Sanctions and export controls programmes: aligning for compliance effectiveness



Firms' sanctions and export control programmes have much in common. Recognising and building upon these similarities can help to drive effectiveness in both compliance functions, write Steve Klemencic, Chris Sidler, and Valtteri Tamminen.

Each year, the US Department of the Treasury's Office of Foreign Assets Control ('OFAC'), which administers US sanctions, and the Department of Commerce's Bureau of Industry and Security ('BIS'), which implements US dual-use export controls, impose millions of dollars'-worth of penalties against dozens of companies. In nearly all cases, the violations that led to the enforcement actions, and the nature and scale of the enforcement responses themselves, could have been prevented or mitigated earlier. Further, the US and international response to Russia's invasion of Ukraine show what could be at stake if firms and subject persons are unable or unwilling to comply with their obligations.

US regulatory guidance and expectation in this space have become clearer and more easily understood in recent years. In designing and maintaining their sanctions and export compliance programmes, firms should look to two documents: OFAC's *A Framework for OFAC Compliance Commitments*[1] and the BIS *Export Compliance Guidelines*.[2]

This is not to say that the programmes should be treated as one and the same. Trade operations and export finance often require specialisation, product knowledge, and familiarity with logistics that are gained over several years in the field. OFAC administers a strict liability regime, while BIS export controls typically have a knowledge component, or *scienter*. However, a firm that aligns the programmes where possible can enhance its compliance effectiveness.

ALIGNING THE COMPLIANCE PROGRAMMES

Management commitment and tone from the top

Management commitment is a key component common to all compliance programmes, as support from the highest levels of the firm drives a culture of compliance that has legitimacy within the firm. Senior management should actively support compliance policies and procedures, while also providing sufficient resources for the compliance teams to be successful. In addition, firms should promote the 'tone from the middle' to drive a culture of compliance throughout the organisation.

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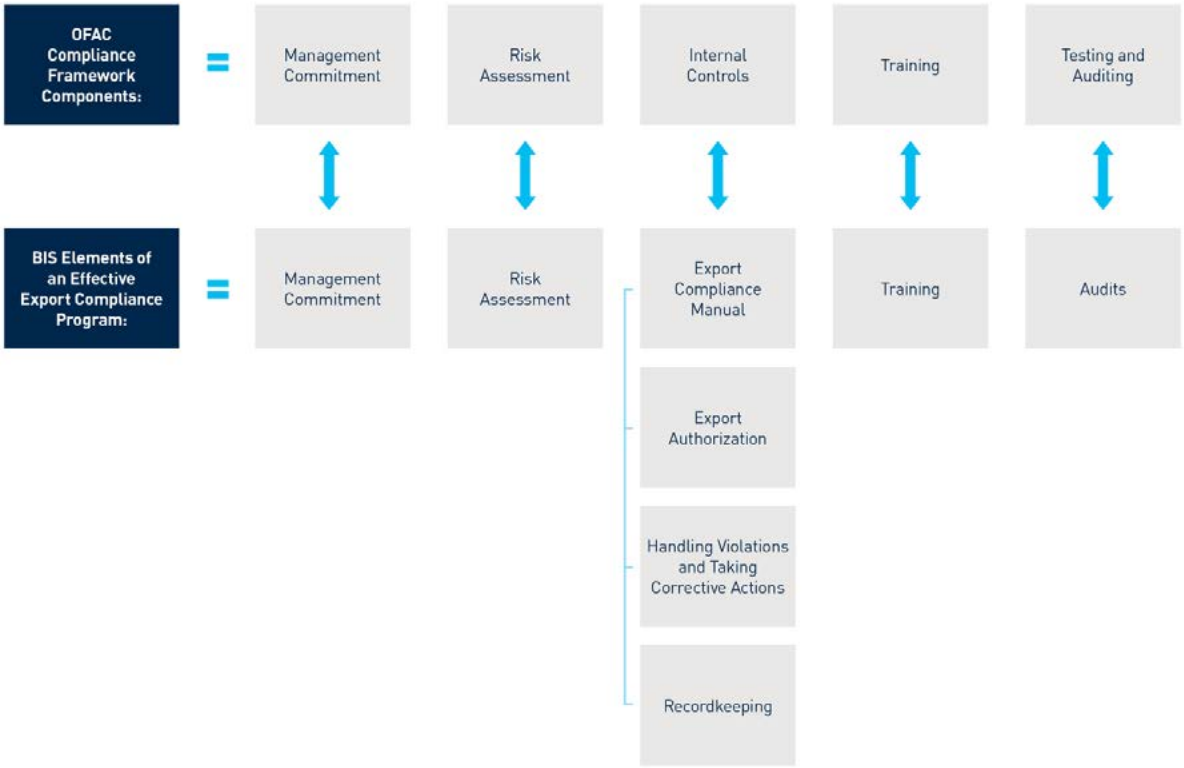
Risk assessment

Each firm has a unique risk profile and is expected to tailor its sanctions and export control compliance programmes accordingly. A risk assessment that identifies and quantifies specific risks forms the foundation of comprehensive compliance programmes. Consistent with published guidance[3] for anti-money laundering regulated institutions, OFAC and BIS recommend that firms consider the following sources of risk:

- The nature of the firm's customers and counterparties, and

TWO GUIDANCE DOCUMENTS, A SHARED COMPLIANCE AIM

The five 'components' from OFAC's compliance framework align closely with the eight 'elements' from BIS's export compliance guidance.



participants in its supply chain, including intermediaries
- The types of products and services that the firm offers, including how and where they fit with other financial or commercial products, services, networks, and systems
- The geographic locations of the organisation and its operations, and those of its customers, supply chains, intermediaries, and counterparties

Internal controls and risk management

OFAC treats internal controls as a section unto itself. The analogous material in the BIS guidance comprises four sections:

1. Export Authorization;
2. Recordkeeping;
3. Handling Export Violations and Taking Corrective Actions; and
4. Build and Maintain Your Export Compliance Manual.

Internal controls form critical components of the compliance programme and should be driven by the risk assessment. These policies and procedures should be written into a compliance manual for the entire compliance programme, including elements such as determining the classification of an item, determining if a licence is required, and applying for licences. OFAC mentions the lack of a formal sanctions compliance programme as a root cause of compliance failures, while BIS specifically outlines the need for a written compliance manual.

There also should be clear protocols for employees to report suspected failures – and near-misses – internally, as well as procedures for voluntarily disclosing violations to the authorities. The firm should detail how cases of noncompliance will be investigated and remediated. Firms that demonstrate a track record of cooperating with authorities and remediating compliance failures are more likely to receive mitigation in the event of failures, among other benefits.

Records must be kept for five years after a transaction is completed, though firms may decide to keep records for longer where they have reason to do so. Firms also should determine where the records will be stored and how they can be retrieved.

Training

Both OFAC and BIS emphasise the importance of training. Training should be job-specific and convey the compliance responsibilities of each employee. Best practices include training staff at onboarding and periodically thereafter, maintaining up-to-date training materials, and keeping attendance records.

Independent audit and testing

The compliance programmes should be subject to periodic independent review to give the board and senior management confidence that the firm adheres to applicable law and regulatory requirements, as well as stated policy and procedures. These reviews can be conducted by an independent internal team or by a qualified third party. Importantly, management should commit to resolving audit's findings and, where possible, the root causes of any identified failures.

COMPLIANCE PROGRAMME CONSIDERATIONS

As firms look for ways to enhance their sanctions and export control programmes, we provide three additional areas for consideration.

Lessons from enforcement actions

Firms should be aware of enforcement cases, particularly when they involve peer institutions of similar industry, size, or risk profile. Where cases identify compliance failures or lapses, firms should

be particularly sensitive to identifying and remediating them in their own programmes. However, firms should not disregard broader trends that can be seen across all enforcement cases.

1. Foreign subsidiaries, branches, and affiliates pose additional risk.
Affiliates – particularly in foreign jurisdictions – can add complexity to the compliance programme. Depending on the size of the subsidiary or the company's corporate structure, compliance and risk decisions may be handled centrally, federated to the local line of business, or organised in a hybrid model. Whatever the structure, responsibilities and standards should be clearly defined and communicated.

Decentralised compliance models have been associated with sanctions and export controls lapses. Among the highest profile of these failures have been the settlements related to 'wire stripping' involving large foreign banking organisations. Non-US branches and affiliates, by omitting payment information identifying sanctions nexuses – and, in turn, compromising their US dollar correspondents' ability to comply with OFAC regulations – have caused billions of dollars in penalties, reputational damage, and deferred prosecution agreements.

2. Firms that do not have a US presence still should consider extraterritoriality.
US sanctions and dual-use export controls apply to US-origin items regardless of where they are in the world. Therefore, it is necessary for a company outside the United States to maintain a compliance programme if it deals with such goods, even if the firm does not have any other apparent connection to the United States. The 2021 OFAC settlement involving Italian manufacturer Nordgas, which was fined nearly $1 million for reexporting US-origin air pressure switches to Iran, highlights the need to consider the extraterritorial nature of the regulations.

3. Technology enhances, and adds complexity to, compliance.
Technology has long been seen as both an enabler of compliance – delivering innovative methods to prevent, detect, and investigate potential concerns – and a source of potential risk.

Firms' sanctions compliance obligations remain, even as innovations in technology and delivery channels may make it difficult to determine the sanctions nexus. OFAC's recent guidance[4] for the virtual currency industry underscores this expectation and reinforces reinforcing guidance already in place. In addition, several settlements in 2021 referenced failures to implement IP-blocking of parties associated with broadly sanctioned countries.

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Similarly, BIS has explored controls on emerging and foundational technologies. In 2018, it released an advanced notice of proposed rulemaking[5] ('ANPRM') that sought comments on potential export controls on 14 categories of emerging technologies, including artificial intelligence, quantum computing, micro robotics, and brain-computer interfaces. BIS released another ANPRM[6] in 2020 and sought comments on foundational technology controls.

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Tabletop exercises and scenario analyses

OFAC's stated in 2009 that it considers 'the totality of the circumstances to ensure that its enforcement response is proportionate to the nature of the violation.' Firms should consider undertaking a similar, comprehensive assessment of their own compliance programmes. They can benefit from tabletop exercises where teams across the lines of defence walk-through scenarios of exposure to sanctions or export control risk.

This technique is well established in the cybersecurity domain. It involves defining a scenario and analysing how the firm's controls would address it. The walk-throughs can expose weaknesses in both preventive and detective controls. For example:

- Do reporting mechanisms provide for timely escalation to senior management, remediation, and prevention in the future?
- Does issue resolution involve root-cause analysis? Is the firm 'joining the dots' between one control weakness and a similar exposure elsewhere?

These exercises can feel uncomfortable. Their findings should be fed back into enhancing the compliance programme.

CONCLUSION

OFAC and BIS broadly agree on the main components of an effective compliance programme. They also stress that there's no one-size-fits-all approach. While certain elements of the programmes may remain separate, we encourage firms to take advantage of the similarities to strengthen and streamline compliance efforts. Doing so will help ensure that the firm maintains a risk-based programme commensurate with its size, complexity, and risk profile.

LINKS AND NOTES

1 https://home.treasury.gov/system/files/126/framework_ofac_cc.pdf
2 https://www.bis.doc.gov/index.php/documents/pdfs/1641-ecp/file
3 https://bsaaml.ffiec.gov/manual/BSAAMLRiskAssessment/01
4 https://www.thinkbrg.com/insights/publications/virtually-consistent-ofac/
5 https://www.federalregister.gov/documents/2018/11/19/2018-25221/review-of-controls-for-certain-emerging-technologies
6 https://www.federalregister.gov/documents/2020/08/27/2020-18910/identification-and-review-of-controls-for-certain-foundational-technologies