28

Office of Financial Sanctions Implementation
HM Treasury
Horse Guard's Road
London
SW1A 2HQ

23 January 2017

Dear Sir/Madam,

Consultation on the process for imposing financial penalties for breaches of financial sanctions

We are grateful for the opportunity to respond to your consultation on the process for imposing financial penalties for breaches of financial sanctions dated 1 December 2016 ('the Consultation). We set out our responses below against each question in the Consultation.

Question 1

Do these introductory sections give you enough information to understand the scope of the law on monetary penalties? What else would be useful?

Response

targets a considerable amount of resource to compliance with the law on financial sanctions and mitigation of financial crime risk more broadly. For this reason, we welcome all practical guidance that is provided by HM Treasury and other competent authorities in the jurisdictions in which we operate as greater certainty is beneficial to business in governing actions and informing decisions as to where to target resources.

We find section 1 of the consultation paper useful in describing the parameters of the law on monetary penalties. There are however two areas, both in paragraph 1.7 where we believe further clarity would be beneficial.

i) **Paragraph 1.7 states that the regulations may be enforced in situations where there is a "UK nexus". We believe that the greater the extent to which this can be defined by OSFI, the greater the certainty and therefore the benefit to business there would be. For example, we believe on the one hand that overseas branches of a UK company would in principle constitute a "UK nexus". By contrast, we believe that certain factors (including if for example a company merely had securities traded on a UK exchange or alternatively, merely held assets in the UK) should not, in isolation, bring**

a company's operations in their entirety within the purview of OFSI- albeit they could in theory constitute a "UK nexus". For this reason, we would welcome greater specificity in this area. Please also see our response to question 4.

ii) The areas listed in paragraph 1.7 of the Guidance define those persons against whom financial sanctions may be enforced. Each person (separately delineated, it appears to us, between semi-colons) appears to have a "UK nexus" other than the statement that the sanctions regulations may be enforced against "companies or entities present in or dealing with other countries". Taken in isolation, this would not appear to suffice to fall within OFSI's remit. It would be helpful if it expressly stated for example that OFSI's remit extended only to entities present in other countries, where there was additionally a "UK nexus".

Question 2

What are your views on OFSI's compliance and enforcement approach?

See response to question 3 below.

Question 3

Is there anything else you would expect a compliance model to tackle?

Response to questions 2 and 3 taken together-

We are supportive of OFSI's approach. We particularly welcome the reference in paragraph 2.5.1 to the intention to engage with the private sector. We believe that compliance in this field works best where there can be open dialogue between business and a competent authority. To this effect, we particularly welcome the intention stated in paragraph 2.5.4 to "provide a better service for the private sector and help ensure that financial sanctions are understood". In this regard, it is difficult to overstate the value to business of swift guidance from OFSI on whether a potential course of action is permissible, requires a licence or would not be permitted under sanctions enforcement.

Question 4

Do you understand our proposed case assessment approach?

Response

Subject to the points set out in this response, we believe that we do.

We understand that the purpose of the test in paragraph 2.7.2 is to ensure that an objective standard is applied. We believe that in other legal tests we have seen, the term "reasonable cause to suspect" is an objective test- hence the insertion of the word "reasonable" into the text. Our

view is that it covers situations where a person either suspected or *should have* suspected a breach. However, the clarification at paragraph 2.7.2 does not appear to support this view and seems to suggest more of a subjective test, referring to a situation where a person "does not have clear confirmation of an event, but they *are* [our emphasis] aware of something that can prompt them to think it may have happened". To this aim, we believe that the final guidance should be explicit on the point of whether OFSI regards the second limb of the test in section 131(1) of the Act to be a subjective or an objective test. We believe that the "objective test" approach works well in many other areas of legal compliance and is well understood by the courts and other competent authorities.

We would also be grateful for clarity on whether, as set out in paragraph 2.7.4, a local subsidiary of a UK parent company would by definition and on this fact alone fall within OFSI's enforcement remit. While we would expect an overseas subsidiary of a UK parent if, for example, it acted on the direction of its parent company or at the behest of officers who were British nationals to be a matter for OFSI, we would not expect an overseas subsidiary- ie a distinct legal person incorporated outside the United Kingdom- of a UK company (ie its shareholder) to fall within OFSI's enforcement remit if this were the sole "UK nexus". Here, we would expect the subsidiary company to fall under the auspices of the competent authority for sanctions enforcement in its own country of incorporation. We believe that it would be logical, for example, that if an Australian incorporated publicly quoted company were majority owned by British shareholders and that this were the only "UK nexus", that the competent authority for such company would be OFSI's Australian counterpart rather than OFSI itself. Indeed, this reflects the position we have understood from previous correspondence with HMT.

We would like to highlight the section "Applicability of financial sanctions" from OFSI's December 2016 publication "Financial Sanctions Guidance" which states-

"All UK nationals and UK legal entities established under UK law, including their branches, must also comply with UK financial sanctions that are in force, irrespective of where their activities take place.

Subsidiaries which are incorporated under EU or UK law must comply with EU and/or UK financial sanctions that are in force, irrespective of where their activities take place".

We note that there is no reference to the UK regime applying (save in respect of an EU incorporated company for EU sanctions purposes) to subsidiary companies incorporated in a jurisdiction other than the UK.

It may be the case that in certain jurisdictions, a locally incorporated company will be obliged under law or regulation to pay a sum owing to a person who is on a UK (but not a local) sanctions list. Failure to do so could result in loss of a licence to operate or a court judgment enforcing a debt action. If a locally incorporated subsidiary company acting under local direction is prohibited from making such a payment by virtue solely of a majority UK shareholding, this would have a profound effect on UK parented groups, effectively preventing them from operating in many countries outside the UK. If OFSI were to pursue this approach, they would need to make this abundantly clear to UK business.

We believe that to depart from this principle opens the possibility of potential conflicts of laws, examples of which we have seen elsewhere in the world. For example, it would not be permissible for our Canadian operation to refuse cover solely on the basis of certain US restrictions. In common with other businesses, it is essential for our locally incorporated group companies to be able to operate within the local laws of the jurisdictions in which they are incorporated.

Question 5

What are your views on our proposed case assessment approach?

Response

We are supportive of an assessment regime that as the consultation paper states is "fair and proportionate". We support the fundamental approach of applying aggravating and mitigating factors to a set of facts. We also welcome the diverging positions that OFSI proposes to take between for example where "the breach has been caused simply by making a mistake" and a deliberate breach or a breach involving professional facilitation- the latter clearly being the more serious in our opinion.

We are supportive of the factors stated regarding reporting of a breach to OFSI. We understand the expectation that a breach should be disclosed in a timely fashion, noting the point that it is reasonable to take some to assess the nature and extent of the breach. We believe that it would be of comfort to those contemplating making a disclosure if the guidance also expressly stated that it is also reasonable to take some time to seek external legal advice. We believe that ultimately, this could also result in better quality breach reporting.

A paragraph which concerns us is the first bullet point in the section "Knowledge and compliance standards in the sector". It is unclear what sector is referred to in this heading. However, we are concerned that those sectors of the economy that have done most to develop compliance systems in this area will be the most harshly penalised, paradoxically because of their desire to be compliant in this area and/or within a broader regulatory framework. The consultation paper states that "...some sectors have more developed compliance systems and processes than others, because of the work they do. OFSI believes it is reasonable to take into account if and how this may apply and be evidenced when it considers the case". We note that this provision sits separately to the subsequent bullet point expecting regulated professionals to meet their regulatory and professional standards. We believe that to penalise further a sector which has done more than some others to seek to comply in the field of financial sanctions is illogical and militates against the broader thrust of the case assessment approach which is to act fairly and encourage compliant behaviour. Further, we believe that to treat more harshly those sectors which already have more developed compliance standards will lead to perverse results. If, for example financial services were deemed to have more developed standards than say, import/export, retail, pharmaceuticals, minerals or oil and gas businesses, the approach suggested by OFSI may act as a disincentive on others to improve their own standards for fear of then being judged more harshly in the event of a breach. We believe that a standard approach across all sectors of the economy would be a far more successful route for OFSI here.

Separately, mindful of the statement in paragraph 2.8 that OFSI "wish[es] to encourage strong compliance cultures", we believe that having sought legal advice on a matter which later transpires to be a breach should be a mitigating factor on the part of a person who may have committed an infraction.

Question 6

Does this guidance give you enough information to help you understand how a penalty is calculated?

Response

We believe so. We interpret paragraph 2.11.10 as stating that as long as a person making a voluntary disclosure of a serious case affirms that a voluntary disclosure is materially complete, when it comes to assessing a penalty, a 50% reduction will *always* be applied. If there would be any instances where this would not be the case following voluntary disclosure of a serious offence, we believe it would be beneficial to state this expressly in final guidance.

Further, we believe that it may be useful to provide expressly that a greater reduction may be available depending on the relevant facts. Any fine should reflect the severity of both (i) the relevant breach; *and* (ii) the compliance culture and systems of the relevant company. We believe that the more flexibility OFSI has in this regard, the fairer the regime will be.

Question 7

OFSI will reduce the level of penalty if there is a voluntary disclosure. What are your views on OFSI's approach to this?

Response

We believe that this is a sensible approach and reflects other regulatory practices. We believe that greater clarity on the application of this process to penalties for information would be helpful. Paragraph 2.11.17 states that if OFSI imposes a penalty for an information offence, it will use the process in paragraph 2.11. The process in paragraph 2.11 is based on reducing a penalty in the event of a voluntary disclosure. Information offences are by their definition failures to disclose, or at least failures to disclose effectively. This is borne out by the bullet points at 2.11.14. Without further explanation, it is therefore difficult for the reader to understand how the reductions in penalty levels for voluntary disclosures apply for information offences.

Question 8

Is the process for imposing a penalty and making representations clear from this guidance?

Response

Yes, we believe so.

Question 9

Do you understand the guidance on seeking Ministerial review?

Response

Yes, we believe so. However, we believe that it would be helpful to receive clarity on the point at which payment is due in the event that a penalty is upheld by a Minister on review. Paragraph 2.12.25 states that once the Minister has decided to uphold a penalty,...the penalty becomes payable". We would be grateful for confirmation of our understanding that the 28 calendar day period to make payment begins from this point rather than the penalty becoming immediately payable as the review upheld a prior decision. Paragraph 2.16 of the guidance deals only with imposition of a penalty by OFSI rather than reference to it being upheld by the Minister.

Question 10

What are your views on the process for seeking a Ministerial review?

Response

We believe that the process set out in the guidance is clear.

Question 11

Does this guidance clearly explain why and how OFSI will publish information on penalties imposed for breaches of financial sanctions regulations?

What are your views on the level of information OFSI will publish?

Response

We believe that it is appropriate and broadly reflects the position in other areas of regulation.

Question 12

Considering the document as a whole, does this guidance help you clearly understand OFSI's approach to imposing monetary penalties?

Response

Yes, subject the points above where clarification is requested, we believe that it does.

Yours faithfully,