemical sector.

These "catch-all" controls extend to ancillary services such as financing, financial services, logistical support and the provision of (re)insurance. The controls are often referred to as "trafficking and brokering" controls and, given their wide-ranging application in relation to both direct and indirect supply of ***any*** product, they are often over-looked.

**Answer:** International sanctions and export control provisions restrict the transfer of any product which may be destined for a prohibited "end-use", such as WMD, nuclear and military end use. In addition, wider controls exist on ancillary services which may facilitate the transfer of products destined for a restricted end-use such as financial services, insurance, or logistical support. Therefore, companies involved in cross-border supply or in providing support for export related activity should ensure that they are aware of the potential purpose of the export and the potential "end use" of any products supplied.

**Key considerations:**

- Is a potential M&A target engaged in the production, manufacture or supply of products which generally attract end-use concerns, e.g. ceramics, laboratory equipment, chemicals, electronic components, filtration equipment, etc?

- Is the applicant or beneficiary of a letter of credit or wider trade financing instrument engaged in activities which may fall into the category of a restricted end-use?

## How Can Dechert Help You?

Dechert's Trade and EU Government Affairs Practice regularly works with corporate and financial institutions on the application of international sanctions measures. We provide an experienced partner able to offer sound commercially focused advice in relation to specific transactions, or wider compliance programming, including:

- Knowledge of the development, implementation, interpretation and legal and practical implications of economic sanctions and trade embargoes applied by the United Nations European Union, United States and Individual EU Member States.

- Designing compliance programmes tailored to individual needs, to minimise compliance risks, as well as reviewing existing company procedures, conducting internal audits and establishing improved compliance plans.

- Advising on jurisdictional issues associated with the administration of economic sanctions, including potential extraterritorial aspects of export, re-export, investment and transactional controls.

- Preparing and negotiating sanctions compliance provisions in contracts, purchase orders, distributor agreements, subcontracts, and supply arrangements and related representations and warranties in connection with mergers, acquisitions and joint ventures.

- Assisting with licence applications and obtaining authorisations in relation to regulatory exemptions and the interpretation of limitations in sanctions provisions.

- Investigating potential violations, responding to enforcement inquiries and representing clients before European and U.S. regulatory and enforcement agencies in connection with voluntary disclosures, enforcement and criminal and civil (administrative) investigations.

- Advising persons and entities which have been targeted under EU and US lists of "designated" entities with regards to their legal rights and obligations and wider public relations considerations.

- Conducting trade embargo and economic sanctions due diligence in connection with

exports and reexports, distributor/supply agreements, mergers, acquisitions and joint ventures.

- Counselling clients with respect to their exposure for sanctions violations committed by third parties and potential courses of action to protect their business interests.

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## Dechert's Trade and EU Government Affairs Practice

Dechert advises on all aspects of trade law and policy, including sanctions, export control, WTO matters, anti-dumping, customs law and trade agreements. We bring together international trade lawyers and practitioners with political advisors to offer a unique blend of legal and strategic trade advice.

We have wide ranging experience in advising European, US and other companies and financial institutions on transactions involving countries, entities and individuals subject to sanctions regimes. We draw on the first hand experience of ex-regulators to provide legal advice and minimise corporate and personal exposure to enforcement proceedings.

## Practice group contacts

For more information, please contact the attorney listed, or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/trade.

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