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EXPERT FORUM

ECONOMIC SANCTIONS COMPLIANCE AND ENFORCEMENT IN THE ASIA-PACIFIC MARKET

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R&C: Could you provide an overview of sanctions enforcement in the Asia-Pacific region? To what extent are regulators becoming more sophisticated, and stepping up their monitoring and enforcement efforts?

Wysong: Regulators in countries such as China, Hong Kong and Singapore are increasingly focused on the role that financial institutions play in detecting and reporting financial crime in the areas of sanctions, money laundering and bribery and corruption. Regulators have high expectations for the design and execution of sanctions controls, whether in banking, securities, insurance, or other sectors. This means hiring more staff and investing more resources in sanctions screening and training. Meanwhile, US regulators, at both the federal and state levels, have sharpened their focus on Asia-based financial institutions and corporates. New York State, in particular, has recently announced two major enforcement cases involving anti-money laundering and sanctions violations against Asian banks. The Office of Foreign Assets Control (OFAC) and the Department of Justice (DOJ) also recently took action against a China-based corporate and several individuals for dealings with North Korea. Other investigations are in the pipeline. These cases underscore the increasing enforcement risk for companies in Asia, as well as a more aggressive regulatory and enforcement posture on the part of sanctions authorities.

Linde: There is a common perception in the financial services industry that the signature standard for economic sanctions trends has been set by the United Nations (UN). There appears to be limited motivation for countries to develop autonomous sanctions lists, rather choosing to adopt those imposed by the UN and US. As a consequence, regulators in Asia-Pacific have not imposed alternative standards of supervision and enforcement and tend to rely more on the application of the UN and US approach. It is also arguable that many countries still view UN sanctions as representative of US foreign policy and are perceived as activity by the US to try and give 'teeth' to the UN proclamations. There have been some 'enforcement' shifts by regulators, notably in Singapore and Australia. The Monetary Authority of Singapore (MAS) recently included sanctions as part of its financial sector compliance reviews, placing forth the requirement for a minimum of two foreign banks to conduct sanctions investigations. In Australia, there is an ongoing review on the shifting of regulatory responsibility with respect to sanctions from the Department of Foreign Affairs and Trade (DFAT) over to AUSTRAC, the Money Laundering Regulator.

Arboleda: Most of the sanctions enforcement cases in Asia-Pacific are the result of either a US

enforcement action, due to the extraterritorial reach of US sanctions regulations, or the local implementation of UN sanctions. This is owing to that fact that most of the countries in the region do not have autonomous sanctions regimes. Having said that, many of these cases have a nexus to countries known to be supporting proliferation activities. There is an increased focus on every possible connection with Iran and North Korea and on how these countries use their network to support illicit transactions despite ongoing sanctions. One of the more notable enforcement cases in 2016 was the Philippine's seizure of a North Korean ship in response to tougher new UN sanctions against North Korea's recent nuclear and ballistic missile tests. The ship was inspected twice by UN experts using an electronic weapons sensor and when no arms, explosives or other banned substances were found, the ship was then allowed to go.

Sumilas: There are a number of sanctions regimes that could affect companies operating in the Asia-Pacific region. The major ones tend to be the US, the UN, the UK and the European Union (EU). The sanctions regimes generally target countries, individuals and entities allegedly involved in issues such as human rights abuses, nuclear threats and state-sponsored terrorism. Examples of countries subject to sanctions under the various regimes relevant to the region include North Korea and Iran. US sanctions against Myanmar were recently lifted. In general, the regulators in the US remain the most aggressive in terms of enforcement. As the US sanctions regimes tend to be broad and extraterritorial in nature, even non-US companies and financial institutions have recently found themselves subject to high profile investigations and massive fines.

R&C: How would you describe the general level of sanctions awareness among companies operating in the Asia-Pacific market? What methods can companies use to keep abreast of regulatory developments and current restrictions?

Arboleda: Generally, multinational companies have robust sanctions and export control compliance programmes, so there is a high level of sanctions awareness among their employees. Where these is a huge disconnect with respect to awareness is in the small and medium enterprises (SME) sector. SMEs are normally targets of proliferators due to their low level of sanctions and export control awareness. This is the reason why regulators in the region have recently shifted their focus on education of SMEs and in giving them the needed support to ensure they are kept abreast of export control developments and are aware of how to comply with sanctions. To keep updated with regulatory changes and new restrictions, companies can join local trade groups

where they can share best practices and benchmark against each others' sanctions compliance programmes. A network of trade compliance professionals who are willing to share knowledge and information can go a long way.

Sumilas: Generally, the level of sanctions awareness is high among multinational companies and financial institutions operating in the Asia-Pacific market. We have found that such companies are generally aware of the risks for a few reasons. First, there have been a number of high-profile sanctions enforcement actions against banks, including non-US banks. As a result, those banks have low risk appetites for processing transactions that may involve sanctioned countries, entities or individuals. Second, if a company operating in this region enters into contracts or joint ventures (JV) with US-based companies or companies that must comply with the various sanctions regimes, those contracts or JV agreements often include provisions regarding sanctions compliance. By comparison, the level of awareness among Asian companies on sanctions issues tend to be lower and more needs to be done to incorporate sanctions compliance into their existing programmes. Companies can stay abreast of regulatory developments by regularly checking information posted by enforcement agencies, such as the OFAC, on their websites and by working with legal counsel who have a sanctions-related practice.

Linde: There appears to be limited awareness among local non-bank financial institutions and other corporates operating in the Asia-Pacific region. These include exporters of high risk goods, like explosives and armaments, where there may not be full appreciation of the importance of adhering to sanction controls. As regimes and sanctions lists are continually evolving, including the creation of new sanctions and the lifting of old ones, it is important for companies to stay on top of the latest developments to navigate and mitigate risk while doing business in Asia-Pacific. The strategy for sanctions compliance really should operate on a risk-based continual loop. This means that information

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> *Lino Arboleda, GE*

obtained from the results of sanctions screening, regulators, industry peers, internal audit, compliance reviews, and any other relevant sources should feed back into the consideration of the sanctions risk assessment and the strategy for the organisation.

Wysong: The level of awareness often varies according to the market and the nature of the company. Financial institutions and corporates based in North America and Europe with operations in Asia are among the most aware in terms of sanctions compliance. However, inquiries from parties based in countries throughout Asia are growing. This includes many parties in ASEAN countries and China, for whom sanctions compliance is becoming increasingly relevant. Much of the interest is driven by new business opportunities following the implementation of the Joint Comprehensive Plan of Action with Iran and the termination of US sanctions against Myanmar. The recent US presidential election has been another major source of interest. Our advice is to take a forward-looking approach to sanctions compliance. We encourage companies to build processes that are responsive to change. This includes designating teams for monitoring regulatory changes and identifying trusted sources of information.

R&C: Have any recent, high-profile sanctions violations caught your eye? What lessons can we learn from such cases about the risks companies face in this area of the law?

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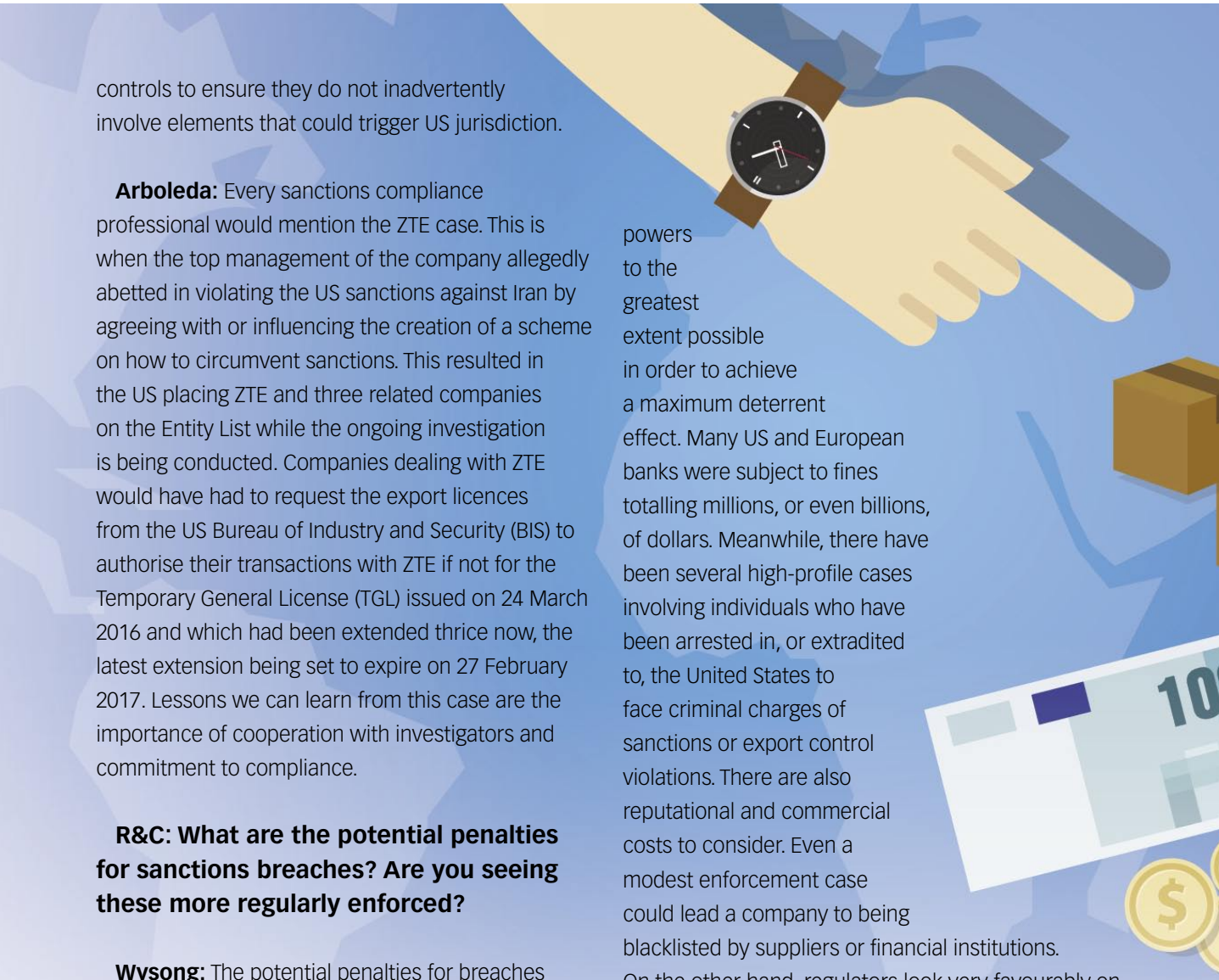
> *Chris Linde*
> *Deloitte Risk Advisory Pty Ltd*

Linde: There has been an increasing level of high-profile sanction violations that demonstrate how a breakdown in effective controls in any aspect of a sanctions compliance programme may place companies at risk of a breach. Even simple agricultural goods to a sanctioned country like Iran can create a regulatory issue. This underlines the importance of establishing clear system based controls that ensure the accurate recording of end-users and beneficiaries including geographies

and testing against sanctions lists, even for those that deal in goods that are not military or dual-use goods. Companies must have sound due diligence processes, especially in high risk jurisdictions. There is an increasing expectation from regulators that transactions will be rigorously scrutinised in regard to beneficial owners and controlling interests. Perhaps the highest profile sanctions violations in Asia-Pacific recently were the prosecutions by the US on Chinese firms suspected of breaching economic sanctions on North Korea.

Sumilas: The headline grabbing settlements reached by some UK and European financial institutions since 2012 are quite significant, including penalties in the billions. Additionally, there have been some recent enforcement actions involving China. In November 2016, the New York Department of Financial Services (NYDFS) imposed a $215m fine and an 18-month corporate monitorship on a Chinese bank. Also, in April 2015, a multinational oilfield services company entered into a settlement agreement with US regulators and agreed to pay $233m for alleged sanctions violations by its British Virgin Islands entity in connection with work done in Iran and Sudan by a US subsidiary. These settlements demonstrate that non-US entities are squarely in the crosshairs of US regulators, including both federal regulators such as OFAC and the DOJ, and state regulators such as the NYDFS.

Wysong: The NYDFS' recent enforcement actions against banks headquartered in Taiwan and China provided yet another reminder of how complex the regulatory environment has become. While the focus is normally on US federal regulators, New York State has been particularly aggressive in recent years in enforcing its banking regulations. Financial institutions with US branches must ensure that their overseas employees have adequate resources and authority to implement strong sanctions compliance controls in accordance with local regulations. Failing to do so could be a costly mistake. Companies should exercise special care when doing business with US persons, US-origin goods or the US financial systems. The DOJ indictment of a Chinese firm and its executives for violations of sanctions against North Korea is especially instructive in this regard. In that case, the DOJ asserted jurisdiction over the activity because the Chinese company had routed certain transactions through the US financial system. Similarly, there are at least two ongoing criminal trials in the United States involving foreign nationals who engaged in US dollar transactions with Iran. Although the activities took place outside of the United States, the DOJ has asserted jurisdiction because the transactions took place in US dollars that cleared through the US financial system. Many companies in Asia choose to do business with countries that are sanctioned by the United States or with sanctioned persons. They should implement strong internal



controls to ensure they do not inadvertently involve elements that could trigger US jurisdiction.

Arboleda: Every sanctions compliance professional would mention the ZTE case. This is when the top management of the company allegedly abetted in violating the US sanctions against Iran by agreeing with or influencing the creation of a scheme on how to circumvent sanctions. This resulted in the US placing ZTE and three related companies on the Entity List while the ongoing investigation is being conducted. Companies dealing with ZTE would have had to request the export licences from the US Bureau of Industry and Security (BIS) to authorise their transactions with ZTE if not for the Temporary General License (TGL) issued on 24 March 2016 and which had been extended thrice now, the latest extension being set to expire on 27 February 2017. Lessons we can learn from this case are the importance of cooperation with investigators and commitment to compliance.

R&C: What are the potential penalties for sanctions breaches? Are you seeing these more regularly enforced?

Wysong: The potential penalties for breaches of US sanctions range from no-action letters to criminal fines or imprisonment, depending on the circumstances. Over the past 10 years, we have seen that US authorities are more willing to use their powers to the greatest extent possible in order to achieve a maximum deterrent effect. Many US and European banks were subject to fines totalling millions, or even billions, of dollars. Meanwhile, there have been several high-profile cases involving individuals who have been arrested in, or extradited to, the United States to face criminal charges of sanctions or export control violations. There are also reputational and commercial costs to consider. Even a modest enforcement case could lead a company to being blacklisted by suppliers or financial institutions. On the other hand, regulators look very favourably on voluntary self-disclosures, especially when they are accompanied by robust internal investigations and remedial measures.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Arboleda: Depending on the nature and severity of the violation, civil or criminal penalties or both could be imposed. This can be a combination of monetary fines on companies and imprisonment for individuals. Non-financial penalties include denial of export privileges, seizure of goods, denied access to the US financial system, property blocking and asset freezing and appointment of an external compliance or legal counsel monitor – all of which could result in substantial revenue loss to the company. The most recent enforcement case in the region was that involving a Singapore company, Chinpo Shipping Company, which was fined $80,000 by a Singapore district court for transferring funds to facilitate the passage of arms concealed in a shipment of sugar from Cuba through the Panama Canal destined to North Korea. This also resulted in Singapore banks acting swiftly after the conviction by closing all personal bank accounts of all the directors and shareholders of Chinpo.

Sumilas: Penalties vary depending on the statutes violated and the enforcement agencies involved. For example, for violations of the International Emergency Economic Powers Act, which generally applies for most US sanctions regimes, penalties are $250,000 or twice the transaction value, whichever is greater, per violation. As penalties can be based on the value of the transactions, the values can quickly escalate and the US regulators have not been hesitant to impose massive fines. In addition, other fines for similar conduct have ranged into the hundreds of millions. Additionally, individuals can face imprisonment for criminal violations. There are also a number of potential collateral consequences, including denial of export privileges, bans from participating in state contracts, private civil lawsuits, adverse publicity and scrutiny from other regulators.

Linde: As sanction regimes become more regularly deployed by countries to enforce political and security policy aspirations, such as efforts to limit Iran's nuclear weapon proliferation, the focus has transitioned to regulatory enforcement. The bar for sanctions compliance has been substantially raised.

Increasing regulatory enforcements add to the pressure. US regulators now impose penalties 'per transaction' that has led to billions of dollars of fines from the failure of major banks to comply. In Australia, individuals can be punished by up to 10 years in prison or fined more than $450,000 or even three times the value of the transaction. For corporates, it would be $1.8m or three times the value of the transaction. Without doubt, there is a greater challenge and pressing need for organisations to take deliberate and overt steps to maintain a sanctions compliance programme that meets regulatory expectations.

R&C: What advice can you offer to companies on creating and maintaining effective sanctions compliance policies

and procedures? Should more be done to strengthen internal controls?

Arboleda: Sanctions compliance policies and procedures must be created based on the company's structure and nature of products and services that it offers. There are various templates that have proven to be effective on which a company can pattern its programme. What is challenging is implementation and maintenance and ensuring that the programme continues to be effective in the midst of a changing regulatory landscape. Export control and sanctions compliance should be part of the code of integrity. Employees should be aware of the 'dos and don'ts' and also know and understand what to do when faced with a transaction concerning sanctioned destinations or denied parties. For a sanctions compliance programme to be effective, there should be an open reporting mechanism in place, one that encourages employees to raise a concern about potential sanctions violations, even anonymously, without the fear of retaliation.

Linde: There are two critical issues that a company must address. The first step would be to identify the global and domestic economic and trade sanctions that would apply to a business. Once the relevant regulations and sanctions are known, then detailed checks of all parties involved in the jurisdiction in which the business transaction will touch become critical. Should there be an identified risk, the next step is to perform a comprehensive risk assessment of all the counterparties and determine all possible sanctions involved. This includes the risk of a sanction being applicable and the value chain assessment of all sanctions risks that might affect the business.

Sumilas: A sanctions compliance programme needs to be specific to unique risks that each entity faces and should appropriately mitigate those risks. Key aspects include conducting an internal risk assessment, including high-risk regions, transactions, such as those involving US jurisdictional nexus, and customers, developing appropriate written policies and procedures and appointing designated compliance officers to manage the programme. The company will also need to communicate the programme to employees through training. On ongoing basis, the programme should include processes for conducting appropriate due diligence and screening on third parties, instituting a system of internal controls and recordkeeping for relevant transactions; developing a system for receiving and managing internal reporting of potential violations, and implementing a system of testing, monitoring and internal audits to ensure employees are properly following the required policies and procedures. Investigations of such issues often require regulators to 'follow the money', thus implementing appropriate

internal controls is a key component of such a compliance programme.

Wysong: Companies need to create sanctions programmes that are appropriate for their businesses. This is especially important in Asia, where international companies operate within many different cultures and languages, not to mention different regulatory systems. Complex regulations have to be boiled down into simple principles that can be understood and operationlised equally well by staff across compliance, operations, technology and business organisations. There is no one-size-fits-all approach. What works for a financial institution may not work for a shipping company or a manufacturer.

potential merger, acquisition or joint venture targets for potential sanction issues. Additionally, companies with a global customer base or extensive network of agents or traders should consider implementing formal or structured due diligence procedures to manage the number of third parties. With respect to screening, this should be done for all third parties – agents, vendors, customers and other business relations – against the OFAC SDN list and other prohibited party lists. Companies can also consider using service providers that also track ownership holdings of SDNs which can help identify high risk transactions. Additionally, because the SDN and other prohibited parties lists can change, it is necessary to rescreen existing third-party agents, vendors and customers periodically.

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> *Wendy Wysong, Clifford Chance*

R&C: How important is it for companies to stringently screen third parties and trading partners through effective due diligence? What other steps can companies take to reduce the likelihood of breaching sanctions?

Sumilas: Conducting thorough, risk-based due diligence and screening partners, on a periodic basis, is paramount for ensuring compliance with sanctions regimes. These steps include conducting due diligence on all transactions including customers and

Wysong: We have seen a number of enforcement cases in the past few years involving failures to adequately conduct due diligence on third parties. In terms of US sanctions, there are two things to keep in mind. First, a person can violate a sanctions regulation by engaging in a transaction where they should have known about the involvement of a sanctions target. For example, the information could have been readily available. Second, entities that are more than 50 percent owned by one or more sanctioned persons are also deemed to be sanctioned. This means that companies must know their counterparts, whether they be customers, suppliers, shipping companies or otherwise. This includes knowing who their beneficial owners are. A rule of thumb is that regulators will expect you to be accountable for any information which can be discovered through a reasonable search. In some cases, an internet search will be sufficient.

Linde: It is critical to rigorously screen suppliers, agents and customers at both the time of on boarding of the customer or supplier, but also on an ongoing basis to reduce risk of any third parties being subsequently added to a sanctions list after the initial screening. However, automated screening is only part of the effort. It is equally important to train employees in the fundamental purpose of sanctions screening and the facilitation of effective screen and controls. Many breaches are observed not because of failure of screening technology but because of inadequate or lack of human knowledge or intervention in dealing with alerts.

Arboleda: Watchlist or denied party screening is a very important part of a sanctions compliance programme. Companies can use third-party screening tools to automate the whole screening process or adopt a manual screening process. Principal countries such as the US, EU and Australia have since issued a consolidated screening list and made this available on their websites as an online screening tool that a company can access to screen trading partners. While these tools help immensely, setting screening parameters should continue to be done to efficiently capture any changes in the government watchlists. The timing of screening is critical especially if the deal involves projects that have multiple parties and a longer fulfilment period, in this scenario re-screening is highly recommended. Sanctions and export control compliance is owned not only by the legal and compliance team but by all functions affected by it. It is crucial that all functional teams are aware of the policy and procedures surrounding sanctions compliance. It is good to have a team of function representatives who serves as compliance champions for the company and who mentor other employees to raise concerns whenever they see red flags or when they spot potential violations.

R&C: How should companies respond if they are the subject of a sanctions-related investigation?

Wysong: Good communication is the key to a successful sanctions investigation. This means communicating effectively with all relevant stakeholders, including regulators, while also taking steps to protect privileged information. The importance of engaging legal counsel as soon as a potential sanctions breach becomes apparent cannot be underestimated. A crisis management team should be assembled with the authority to manage the investigation and make decisions. Data sources, including emails, transaction records, and other relevant information, should be identified and secured as soon as possible. Regulators increasingly expect companies to conduct an internal investigation and to undertake remedial actions, including employee discipline, where necessary. Regulators also value transparency and cooperation.

Arboleda: As previous enforcement cases have demonstrated, cooperating with the investigators has always resulted in lesser fines and penalties. The first thing that a company should do when confronted with an investigation notice or summons from the regulators is to understand the scope of the request and respond right away, to acknowledge receipt and indicate that the request is being addressed. An internal investigations team with clear and defined roles and responsibilities can be created for this purpose. This team will lead in identifying all possible sources of data and information and in ensuring that evidence and documents are maintained. They will also be managing all communications with respect to the investigation including maintaining an open line of communication with the government investigators to ensure that requests for information are addressed in a timely manner.

Sumilas: Two key issues that regulators will want to know from companies subject to a sanctions-related investigations are whether the misconduct is ongoing and what steps the company has taken to preserve data. Companies should therefore ensure that the misconduct is stopped and that all relevant data, in both electronic and hard forms, are preserved. After that, the company should then develop an investigation work plan that lays out key investigation steps including scoping the investigation and identifying key custodians and sources of data. Then the company can collect and review the relevant data, conduct interviews of key employees and third parties, and report to the appropriate stakeholders. Having a full understanding of the facts and legal liability analysis is necessary for then managing interactions with government regulators. Other key issues in investigations that may require local law advice include legal privilege,

employment law, data privacy, state secrets, and local enforcement and reporting issues.

Linde: Companies need to be timely, transparent and cooperative as this can impact the size of any penalty that a regulator might levy. When faced with a sanctions investigation, there are some key considerations that companies should be careful to apply. First, consider the scope of the investigation. Identify if the breach can be localised and focus investigations there. Regulators often ask "so have there been others like this one?" Consider whether you need to do a broader transaction analysis. Have you engaged consultants and legal counsel who have relevant experience in large scale sanctions investigations? Dealing with multiple regulators will be complex and navigating different requirements can be a huge task. Consider whether legal professional privilege applies and should be adopted for the investigation. Resist the temptation to over invest in 'ad hoc' investigations, as this will complicate investigations in the longer term. Make your initial investigation thorough and it will save you time and costs in the future. What penalties may apply to you? Refer to OFAC's penalty matrix for guidance. Improve your sanctions compliance programme immediately. Remember that the regulator often already has the 'other side of the transaction' as they regularly request transaction details from banks they investigate.

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>
> *Paul Sumilas,*
> *Norton Rose Fulbright LLP*

R&C: How do you envisage the economic sanctions compliance and enforcement landscape in the Asia-Pacific region developing over the next 12 months or so? Are there any specific trends you expect to see?

Linde: Given the recent winding back of sanctions for Iran and Myanmar, we expect to see more businesses ramp up dealings with these countries. Improved controls will be needed, especially when blanket bans that were previously in place, and also more easily enforced, will now be crafted with limited and specific sanctions, drawing the need for businesses to exercise a higher level of

vigilance. The widening of the Russia sanctions will continue to pose challenges. Governments in Asia-Pacific are quickly realising that the development of autonomous sanctions lists without requisite supervision and regulatory enforcement is somewhat limited. Using Australia as an example, there has been developments which have seen AUSTRAC take over the supervision and enforcement of Australia's autonomous sanctions regime in the next 12 months, up to 2018. This is a notable change in the Australian regulatory landscape. Looking ahead, the need for a robust sanctions compliance programme is crucial. Companies will do well to perform comprehensive risk assessments and find the best way to future proof themselves against breaches from new sanctions.

Arboleda: In most of the jurisdictions in Asia-Pacific and elsewhere in the world, sanctions programmes are part of export control regimes. As more and more countries are implementing export control laws and regulations, so did the increasing effort in enforcement of UN multilateral sanctions or adoption of autonomous sanctions. The Philippines, for example, is expected to implement its Strategic Trade Management Act in 2017. The law was passed in 2015 pending final issuance of implementing rules and regulations (IRR). The draft IRR contains a provision on end-use control when the item or technology is intended for destinations subject to UN sanctions or to prohibited or restricted end-users. Thailand's law on Trade Management of Dual-use Items will come into effect in 2018. Indonesia and Vietnam are expected to follow suit.

Sumilas: From a US perspective, the sanctions regime is an important, and often-used, centrepiece of foreign and national security policy; the OFAC regulations are imposed by executive orders issued by the president and the US will undergo an administrative change in January 2017. It is also possible that there may be changes to the economic sanctions compliance and enforcement landscape in the Asia-Pacific region in the next year. To date, president-elect Trump has made various statements about US foreign policy and in particular with respect to countries subject to current sanctions regimes, including Iran, Cuba and Russia. While it is difficult to predict exactly how his administration will approach these issues, we expect that the sanctions regimes with respect to those countries will be closely scrutinised and may be subject to changes.

Wysong: A lot depends on how the new US president chooses to use his powers to adopt, modify and terminate economic sanctions. If the United States diverges from its allies on questions concerning Cuba, Iran, Russia and Syria, the landscape may become very complicated. At the same time, the international community is more aligned on sanctions against North Korea under the direction of the UN. This is a trend that is likely to

continue. On the enforcement front, we expect US authorities to focus more on Asia and, in particular, on China. We would not be surprised to see several large enforcement cases in the coming year. We also expect parties to continue to commit resources to sanctions compliance while they will benefit from new technologies and services to achieve greater operational efficiency. The FinTech sector will be an exciting area of development. R&C