Russia-Ukraine war: Managing third-party compliance with sanctions

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The Russia-Ukraine war has prompted many companies to cease operations in Russia, at least until the fighting stops. But for many firms, the war and related sanctions create additional challenges including ensuring that their supply chains – and their supply chains' third-party suppliers – are not subject to the growing list of sanctions being applied by the U.S. and other governments. Failing to adhere to the complex sanctions rules could prove very costly, both financially and in potential damage to reputation.

In this article, we detail some of the more recent sanctions and what companies need to do now to stay compliant.

The sanctions list keeps evolving

With the fast-growing list of sanctions on Russian companies, banks and individuals, U.S. companies need to increase scrutiny on third parties to manage compliance, not just with U.S. regulations, but with more stringent European sanctions that could affect U.S. overseas subsidiaries. These are some recent sanctions that companies should be considering for third-party compliance:

- **Ban on new investment in Russia:** President Biden issued an executive order on April 6, 2022, which imposes a ban on all new investments in Russia. This is a potentially huge development, which prohibits companies from even investing in their own subsidiaries.
- **The 50 Percent Rule** from The Office for Foreign Assets Control (OFAC) in the U.S. Department of Justice: Any company that is 50 percent or more owned by a blocked individual or company, is considered blocked by the sanctions. The European Union adopted an even more restrictive rule for companies owned or controlled by blocked individuals.
- **Expanded export controls:** Another major challenge for companies is a focus on navigating export control restrictions with limited exceptions and extraterritorial controls on foreign-produced items. Third-party due diligence requires checks for certain end-uses and end-users, even for foreign-produced, non-U.S.-origin items that could be subject to U.S. export controls.
- **Import bans:** New import bans on Russian and Belarusian products present a challenge as some companies are required to reshuffle their supply chains and enhance due diligence.

What you can do now

Company compliance programs will differ, depending on how directly it and its suppliers are involved with Russian trade and products imported and exported to the region. Here are some steps that every company should consider to comply with sanctions and avoid financial and reputation risks from violations:

- **Screen and rescreen:** Screening involves comparing data from your potential business partners, including distributors and resellers with the "watchlists" issued by U.S. OFAC and other global regulators. It is not enough to screen only once; instead, implement a program of frequent rescreening and risk-based due diligence involving beneficial ownership, political exposure, military end use ("MEU") implications as well as overall adverse reputation of the third parties.
- **Conduct risk assessments:** Given the potential liability associated with knowing your supplier/customer base and where products are coming from/going, conduct third-party risk assessments that also evaluate export controls and sanctions risks.

- **Review contracts:** All contracts with third parties should contain language that the company will not be involved in any transaction that would be prohibited by sanctions or export controls. Consider adding in a right to audit and provisions for indemnification if violations occur.
- **Improve data collection:** Gather quality, accurate data from your third-party business partners through the onboarding process to include relevant questionnaires. This may involve requesting information regarding the end-use and end-users of export-controlled products for distributors and resellers, obtaining country of origin and supply chain networks information from suppliers, as well as acquiring beneficial ownership structures when appropriate.
- **Evaluate your program:** Measure your third-party risk management and trade compliance programs to improve effectiveness of policies, procedures, desk instructions, and ongoing internal assessments. Make sure personnel have adequate training and can recognize red flags for third-party risks.
- **Act expeditiously:** Implement a comprehensive sanctions compliance program as soon as possible. While there has been no determination so far about the extent of financial penalties for violating sanctions, the costs could be considerable if a third-party supplier is found to be in persistent violation of the rules. Perhaps even more important, a company could suffer damage to brand and reputation if the government makes a public case for sanctions violations. Consumer boycotts have already been launched against companies that continue to operate in Russia. The consequences for companies found to be in violation of the law could be more severe.

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