



## Rage against the regime

Angela Bilbow - 29 July, 2015

**With global financial sanctions now reaching an unprecedented level, Angela Bilbow casts a view over the consequences sanctions have on Channel Islands financial institutions, how they are being tackled and what lies ahead.**

Advising the financial sector on contentious, or potentially contentious, regulatory matters has created a shift, both of focus and of opportunity, for the traditional litigation practice to play an advisory role on helping clients navigate regulatory risk and remain compliant.

While regulatory advice straddles the divide between litigation and corporate mandates, one subset of important advice increasingly being sought is advisory work stemming from the impact of ever-increasing global financial sanctions.

Because the parameters of sanctions are broad – from restrictions up to outright prohibition – the wording in sanctions legislation is more difficult to interpret than, for example, in the more finely drafted wording of anti-money laundering legislation.

Some, like the Iranian sanctions, are straightforward – affording institutions a relatively clear view on whether or not to be involved in Iranian transactions, while others are less so. Russian sanctions, in particular, present a complex miscellany of rules which institutions have to dissect, presenting the finance sector multiple challenges in terms of risk, compliance and ongoing monitoring.

In addition, sanctions are not only confined to designated targets, like people or companies, they also extend to ‘known associates’ of targets, certain types of investment in sectors and jurisdictions, like Crimea or Sevastopol, and list dual-use goods that may appear for legitimate use, but which could also be used in the manufacture of nuclear weapons, for example.

### **A LEADING OFFSHORE FINANCIAL CENTRE**

With over GBP 200 billion in bank deposits, more than a trillion dollars in assets, and dealing with clients in over 200 countries, the well-regulated financial institutions of Jersey and Guernsey adopt a risk-based approach to sanctions; screening jurisdictions, clients and transactions of the most concern.

Jersey and Guernsey each have their own Financial Services Commissions (the JFSC and GFSC) which are responsible for checking that the Islands’ financial sectors have the correct compliance policies and procedures in place to cope with stringent regulation. They also have their own parliaments, with government departments that draft their own corresponding sanctions legislation – ‘Orders’ – which modify and give effect to **European Union**-issued sanctions.

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The Islands' corporate compliance culture is strong; not one banking failure came out of the Channel Islands following the recent global financial crisis, and so far there have been no prosecutions arising from sanctions breaches.

## THE COST OF SANCTIONS

The risks of breaching sanctions are high, transactions and company structures can span multiple jurisdictions and include various currencies, and breaches do occur. More often than not a reported breach goes no further if the institution making the declaration can show it maintained high standards of compliance. However, if a deliberate or completely negligent breach of a sanction occurs, or a breach goes unreported and is later discovered, then fines are unlimited and individuals could be liable for up to two years' imprisonment.

"A policy for regular screening is essential, i.e. not just when the business is taken on. Key events such as a change in directors, or changes to the business, should prompt re-screening. Also, sanctions lists are regularly updated so your initial screening may become outdated. The compliance emphasis is on a proportionate screening policy and on a clear audit trail showing the results of that screening," says **Stephen Baker**, founding partner at disputes firm **Baker & Partners** in Jersey.

Compliance is a huge financial undertaking; putting policies in place, ongoing monitoring and the use of sophisticated software that cross-references multi-jurisdictional sanctions lists is a necessity.

"A single client can present a catastrophic risk to the future of a regulated business, its directors, and to its staff through exposure of systematic failings," says **William Grace**, a Jersey-based financial services disputes partner at **Carey Olsen**.

"Regulation is always about the future, as you cannot change what has happened in the past," Grace says. "You need a triple lock which is: policies and procedures so you make the right decisions, policies and procedures so that even if nothing goes wrong you can still demonstrate to the [regulator] it was by design not luck, and policies and procedures so when it does go wrong you have the best defence and mitigation."

Adding to the workload, inconsistencies between designated targets on sanctions lists are not uncommon; the UK may add targets to its own list who are designated domestically because of links to terrorism or otherwise, but they may not appear on an EU or UN list, so there is a need to monitor consolidated lists from the UK, EU, UN, and OFAC if the transaction involves US dollars.

Institutions, then, find themselves between a rock and hard place in terms of compliance and the efficiency of ongoing monitoring, **Michael Adkins**, a financial services disputes partner at **Collas Crill** in Guernsey, tells *CDR*.

On one hand they have a client giving an otherwise lawful instruction at the time, but a new sanction or changed sanction may come into play during the process.

Finding a balance between the cost of efficiently operating as a business and maintaining effective systems and controls is challenging, says **Rob Knox**, a director at **Ernst & Young** specialising in financial services compliance.

"The cost to institutions of non-compliance with sanctions regimes remains unpalatably high, and the operational impact of increasingly complex sanctions measures is driving a higher cost of compliance," Knox says.

For some the cost is too high; lawyers *CDR* spoke to reported that some institutions had begun de-risking by applying a blanket ban on business from certain jurisdictions, for example Iran, in order to avoid the risk of losing licences, and that business is being accepted by institutions in other jurisdictions, even (ironically) in the UK. Should those sanctions relax, such clients would be hard to win back.

## DISPUTES

While the Channel Islands' financial sector has seen no actual prosecutions from sanctions breaches, disputes arising from financial sanctions are there.

In addition to helping clients analyse their approach to sanctions, **Lisa Springate**, a disputes partner at **Bedell Cristin** in

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Jersey, identifies that sanctions are not always the end of the road for clients: “We can challenge the over-zealous and unnecessary sanctioning of individuals, for example by following an EU appeal route. Often, the countries initiating the sanctions know their main target but take a scattergun approach to who else should be included. They also do not revisit that characterisation when circumstances change.”

More are expected, with disputes work generally tending to be about 18 months to two years behind the curve, says Adkins. “I am sure as we work through the range of structures that are out there – particularly legacy structures – there will be more disputes emerging from either between client and institution, or between institutions, clients and the regulator.”

## **THE ROAD AHEAD: RISK AND OPPORTUNITY**

The marked increase in the use of coordinated economic sanctions will continue to impact upon the Channel Islands’ financial sector. The territorial effect of these sanctions is far-reaching and has material consequence outside of the targeted state or territory.

“A really interesting area for us has been the effect of sanctions on trusts and other structures administered in Jersey. For example, whether asset trusts constitute a fund or economic resource of a designated person named in sanctions is not necessarily a straightforward question for a trustee if such designated person falls within the beneficial class of the trust,” says **James Campbell**, a trusts partner at Bedell Cristin who has increasingly worked alongside his colleague Springate due to a crossover in their practices.

Adkins predicts Russian activity on the horizon as Russian clients look to maintain tax efficiency in light of law reforms, known as de-offshorisation: “We can expect increased interest in more mature finance centres like Guernsey and Jersey which offer a flexible, innovative range of structures in which to hold and manage wealth, such as cell companies, foundations and private trust companies. There are risks and opportunities here,” he comments.

With de-risking on one side, and an increase of sanctions on the other, Grace sees a clash that is boxing in clients who are trying to do lawful business, like “shipping good things to good people in Syria”.

“The banks have been battered left right and centre so far as sanctions and risk go, the banks are not to blame, but it is squeezing honest, decent clients trying to undertake activities in accordance with Jersey and EU law,” he states.

While financial sanctions set out to achieve political goals of not feeding into terrorism, or a sanctioned country’s corrupt regime, it is difficult to say if they achieve the desired effect. Recent history, from the Rhodesian crisis onwards, shows that the force of sanctions tends to grow over time, as allies ratchet up the level of sanctions, without necessarily resolving the underlying dispute. Worse, a sanctioned jurisdiction, such as Russia, may impose its own sanctions abroad, hitting back.

A question remains as to how the financial sector’s appetite for risk might play out in the future with regards to how they approach those on sanctions lists. Particularly as some targets start to challenge their inclusion on sanctions lists and authorities have to adopt a different approach in response.

“It will be interesting to see over the next few years whether or not there is a change in the approach by some financial institutions with regards to individuals on sanctions lists. With the sanctions regime becoming more global, I think we are going to reach a more level playing field in due course, but that is going to take time,” concludes Springate.

## **JERSEY: CHIEF MINISTER’S VIEW**

Giving effect to sanctions measures in Jersey, the largest of the Channel Islands, is the Chief Minister’s Department (Department) of the States of Jersey is a key contact to Jersey’s financial sector for making statutory disclosures on freezing assets and sanctions breaches, as well as providing guidance.

Another core function of the Department is assisting in drafting sanctions legislation. With its own democratically elected parliament, Jersey is able to bypass the United Kingdom and give quick effect to European Union sanctions by drafting its own corresponding, modified Jersey Order, usually within days of the EU sanction being issued.

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“The complexity and the need to understand the legislation, and to have confidence and certainty to its interpretation, is the problem for the finance industry,” says **Mike Entwistle**, deputy director of international relations at the Chief Minister’s Department.

The problem is the frequency of changes, says Entwistle. “Every week new names are added to, or removed from, sanctions lists. For example, the United Nations adds names to Al Qaeda or Taliban sanctions, and although they are listed by the UN, they do not have legal effect in the UK or Europe until the EU has introduced a regulation.”

In addition, uncertainty can arise as to whether to make a sanctions disclosure to the Department or file a Proceeds of Crime suspicious activity report with the Jersey Financial Crimes Unit. “This is why it is important for financial institutions to know exactly which legislation they are dealing with, understand it and make the appropriate disclosure,” says Entwistle.

“Inevitably, I do not think financial institutions get it 100% right – it would be impossible to do so,” he notes, “what we want to do in Jersey is to make sure we have in place everything that is applicable in the EU, and nothing more because we want to make sure that, for example, banks are working to a standard set of rules; whether they are in Jersey, France or the UK, they know what those rule are”.

Reporting a breach is the right thing to do, and Entwistle believes that the institutions he deals with are well-versed in understanding the importance behind sanctions.

“Banks I speak to are very aware of situations, like in Syria, where there is abuse of human rights and mistreatment of the civilian population, and people are shocked and motivated by it and want to make sure they do not inadvertently allow any assets to go to the wrong people. They really care about that.”