Implementing an Effective Sanctions and Export Compliance Program

Topics for Today:
- Regulatory Overview: BIS and OFAC
- Integrating Export Compliance within Operations
- Export Compliance Risk Assessment
- Elements of an Effective Export Compliance Management Program
Regulatory Regimes

- Export Compliance falls under several regulatory regimes:
  - Department of Commerce's Bureau of Industry & Security ("BIS")
    - Controls export of most commercial, or dual-use products
  - Department of State's Office of Foreign Assets Control ("OFAC")
    - Economic and trade sanctions based on U.S. foreign policy and national security goals
      - Comprehensive (eg country-wide) and Selective: on the Specially Designated Nationals ("SDN") list
  - Department of State's Directorate of Defense Trade Controls
    - Administers defense items export controls under International Traffic in Arms Regulations (ITAR) and is beyond the scope of this overview

Sanctions

- Economic sanctions have been used throughout history as a valuable tool to destabilize a hostile nation with non-violent means.
  - OFAC is one of the oldest law enforcement agencies in the United States. OFAC is an enforcement agency, not a regulator
- Sanctions apply to:
  1. Any corporation or company physically located in the United States
  2. Corporations organized under U.S. law no matter where they are located
What Sets Sanctions Programs Apart?

<table>
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<th>Export Controls and Sanctions</th>
<th>Other Compliance Programs</th>
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<tr>
<td>• Strict or absolute liability!</td>
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<td>• Screening must be done real-time: lists are constantly changing</td>
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<td>• Responsibility for real-time compliance must be operationalized</td>
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<td>• No minimum dollar threshold – any transaction is a violation</td>
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<td>• Generally other compliance programs have a reasonableness standard</td>
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<td>• Often include retrospective reviews</td>
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<td>• Dollar-based thresholds often used (eg GME policies)</td>
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<td>• Red flags and circumstances usually indicate risk – not always a clear yes or no list</td>
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Regulatory Compliance: OFAC Overview

- OFAC sanctions regimes prohibit transactions with listed entities and sanctioned countries
  - Comprehensive Sanctions are applied to whole countries
    - Comprehensive sanctions can be loosened (Cuba and secondary sanctions, affecting non-US entities, for Iran) or lifted completely (Burma and possibly soon Sudan)
  - Selective Sanctions are targeted to certain industries, entities, or individuals
    - Examples: Ukraine-Russia related sanctions target oil & gas industry, Counter-terrorism related sanctions lists certain individuals and entities found to be supporting or committing terrorism.
OFAC Lists and Sanctions: Purpose Prohibitions

- **SDNs**: individuals and entities blocked pursuant to the various sanctions programs.
  - Foreign narcotics traffickers
  - Foreign terrorists
  - Transnational criminal organizations
- **Restricted end-uses:**
  - Proliferation-related end-uses
    - Nuclear, Chemical/biological weapons, Missile technology
- **The Commerce Department’s Denied Persons List and the Entity List**
  - Individuals and companies that have been denied export and re-export privileges because of risk they pose.

Prohibited Transactions – Varies by Sanctions Program

- U.S. persons may not engage unless authorized by OFAC or expressly exempted by statute.
- All “U.S. persons” must comply with OFAC regulations
  - U.S. citizens and permanent resident aliens regardless of where they are located or employed
  - All persons and entities within the United States
  - All U.S. incorporated entities and their foreign branches
  - US entity facilitation of transactions by non-US Persons
- Some cases (Cuba, North Korea) all foreign subsidiaries owned or controlled by U.S. companies and foreign branches
- Certain programs also require foreign persons in possession of U.S. origin goods to comply.
OFAC Licensing

- **General License** authorizes transactions otherwise prohibited
- **Specific License** authorizes a transaction otherwise prohibited and must be requested by filing application
- OFAC License Application Page http://www.treasury.gov/resource-center/sanctions/Pages/licensing.aspx

OFAC Compliance

- Companies that have overseas suppliers, customers, clients, or partners must have OFAC compliance procedures in place
  - OFAC Export authorizations take the form of:
    - Exemptions (specific and outlined in regulations)
    - General Licenses (eg for humanitarian reasons such as medical equipment)
    - Special Licenses (must be applied for)
- Penalties can be criminal or civil and result in large fines or jailtime
- OFAC Compliance must be done real time
  - Sanctions programs are constantly changing
  - If an entity or individual is on the SDN list virtually all transactions are prohibited!
Compliance Reminder: Reinterpretation of 50 Percent Rule

- OFAC has also broadened the application of its "50% rule" (February 2008)
  - Originally, entity falls under OFAC’s jurisdiction if any single prohibited entity owned 50 percent or more of a related entity
  - Expanded now to include entity if any combination of prohibited entities collectively own at least 50% of that entity.

- For example, if Blocked Person X owns 25% of Entity A and Blocked Person Y owns 25% of Entity A, then Entity A is now blocked, because Entity A is owned 50% or more in the aggregate by blocked persons.
- Previously, the 50% rule did not require an aggregation of interests, with the rule being that a single sanctioned entity must own 50% or more of another entity to bring that entity within the scope of sanctions.

OFAC Screening Process Summary

Collect information from the potential third party/customer via standardized form or questionnaire.

Screen the potential third party/customer against OFAC SDN lists and targeted countries. Screen beneficial owners.

Are there any hits? Compare the complete SDN entry information with all information you have on the matching customer.

Approve, Deny, Escalate, or Collect More Information.
Regulatory Compliance: BIS Overview

- BIS administers: Export Administration Regulations (“EAR”) 15 CFR Parts 730-774
- Small percentage of exports under BIS jurisdiction require license
- Most commercial items regulated under EAR
  - Both “dual-use,” items with both commercial and military use, and purely commercial items
- Items with the greatest potential for military use are regulated the most strictly

Complying with BIS’ EAR

- Questions you have to ask to determine EAR compliance requirements:
  1. What am I exporting?
     1. Different types of items have different levels of controls.
  2. Where is it going?
     1. Different countries have different levels of controls.
  3. Who is receiving it?
     1. The end user may affect the level of controls.
  4. What is the end use?
     1. The end use may affect the level of controls.
- Answers to these questions should guide your BIS Compliance Program
Very Basic Overview of BIS Compliance Process

• Generally, the first step is to determine the appropriate Export Control Classification Number (“ECCN”)
  o Listed on the Commerce Control List (“CCL”) in the EAR
  o This is a technical and engineering-based determination that is best made by the manufacturer.
  o You can request an ECCN classification from BIS if you are unsure.

• Generally, the next step is to review the Commerce Country Chart (Supplement No. 1 to Part 738) to determine the level of control for the country of export or reexport
  o Different countries are subject to different levels of control

• Then, determine if a license is required or if an exception is available

BIS & OFAC... What is really required for export compliance?

• Any entity conducting activities abroad should have an export compliance program!
  o Targeted to the unique risks your entity faces
  o Appropriate for the size and scope of your entity

• Sanctions and licensing compliance is a strict liability offense – you can face penalties even if you didn’t “know” about a violation!

• Yes – your export compliance program can address both BIS and OFAC compliance
Integrating Export Compliance within Operations

1. Involve Operational Personnel in Your Initial Risk Assessment
   1. Participating in a risk assessment requires understanding the \textit{WHY} of export compliance

2. Build your Export Compliance Program around your operational structure
   1. It doesn’t work the other way around
   2. Ask your operational personnel:
      1. Who should be responsible?
      2. Where should checks occur?
      3. How can oversight best be managed?

Examples of Operational Check Points

- Every company will be different, where does it make sense to have export compliance checks for your company?
- Build your export compliance and management program based on what makes sense for your organization
Starting Point: Risk Assessment

- Identify your risk sources – where do your export compliance risks come from?
  - Are you exporting overseas?
  - Do you have suppliers overseas?
  - Are you a bank that faces unique compliance challenges and must have robust internal controls in place for every financial transaction?
  - Are you an educational institution whose personnel may be exchanging information with those overseas?
  - Does your business use complex or technologically advanced products overseas?
- This is a chance to involve operational personnel in the discussion!

BIS’ Elements of an Effective Export Compliance Management Program

BIS has provided comprehensive guidance for export compliance programs – list of nine core elements.

1. Management Commitment
   1. Written export compliance documents established by senior management
   2. Sufficient resources
   3. Designated personnel responsible for compliance

2. Continuous Risk Assessment
   1. Yearly update to program
   2. How do your risks change over time?

3. Formal Written Export Management and Compliance Program
   1. Adherence to written policies and operational procedures
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4. Ongoing Training and Awareness
   1. Export compliance is complex, your employees and managers need training to understand their responsibility for compliance

5. Pre/Post Export Compliance Screening
   1. Screen all parties to a transaction throughout export life cycle
   2. This step is critical for OFAC compliance
   3. OFAC sanctions change frequently – you must screen in real time

6. Recordkeeping Regulatory Requirements
   1. FIVE year record retention
   2. System for keeping organized

7. Internal and External Compliance Monitoring – Periodic Audits
   1. Export compliance audits are critical to ensure your program is working
   2. An export compliance audit can be scaled to the size of your company
   3. Third parties may be appropriate for large entities to ensure comprehensive review

8. Reporting Structure
   1. Provide system for internal reports – encourage whistleblowers
   2. System for reviewing and reporting potential violations – significant decrease in likelihood of any penalty

9. Corrective Actions in Response to Export Violations
   1. When discovered, be proactive in remediation
   2. Voluntarily report AND initiate changes to internal controls to prevent from reoccurrence
Voluntary Disclosures

- **Procedures** are set forth in regulations
  - OFAC and BIS
- Self-disclosure is a **mitigating factor** in Civil Penalty proceedings.
- OFAC and BIS review the **totality of the circumstances** surrounding any violation, including the quality of a company’s export and sanctions compliance program.
- **Results:**
  - No Action Letter
  - Warning Letter
  - Civil Penalty
  - License revocation
  - Criminal referral

Stepping Back: Basic Steps of an Export Compliance Program

1. **Risk Assessment** to determine which regulatory compliance obligations will impact your business – BIS? OFAC?
   - Where do you do business? Who are your customers? Are your products dual use?
2. **Identify where** in your operational chain responsibility for export compliance checks should rest
   - What step in your sales or operational process should be responsible for what aspect of export compliance? Who should screen your customer names?
3. **Design an export compliance program** that fulfills the expectations of enforcement agencies
   - BIS has clearly laid out the elements of an effective export compliance management program.
4. **Perform annual audits and reviews** to determine how your program is performing and how it can be improved
Questions?

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