STEPTOE **OUTSIDE COUNSEL**

New caution light for non-US banks' export control compliance

Sanctions compliance has always been challenging for international banks. Recently, US regulators flashed a new caution light aimed at banks' export control compliance, an area some banks may have overlooked in their trade finance business.

On 28 June 2022, the US Treasury's Financial Crimes Enforcement Network ("FinCEN") and the US Department of Commerce's Bureau of Industry and Security ("BIS") issued a rare joint alert. The Alert advised financial institutions regulated under the Bank Secrecy Act ("BSA") to identify and report potential attempts to circumvent the heightened US export controls restrictions against Russia and Belarus. Below, we highlight the implications for non-US financial institutions engaged in trade finance that may involve US export-controlled items.

Rising export controls-related risks for trade finance

Under the US Export Administration Regulations ("EAR"), jurisdiction is mainly based on the involvement of items subject to the EAR. Given that many non-US banks may be involved in financing, processing payments, or performing other services associated with international trade involving items subject to the EAR, these non-US banks are also required to comply with the EAR.[1]

Since 24 February 2022, BIS has expanded the scope of the existing export restrictions on Russia and Belarus. The Alert highlighted 16 "commodities of concern" that financial institutions should pay special attention to in their risk-based screening. These commodities include aircraft equipment, integrated circuits, oil field equipment, and cameras, which are subject to BIS license requirements prior to export or reexport to Russia or Belarus.

> The Alert marks the first time that the agencies have issued formal export control advice specifically for financial institutions.

Compliance suggestions in the Alert

The Alert advises that regulated financial institutions adopt a risk-based approach to trade finance and devote compliance resources to areas with greater export compliance-related risks. The Alert highlights 22 transactional and behavioral "red flags," which can be categorized into five types:

- Document inconsistency;
- Last-minute change of material details of transactions or rapid shift of business;
- Suspicious practices that are atypical or make little or no business sense;
- Large dollar or volume purchases, combined with other suspicious information;
- Activities with additional risks in terms of the business nature, product/service type, geographical presence, and parties involved.

Our observation and suggestions for non-US banks

The Alert marks the first time that the agencies have issued formal export control advice specifically for financial institutions. Although the Alert is directed at US-regulated financial institutions, it is equally applicable to non-US financial institutions engaged in trade finance. It signals BIS's expectation that both US and non-US financial institutions should adopt enhanced compliance measures in response to the heightened export control restrictions against Russia and Belarus. Failing to do so, non-US banks would be held liable under General Prohibition 10 for violating the EAR as a result of their "facilitation" of an export control violation; at the least, expect BIS subpoenas seeking information about customers' potential evasion.

Compared with sanctions, export controls requirements spawn unique challenges for trade finance. Export control screening requires greater investment in manual checks. Moreover, it is challenging for non-US banks to determine whether the goods in various industries are subject to the EAR. Further, information about the concerned goods could be dispersed over various trade documents such as bills of lading or letters of credit in a bank's possession, which may or may not be reviewed by a bank in the ordinary course of business. Compliance with the EAR will require burdensome efforts to consolidate and verify the information.

Following the Alert, BIS will expect non-US banks to:

- Familiarize themselves with the new export control restrictions;
- Evaluate their Russia- and Belarus-related businesses, and their involvement with the 16 "commodity of concerns" in their transactions;
- Update transaction screening

measures and procedures, and incorporate/enhance the escalation procedures for further identification and investigation of the nature of the goods;

- Conduct enhanced due diligence for high-risk customers/businesses – they may need to review and analyze the underlying transaction documents, paying special attention to the products/services involved, Russian counterparties involved (even their indirect customers), the end use/end-user/transportation method and transportation provider, among others; and
- In general, ensure that their due diligence, transaction monitoring, auditing, and recordkeeping mechanisms are updated to address these new risks and threats. ■

[1] General Prohibition 10 at Part 736 of the EAR makes clear that both US persons and non-US persons are prohibited from financing, aiding, abetting, or facilitating a transaction involving the export, reexport, and in-country transfer of items subject to the EAR, with knowledge of or having reason to know of a violation of the EAR in respect of those items.

About the authors:

Wendy Wysong and Ali Burney are Partners and Zoey Hong is a Law Clerk in the Hong Kong office of Steptoe.

www.steptoe.com