

FSA guidance on EU sanctions restrictions highlights growing compliance focus for regulated companies

May 21 2009 [David Lorello](#)



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The Financial Services Authority recently provided another reminder of its widening focus on legal compliance issues that affect regulated companies. On April 27, 2009, the regulator's financial crime and intelligence division issued a [report](#) on financial services firms' approach to UK financial sanctions. The report details the findings of a review that the FCID conducted, involving a survey of the compliance practices of 228 regulated companies. The report highlights the ways in which UK and EU financial sanctions restrictions can affect FSA-regulated companies, and outlines a range of best practices and compliance standards for companies to consider.

Background — financial sanctions in the UK

The UK and other EU member states implement economic sanctions controls that target certain designated individuals and entities. Designated parties include persons and entities that have been identified as supporters of international terrorism, weapons proliferation, or who have been deemed to be affiliated with governments that have been targeted for European or international sanctions (including, among others, Belarus, Burma/Myanmar, the Democratic Republic of Congo, Iran, and Zimbabwe). A consolidated list, which comprises nearly 2,000 sanctioned persons and entities across the various sanctions programs, is available for review on HM Treasury's Asset Freezing Unit's [web site](#). Many sanctions programs apply more broadly to cover any companies that designated parties own or control or act on their behalf, even if that company is not specifically identified in the list, so the scope of restrictions may, in some cases, cover persons and entities beyond those that appear on the HM Treasury list.

EU financial sanctions derive from a combination of EU regulations and United Nations Security Council resolutions, along with member state implementing legislation. Their overarching purpose is to deny restricted parties access to the EU financial system. The different regulations are not identical in scope, but they broadly restrict the provision of "economic resources" to targeted persons and entities — including, in some cases, the provision of financial services — and require the freezing of assets of designated parties that EU persons and companies come into possession of. Sanctions restrictions apply to all persons and entities that conduct business in the EU, including nationals of non-EU countries that act in the EU, as well as certain activities by EU persons and companies that occur outside the EU.

The FSA's attention to these issues highlights that financial sanctions restrictions are an important part of FSA-regulated companies' legal compliance responsibilities. The activities restricted under the sanctions regulations can include a range of standard banking and insurance transactions and services. The restrictions could apply to banks' or insurers' direct customers, as well as, notably, to customers that may be

several tiers removed, such as, for example, beneficiaries under group insurance policies, or under pooling arrangements or treaty-based reinsurance programs. Moreover, this area has gained importance in recent years as the number, geographic scope, and variety of persons designated under the various financial sanctions regulations has expanded. For example, the aggregated list of restricted parties now contains 12 entities located in the UK (including financial institutions, such as Iranian banks Melli and Sepah, which historically have had significant ties to the EU), as well as entities in a range of countries with high volumes of trade with the UK.

Non-compliance with UK and EU financial sanctions restrictions raises a range of criminal penalty risks, as well as significant reputational risks for firms. There also may be important commercial consequences, for example, if a firm engages in transactions with restricted parties and only learns of those designations after the fact, the firm may be required to freeze assets associated with the account, or take other action that could result in significant internal costs to the firm.

FCID findings

The FCID's report concludes that there are "inadequacies in firms' systems and controls to reduce the risk of a breach of UK financial sanctions in all size of firms across all financial sectors". The report highlighted a number of significant pitfalls, for example:

- A number of firms exhibited misunderstandings of the regulations, such as the view that low-value transactions were exempt, that regulated companies' anti-money laundering screening mechanisms are sufficient to cover financial sanctions risks, and that insurance services were not covered under the sanctions regulations. Those are all common misconceptions that, if not addressed, could lead to serious compliance breaches.
- Many firms had written compliance procedures in place, but the FCID found that company personnel had misunderstood many of those procedures or they were not being implemented adequately or were not subject to audits or senior management review (notably, the FSA cited non-compliance with existing company policies as one of the main issues the [£5.25m fine](#) that it imposed on Aon Limited in January of this year, for failing to implement effective anti-corruption compliance controls).
- The FCID found that many firms relied heavily on external service providers to conduct screening of restricted parties, but failed to fully understand the screening techniques that the external providers were using, or how those techniques matched up with the firms' individual risk profiles. The FCID also criticised firms for failing to conduct screening in cases where they took on a group of customers or beneficiaries from another FSA-regulated company, on the assumption (which the FCID found proved false in many cases) that the prior company had already conducted adequate screening.

Maintaining effective compliance

Firms with greater exposure in countries where EU and UN financial sanctions are in place should consider more focused transaction reviews and screening, with regular audits on the effectiveness of those measures; however, those are not the only firms that should be considering compliance measures. For any firm, the most important aspect of the sanctions compliance function will be determining how screening takes place, and how potential "matches" with restricted party names are resolved. The threshold questions of which parties to screen, how often, and when, are critical choices that senior managers should resolve, and will depend largely on the nature of the firm's business. If third-party screening services or software programs are used (as is the case for many large and medium-sized firms), the firm should have a clear understanding of how those resources are calibrated to evaluate whether a given name in a transaction "matches" the criteria (i.e., name, address, affiliation) of a restricted party designee. There are implicit risk-based choices built into any automated screening program, which the firm should know and endorse.

Firms also should be aware of other international financial sanctions controls that may apply to their operations. For example, firms with ties to the United States may be subject to the financial sanctions restrictions that the US Department of the Treasury's [Office of Foreign Assets Control](#) implemented, which have very wide international application for affected companies (including, in many cases, in transactions that occur entirely outside of the territory of the US). Moreover, staff who are responsible for administering the program should be trained to understand the nature of any applicable economic sanctions regimes, and

clear procedures should be implemented to resolve, in an efficient manner, any potential "matches" that arise. With appropriate attention to these issues, sanctions compliance can be managed effectively and with minimum disruption to a firm's operations.

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