

UK's Sanctions Enforcement Authority Signals Tough Penalties for Russia Sanctions Breaches, Imposes Largest Ever Fine

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On Tuesday 31 March 2020, the UK's Office of Financial Sanctions Implementation ("OFSI") imposed a monetary penalty of £20.47 million on Standard Chartered Bank ("Standard Chartered") for breaching EU sanctions against Russia. This followed months of press speculation about OFSI taking enforcement action against Standard Chartered given the enforcement actions taken by the UK Financial Conduct Authority and U.S. regulators in 2019 for anti-money laundering and sanctions-related breaches.

This is only the fourth civil penalty imposed by OFSI but by far the highest (far exceeding the next-highest penalty of £146,341, imposed by OFSI on Telia Carrier UK Limited in September 2019). It is also the first publicised UK enforcement action (civil or criminal) relating to the EU capital market restrictions against Russia. Those restrictions have been in place since July 2014 and previously have not been subject of any major enforcement actions in the EU.

BACKGROUND TO THE RUSSIA CAPITAL MARKET RESTRICTIONS

The EU introduced capital market restrictions against certain Russian state-owned banks in late July 2014, restricting persons subject to EU jurisdiction from dealing with money market instruments or transferable securities issued by these entities after 1 August 2014, if they had a maturity of over 90 days. In September 2014, these restrictions were expanded (i) to target certain state-owned military and oil and gas companies, (ii) by lowering the maturity date threshold to 30 days, and (iii) through the introduction of a restriction on providing new loans or credit to targeted entities.

These capital market restrictions do not only affect entities expressly listed in the legislation; they automatically apply to (i) any entity incorporated outside of the EU which is more than 50% owned by a listed entity; and (ii) any entity acting on behalf of or at the direction of entities affected by these restrictions.

The restriction on issuing new loans or credit to targeted entities includes an exemption for granting loans or credit that have a specific and documented objective of financing

the import or export of goods between the EU and any third country (including Russia), provided that the relevant goods are not restricted by other measures (the “Trade Finance Exemption”).

BREACH AND FINE CALCULATION

OFSI established that, between April 2015 and January 2018, Standard Chartered made 102 loans to Denizbank A.Ş., a Turkish bank majority-owned by Sberbank, one of the entities listed as a target of the EU capital market restrictions. Although Standard Chartered purported to rely on the Trade Finance Exemption when making these loans, 70 of them, worth over £266 million, turned out not to have met the criteria for this exemption. They involved financing of trade between countries with no nexus to the EU. Standard Chartered made a voluntary disclosure to OFSI, disclosed the results of its internal investigation, and cooperated throughout OFSI’s investigation.

OFSI determined that these breaches were sufficiently serious to warrant enforcement action. However, because OFSI was granted the power to impose civil fines only as of 7 April 2017, the enforcement action focused on Standard Chartered’s loans issued after this date, 21 loans worth approximately £97 million. OFSI still cited the loans issued prior to 7 April 2017 as constituting sanctions breaches, but did not pursue other enforcement action, which would have required referral to criminal enforcement agencies in the UK.

OFSI initially imposed a penalty of £31.5 million, which included a voluntary disclosure discount of 30%, the maximum permissible for a case judged to fall into the “*most serious*” category. Standard Chartered subsequently sought Ministerial review of this penalty (the first stage in the appeal from an OFSI fine). The Minister upheld OFSI’s factual conclusions, but reduced the penalty to £20.47 million. The Minister noted that OFSI had not given sufficient weight to Standard Chartered’s lack of wilful breach of sanctions, its cooperation, good faith, and remediation steps when calculating the penalty. Standard Chartered did not seek to appeal further.

KEY IMPLICATIONS FOR COMPANIES

This enforcement action provides a number of important takeaways for companies operating in the UK and beyond.

First, the initial size of the penalty suggests that OFSI is taking a more aggressive approach to penalty calculations. The maximum penalty that OFSI can impose is the

greater of £1 million or 50% of the value of the breach. This figure is then adjusted to be “reasonable” and “proportionate”. Because OFSI has not released a breakdown of the 21 loans underlying its enforcement action, it is not possible precisely to calculate the maximum baseline penalty. However, OFSI did disclose that its initial penalty (prior to the voluntary disclosure discount) was approximately £42.5 million. This would suggest that the initial fine calculation was close to 50% of the value of the overall breach, with little adjustment made during the “reasonable” and “proportionate” stage. This marks a departure from OFSI’s previous fines, where that stage of the calculation usually resulted in significant penalty reductions.

Second, this is the second OFSI penalty in which the Ministerial review appeal process led to a material reduction in the penalty (the Telia Carrier case resulted in OFSI’s penalty being reduced from £300,000 to £146,341). While there have been too few enforcement actions to draw definitive conclusions, it does appear that OFSI has been taking an aggressive approach to penalty calculations; Ministerial review may be an effective route for challenging those fines.

Third, the 30% voluntary disclosure discount applied by OFSI shows the potential value of co-operating with OFSI and making a prompt self-disclosure where sanctions issues are identified. Notably, OFSI specifically referred to the fact that Standard Chartered had shared information from its internal investigation as a factor in applying the maximum discount. This illustrates the value of prompt and thorough investigations of sanctions breaches.

Fourth, this is the first significant enforcement action relating to the EU capital market restrictions on Russia, and the largest reported penalty for any breach of the EU sanctions against Russia. In the past, EU sanctions enforcement was viewed as lagging significantly behind US sanctions enforcement. Companies in the UK and the EU should take note of the increased enforcement risks heralded by this action.

Finally, Standard Chartered’s loans that led to the fine illustrate the risks of misinterpreting the scope of the exemptions to the EU capital market restrictions, which can be very technical. Companies doing business with Russia should review this enforcement action closely and ensure that they are confident in their approach to interpreting and approaching such exemptions.

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Please do not hesitate to contact us with any questions.

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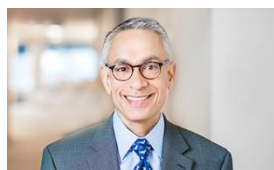


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