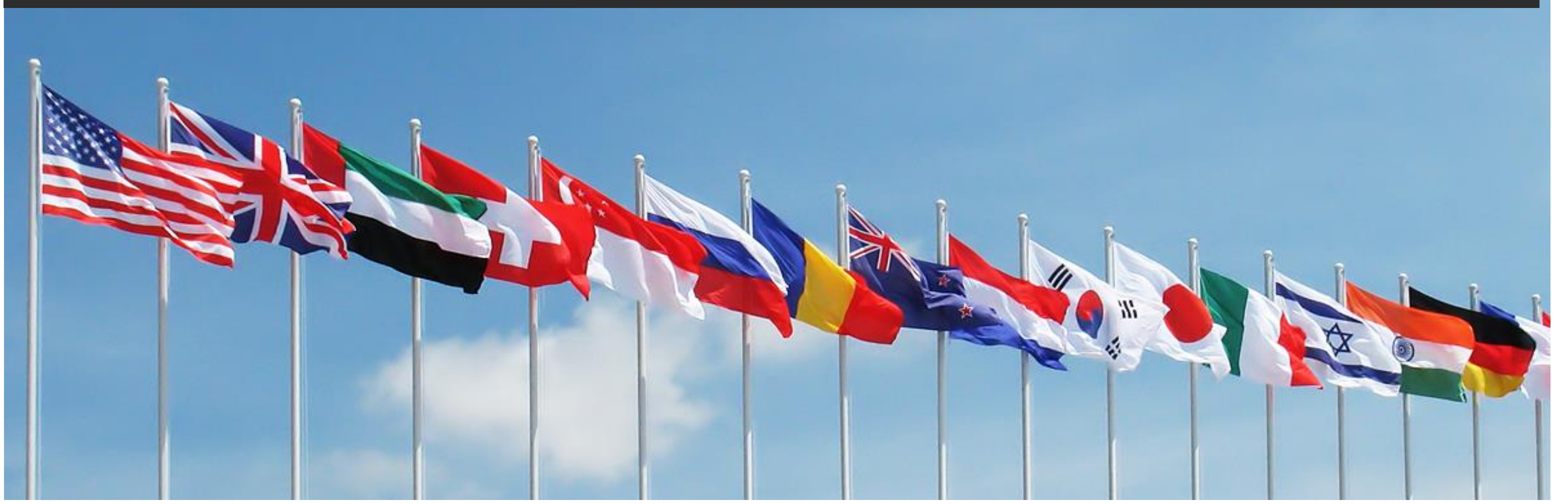
GT GreenbergTraurig

Alert | Export Controls & Economic Sanctions / White Collar Defense & Special Investigations



December 2019

EU Sanctions: European Commission President Pushes for Greater Resilience, Proper Enforcement

Ursula von der Leyen, the new president of the European Commission, has called for 'new proposals to ensure Europe is more resilient to extraterritorial sanctions by third countries and to ensure that the sanctions imposed by the EU are properly enforced…throughout its financial system.' See September 2019 Mission Letter from President von der Leyen to Valdis Dombrovskis, Executive Vice-President responsible for the Directorate-General for Financial Stability, Financial Services and Capital Markets Union (FISMA). A portfolio-allocation document published early December 2019 confirms that responsibility for sanctions has formally been moved from the EU's Foreign Policy Instrument Service (FPI) to FISMA.

FISMA's work includes:

1. Presenting new policy initiatives to ensure that financial markets are well-regulated and supervised;

2. Monitoring financial-sector developments and structures in the Member States and ensuring satisfactory implementation of EU legislation at the national level; and

3. Working closely with international partners to promote consistent regulation and the implementation of agreed standards and principles around the world.

See European Commission 2018 Annual Activity Report.

As a Directorate-General, FISMA is responsible for monitoring the areas that fall within its remit, which now includes EU sanctions.

In her letter, President von der Leyen urges Mr Dombrovskis to 'coordinate efforts to ensure a level playing field in [the EU's] economic relations with other partners, promoting Europe's competitiveness and strategic autonomy…' She goes on to say that Dombrovskis 'should pay particular attention to our trade and economic relations with our competitors and strategic partners.'

The switch could mark a change in the EU's approach to sanctions as they battle to establish parity with a tough U.S. regime which includes the imposition of so-called secondary sanctions monitored and enforced by the Office of Foreign Assets Control (OFAC).

Primary and Secondary Sanctions

'Primary' sanctions are those prohibiting the citizens of and companies incorporated in the sanctioning country from engaging with named individuals and companies in the sanctioned country.

In the EU, the decisions to impose these types of sanctions are taken by all 28 EU Member States. Initially a political decision, sanctions are then crystallised by EU regulations, which have direct effect in the EU Member States.

While the sanction itself has direct effect, such as the requirement to freeze the funds of a person designated by the regulation, the enforcement of sanctions, including the setting of penalties and issuance of guidance, is left to each Member State. In the UK, for example, sanctions are monitored, administered and enforced by the Office of Financial Sanctions Implementation (OFSI). OFSI issues guidance on the operation of sanctions in the UK, and penalties for violations are set out in both primary and secondary legislation. Given the UK Conservative Party's gains in the 12 December 2019 general election, the UK will most likely leave the EU on 31 January 2020. However, the transition period until at least the end of 2020 means EU sanctions apply in the UK for another year at minimum.

'Secondary' sanctions threaten to remove a third party's access to the sanctioning country, its market and currency if the third party carries on trade activities with the sanctioned country. These types of sanctions have extraterritorial effect, because it does not matter where the third party is based – they are still at risk of enforcement action if they violate the sanction. These measures are well-illustrated by the sanctions reimposed on Iran by the U.S. in late 2018, which forced many EU-based companies to cease any form of trade with Iran or risk facing exclusion from U.S. markets, not to mention enforcement action which could include severe financial penalties.

Although there has been some EU resistance to the Trump administration's sanctions against Iran (including the revival of the 1996 Blocking Regulation, declaring U.S. sanctions null and void) the EU's response to the situation has been described as 'passive' and having 'failed to affect the calculations of major European companies and banks'. See European Council on Foreign Relations Policy Brief, "Meeting the challenge of secondary sanctions," June 25, 2019.

This compounds criticism that the lack of uniformity in how EU sanctions are imposed nationally makes for a weak system.

A new approach under FISMA?

New Proposals?

President von der Leyen's statements in her letter to Mr Dombrovskis and the transfer of responsibility for sanctions to FISMA are at least the beginning of an answer to these criticisms.

'New proposals to ensure Europe is more resilient to extraterritorial sanctions by third countries' is an obvious reference to the U.S. situation. Part of the EU response was to establish the Instrument for Supporting Trade Exchanges (INSTEX), a special-purpose vehicle established by France, Germany and the UK to help EU companies continue certain trade activities with Iran by providing a mechanism for non-USD transactions to occur ostensibly outside the scope of U.S. sanctions jurisdiction and attempt to preserve the Iran nuclear deal in the process.

However, the role of INSTEX in increasing resilience against U.S. sanctions is at this stage limited – it has not yet led to any transactions, and in any event, is restricted to facilitating the trade of humanitarian goods such as food and medicine, which are not targeted by U.S. sanctions.

If INSTEX or any similar mechanisms aim to counter the effect of U.S. sanctions in the EU, they will require the involvement of most if not all EU member states, of which only nine are currently signed up to INSTEX. Finland, Belgium, Denmark, Netherlands, Norway, and Sweden joined late November. While this will elevate the profile and credibility of such a mechanism, a bolder approach to the types of trade INSTEX covers may also be required if the EU wishes to achieve meaningful resilience.

'Proper enforcement' - Be more 'OFAC'?

The fact that the EU approach to sanctions requires active implementation by Member States when it comes to enforcement and penalties is seen by many as a weakness in the system. This is because Members States are not aligned in the way they monitor or punish sanctions violations. In addition, when enforcement actions do occur, they are likely to be publicised on a relatively limited basis.

This, in turn, reduces the credibility of the system in the minds of those at OFAC used to punishing violations with severe and publicly announced fines – OFAC has imposed penalties of just under $1.29 billion in 2019 alone, including settlements with non-U.S. entities such as the British Arab Commercial Bank PLC. See November 2019 GT Alert, OFSI Finds Its Teeth While OFAC Continues to Enforce Against Non-U.S. Corporates.

To achieve a more concerted approach, one option would be the establishment of an EU-wide sanctions-enforcement body. However, such an approach would require significant cooperation between all member states, many of which have differing attitudes towards enforcement, not to mention significant funding and a new body of EU legislation and rules.

Money Talks

Although increased monitoring may yield positive results at the national level, much of the weight of global authority that surrounds U.S. sanctions can be attributed not only to dedicated enforcement but to the primacy of the U.S. dollar for corporate transactions; it is argued that until there is an alternative, this authority will not be dislodged.

As the Commission department responsible for EU policy on banking and finance, FISMA is well-positioned to address this issue on behalf of the bloc. President von der Leyen expects Mr Dombrovskis to 'lead the work on strengthening the role of the euro as a strategic asset…' including '…increasing the global use of the euro for payments as a reserve currency' – an ambitious aim for a currency damaged over the years by a number of crises in the region, and one unlikely to be achieved in President von der Leyen's five-year term.

Looking Ahead

Going forward, the existing EU framework and its implementation at the national level will likely be subject to more intense monitoring. This probable increased scrutiny could lead to Member States taking a more proactive and aggressive approach as they aim to avoid the EU microscope.

The EU is recognising the global significance of an effective sanctions framework as well as the limitations and weaknesses in the current regime; how these are to be addressed remains to be seen. Nevertheless, companies operating across borders should watch closely to ensure that their own policies and procedures are robust and compliant.

Companies that have uncovered a potential sanctions violation within the business which may require the submission of a report to OFAC or OFSI should seek legal advice immediately.

Authors

This GT Alert was prepared by **Kara Bombach**, **Erik de Bie**, **Anne-Marie Ottaway**, **Barry Vitou,** and **Gareth Hall**. Questions about this information can be directed to:

- Kara M. Bombach | +1 202.533.2334 | bombachk@gtlaw.com
- Erik de Bie | +31 (0) 20.301.7315 | debiee@gtlaw.com
- Maura E. Miller | +1 212.801.9372 | Maura.Miller@gtlaw.com
- Anne-Marie Ottaway | +44 (0) 203.349.8700 | ottawayam@gtlaw.com
- Barry Vitou | +44 (0) 203.349.8700 | vitoub@gtlaw.com
- Gareth Hall | +44 (0) 203.349.8700 | hallg@gtlaw.com
- Or your Greenberg Traurig attorney