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Insights

OFSI: THE UK'S HITHERTO SLUMBERING REGULATOR FINALLY BARES ITS TEETH

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SUMMARY

In its most significant enforcement action to date, HM Treasury's Office of Financial Sanctions Implementation ("**OFSI**") has imposed a £20.47 million penalty on Standard Chartered Bank ("**SCB**") for breaching a prohibition imposed by EU financial sanctions legislation. This penalty, the fourth since OFSI's establishment, is of an entirely different magnitude to the three penalties previously imposed and which totalled just over £160,000.
The published decision from OFSI is regrettably opaque in identifying the precise considerations that resulted in that unprecedented penalty, provides little positive guidance to financial institutions as to how that penalty for a 'very serious' case has been calculated and how such firms might expect penalties to be calculated in relation to breaches that come to light.

HM Treasury's Office of Financial Sanctions Implementation ("**OFSI**") is the body responsible for ensuring that financial sanctions are implemented and enforced in the UK.

Since its establishment in March 2016, OFSI has imposed only four penalties. Its first was a penalty of £5,000 in January 2019. That was followed by a penalty of £10,000 in March 2019 and then, in September 2019, a penalty against telecoms company, Telia Carrier UK, of £146,341.

The penalty imposed on SCB Bank is therefore by far the biggest that OFSI has levied and is the first time that OFSI has bared its teeth and demonstrated its powers as an enforcement agency.

Background/context to penalty

OFSI was established in March 2016 and, in April 2017, gained significant and new powers to impose civil monetary penalties under the Policing and Crime Act 2017 ("**PACA**") for financial sanctions violations. Until the imposition of the penalty on SCB, it had kept a very low profile as an enforcement agency.

OFSI found that SCB had breached Article 5(3) of EU Regulation 833/2014 and Regulation 3B of The Ukraine (European Union Financial Sanctions) (No.3) Regulations 2014 for a series of loans that it made to Denizbank A.Ş. The penalties ultimately imposed £7.69 million and £12.78 million, for each respective series of breaches, making a total penalty of £20.47 million.

SCB made a series of 102 loans to Denizbank between 8 April 2015 and 26 January 2018. At the time the loans were made Denizbank was almost wholly-owned by the Russian Sberbank, which itself was subject to the measures set out above. This meant that Denizbank, as a subsidiary, also fell into the scope of the restrictions.

Article 5(3) of the EU Regulation prohibits any EU person from making loans or credit available to sanctioned entities, where those loans or credit have a maturity of over 30 days. There is an exemption to this under Article 5(3)(a) which ensures the protection of legitimate EU trade. In order to rely on this exemption there must be an 'EU nexus' i.e. that the financed trades concern goods coming in or out of the EU. OFSI determined that 70 of the 102 loans made by SCB to Denizbank did not have a qualifying EU nexus and therefore they were in breach of the EU regulation.

OFSI apply the civil standard of balance of probabilities when considering the evidence and, in this case, was satisfied that SCB breached the relevant prohibition and had reasonable cause to suspect that it was in breach of the prohibition.

Calculation of the penalty

So, why was the penalty handed out by OFSI so large in this instance? There are numerous reasons, including its classification as one of the 'most serious' cases, the fact that that the loans persisted over a number of years, and the value of the breach at an estimate £97.4 million transaction value.

Although 70 of the loans (with an estimated transaction value of over £266 million) were deemed to be violations, because OFSI's powers to impose monetary penalties only came into force in April 2017, they were only able to penalise SCB for the 21 loans that fell after this date (those issued between 7 April 2017 and 26 January 2018). So, the amount imposed was a reflection of the period over which SCB was liable rather than a reflection of the scale of the breaches.

Before applying any reductions, OFSI assessed the penalties in these cases at £17 million and £28 million respectively giving a total of £45 million.

In line with OFSI's published guidance on case assessment, a 30% reduction of the monetary penalty was applied in this case because SCB voluntarily disclosed the suspected breaches to OFSI and fully cooperated with their investigation, among other reasons. This was the maximum reduction available in a case classified by OFSI as 'most serious'. In cases classified as merely 'serious' OFSI may offer firms up to a 50% reduction on the monetary penalty upon assessment of a variety of aggravating and mitigating factors.

That reduction resulted in penalties which OFSI initially sought to impose in the amounts of £11.9 million and £19.6 million resulting in a total penalty of £31.5 million.

SCB sought a Ministerial review of OFSI decisions under section 147 of the Policing and Crime Act 2017 which enables a Minister of the Crown to (a) uphold the decision to impose the penalty and its amount; or (b) uphold the decision to impose the penalty but substitute a different amount; or (c) cancel the decision to impose the penalty.

In terms of the Minister's methodology, OFSI's report at paragraph 14 sets out the following:

"The Minister upheld OFSI's decision to impose the penalty. The Minister agreed that Standard Chartered Bank had made the 21 loans, with a combined estimated transaction value of £97,484,808.71 (£97.4 million GBP), directly available to a person subject to the prohibitions contained in Article 5(3) of the EU Regulation. He agreed that this was a 'most serious' breach of financial sanctions. However, he gave further consideration to Standard Chartered Bank's investigative report and found that they did not wilfully breach the sanctions regime, had acted in good faith, had intended to comply with the relevant restrictions, had fully co-operated with OFSI and had taken remedial steps following the breach. The Minister took the view that while these factors had been considered in OFSI's assessment, they should have been given more weight in the penalty recommendation."

In consequence, the Minister upheld the decisions to impose the penalties but substituted penalties of £7,693,233.50 and £12,778,576.33, thus making a total penalty of £20,471,809.83.

However, what is entirely unclear is whether the Minister agreed that the starting point for a penalty before any reductions was £45 million as OFSI had originally calculated (in which case the final penalties had been discounted by more than 55%) or whether he had taken a lower starting point in which case the amount of the discount is entirely uncertain. It would have been helpful to know the answer to this so that financial institutions have a clear understanding of how breaches and any co-operation provided

It should be noted that SCB also had the option of a further avenue of appeal via the Upper Tribunal which they decided not to exercise.

Significance of this decision for financial institutions

This level of monetary penalty from OFSI is certainly unprecedented and it highlights the importance for financial institutions to ensure their full understanding of and compliance with, relevant financial sanctions legislation, and the specific prohibitions within that legislation. The Financial Sanctions Guidance (updated in January 2020) must be embedded in any compliance programme.

Establishing an effective sanctions compliance programme with appropriate policies and processes, including robust KYC checks to ensure that high-risk counterparties are identified, has never been more important for firms to ensure that breaches of financial sanctions are either prevented or recognised early. OFSI publish a comprehensive list and offer email alerts as to which persons and entities are designated under each financial sanctions regime and firms should make certain they have the appropriate checks in place so that they are aware of any changes or updates to these lists. Processes should also be reviewed on an ongoing basis to ensure they remain effective.

Upon discovering a potential financial sanctions breach, firms must also bear in mind their other legal and regulatory notification duties. In particular, UK authorised financial services firms may have a duty to notify the FCA and, if applicable, the PRA. The FCA has made clear that it regards financial sanctions systems and controls as an area of focus and consequently there may be separate regulatory exposure for firms and individuals in connection with systems and controls failings in this area. Notifications to regulators should therefore be drafted with care and accuracy.

It is clear that full voluntary disclosure can make a very significant impact within OFSI's enforcement regime: it may be a mitigating factor when OFSI initially assesses a case and, if OFSI decides to impose a penalty, voluntary disclosure will substantially reduce the level of the penalty imposed. It is important to keep in mind that there have been cases, in our experience, where voluntary disclosure coupled with full co-operation have resulted in OFSI determining to take no action.

This decision also demonstrates there may be real value for firms in challenging the level of penalty decisions as they are entitled to do under the regime. In this case, SCB's decision to exercise its statutory right in seeking a Ministerial review of the decision led to a reduction of some £11 million from the penalty originally imposed by OFSI.

The lack of transparency in the methodology adopted by the Minister here, however, leaves a level of uncertainty for firms which could readily have been ameliorated or extinguished. Firms and those that they turn to for advice should not have to guess as to the methodology to be applied. Each case will turn, of course, on its own facts but where previous cases can provide that methodology, they should do so in clear terms.

Firms will scrutinise this decision with care and with an increased appreciation of OFSI's powers. This decision should underline that no firm can afford to be complacent in its compliance obligations in relation to financial sanctions.

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