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OFSI Fines Standard Chartered Bank £20M for Sectoral Sanctions Breaches

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- The Office of Financial Sanctions Implementation ("OFSI") has announced the imposition of a £20.4 million penalty on Standard Chartered as a result of the bank's loans to a Turkish bank, Denizbank, which was majority owned by Russian bank Sberbank.
- Sberbank is one of Russia's largest banks and is subject to so-called "sectoral sanctions" imposed by the European Union ("EU") (and the U.S.).
- This case is by far OFSI's largest and most significant sanctions enforcement action.
- Standard Chartered exercised its rights to have OFSI's original penalty decision reviewed. Following this review, the Economic Secretary to the Treasury, John Glen, upheld the decision to impose two penalties against Standard Chartered, but reduced the total penalty from £31.5 million to £20.47 million.

Background

The Rules

Following Russia's annexation of Crimea in March 2014, the EU (along with other countries) adopted regulations that imposed so-called "sectoral sanctions" against a small number of Russian companies in the banking, oil, and defense sectors, including Sberbank. These sanctions prohibit EU operators from dealings in certain types of debt and equity issued by targeted companies and prohibit EU operators from, directly or indirectly, making or being part of "any arrangement to make new loans or credit with a maturity exceeding 30 days" available to these companies.

In addition to the small number of companies specifically listed in the EU Regulations, the sectoral sanctions apply to any legal person: (a) established outside of the EU that is owned more than 50% by one of the listed companies, and/or (b) who acts on behalf (or at the direction) of any of the listed companies or any entity based outside of the EU that is 50% or more owned by any listed company. However, neither the EU nor the UK publishes an official list of legal persons that are majority owned or controlled by a sanctioned company.

The sectoral sanctions contain exemptions that permit transactions that otherwise would be prohibited. One such exemption, set forth in Article 5(3)(a) of EU Regulation 2014/833, permits EU operators to provide loans to sectorally sanctioned companies that have the "specific and documented objective [of] . . . financing . . . non-prohibited imports or exports of goods" between the EU and any third country. For this exemption to apply, the financing must contain an "EU nexus" such that goods are either imported to, or exported from, the EU.

OFSI's Role in Sanctions Enforcement

In 2016, the UK government established the OFSI to create a statutory body to administer and enforce economic sanctions. In April 2017, OFSI was granted the authority to impose significant civil financial penalties on sanctions violators pursuant to section 146 of the Policing and Crime Act 2017 ("PACA"). Section 146 of PACA enables OFSI to impose maximum penalties that are the greater of £1 million or 50% of the value of the funds or resources involved in the sanctions breach. Notably, it seems that these penalties are to be calculated on a per breach basis, which means that the maximum penalties associated with sanctions violations can add up quickly.

When determining penalties for sanctions breaches, OFSI first determines the statutory maximum penalty. OFSI then assesses what level of penalty would be reasonable and proportionate based on the breach at issue by considering various factors, including the value of the breach (if known) and how seriously the breach undermined the sanctions regime. In addition, OFSI categorizes sanctions breaches as either "serious" or "most serious." The latter category of penalties involves higher value breaches, flagrant or willful breaches and/or breaches that significantly undermine the purposes of the relevant sanctions regime.

OFSI reduces the baseline penalty amount for parties that voluntarily self-disclose sanctions violations. Parties that self-report "serious" violations can receive a voluntary disclosure reduction of up to 50%. The potential reduction for the "most

serious" sanctions violations is more limited, with self-reporting parties receiving a maximum discount of 30% off the baseline penalty.

The Facts

Denizbank is a Turkish private bank that was majority owned by Sberbank in 2014. Sberbank's equity interest meant that Denizbank was subject to the same EU sectoral sanctions as Sberbank. Standard Chartered appears to have had an existing relationship with Denizbank but ceased all trade finance business with Denizbank after Sberbank was targeted by the sectoral sanctions in 2014.

However, Standard Chartered resumed business with Denizbank in 2015, following the bank's assessment that certain dealings with Denizbank were permissible pursuant to the Article 5(3)(a) exemption (see above). Between 8 April 2015 and 26 January 2018, Standard Chartered made a total of 102 loans to Denizbank. At some point after January 2018, Standard Chartered apparently concluded that its loans to Denizbank did not, after all, fit within the Article 5(3)(a) exemption. Standard Chartered subsequently self-reported its violations to OFSI.

OFSI determined that 70 of the 102 loans that Standard Chartered made to Denizbank did not have an EU nexus, so were not covered by the Article 5(3)(a) exemption and constituted breaches of the sectoral sanctions. The estimated value of these 70 loans was over £266 million. OFSI's enforcement powers only permit it to penalise parties for sanctions violations that occur after April 2017. As a result, OFSI only penalised Standard Chartered for 21 of the violative loans, which totaled £97.4 million. OFSI imposed two separate penalties on Standard Chartered of £11.9 million on 5 August 2019 and £19.6 million on 6 December 2019 (totaling £31.5 million).

Standard Chartered exercised its rights to have OFSI's penalty reviewed by a Minister of the Crown.[1] The Economic Secretary to the Treasury, John Glen, upheld OFSI's finding that Standard Chartered's loans to Denizbank violated the sectoral sanctions and that such violations constituted a "most serious" breach. However, he reduced the penalties from £31.5 million to £20.47 million because Standard Chartered had: (a) not willfully breached the sanctions regime, (b) acted in good faith, (c) intended to comply with the relevant restrictions, (d) fully co-operated with OFSI and (e) taken remedial actions. Although OFSI had considered these factors when calculating its initial penalty, the Economic Secretary to the Treasury concluded that OFSI should have given them more weight when calculating the applicable penalty.

Key Takeaways

- **OFSI Imposed an Unprecedented Monetary Penalty on Standard Chartered.** Standard Chartered's £20 million fine in this case stands in very stark contrast to earlier financial penalties imposed by OFSI for sanctions violations, which included a £5,000 fine against Raphaels Bank and a £10,000 fine against Travelex. OFSI's more recent fine in late 2019 of £146,341 against Telia Carrier UK Limited and this Standard Chartered matter represent a sea change in OFSI's approach to enforcement.
- **Standard Chartered Benefited From Appealing OFSI's Initial Penalty.** After challenging OFSI's penalty through ministerial review, the Treasury Minister concluded that OFSI failed to give adequate weight to certain mitigating factors when calculating the penalty. As a result, the Minister reduced Standard Chartered's total penalty from £31.5 million to £20.47 million. Other parties have also had their penalties reduced on appeal. OFSI initially assessed a £300,000 penalty on Telia last year, but the amount was reduced on appeal by over 50%. These cases suggest that parties subject to OFSI enforcement actions may achieve significant benefits by invoking ministerial review.
- **Standard Chartered Identified Sanctions Concerns Regarding The Loans, but Appears to Have Incorrectly Analyzed These Issues.** The details regarding Standard Chartered's underlying conduct are sparse. Based on the limited available information, it is hard to reconcile how Standard Chartered considered sanctions issues when deciding to grant the loans in 2017 and 2018 and then subsequently self-reported these loans to OFSI. Presumably, Standard Chartered determined that it had made a mistake in its original assessment.
- **Standard Chartered Received Self-Disclosure Credit.** OFSI's Penalty Report states that Standard Chartered notified OFSI of its violations by submitting a voluntary disclosure. As a result, OFSI lowered Standard Chartered's baseline penalty by the maximum amount of 30%. However, Standard Chartered likely also would have had to consider mandatory reporting obligations to OFSI and other UK government agencies (e.g., the National Crime Agency).
- **This Enforcement Action Highlights the Importance of KYC.** Neither the EU nor the UK publishes a list of companies that are majority owned by or act on behalf of sectorally sanctioned Russian companies. In the absence of such lists, it is critically important for financial institutions and operating companies to conduct robust "know-your-counterparty" checks to ensure that they understand with whom they are doing business. By taking these steps, entities will be better positioned to identify entities that are indirectly subject to sectoral sanctions (or other types of sanctions) and thus mitigate their potential risk.
- **The U.S. Government has not Brought an Enforcement Action Against Standard Chartered for These Loans.** In the past decade, OFAC brought two significant enforcement actions against Standard Chartered for violating U.S.

sanctions programs. However, OFAC has not penalised Standard Chartered for running afoul of the U.S. sectoral sanctions through its loans to Denizbank. Based on OFSI's report, it is unclear whether the Denizbank loans had a U.S. nexus sufficient for OFAC to assert jurisdiction over Standard Chartered. But even if they did, Standard Chartered likely would not face an OFAC enforcement action because OFAC published a general license in 2014 authorizing transactions with Denizbank (and entities 50% or more owned by Denizbank) that otherwise would be prohibited by Directive 1 of the U.S. sectoral sanctions.

Conclusion

The penalty that OFSI imposed on Standard Chartered is unprecedented, and this case could represent the start of a new era of sanctions enforcement in the UK. This matter highlights the importance of banks and operating companies establishing effective sanctions compliance programs, thoroughly vetting counterparties and carefully analyzing specific transactions involving sanctioned parties. As this matter illustrates, failing to do so can have severe consequences.

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1. Pursuant to section 147(3) of PACA, the recipient of such a penalty "is entitled to seek a review by a Minister of the Crown."↩

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