OFSI gears up to use its civil enforcement powers



The Office of Financial Sanctions Implementation is the UK's new(-ish) financial sanctions authority. Eighteen months old, it's yet to use its civil enforcement powers. Rachel Barnes, Patrick Hill and Genevieve Woods consider why and what the future may hold.

The UK's Office of Financial Sanctions Implementation ('OFSI') is the UK's competent authority for implementing and enforcing financial sanctions. It has enjoyed powers to impose civil monetary penalties for serious breaches of financial sanctions since April 2017, yet in 18 months it has never exercised those powers. This article examines why that may be the case, why OFSI's approach may now be changing, and what the future may bring.

OFSI's first year: education and engagement

OFSI was established on 31 March 2016. The government's intent, set out in the 2015 Summer Budget, was that:

'The Office will provide a high-quality service to the private sector, working closely with law enforcement to help ensure that financial sanctions are properly understood, implemented and enforced. This will ensure financial sanctions make the fullest possible contributions to the UK's foreign policy and national security goals and help maintain the integrity of and confidence in the UK financial services sector.'

During its first year of operation, OFSI primarily focused on education and engagement. It issued guidance on compliance while its proposed enforcement powers progressed through parliament, in the form of the Policing and Crime Bill. Until that bill was passed, OFSI did not have the power to impose civil monetary penalties for breaches of financial sanctions and nor could appropriate sanctions cases be resolved by deferred prosecution agreements.

OFSI's second year: gaining new powers

The Policing and Crime Act 2017 ('the 2017 Act') came into force on 1 April 2017. Along with adding sanctions cases to the list of cases to which deferred prosecution agreements ('DPAs') can be applied, the 2017 Act gave OFSI new civil enforcement powers as an alternative to referring matters for criminal prosecution.

The 2017 Act is not retrospective; OFSI's civil enforcement powers only apply to breaches which have occurred after 1 April 2017.

In order to impose a civil monetary penalty, OFSI must be satisfied on the balance of probabilities that there has been a breach or failure to comply with an obligation imposed by or under financial sanctions legislation, and that the person or corporation in breach knew or had reasonable cause to suspect that they were in breach of the prohibition or had failed to comply with the obligation.

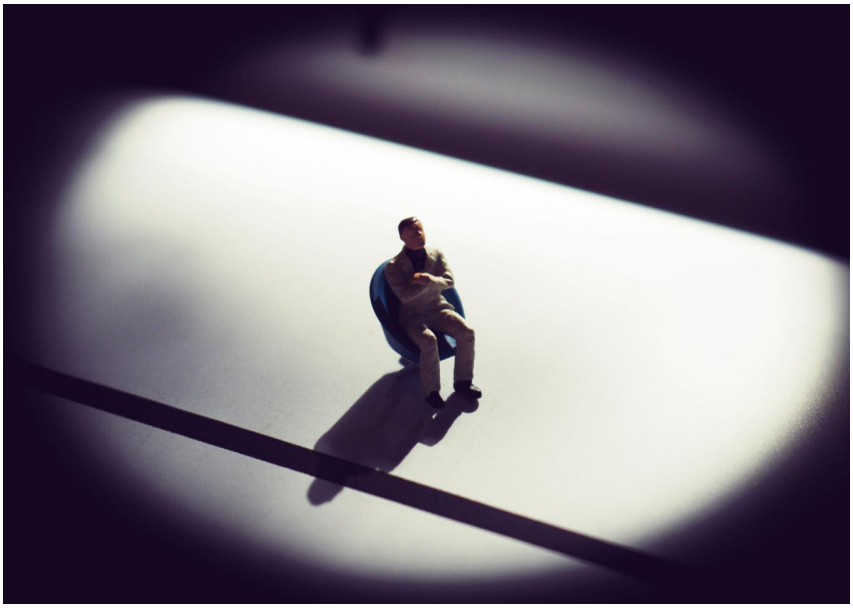
If OFSI can estimate the value of the funds involved in the breach, the maximum penalty is the greater of £1,000,000 or 50% of the estimated value. In all other cases, the maximum penalty is £1,000,000.

Why OFSI hasn't yet used its civil powers

OFSI has been empowered to impose heavy fines for breaches of sanctions at its discretion for the past 18 months, so why has it been so reluctant to exercise these powers?

An initial clue lies in a blog written by the Head of Enforcement and Engagement for OFSI on 29 March 2018:

'I think that the best enforcement is 100% compliance – that is, everyone has properly assessed their risks, taken sensible steps to manage them and, consequently, doesn't break the law. That can only happen if people



understand how financial sanctions work – what your risk is and how the law applies to you'.

In other words, and consistent with the statement of intent in the 2015 Summer Budget, OFSI's compliance and enforcement strategy has to date been concerned with ensuring that financial sanctions are 'properly understood' and 'implemented' as a necessary precursor to 'enforcement' (an overall policy summarised by OFSI as: 'promote, enable, respond [and] change'). To the extent that 'preventative education', promoting a culture of compliance, and 'capacity development' are successful, resort to 'hard' enforcement powers may be less necessary.

Second, and perhaps most significantly, the 2017 Act is not retrospective; OFSI's civil enforcement powers only apply to breaches which have occurred after 1 April 2017. The fact that penalties have not been imposed to date should therefore not be taken as an indication of the overall health of sanctions compliance in the UK. OFSI investigations into some reports of suspected breaches are ongoing and the regime's 'youth' together with OFSI's initial compliance strategy has resulted in a measure of early restraint that cannot be assumed to persist indefinitely. OFSI has made plain in its guidance that it is in the process of 'learning'. Part of OFSI's own learning has been the 'mock' application of its civil enforcement powers to pre-April 2017 breaches reported to it: telling a reporting company that had it been able to apply a monetary penalty to the breach, it would have done so and specifying an amount of such a penalty. OFSI will become more confident in its enforcement function as it 'matures'. In the interim, it is biding its time until it receives reports of sufficiently serious breaches post-dating the April 2017 start date that are appropriate for disposal by way of civil monetary penalties.

A third (and related) reason why OFSI has not yet imposed penalties is that it has thus far preferred to exercise its soft powers. Those powers include: (1) contacting persons and explaining OFSI's view that the action may breach sanctions; (2) issuing correspondence requiring details of how a party proposes to improve their compliance practices in the future; or (3) issuing warnings or cautions. Of course, OFSI's willingness to exercise those 'soft' powers will invariably depend on a number of factors. An indication of 'circumstances in which [OFSI] may consider it appropriate' to impose civil monetary penalties may be gleaned from OFSI's statutory guidance, most recently the Monetary Penalties for Breaches of Financial Sanctions Guidance issued in May 2018.

In the May 2018 guidance, OFSI sets out its case assessment and penalty decision strategy (see box). The guidance stresses the need for a 'proportionate' and 'fair' assessment of every case and states that penalties will only be imposed in cases classified as 'serious' or 'most serious'. OFSI emphasises in its guidance (at 4.4) that the imposition of a penalty is permissive and not mandatory: 'If the penalty threshold is reached, we may impose a penalty. We have discretion not to do so.'

OFSI's guidance is due to be revised in April 2019 and there are indications that the existing approach of restraint and reluctant punishment may change.

The May 2018 guidance identifies a non-exhaustive list of factors that OFSI will take into account when deciding whether to impose penalties. The following factors will generally tend in favour of penalties:

1. funds or economic resources are made available to a designated person;
2. intentionally and knowingly circumventing sanctions and/or facilitating a breach by others;
3. high-value breaches;
4. calculated and deliberate breaches and possibly also where there is evidence of neglect or a failure to take reasonable care (other, less serious, factors OFSI will consider are whether there has been a systems and control failure, an incorrect legal interpretation, a lack of awareness of one's responsibilities or simply a mistake);
5. serious harm to the sanctions regime's objectives;
6. actual or expected knowledge of and the extent of ways of complying with the sanctions;
7. repeated, persistent or extended breaches.

(See also box on following page.)

Monetary penalties are on the horizon

OFSI's guidance is due to be revised in April 2019 and there are indications that the existing approach of restraint and reluctant punishment may change. Certainly, the fact that OFSI has not exercised its hard powers to date should not be taken as an indication that it will not do so in future. In fact, the OFSI 2018 annual report expressly states that penalties are on the horizon, though it suggests that they will remain the exception rather than the rule: 'It is likely that OFSI will impose monetary penalties in 2018-19. We will continue to consider the full range of potential action in every case. The majority of cases, as now, will be resolved by enforcement activity short of a penalty.'

OFSI Monetary Penalties for Breaches of Financial Sanctions Guidance (May 2018)

Discretion not to impose a penalty

4.21 To ensure fair treatment of all on whom we impose a penalty, we will normally follow the above process in each case. However, we reserve the right not to impose a penalty in certain circumstances. These may vary, but will generally include the following:

- imposing the penalty would have no meaningful effect – for example, the value of the penalty is so low it would neither deter offending nor provide restitution for the wrongdoing;
- imposing the penalty would be perverse – for example, the tests for a penalty are met but there is clear evidence that the offence arose from improper coercion;
- it is not in the public interest to impose a penalty.

OFSI Monetary Penalties for Breaches of Financial Sanctions Guidance (May 2018)

Seriousness factors

- 'We are likely to treat a case that directly and openly involves a designated person more seriously than one that is a breach of financial sanctions but does not make funds or economic resources available to a designated person and openly involves a designated person more seriously than one that is a breach of financial sanctions but does not make funds or economic resources available to a designated person' (3.16)
- 'OFSI takes circumvention very seriously because it attacks the integrity of the financial system and damages public confidence in the foreign policy and national security objectives that the sanctions regimes support. We will normally impose a monetary penalty if the case is not prosecuted criminally.' (3.17)
- 'A high-value breach is generally more likely to result in enforcement action.' (3.18)
- 'Calculated and deliberate flouting of sanctions' (3.18), likewise OFSI will consider 'whether the breach seems to be deliberate; whether there is evidence of neglect or a failure to take reasonable care; whether there has been a systems and control failure or an incorrect legal interpretation; whether the person seems unaware of their responsibilities; or whether there has simply been a mistake' (3.24)
- 'The greater the risk of harm to the regime's objectives, the more seriously we are likely to regard a case' (3.19)
- 'The level of actual or expected knowledge and the extent of relevant ways of complying' will be taken into account (3.20)
- 'Repeated, persistent or extended breaches' are more likely to result in 'more serious action' being taken by OFSI (3.28)

This prediction is supported by the number of suspected breaches which have been reported to OFSI: in 2016, £75 million worth of breaches was reported, while in 2017 the total was £1.4 billion. Some of these cases are still under investigation. Between the coming into force of the 2017 Act and the publication of its 2018 annual report, OFSI received reports of 103 contraventions. As the number of reports increases, so too does the likelihood that OFSI will find cases which cross its penalty threshold, and that it will broaden its 'fair and proportionate' focus on soft compliance to encompass stronger punitive measures.

That trend would echo the approach taken by OFAC, where monetary penalties have been used extensively and for many years. In 2017, OFAC imposed fines of $119 million on companies found to have breached US financial and trade sanctions, including companies based in the EU.

DPAs

In addition to imposing civil penalties, OFSI now has another tool since the 2017 Act brought financial sanctions into the scope of deferred prosecution agreements for the first time. Rather than pursuing criminal prosecutions, those who are found to be in serious breach of UK sanctions may be permitted to enter into a DPA. OFSI has not issued separate guidance on DPAs; the DPA Code of Practice adopted by the Crown Prosecution Service and the Serious Fraud Office will apply, together with the Code for Crown Prosecutors and the Joint Prosecution Guidance on Corporate Prosecutions. Factors such as self-reporting and restorative measures would likely be prerequisites to a prosecutor offering a DPA, which is in keeping with OFSI's emphasis to date on compliance and monitoring rather than the use of punitive measures.

As OFSI matures and the number of breaches reported to it increases so will the number of cases which could appropriately be resolved by way of a DPA. That said, the Rolls-Royce, Tesco and Skansen Interiors cases show that obtaining the offer of, and successfully negotiating and obtaining judicial approval for, DPAs can be complex and by no means a given outcome in a seemingly appropriate case. We anticipate that DPAs will remain relatively limited in sanctions cases and that OFSI will look first to use its monetary penalties powers. As such, OFSI's approach will have similarities to HMRC's use of its compound penalties scheme in export control cases.

Concluding observations

Much of the commentary on the potential impact of Brexit upon the UK's financial sanctions landscape has focused upon the substance of the UK's future sanctions regimes rather than their enforcement. The government has reaffirmed the UK's commitment to the application of EU sanctions after Brexit; for example, at the Munich Security Conference in February 2018, Prime Minister Theresa May stated: 'We will look to carry over all EU sanctions at the time of our departure. And we will all be stronger if the UK and EU have the means to co-operate on sanctions now and potentially to develop them together in the future'. The new Sanctions and Anti-Money Laundering Act 2018 enables that transition. Beyond the immediate aftermath it remains to be seen precisely what the UK's sanctions post-Brexit landscape will look like. The potential penalties that can be imposed in the UK for sanctions breaches are already greater than in many European states. What is likely is that the UK's sanctions enforcement will increase in frequency and severity as OFSI embraces its new powers.

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