KPMG SMART PRACTICE

Sectoral sanctions: You're not just managing the SDN list anymore

Many export compliance professionals live and breathe US sanctions regulations – and with good reason. US sanctions typically prohibit US persons and entities from conducting business with certain designated persons, entities, countries or regions. When managing designated entities or individuals, the focus is typically on the Office of Foreign Assets Control ("OFAC") Specially Designated Nationals ("SDN") list. This list prohibits any transaction with the designated person or entity. For a US person, it is a blanket prohibition on commercial engagement. While the size of the SDN list makes it challenging to manage, the general prohibition means there is little nuance in applying it. This contrasts with sectoral sanctions.

Unlike the SDN list, sectoral sanctions are designed to target specific industries or entities while limiting the negative effects on others. Sectoral sanctions emerged as an important policy tool in 2014 with the Russian incursion into Ukraine. In response, the US government announced the Sectoral Sanctions Identifications ("SSI") list pursuant to Executive Order 13662 limiting US person association with certain economic sectors. However, although these sanctions have been effective, they are also challenging for compliance professionals to manage. Unlike the SDN list, the SSI list doesn't impose restrictions – those come through directives. So, not only must compliance staff understand the scope of each directive and how it applies to their company's activities, but they must also stay on top of any amendments. The directives associated with the SSI list have been modified a number of times, impacting the scope of permissible activities.

Defining the scope of the directives can be another challenge. In an OFAC enforcement action, a US company accepted payment from a SSI entity (designated under Directive 2, which prohibits dealing in new debt with a tenor of more than 90 days) that had been owed for more than 90 days, meaning that the US company had dealt in prohibited new debt of the designated entity. This violation resulted in a fine exceeding $75,000. This is just one example of sectoral sanctions' complexities – there are a growing number that compliance professionals may need to consider.

As OFAC has also sought to apply the nuanced sectoral sanctions approach to sanctions in other jurisdictions, like Venezuela, – rather than outright prohibitions – by targeting specific sectors of each economy, the message is clear: this new approach is here to stay. As a result, export compliance professionals would be well advised to incorporate sectoral sanctions management into their programs.

Export compliance professionals should consider a tiered approach to sectoral sanctions management when crafting processes and procedures. Given that many sectoral sanctions are highly nuanced, a multi-layer review provides the most certainty around maintaining compliance while not taxing resources.

The first level of review is a preliminary determination about whether a potential transaction may be subject to sectoral sanctions. This may include an initial review of the geographic location and type of product or service involved.

Example of Russia sectoral sanctions

The Russian sanctions not only involve multiple directives but also multiple executive orders ("EOs"). The below chart illustrates the complexity of managing sectoral sanctions.

Directive	Target	Restrictions
#1 under EO 13662	Financial sector	New debt and new equity with a tenor of more than 14 days*
#2 under EO 13662	Energy sector	New debt with a tenor of more than 60 days**
#3 under EO 13662	Defense and related materiel sector	New debt with a tenor of more than 30 days
#4 under EO 13662	Energy sector	Oil production activities
#1 under 15 April 2021 EO	Sovereign debt	Non-Ruble denominated bonds

*Applies to debt or equity issued after 28 November 2017. For new debt or new equity issued on or after 12 September 2014 and before 28 November 2017, maximum tenor is 30 days. For new debt or new equity issued on or after 16 July 2014 and before 12 September 2014, maximum tenor is 90 days.

**Applies to new debt issued after 28 November 2017. For new debt issued on or after 16 July 2014 and before 28 November 2017, maximum tenor is 90 days.

For instance, all transactions pertaining to a specific geographic region or type of industry would be routed to this team member. This person would then perform a high-level review based on available information. If the transaction appeared on its face to be subject to sectoral sanctions it would be escalated for a more in-depth assessment.

The next level of review would be a detailed analysis of the specific facts of the proposed transaction in relation to the applicable sectoral sanctions regime. The team member performing the review would have a deep knowledge of the applicable sanctions program and sufficient seniority to make a final determination about whether to proceed. This review would include identifying all parties and geographic regions involved, the controlling sectoral sanctions, the scope of the transaction and then documenting the permissible activities and limitations. Additionally, this person would oversee any change management required as the applicable sectoral sanctions evolved. Using this structure, substantive expertise can be concentrated at higher levels, while a junior team member performs an initial review. This allows experienced personnel to have visibility into potentially sensitive transactions while facilitating the development of junior personnel.

Sectoral sanctions are certainly tricky but investing the time into developing a sound compliance plan will help manage the risk. Further, it is likely that sectoral sanctions are the wave of the future – meaning that knowing your risk areas will be an imperative. Promoting a nimble compliance culture combined with clear procedures will help your enterprise to stay one step ahead of potential pitfalls. ■

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