

OFSI Clarifies UK Sanctions “Ownership and Control” Due Diligence Expectations

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On 16 March 2023, the United Kingdom’s Office of Financial Sanctions Implementation (“OFSI”) updated the “OFSI Enforcement and Monetary Penalties for Breaches of Financial Sanctions Guidance” (the “Guidance”) to set out how an incorrect determination of “ownership or control” by a UK designated person over an entity may affect OFSI’s enforcement decisions.

The updated Guidance establishes that OFSI will consider a reasonable and good-faith (but incorrect) determination of a counterparty’s ownership and control to be a “mitigating factor” in any enforcement decision. The Guidance also provides indicators of the types of information that should form the basis for such determinations to meet this standard.

Strict Liability Risks. Under UK sanctions, if an entity is determined to be owned or controlled by a designated asset frozen person (a “Designated Person”), that entity must also be treated as a designated person. OFSI previously issued limited guidance on what constitutes “ownership” and “control.” But, due to the broad definitions of these terms in the relevant legislation, there was significant ambiguity regarding OFSI’s expectations for companies trying to make these determinations.

The broad nature of the “ownership and control” test has been particularly problematic since 15 June 2022, when OFSI gained the ability to impose civil penalties for UK financial sanctions breaches on a strict liability basis.¹ Under this new standard, a person that has conducted good faith due diligence of a counterparty and has not identified any signs of ownership or control by a Designated Person could still be ordered to pay the maximum monetary penalty if OFSI disagreed with their assessment.

Not Quite a “Safe Harbour”. The Guidance states that, if OFSI determines that a UK sanctions breach has occurred, it will consider evidence of a reasonable and good faith

¹ For a further discussion of this development, see: Debevoise Update, “OFSI Publishes Updated Enforcement and Penalty Guidance” (13 June 2022), available at: <https://www.debevoise.com/insights/publications/2022/06/ofsi-publishes-updated-enforcement-and-penalty>

inquiry into the ownership and control of an entity to be a “mitigating” factor in deciding whether the breach warrants enforcement action.

Although this statement is helpful, it is important to note what the Guidance does not provide. Specifically, the Guidance does *not* state that evidence of such reasonable and good-faith inquiry will *always* mean that no enforcement action would be taken. The Guidance also does not state that the presence of this mitigating factor will result in a particular discount from the monetary penalty. Conversely, the Guidance states that inadequate due diligence, or a determination made in bad faith, will increase the likelihood of enforcement action.

The burden of demonstrating that the due diligence and final determination were made reasonably and in good faith rests with the person against whom OFSI is contemplating the enforcement action.

Mitigating Efforts and Criteria to Consider. OFSI makes clear that by issuing the updated Guidance, it does not prescribe a specific level or type of due diligence, but the Guidance notes that OFSI will consider the following efforts as potentially mitigating sanctions liability:

- Examination of the formal ownership and control mechanisms, as well as actual or potential influence or de facto control by a Designated Person;
- Open-source searches to reveal any links to Designated Persons;
- Direct contact with an entity to probe into indirect or de facto control by a Designated Person, including seeking commitments as to the role of any Designated Persons or their affiliates vis-à-vis the entity;
- Regular checks that information held in relation to that entity remains accurate and monitoring for anything that could affect the ownership and control determination.

OFSI notes that it does not aim to set out an exhaustive list of factors that one should consider in the course of sanctions due diligence because the checks should be tailored to the degree of sanctions risk of a particular transaction or conduct. However, the Guidance does indicate that the following inquiries may be appropriate:

Areas of inquiry for formal ownership and control:

- Percentage of shares and/or voting power of shareholders;
- Ownership and distribution of other shares in the company;

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- Recent changes to or divestments of ownership/shareholding, including whether they are made in anticipation of or in response to sanctions;
 - Whether any changes to ownership or control were a part of a pre-planned or wider business or financial strategy;
 - Composition and split of shares into classes and other structural changes;
 - Corporate constitutional documents and agreements among shareholders or between shareholders and the entity; and
 - Commercial justification of complex ownership and control structures.

Areas of inquiry for indirect or de facto control:

- Continued influence or potential for influence by a Designated Person, including through personal connections and financial relationships;
- Involvement of proxies and trusts;
- Any relationships between a Designated Person and the person to whom the shares or ownership interests of the Designated Person have been divested;
- Funding and valuation of recent share transfers;
- Operational steps to ensure that a Designated Person does not exercise control and cannot benefit from or use corporate assets;
- Board and management appointments, running of Board meetings, and governance processes;
- Ongoing financial liabilities directly related to a Designated Person (e.g. personal loans);
- Any shareholder or voting agreements, put or call options, or other coordination agreements with a Designated Person; and
- Any benefits conferred to or transactions with the Designated Person.

Consequences for Business. The updated Guidance has clarified OFSI's due diligence expectations and will encourage UK companies to revisit and adjust their sanctions systems and controls. Although OFSI did not create a true "safe harbour" from the strict

liability standard, it appears that OFSI will take a reasonable and proportionate approach to unintentional sanctions breaches resulting from opaque ownership and control structures or lack of cooperation from counterparties.

That said, the Guidance still sets a relatively high bar for companies having to make an “ownership or control” determination. In this respect, it remains to be seen how the Guidance would be interpreted in light of the judgment in *PJSC National Bank Trust and another v. Mints and others* [2023] EWHC 118 (Comm), where Mrs. Justice Cockerill emphasized that it would be “implausible” if major entities “were intended to be sanctioned by a sidewind, in circumstances where they would have no notice of the sanction and be unable themselves to challenge the designation” and noted that “it is not the intent for complex investigations to have to be made or evidence gathered” in order to resolve the question of ownership or control.²



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² For further discussion of this case, see: Debevoise Update, “UK High Court Issues Key Decision Considering UK Sanctions ‘Ownership and Control’ Test” (21 February 2023), available at: <https://www.debevoise.com/insights/publications/2023/02/uk-high-court-issues-key-decision-considering-uk>