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Things That You Wanted to Know About the U.S. Sanctions Program But Were Afraid to Ask: Sanctions Challenges for Asset Managers

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Implementation and Enforcement of Sanctions

- The U.S. Department of the Treasury, Office of Foreign Assets Control ("OFAC") administers and enforces most economic and trade sanctions.
- OFAC administers civil enforcement.
  - Civil enforcement is subject to strict liability, i.e., without proof of fault or intent. U.S. statute authorizes civil penalties of $295,141 per transaction or twice the value of the transaction.
- The U.S. Justice Department may pursue criminal investigations independently of and in addition to OFAC enforcement for "willful" violations.
- OFAC issues general and specific licenses to authorize activity that would otherwise be prohibited:
  - General license: authorizes the performance of certain categories of transactions.
  - Specific license*:* particularized authorization on a case-by-case basis.

Who Do U.S. Sanctions Apply To?

- U.S. Persons
  - Generally, primary sanctions prohibit transactions only by U.S. persons.
  - "Facilitation" is also prohibited for a transaction by a foreign person that would be prohibited for the U.S. person, e.g. one facilitated by a U.S. investment advisor of a Cayman fund.
- Non-U.S. Subsidiaries
  - For Iran and Cuba, the restrictions also apply to foreign entities that are "owned or controlled" by a U.S. Person (i.e., foreign subsidiaries of U.S. companies).
- Non-U.S. Persons
  - Non-U.S. persons are subject to U.S. sanctions if the transaction involves a U.S. nexus.
  - Certain transactions with no U.S. nexus could result in the imposition of "secondary sanctions."

Comprehensive Sanctions

- The United States maintains a comprehensive trade embargo against Cuba, Iran, North Korea, Syria, and the Crimea region of Ukraine.
- Generally, the following activities are prohibited:
  - Transactions involving embargoed assets or property.
  - Transactions that facilitate the export, reexport, or import of goods or services to/from embargoed countries.
  - Transactions for which the benefits are received in an embargoed country.

Targeted Sanctions

- Individuals or entities may be included on an OFAC sanctions list for one or more reasons, including:
  - Narcotics trafficking
  - Terrorism
  - Nuclear or other weapons of mass destruction proliferation activities
  - Human rights violations
- A designated person will be added to OFAC's List of Specially Designated Nationals and Blocked Persons (the "SDN List").
- Not every blocked person can be found on the SDN List, however, because any legal entity that is owned 50% or more by an SDN (or 50% or more in the aggregate by several other SDNs) is also blocked.
- There is a general prohibition on facilitating transactions for the benefit of an SDN.

Russia “Sectoral Sanctions”

- Beginning in 2014, the United States imposed sanctions that prohibited U.S. persons from “dealing in” new debt or new equity of a sanctioned entity that was issued after the restrictions were imposed.

- Russia – Restrictions imposed on dealing in certain debt and/or equity over a certain maturity for:
  - Major Russian financial institutions (Directive 1)
  - Major Russian energy companies (Directive 2)
  - Major Russian tech companies (Directive 3)

- Restrictions apply to “new” debt and equity issued before the effective date of the restrictions, most of which went into effect in 2014.

- Keep in mind, there are also SDNs in Russia, prohibiting ANY investment in which those SDNs have an interest, unless licensed. E.g., Oleg Derepaska.

Venezuela Sectoral Sanctions

- General prohibition on dealing in new debt or equity issued by the Government of Venezuela from August 2017 of over 90-day maturity.

- General licenses authorize dealing in specified bonds:
  - Transfer or divestment of GL 3E bonds to non-U.S. persons
  - Clearing of trades placed prior to 4:00p.m., February 1, 2019 for GL 3E bonds.
  - Wind-down of agreements entered into prior to 4:00p.m., February 1, 2019 related to GL 3E bonds

- Keep in mind, there are also SDNs in Venezuela (e.g., PdVSA)
  - General prohibition in dealing in any instrument issued by PdVSA
  - General licenses authorize dealing in specified bonds
    - Divestment of PdVSA debt to a non-U.S. person.
    - Clearing trades placed prior to 4:00p.m., January 28, 2019.
    - Wind-down of agreements entered into prior to 4:00p.m., January 28, 2019.

“Secondary” Sanctions

- The U.S. government threatens sanctions against foreign funds engaged in certain transactions involving:
  - Russia
  - Iran
  - North Korea
  - Hezbollah
- The U.S. government can impose these “secondary” sanctions on foreign persons regardless of any U.S. nexus to the transaction.

U.S. State Divestment Sanctions

- A number of U.S. states maintain sanctions against firms that do business in sanctioned jurisdictions, particularly Iran and Sudan.
- State sanctions will limit public investment (including state pension funds) in funds on those lists.
- Inclusion on a state list for investments in a sanctioned jurisdiction could result in loss of U.S. investment and reputational damage.

50 Percent Rule

- For both SDNs and SSIs, the restrictions apply to any entity owned 50 percent or more by an SDN or an SSI.

Sberbank

Owned 50% by Sberbank

Owned 20% by Sberbank

Owned 80% by immediate parent

Owned 100% by immediate parent

Owned 10% by immediate parent; 40 percent by Gazprombank

Owned 10% by immediate parent; 40% by Igor Sechin

50 Percent Rule

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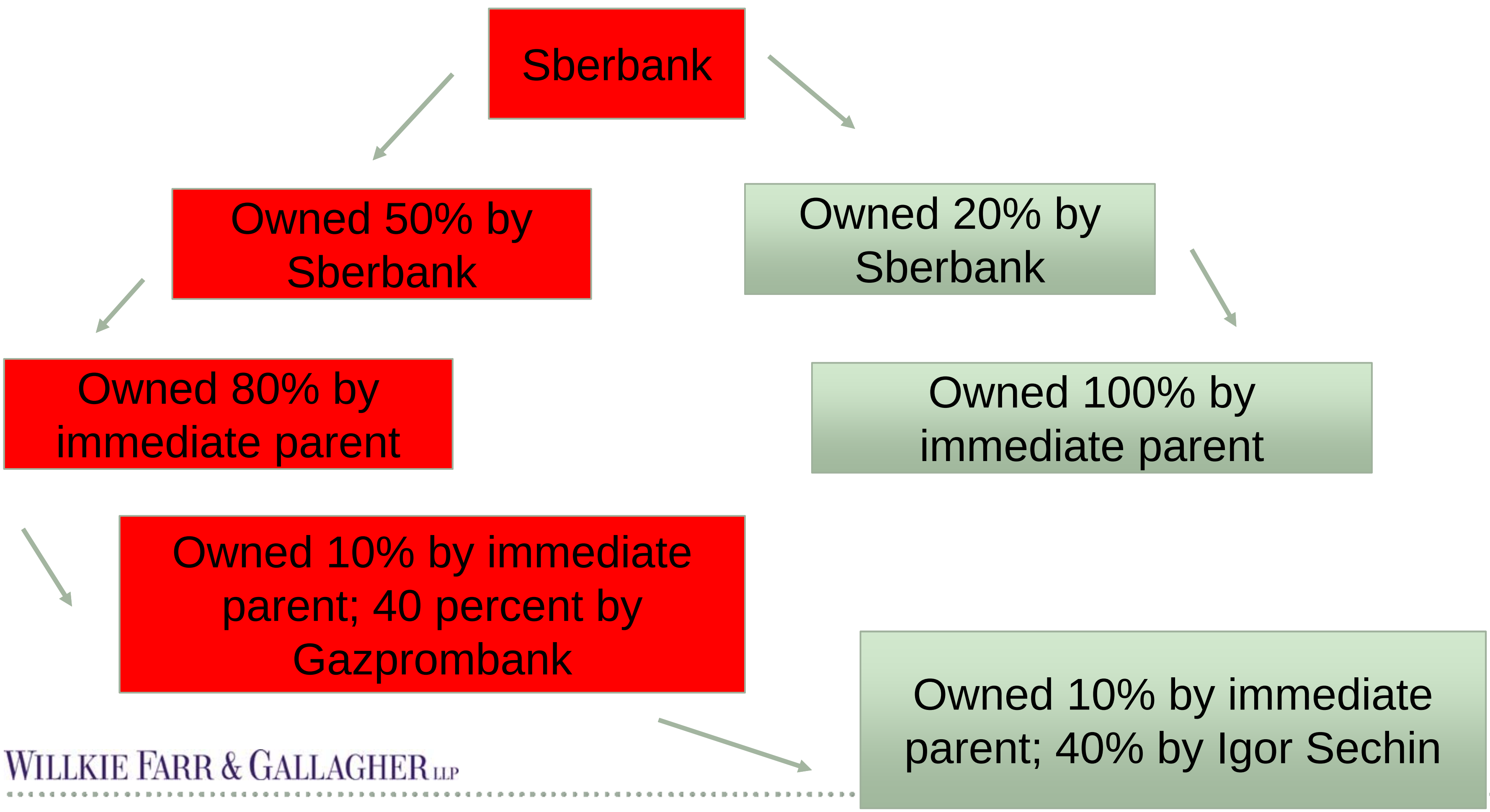

Dealing with New Investments?

- Sanctions are strict liability, but OFAC expects a “risk based approach” when deciding whether an enforcement action is warranted.
  - “Risk based” assessments will likely vary dramatically depending on the nature of the fund, from private equity to public investments.
- What if the investment company has business with a sanctioned jurisdiction, entity, or individual?
  - Should be part of the diligence process to discover this.
  - Not necessarily prohibited for a U.S. fund (or a foreign fund facilitated by U.S. persons) to invest in such a target.
    - How will the investment be allocated?
    - Is the business with sanctioned parties “limited”?

Dealing with Potential Investors?

- Sanctions screening should be part of any KYC process to onboard investors.
  - Subscription software services incorporate all sanctions lists, as well as research on any entities owned 50 percent or more by a sanctioned person.
  - Screening should include beneficial owners of potential investors.
  - The SDN List changes almost daily, so screening should be dynamic.
- Screening is generally the role of a transfer agent, administrator, or broker dealer. Important to confirm roles at the inception of the relationship.
- Consequences if an investor is sanctioned?

What if Something Goes Wrong?

- Investigate and remediate
  - Part of a "risk based approach"
  - Stem any further violations
  - Do compliance practices need to be updated?
- Decision to voluntarily disclose
  - Approximately 50 percent discount of base penalty
  - Could result in significant follow-up from OFAC
- Is reporting to OFAC required for blocked property?

Questions

Contacts

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Benjamin J. Haskin is a partner in the Asset Management Group. Benjamin advises mutual funds, exchange-traded funds, private and offshore funds, investment advisers and broker-dealers on a wide range of investment management issues, including compliance, corporate governance and regulatory matters. He represents fund boards of directors and regularly conducts internal reviews on behalf of investment companies and investment advisers. He additionally advises investment managers on matters related to the purchase and sale of advisory businesses.

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David Mortlock is Chair of Willkie's Global Trade & Investment Practice Group in Washington. He advises clients on international trade and government regulation of cross-border transactions, particularly the intersection of economic regulation and national security.

David helps clients pursue their business goals in compliance with foreign policy and national security-based regulation, including:

- Compliance with U.S. economic sanctions, export controls, and anti-money laundering regulations;
- Navigating the CFIUS review process, including both voluntary and mandatory filings;
- Internal investigations for potential violations of statutes and regulations;
- Self-disclosures of apparent violations to enforcement agencies;
- Criminal and civil enforcement actions;
- Development of compliance programs;
- Due diligence for compliance by investment targets, vendors, and other partners; and
- License requests with the Departments of the Treasury, Commerce and State.

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