

UK SANCTIONS AFTER BREXIT – KEY CHANGES OF WHICH TO BE AWARE

At 11pm on 31 December 2020, EU sanctions will cease to apply within the UK, and will be replaced by a new UK sanctions regime which is similar, but not identical to the current EU sanctions regime. In particular, there are a number of key differences both in drafting style and substance that will be relevant to compliance efforts by both UK and international businesses. In this briefing, we identify some of the key changes of which to be aware.

BACKGROUND

The post-Brexit sanctions regime in the UK will comprise of, principally, a series of statutory instruments made under the Sanctions and Money Laundering Act 2018 (the "**Sanctions Act**"). These new statutory instruments (the "**UK SIs**") are denser and more complex than the EU Council Regulations which they replace, reflecting a different drafting style to that adopted in Brussels. In addition, as well as containing operative prohibitions relevant to private parties, the UK SIs include detailed provisions on listing criteria and de-listing as well as travel bans and other matters formerly addressed in EU Council Decisions. Some former EU regimes have been renamed and some terms used in the UK SIs are defined in the Sanctions Act rather than the SIs themselves.

All of this makes for a more hazardous task of navigating the legislation to identify the relevant provisions applicable in any given scenario, and the corresponding derogations and licences. Particular care must be paid as an assumption that the rules are unchanged from the EU regime is incorrect, even while the UK and EU policy considerations remain aligned.

For reference, a list of all the new UK regimes, corresponding UK SIs and guidance issued by the Office of Financial Sanctions Implementation ("**OFSI**") that will apply from 1 January 2021 is available online at the website of the Foreign, Commonwealth & Development Office:

<https://www.gov.uk/government/collections/uk-sanctions-regimes-under-the-sanctions-act>.

Key issues

- The UK's sanctions regime is not identical to corresponding EU sanctions.
- Financial institutions should review their due diligence procedures and operational policies in light of the UK SIs.
- In particular, tests for ownership and control may be more stringent.
- UK and EU subsidiaries may fall foul of the new UK, and existing EU, Russian Sectoral Sanctions if not careful.
- In collaboration with Clifford Chance and a consortium of other firms, industry body UK Finance has recently published a detailed review of the UK SIs which highlight key changes¹, some of which are described in this briefing.

KEY ISSUES

Jurisdictional Scope of the UK Sanctions Regime

As under the EU regime, UK financial sanctions will apply to all persons within UK territory and to all UK Persons (i.e. UK nationals and UK-incorporated entities), wherever they are in the world. In addition, anyone conducting activities within the UK (whether or not they are a UK Person) must comply with UK sanctions in respect of those activities.

In 2017, OFSI issued guidance ("*Monetary penalties for breaches of financial sanctions – guidance*") which explains the circumstances in which it may impose monetary penalties for breaches of UK sanctions. In that guidance, OFSI stated that:

"3.6 A breach does not have to occur within UK borders for OFSI's authority to be engaged. To come within OFSI's enforcement of sanctions, there has to be a connection to the UK, which we call a UK nexus. ...

3.7 A UK nexus might be created by such things as a UK company working overseas, transactions using clearing services in the UK, actions by a local subsidiary of a UK company (depending on the governance), action taking place overseas but directed from within the UK, or financial products or insurance bought on UK markets but held or used overseas. These examples are not exhaustive or definitive – whether or not there is a UK nexus will depend on the facts in the case."

We do not believe this means that OFSI would necessarily consider it has jurisdiction to impose a penalty on a non-UK company in all cases. However, it is possible that OFSI could assert that a payment flow through a bank in the UK means that a transaction is conducted in part within the UK for these purposes.

Asset Freezing Measures – Ownership and Control

The EU has issued guidance in the form of its "*EU Best Practices for the effective implementation of restrictive measures*", which states (at paragraphs 66-67) that if a non-designated person is more than 50% owned or controlled by a designated person, there is effectively a presumption that the making available of funds or economic resources to that non-designated person will amount to making them available indirectly to the designated person. The EU guidance sets out criteria to be taken into account when assessing whether a person is owned or controlled by a designated person for these purposes and states that the presumption may be rebutted where facts support the conclusion that funds or economic resources will not be channelled to, used by, or be for the benefit of a designated person.

Under the new UK sanctions regime the presumption is no longer rebuttable. Instead, the UK SIs codify the circumstances in which a legal entity will be deemed to be "*owned or controlled directly or indirectly*" by a designated person (which are similar but not identical to the criteria in the EU guidance). Where these criteria are met, even though not listed in its own right, an asset freeze and the prohibition on making funds or economic resources available without a licence will apply automatically, in a manner similar to the so-called 50% rule in the US.

Sectoral Sanctions on Russia

There are a number of potentially significant changes that affect the scope of the UK's sectoral sanctions on Russia. In particular, UK Persons working or operating in the EU may need to ensure that they are not engaging in activities which are now prohibited:

- Existing EU Sectoral Sanctions prohibit: (i) dealing with certain transferable securities or money market instruments issued by specified Russian entities, their non-EU incorporated subsidiaries or entities acting on their behalf or at their direction; and (ii) making or being part of an arrangement to make new loans or credits of more than 30 days' maturity available to any such entities. The EU sanctions include a carve-out for subsidiaries incorporated in the EU (except where acting on behalf of or at the direction of a listed Russian entity or its non-EU subsidiaries), which will no longer apply to subsidiaries in the UK. Similarly, the carve out in the new UK Sectoral Sanctions applies only in relation to subsidiaries incorporated in the UK. There is therefore a potential lacuna.
- The EU Sectoral Sanctions identified at (ii) above (i.e. the prohibition on new loans or credits) include an exemption where the loan or credit has a documented and specific purpose of financing the import or export of goods between the EU and a third country. As it is now no longer part of the EU, trade between (for example) the UK and Russia will no longer qualify. Similarly, the equivalent exemption in the new UK Sectoral Sanctions requires a UK nexus to apply, and therefore loans which finance otherwise non-prohibited trade between the EU and Russia will not be exempt from the UK prohibition.
- The UK SI in relation to Russia also widens the existing prohibitions in relation to energy-related goods and services. A licence is now required for the sale, supply, or export of energy-related goods (referred to under the EU regime as "Annex II Items") or the provision of certain services not only when destined "*for use in Russia*" but also "*to a person connected with Russia*". This includes individuals resident ordinarily in, or located in, Russia, and businesses incorporated or constituted under Russian law or domiciled in Russia. This is broader than the prohibition under the current EU regime, and potentially could apply to the provision of certain services to Russian companies for operations outside of Russia.

OFSI has issued a specific guidance note on the application of the UK Sectoral Sanctions. This includes some FAQs which are similar to, but less extensive than, the FAQs included in the guidance issued by the European Commission on the scope of the prohibitions in Council Regulation 833/2014. Where equivalent guidance is not contained in the FAQs issued by OFSI, it may not be safe to assume the same interpretation applies – each issue should be considered carefully on its facts.

Provision of Brokering Services

A number of UK SIs include a prohibition on the provision of "*brokering services*" related to certain goods without a licence. The term is given a broader definition under the UK regime than currently applies under the EU regime. Brokering services are defined in the EU Regulations as the buying or selling of goods, or the negotiation or arrangement of transactions for the purchase, sale or supply of goods, technology or financial or technical

services from a third country to another third country. Under the new UK regime, the definition of brokering services is expanded considerably, and includes "*the facilitation of anything that enables the arrangement to be entered into*" and "*the provision of any assistance that in any way promotes or facilitates the arrangement*" (i.e. whereby a controlled item is transferred etc. to a party or country where sanctions prohibit it or require a licence). This definition is therefore broader and may include the provision of direct or indirect financing, or even the provision of related professional advice where it "*in any way*" promotes or facilitates the arrangement in question.

Payment Processing

The scope of the prohibition on providing "*financial services*" is also wider under the UK regime, at least insofar as that term is interpreted in the context of the UK SI imposing sanctions on Russia.

In an express departure from the recent ruling of the Court of Justice in *PJSC Rofsnet Oil Co. v. Her Majesty's Treasury*, guidance issued by OFSI on the Russian sanctions confirms that "*Where the provision of financial services is prohibited, this includes the provision of processing payments.*" Although this guidance is given in the context of the UK sanctions on Russia, it seems likely that the same interpretation would be afforded by OFSI in the context of other UK sanctions programmes.

Licences

OFSI has confirmed that most extant licences will continue to remain valid until expiry. New specific licences issued from 11:00pm on 31 December will be issued only where permitted under UK SIs. This includes some changes to the conditions set out in EU Regulations, including a new derogation for "*extraordinary situations*" (which is not clearly defined, albeit cannot be used to avoid the clear limitations of other licensing ground). There is also a new power to issue general licences. This power has not yet been used and where it is, will be accompanied by specific guidance.

Lists of Designated Persons

OFSI has confirmed that it will continue to maintain its Consolidated Lists of financial sanctions targets online at: <https://www.gov.uk/government/organisations/office-of-financial-sanctions-implementation>. This will include all UK sanctions targets. From 31 December at 11pm, this list will no longer contain EU sanctions targets and the descriptions of the corresponding UK sanctions targets may differ. To assist in addressing the changes this will entail for automated screening systems, a so-called "*Bridging Document*" will be published on 31 December.

CONCLUSION

The UK SIs do more than "*on-shore*" the existing EU regime into UK domestic law after Brexit. We have sought to highlight some of the more significant divergences from current EU sanctions, but given the different drafting used, the number of individual changes is significant. Companies should take care to review their policies and operational processes to ensure they are ready for compliance with the UK SIs from 31 December 2020 and beyond.

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