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INSIDE THIS PUBLICATION:

Navigating the unchartered waters of Geopolitical risk

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Inside this e-Book

Compliance considerations of Iran sanctions

President Trump's recent decision to withdraw the U.S. from the Iran nuclear deal will not only have severe sanctions implications for foreign subsidiaries of U.S. parent companies, but will also negatively impact EU firms. **Joe Mont** has more.

Compliance sanctions headaches have only just begun for foreign subsidiaries of U.S. parent companies, following President Donald Trump's recent decision to withdraw the United States from the Iran nuclear deal, even as the European Union took contrary actions of its own.

In 2015, Iran committed to various limitations on its nuclear program as part of an agreement with other countries and coalitions—including the United States, the European Union, and the United Nations. This accord was called the Joint Comprehensive Plan of Action (JCPOA).

As part of the JCPOA, the United States in January 2016 lifted or waived certain "secondary sanctions," effectively allowing non-U.S. entities access to the Iranian market without risking their access to the U.S. market to pursue Iranian deals. But those sanctions were re-imposed on May 8, 2018, when President Trump issued a Presidential Memorandum ceasing U.S. participation in the JCPOA, subject to certain wind-down periods.

As described in a series of frequently asked questions (FAQs) issued by the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC), the re-imposed U.S. sanctions took effect following the 90-day wind-down period (Aug. 6) for certain sanctions, and 180 days (Nov. 4) for others, to give time for Iran-related transactions and contracts to be completed or terminated.

Greta Lichtenbaum, an international trade partner with law firm O'Melveny, says U.S. withdrawal from the JCPOA will have "a significant impact on multinational firms that have business interests in both the United States and Iran."

Because U.S. "primary sanctions" remain in force, restricting persons and entities under U.S. jurisdiction from generally doing business with Iran, sanctions compliance implications resulting from U.S. withdrawal from the JCPOA most significantly apply to non-U.S. subsidiaries of U.S. parent companies. "For foreign companies, secondary sanctions have returned as a real threat, if they have any significant business in the United States," says Theodore Kassinger, a partner at O'Melveny.

Specifically, General License H, which authorized foreign entities of U.S. companies to do certain business in Iran, will be revoked by November. Additionally, sanctions against individuals and entities previously removed from the U.S. "Specially Designated Nationals List" also will be re-imposed.

The extractives industry, automotive and rail sectors, the shipping and shipbuilding sectors, and the financial and insurance industries will take a hard hit—but perhaps none harder than suppliers of commercial passenger aircraft and related parts and services, which had been specially licensed under the Iran nuclear deal.

In an April 25, 2018, earnings call, Boeing Chief Executive Officer Dennis Muilenburg stressed that the Boeing organization "understands the risks and implications around the Iranian aircraft deal. First and foremost, it's important again to restate that we continue to follow the U.S. government's lead here, and everything is being done per that process."

Global implications

The question many companies are grappling with now is whether other general licenses or specific project waivers will be made available through which they can establish some aspects of trade. If not, the follow-up question is how to wind down that activity in the time allotted, says Adam Smith, former senior advisor to the director of OFAC and now a partner with law firm Gibson Dunn.

As just one example, French oil and gas company Total announced on May 15 that it will not be able to continue its SP11 gas development project in Iran and will have to unwind all related operations by November, "unless Total is granted a specific project waiver by the U.S. authorities with the support of the French and European authorities. This project waiver should include protection of the company from any secondary sanction as per U.S. legislation."

Total further stressed that it "cannot afford to be exposed to any secondary sanction, which might include the loss of financing in dollars by U.S. banks for its worldwide operations (U.S. banks are involved in more than 90 percent of Total's financing operations), the loss of its U.S. shareholders (U.S. shareholders represent more than 30 percent of Total's shareholding) or the inability to continue its U.S. operations (U.S. assets represent more than $10 billion of capital employed)."

Sanjay Mullick, a partner with law firm Kirkland & Ellis, notes that "the big hook here is that the global economy is largely a U.S. dollar economy." Total's response is just one example highlighting how significant a role U.S. banks play in the financing of many global companies. "Secondary sanctions are discretionary, meaning the United States can draw the sword, but doesn't necessarily have to use the sword—but the deterrent effect is quite powerful, nonetheless," he says.

In response, the European Commission announced steps to preserve the interests of European companies investing in Iran and to demonstrate the EU's commitment to the Iran nuclear deal. "As long as the Iranians respect their commitments, the EU will of course stick to the agreement of which it was an architect," European Commission President Jean-Claude Juncker said in a statement. "But the American sanctions will not be without effect, so we have the duty—the Commission and the European Union—to do what we can to protect our European businesses."

As part of a series of countermeasures, the European Commission activated the Blocking Statute, which forbids companies in the European Union from complying with the extraterritorial effects of U.S. sanctions, allows companies to recover damages arising from such sanctions from the person causing them, and nullifies the effect in the EU of any foreign court judgments based on them. The aim is to have the measure in force before Aug. 6, 2018, when the first batch of U.S. sanctions take effect.

Sanctions compliance implications

From a broader compliance standpoint, sanctions compliance officers of companies that have relied on the JCPOA waivers must immediately assess how these "snapback" sanctions affect them, and act now. "Whether you're dealing with products or services, order or contract fulfillment, outstanding payments—those are the kinds of rubber-meets-the-road issues that have to be handled," Mullick says.

Identify Iran-related touchpoints. The first step companies should take is to identify their Iran-related touchpoints, both direct and indirect. Questions to consider, for example, include: Do any non-U.S. subsidiaries conduct business with Iranian counterparties? Where do your ships port? Are you transacting in U.S. dollars?

Take an assessment of those touchpoints. "What companies should do is take an inventory of their activities related to Iran," Kassinger says. That involves assessing not only what existing contracts there may be, but understanding what delivery schedules there are and how that fits into the wind-down period; what's in the pipeline for potential contracts that could be rewarded; what payments are owed; and what operational, organizational setups have been put in place to handle business with Iran.

Review existing contracts. Companies should also review existing contracts with Iranian counterparties and any other agreements that touch Iran to assess how to fulfil the terms of the contract, or terminate it, before the wind-down period approaches.

In terms of contract fulfilment, the Treasury Department clarified in its FAQs guidance that where a non-U.S, non-Iranian person is owed payment after the conclusion of the wind-down periods for goods or services fully provided or delivered to an Iranian counterparty "and such activities were consistent with U.S. sanctions in effect at the time of delivery or provision, the U.S. government would allow the non-U.S., non-Iranian person to receive payment for those goods or services according to the terms of the written contract or written agreement."

For goods or services not fully provided or delivered to an Iranian counterparty, "suppliers should be in discussions with their Iranian customers on how to handle matters already contracted for that may not be completed within the wind-down periods," Kassinger says.

Revise relevant policies and procedures, and then communicate them. Internal sanctions compliance policies, procedures, and controls will also need to be updated to reflect the snapback sanctions, says Katherine Toomey, a partner with law firm Lewis Baach. They should then communicate those changes to relevant employees, subsidiaries, portfolio companies, and other business partners.

"It's critical that everybody has a good sense, at least in broad strokes, of what the changes could mean for them," says Adam Smith, Gibson Dunn. If questions surface, they should be immediately raised to those with expertise in this area, such as to the sanctions compliance officer or outside counsel.

The wild card among all this uncertainty is whether any sort of U.S. renegotiation occurs between now and November.

"It's a tough one because the dust hasn't settled," Smith says. "We don't know a lot about how this is going to play out." ■

Below is a look at some sanctions to be reimposed

1.2. Which sanctions will be re-imposed after the 90-day wind-down period ending on August 6, 2018? After the 90-day wind down period ends on August 6, 2018, the U.S. government will re-impose the following sanctions that were lifted pursuant to the JCPOA, including sanctions on associated services related to the activities below:

- Sanctions on the purchase or acquisition of U.S. dollar banknotes by the Government of Iran; Issued on May 8, 2018
- Sanctions on Iran's trade in gold or precious metals;
- Sanctions on the direct or indirect sale, supply, or transfer to or from Iran of graphite, raw, or semi-finished metals such as aluminum and steel, coal, and software for integrating industrial processes;
- Sanctions on significant transactions related to the purchase or sale of Iranian rials, or the maintenance of significant funds or accounts outside the territory of Iran denominated in the Iranian rial;
- Sanctions on the purchase, subscription to, or facilitation of the issuance of Iranian sovereign debt; and
- Sanctions on Iran's automotive sector.

In addition, the U.S. government will revoke the following JCPOA-related authorizations under U.S. primary sanctions regarding Iran:

- The importation into the United States of Iranian-origin carpets and foodstuffs and certain related financial transactions pursuant to general licenses under the Iranian Transactions and Sanctions Regulations, 31 C.F.R. part 560 (ITSR);
- Activities undertaken pursuant to specific licenses issued in connection with the State ment of Licensing Policy for Activities Relaed to the Export or Re-export to Iran of Commercial Passenger Aircraft and Related Parts and Services (JCPOA SLP); and
- Activities undertaken pursuant to General License I relating to contingent contracts for activities eligible for authorization under the JCPOA SLP.

1.3. Which sanctions will be re-imposed after the 180-day wind-down period ending on November 4, 2018?

- Sanctions on Iran's port operators, and shipping and shipbuilding sectors, including on the Islamic Republic of Iran Shipping Lines (IRISL), South Shipping Line Iran, or their affiliates;
- Sanctions on petroleum-related transactions with, among others, the National Iranian Oil Company (NIOC), Naftiran Intertrade Company (NICO), and National Iranian Tanker Company (NITC), including the purchase of petroleum, petroleum products, or petrochemical products from Iran;
- Sanctions on transactions by foreign financial institutions with the Central Bank of Iran and designated Iranian financial institutions under Section 1245 of the National Defense Authorization Act for Fiscal Year 2012 (NDAA);
- Sanctions on the provision of specialized financial messaging services to the Central Bank of Iran and Iranian financial institutions described in Section 104(c)(2)(E)(ii) of the Comprehensive Iran Sanctions and Divestment Act of 2010 (CISADA);
- Sanctions on the provision of underwriting services, insurance, or reinsurance; and
- Sanctions on Iran's energy sector.

Source: OFAC

As global politics get more complicated, risks thrive

From sanctions to tariffs, the United States is increasingly a source of geopolitical risk. How can companies protect their own interests when it seems the world is against them? **Joe Mont** has more.

There is an ever-swaying pendulum between regulation and deregulation; a global shift to populism and nativism; developing trade wars; international unrest; ever-shifting sanctions; and increasingly tense relationships with allies even as olive branches are extended to traditional enemies.

Among the upcoming events to watch: the aftermath of the U.S. summit with North Korea; Russian sanctions; disruptions in oil prices and production; the Iranian nuclear deal; Brexit; three-way trade battles between the U.S., Canada, and Mexico and the brewing trade war between America and the European Union; and the election of a Mexican president. Venezuela, once a key oil producer, faces numerous threats to its already tenuous stability, including a collapsing economy, hyperinflation, and food shortages. Any combination of these events could be a boon or disaster for individual companies.

Ground Zero of these geopolitical shifts is the United States under the current presidential administration. Once a steady rock in an unstable world, America is now a catalyst for much of the world's uncertainty.

Nearly all companies need to ask: What's their exposure to geopolitical risk, and how can they both prepare for present problems and predict what will vex them in the future?

EY's Center for Board Matters has done considerable research on anticipating and planning for geopolitical and regulatory changes.

Boards, it says, must understand, prepare, and respond to geopolitical forces with "a deep understanding of the company's strategy" and swiftly pivot from current strategy when necessary.

"Historically, the U.S. has been viewed more as a unifier that was in lock step with our allies," says Jon Shames, leader of EY's Geostrategic Business Group. "Obviously, the current administration has changed that and taken a more nationalistic approach, particularly as it relates to trade imbalances. That's causing disruption, uncertainty, and confusion."

"A lot of companies are taking a step back and trying to figure out how much of this is negotiation, versus how much of this is a view that is going to last long term and be more permanent," he adds. "It is causing a lot of uncertainty, which also plays into the other issue we are hearing in the boardroom from institutional investors on the need for creating long-term value. It is awfully hard to place long-term investments when you have this level of uncertainty."

One of the most important things companies can do is evaluate their current board's expertise, says Steve Klemash, Americas leader for EY's Center for Board Management.

"There is a lot of discussion around board composition, board committee structure, and who has responsibility for risk management," he says. "What's not discussed, as much, is how management is addressing these issues. Are they addressing geopolitical risk in a comprehensive fashion? What is their comprehensive approach around strategic implications, and financial reporting and compliance implications? What analysis tools are they using? Are they comfortable relative to what management is doing about these risks?"

Klemash routinely hears from boards that they are spending so much time dealing with regulatory burdens they are not getting to explore strategic opportunities and look at opportunities to position themselves for the long term. They are also consumed with putting out "fires" that pop up on an almost daily basis.

"They get paralyzed at times by the headline news," he says, explaining that responses are often event-driven, rather than created with a big picture, longer-term view. Companies should be developing geopolitical scenario plans and stress testing against them. Consequently, they "run the risk that they are off chasing their tail over one-off things as announcements come out, instead of building a comprehensive framework around these risks."

Because geopolitical issues are complex and often unpredictable, it is tempting to view them as impossible to prepare and plan for or control. A recent EY report, however, makes the case that geopolitics are not a problem to solve, but an external business force that must be understood and managed.

The board, it says, should set the tone for confronting this challenge by understanding management's framework for analyzing and managing geopolitical threats and opportunities. At its core, management's approach should involve a process for "understanding, preparing, and acting."

Companies also need to make sure they have the

POLITICAL	ECONOMIC	SOCIAL
What are the critical political factors and developments? What are the expected changes and implications from pending elections or electoral results? What is the nature and extent of government intervention and influence? **Developments to consider include:** governmental stability, taxes and taxation policies, intergovernmental cooperation, government expenditure levels, foreign trade relations (balance of trade between countries, trade restrictions, tariffs).	What is the current and projected economic environment? Would market diversification offer stability in the company's growth and performance? Are there significant barriers to entry? **Developments to consider include:** monetary policy (interest rates), fiscal policy, inflation, foreign exchange rates, availability of credit, GDP growth, growth of developing economies, unemployment rates, labor supply and wage rates.	What cultural aspects and demographic and consumer trends are important, and how are they evolving? **Developments to consider include:** customer needs or expectations, population demographics (age, education levels, distribution of wealth), changes in lifestyles and trends.
TECHNOLOGICAL	**LEGAL**	**ENVIRONMENTAL**
What technological innovations are emerging, and how will these impact the company and society at large? Is the company able to sustain quality in its product or service delivery? Are there opportunities to enhance the company's management systems to better support various business processes? **Developments to consider include:** R&D activity, automation and technology incentives, rate of technological change or disruption, speed of transfer, innovation.	What current, impending, and proposed legislation could impact the company and its industry? Is the rule of law enforced? **Developments to consider include:** laws (data protection and privacy, employment, contract, consumer, health and safety), regulations, industry standards.	What are the environmental and ethical considerations? **Developments to consider include:** natural or human-caused catastrophes, ethical and fair business practices in local jurisdictions, ongoing climate change, changes in energy consumption regulations, waste disposal standards, attitudes toward the environment, other sustainability matters.

QUESTIONS FOR THE BOARD TO CONSIDER

Does the board have complete visibility around the potential geopolitical and regulatory impacts that the company faces?

Does the management team utilize a robust framework to identify and assess relevant geopolitical and regulatory factors?

Does the board understand management's process for mitigating geopolitical and regulatory risk through scenario analysis and stress testing?

Is the company approaching such impacts only from an "event" lens or as part of a broader sociopolitical analysis that is updated with dynamic, holistic monitoring?

Source: EY "Anticipating and planning for geopolitical and regulatory changes" report.

right people in the boardroom to effectively oversee geopolitical developments, EY says. For some boards, that may mean having a director with specific regulatory or public policy expertise, or expertise relevant to volatile markets where the company operates or plans on operating in the future.

"I think board members get this. I just don't think they always know what to do," Shames says. "This is an emerging science."

"Companies are very focused on digital disruption, but we think geopolitical disruption is just as important," he says. "Companies get it; they just don't have the tools and the processes to be able to figure out what to do. They have a long way to go. We are at the beginning of a learning curve, but we are going to see better and better actions."

Companies should consider potential impacts to their supply chain (for example, how trade agreements or military conflicts could impact operations), human capital (how immigration laws may affect the ability to attract and retain talent), corporate functions, and stakeholders.

Among the tools companies can turn to for these assessments and analysis is a PESTLE (political, economic, social, technological, legal, and environmental) analysis, a framework adapted from COSO's 2017 ERM update as an approach for analyzing the external business environment.

Coupled with a comprehensive ERM framework, it can help steer companies toward identifying the geopolitical threats and opportunities most relevant to their strategy, or operations, the EY report says.

The results of the PESTLE analysis can then be used to determine the threats and opportunities that can then be incorporated into a SWOT (strengths, weaknesses, opportunities, and threats) analysis to further help organizations assess their internal capabilities relative to external opportunities and threats.

"Risks and opportunities identified through the PESTLE framework, however, can change rapidly, requiring a dynamic process for monitoring, communicating, and updating an organization's risk profile, the EY report says. "Monitoring threat levels for many geopolitical- and regulatory-related risks may require deep trend analysis, tracking of complex leading or lagging indicators, and qualitative and quantitative business intelligence reporting. … Key indicators should be identified and tracked to monitor for changes that could invalidate the company's underlying strategic assumptions or that could open up new strategic opportunities or prospects."

Once risks and opportunities have been identified and assessed, companies can respond by accepting, mitigating, eliminating, or transferring risk, or strategically pivoting to seize opportunities—all while avoiding knee-jerk reactions.

Contingency planning for geopolitical factors should focus on designing and testing responsive controls. EY suggests that these may include a range of stress-test exercises, including tabletops, quarantines, and resiliency plans.

"Look for opportunities along with risk," Klemash advises. "What you don't want to do is go about this in a very siloed way. In the context of strategy, you need to need to have scenarios. You need to do due diligence and stress testing, and you need to be agile."

An evergreen complexity facing companies is keeping abreast of international sanctions regimes, a constantly moving target of people, places, and things.

"Failing to keep an eye on the implications of geopolitical events because their compliance team is too overburdened will serve as no excuse when a bank is caught flat-footed in formulating its response to new restrictions," warns Oliver Bodmer, senior product manager at SIX sanctions compliance division. SIX is a global central infrastructure provider that facilitates the flow of information and money between banks, traders, merchants, investors, and service providers.

"In light of the U.S.' recent withdrawal from the Iran nuclear deal, compliance departments are once again grappling with another bevvy of regulatory obligations," he says. "Smart financial institutions understand that it is not enough to simply be aware of and ready to comply with potential sanctions. It is equally important to have systems and processes in place to proactively and accurately gather and translate voluminous amounts of financial data to target risky securities and safeguard client portfolios."

David Pressman was appointed as the U.S. ambassador to the United Nations for Special Political Affairs by President Obama and represented the U.S. on the United Nations Security Council. He has also served as the senior U.S. negotiator on international disputes and previously led U.S. negotiations with China to develop multilateral sanctions in response to nuclear activities on the Korean Peninsula.

Pressman has also served as the assistant secretary of Homeland Security. With George Clooney, Brad Pitt, and Matt Damon, he co-founded Not On Our Watch Project, a leading advocacy and grant-making organization focused on raising awareness about mass atrocities. He is currently a partner with law firm Boies Schiller Flexner.

Geopolitical defenses, he says, need to approach issues from multiple perspectives.

"Compliance officers don't generally focus on or appreciate the nexus between homeland security and national security," he says. "There is a natural focus from compliance officers on street-level bureaucrats, and I don't use that term pejoratively, such as the SEC's attorneys or whoever it may be that's on the enforcement end of what they are they looking at. The real strategic challenge for those in leadership positions of complex multinational organizations and their sanctions exposure is to look beyond the immediate decision making of street-level enforcement offices within the government, and look more upstream."

Specifically, companies must deal with day-to-day policy implications, but also understand the strategic motivations of other organizations in the government's national security space. Where is the government devoting its security funding? The problems it is trying to address may someday be your problems.

"There is a lot more work that goes into enforcement efforts, whether they are sanctions or the Foreign Corrupt Practices Act, or whether it may be that companies are confronting," Pressman says. "If you want to mitigate risk, you had better be including these sorts of broader considerations and strategic considerations that are shaping the actions on the blunt end of enforcement." ■

Tariffs on/tariffs off: a compliance nightmare

Dealing with compliance issues under the current U.S. administration has become a nightmare for CCOs in the United Kingdom, Europe, Canada, and Mexico, writes **Paul Hodgson**.

Picture this scenario: "I have steel on the water on the way to the United States at the moment. How do I invoice my customer with a 20 percent tariff? How do we cope with the VAT [value added tax] on that?" This is just one example of the problems facing CCOs following the notice of U.S. Section 232 tariffs, according to U.K. Steel Director Gareth Stace.

In this world of on-again, off-again sanctions and tariffs, dealing with compliance issues under the current U.S. administration has become not just a nightmare for compliance officers in the United States, but also for those in the United Kingdom, Europe, Canada, and Mexico. The latest tariffs on steel and aluminum for the European Union, which still includes the United Kingdom, makes complying with trade rules extremely challenging. It's not just tariffs on exports; if you're an importer—EU officials have activated their threats to retaliate against U.S. products, including orange juice, peanut butter, jeans, motorcycles, and bourbon—suddenly your planned imports are contraband. Trump threatened to put a 20 percent tariff on all European cars coming into the United States.

And it could get more challenging if there is a tit-for-tat trade war, as seems likely, despite conciliations like the one that came from the Confederation of British Industry's (CBI) International Director, Ben Digby, who said, "… this is a shared challenge whose root causes should be tackled jointly by the EU and the USA." Most other responses were less conciliatory. France's president Emmanuel Macron called Trump's move illegal and added: "Economic nationalism leads to war. That is exactly what happened in the 1930s."

The European Union has initiated a dispute settlement case at the World Trade Organisation (WTO) in response to the claims of illegality. EU Trade Commissioner Cecilia Malmström said, "This is not the way we do business and certainly not between longstanding partners, friends, and allies."

The political reaction is typically different from the industry one. Neither British Steel, nor Indian steel manufacturer, Tata, which owns many steel works in the United Kingdom, would field anyone to talk about the issues. But reactions from industry trade groups have been as forthright as the politicians. U.K. Steel's Stace said, "President Trump had already loaded the gun and, today, we now know that the U.S. Administration has unfortunately fired it and potentially started a damaging trade war." Stace warned the damage will not only be to the U.K. steel sector, but also the U.S. economy. "Any U.S. calls for the EU to voluntarily place hard limits on its exports of steel were completely unjustified, against WTO rules and run counter to central tenets of free-trade," he said.

Stace predicted supply chain disruption and warned that with some half billion dollars of steel exported from the United Kingdom to the United States last year, U.K. steel producers are going to be hit hard. He added, "The only sustainable solution to the root cause of the issue, global overcapacity in steel production, is multilateral discussions and action through established international channels." Like the CBI, Stace said the two economic blocs must continue discussions, but unlike the CBI he felt it correct to forge "ahead with safeguard action, to shield against diverted trade swamping the European market."

International Trade Secretary for the U.K. Liam Fox said, "We share a strong defence and security cooperation relationship. These unilateral trade measures have weak foundations indeed in international law and they are not consistent with the U.S. Department of Defense's own judgement in an investigation that was conducted on the basis of national security." He added the U.K. is still seeking tariff exemptions based on specific products and geographic location and Prime Minister Theresa May would dispute the tariffs.

Fox added that the U.K. exports complex steel products to the United States, part of their national security programmes themselves, and argued that this undermines the national security argument used as a basis for the tariffs in the first place. So, the prospect of product exemptions and/or lifting of the tariffs is a real one. Stace added, "Whilst tariffs have come into force, this is far from an end to the conversation." He also said steel firms would be grateful for the government's help in seeking to attain product exemptions from tariffs and helping to have such applications expedited by the U.S. Department of Commerce. While the negotiations could be good for the economy, they only serve to add to the complexity of CCOs' ability to help their employers stay within the law.

"There are something like 12,000 product exemption applications with the Commerce Department at the moment," said Stace. "And that's just steel. Maybe another three or four thousand for aluminium." Stace added that the Department of Commerce is understaffed and does not have the resources to make rapid judgments on these exemptions. "You might find your application rise to the top of the pile in a few months; but if there is a mistake, it will be rejected out of hand and you have to start again. Also bear in mind that exemptions only last a year, so it will all have to be done again in 12 months."

The exemption applications must be submitted by U.S. customers of EU firms and must include very specific, commercially confidential information, even though they are publicly available. This can be redacted, but there is no guarantee that it will be. Many manufacturers commented that this would be like Coca-Cola disclosing the recipe for Coke. Stace shared an exemption application from Universal Bearings that provides enough proprietary information for a U.S. company to take the information and reproduce the particular grade of steel that is currently only available via import from the United States. Domestic steel producers in the United States can object to product exemption applications in a 30-day window after they are initially approved, and this can delay full approval by another 90 days, leading to further uncertainty. "As of [early June], no applications have been approved."

Digby said the U.K. is the largest foreign investor in America, with British firms supporting more than 1 million U.S. jobs. "Overproduction can distort the global market," he continued, "and erode the level playing field that business depends on to stay competitive. But this is a shared challenge whose root causes should be tackled jointly by the EU and the USA. There are no winners in a trade war, which will damage prosperity on both sides of the Atlantic." ■

Iran the start of sanctions compliance debacle

EU companies are winding down investments in Iran, as the European Union advises them to hang in there while it looks for ways around U.S.-imposed sanctions. **Paul Hodgson** has more.

Following the U.S. decision to pull out of the Iran nuclear deal known as the Joint Comprehensive Plan of Action (JCPOA) and to reimpose sanctions, EU companies, such as carmaker Peugeot, engineering firm Siemens, and oil producers Total and BP, have begun to wind down investments and joint ventures in Iran despite the fact that European leaders have said that they will remain in the deal and find ways around the sanctions. While this is leading to confusion and uncertainty for compliance officers, both Pekka Dare, a director with International Compliance Training (ICT), and Foundation of Defense for Democracies senior advisor Richard Goldberg agreed that trying to comply with sanctions over Iran was already a compliance nightmare.

"Over the last few years, even with the JCPOA, there has still not been a stampede of European companies getting into Iran," said Dare. "You have three basic categories of banks in Europe—you have banks with U.S. DPAs (deferred prosecution agreements) such as the HSBCs and Standard Chartereds of this world; the terms of those agreements with the American authorities would preclude them from doing much of anything in Iran. Then, you have banks that don't have a DPA but have a significant presence in the U.S., for example Barclays; and then a third category with very little direct exposure to the U.S. What we've seen is that all three categories are very wary of doing any direct business with Iran."

"A couple-of-hundred-billion-dollar economy in Iran is in no way worth the risk of losing a multitrillion-dollar economy in the U.S.," said Goldberg. "This means most banks are walking away from Iran unless they are illicit, borderline financial institutions."

"Part of this has been about the uncertainty," continued Dare "and it's also been about direct and indirect exposure and the fear of secondary sanctions from the U.S. Obviously, those banks that follow UN [United Nations], EU, and OFAC [Office of Foreign Assets Control] sanctions, there will be a list of countries and, in the case of Crimea, territories where they will not do any direct business, like Syria, Iran, and Iraq. They will have policies that preclude any direct business with those countries, which means that they could not deal with a customer who has residence in that country or facilitate goods flowing directly into that country or money coming from that country."

But, with the JCPOA, said Dare, banks' customers have wanted to explore opportunities in Iran, so the challenge for banks has been to conduct proper sanctions risk assessment of their customers. "So, for example," explained Dare, "when a relationship manager onboards a commercial client in a commercial bank, part of the job is to assess the jurisdiction of that customer, who are their customers, who are they selling to. The banks have all had to work out what their tolerance is for indirect exposure. That might be where you have a customer who was wasn't necessarily selling goods directly to Iran or Syria, but might be selling those goods to hundreds of distributors, and maybe one or two of those distributors might then sell those products into a sanctioned country." Banks are struggling with this kind of indirect exposures and are wary of being involved in facilitating the flow of goods into a sanctioned country and then facing some sort of secondary sanction from the U.S.

"They're doing a lot of work on due diligence, and their risk appetite is really low. And with the Americans backing right out of the JCPOA and threatening sanctions against anybody who dares to disagree with them, that appetite is really reduced," said Dare. "A lot of banks might use an informal rule of thumb and say we would tolerate a client who had maybe 10 percent of their overall business indirectly exposed to a sanctioned country. But, we must not directly facilitate any of that business. Now all the banks will be looking again at those levels of tolerance."

Dare reiterated that the latest withdrawal from the JCPOA has not had a massive impact, because most of the banks have already made this judgment. "Even if legally under the JCPOA our clients can do business in Iran," said Dare, "what are the risks in that, and how are we going to do customer due diligence and understand the structures of entities we are dealing with in Iran? Because, while many of the sanctions were lifted, there were still many sanctions in relation to, for example, the Iranian Revolutionary Guard. So, if you are going into a joint venture with a customer who is a corporate entity in Iran, how easily could you see through the transparency of the ownership structure? There is nervousness about that."

FDD's Goldberg described the complicated situation: "From a compliance perspective, the baseline was that it was already hell to do business in Iran. Iran does not allow an independent compliance mechanism that would allow due diligence over your investments or contracts. You have to use an Islamic Republic sanctioned compliance team in the country. If you want to do a deal with an Iranian company," he said, "you have to do the due diligence that would ensure that the IRGC [Islamic Revolutionary Guard Corps] is not behind that company, but the only way to do that is to ask the Iran-based compliance team to undertake that for you. That's been a major hindrance to investment in Iran."

Goldberg added: "Now you have layers and layers of sanctions coming back. Even if you paid a whole team of compliance officers around the clock they would still be likely to fail."

Goldberg also noted that Iran could not reap the rewards of the sanctions relief because of the risk of the Iranian financial system and the fact that the IRGC was still designated as a terrorist organisation.

"There is also nervousness about the risk of litigation," said Dare. The U.S. Anti-Terrorism Act allows individuals to sue anyone who provides material support to a foreign terrorist organization, such as in the cases of *Freeman v. HSBC* and *Weiss v. NatWest*, Dare noted. Banks have been prosecuted on a civil basis, because they've had exposure to Iran. "Even with Trump's actions it has probably not resulted in a great deal of change; it's just reinforced the banks' current policies, which are already centered around all the uncertainties," he said.

The difficulties of doing deals in Iran and still complying with sanctions law, said Goldberg, is disconnected from what European leaders are saying. "The political leadership is saying: Stay in the deal; we are going to provide ways for you to be protected from U.S. sanctions. We will bring in blocking regulations, which will shield you from any U.S. sanctions and, if the U.S. tries to fine you, you can sue in European court to try get your money back. But this is total market access being threatened; it's not just a fine."

Goldberg said the EU was considering a plan that would allow them to evade U.S. sanctions and continue to do business with Iran. Basically, Germany would allow anyone who wants to continue to do business with Iran to send the central bank—either the European Central Bank or the Bundesbank—their transactions; conversions would occur there, with all transactions settled at once. Then, a billion-dollar payment that is a total of all the European payments owed would be sent to the Central Bank of Iran. Goldberg said that it would be very difficult for U.S. regulators to parse out every transaction. "If the Royal Bank of Scotland sends a series of different messages to the central bank in Germany, which they do all the time, they will not be able to parse out which one is for Iran and which one is for Germany. The game of chicken is that the Bundesbank is daring the United States to designate a central European bank and to impose sanctions on them."

But he also said that the sanctions regime allows the U.S. to pursue individuals such as the bank's governors, its directors, or even just employees. "There are ways for the U.S. to exert an enormous amount of pressure short of designating a central bank." Goldberg added that the Iranian financial sector as a whole has been designated as being a jurisdiction of money laundering concern and that this has stayed in place throughout the life of the JCPOA.

And that's just Iran. Dare said the situation with Russian sanctions can be even more complicated. "Russia is different, because you have you have SSIs [sectoral sanctions identifiers]," he said. "There's not a comprehensive ban on doing business with Russia, but there are targeted sectoral sanctions—so the challenge there is what can happen with those sanctions regimes, because they're incredibly complicated. For example, you have a comprehensive ban on dealing with anyone in the Crimean Peninsula—but that's not simple, because how do you screen for a part of a country? You have to screen the names of ports, names of towns. … And, of course, in eastern Ukraine many people consider themselves to be Russian and describe themselves as living in part of Russia, so there's real challenges with that. If you're dealing with a Russian bank for example, like Sberbank, you can deal with them, but you can't give them certain financial products like long-term capital loans."

Dare said this meant that compliance officers had to conduct incredibly complicated screening of any transactions involving these Russian sectors, like deep sea oil, to make sure that they're complying with sectoral sanctions. "An additional challenge for banks at the moment, with Americans daily bringing in new sanctions targeted against Russian individuals, is keeping their systems and policies up-to-date. The sheer pace and volume of change is a big challenge for banks, and all of us."

Sanctions compliance has become a recognized, defined professional discipline within banks, and people with those skills are very sought after. "It's a very gray area," said Dare. "People think it's simple; if somebody or some entity is on the sanctions list you can't deal with them. But what the banks are wrestling with are these gray issues around direct and indirect exposure, and sectoral lists. There's a huge amount of fear factor around the size of the penalties as well."

Dare pointed to the new U.K. Office of Financial Sanctions Implementation (OFSI), which has new regulatory powers that allows it to connect with the National Crime Agency. "They are actively reviewing many enforcement actions at the moment. You're going to see more enforcement action in the U.K. as a result of this," he said.

"There's a lot going on," said Dare. "Banks are constantly upgrading and downgrading their risk tolerance regarding certain countries. Who knows where we are going to be with Russia in six months' time? And you've got North Korea on top of that." ■

How election results will impact regulation

America voted on in November. Now corporate America and its regulators need to see what it all means. **Joe Mont** explores.

The playbook for how Washington will be either reshaped or trapped in a lame-duck vortex until 2020 remains unclear in the immediate aftermath of recent mid-term elections, especially amid ongoing recounts and vote challenges. What is a certainty, however, is that companies cannot afford to place their bets on the Trump-era status quo of deregulation and economic nationalism.

In the November elections, Democrats recaptured the House of Representatives and Republicans held onto the Senate. The question now is how this parity among the chambers will affect governance.

In the immediate aftermath of the election, stock prices surged on the apparent belief that a divided Congress would mean a legislative stalemate and far fewer new rules and regulations to fret about. A counter argument, however, is that forcing the "kids to play together" could reawaken, at least to some degree, a spirit of bipartisanship on broadly popular initiatives. History offers a case in point: In the 1990s, Bill Clinton floundered as president until Republican victories forced compromises that benefitted nearly all involved (at least until impeachment hearings began).

Big changes for financial institutions?

Changes in the regulatory climate for financial institutions will likely remain a bit of a coin-flip for weeks and months to come as party politics sort themselves out.

Supporters affectionately call her “Auntie Maxine.” President Trump infamously called her “crazy” and an “extraordinarily low IQ person.” Now, Maxine Waters (D-Calif.) will be one of the most important legislators in the House as the new chairman of the House Financial Services Committee. Rep. Patrick McHenry (N.C.) and Rep. Blaine Luetkemeyer (Mo.) are favorites to serve as the Republican ranking member of the committee.

Waters outlined her post-election, pre-appointment agenda.

“I will prioritize protecting consumers and investors from abusive financial practices, making sure that there are strong safeguards in place to prevent another financial crisis … encouraging responsible innovation in financial technology, promoting diversity and inclusion in the financial services sector, and ensuring that hardworking Americans and small businesses have fair access to the financial system and opportunities to thrive,” she wrote in a statement.

Waters, in recent months, has increasingly been thorn in the side for both the Trump administration and big Wall Street banks.

In September, as ranking member of the committee she is now all but assured to chair, she urged the Federal Reserve to maintain strong capital requirements for Global Systemically Important Banks.

“Strong capital requirements are the cornerstone of an effective regulatory regime that promotes financial stability while supporting stable economic growth,” she and her colleagues wrote, urging the Federal Reserve “to maintain the appropriately tough capital requirements on G-SIBs.”

The letter responded to a Republican request to Randal Quarles, the Fed’s vice chair for supervision, to weaken capital requirements due to concerns of “unwarranted capital burdens.”

The Fed’s board of governors did ultimately agree to that plan, citing the need to more specifically tailor Dodd-Frank Act rules regarding liquidity, surcharges, and loss-absorbing capital buffers to the size and complexity of financial institutions. A similar push is afoot, with a measure of support from pro-business Democrats, to ease perceived compliance and operational burdens caused by the Volcker rule and Dodd-Frank’s derivatives rules.

As for community banks and those with more modest assets, the Independent Community Bankers of America, the primary trade group for small U.S. banks, focused on how Democrats might deploy their House majority in its post-election analysis.

“Control of the House will provide the Democrats with a formidable bully pulpit,” it wrote. “Each party will try to drive a message to help them capture the White House and add Congressional seats in 2020. Both parties will have to balance appeals to centrist voters with appeals to their base.”

“The House will likely pass a series of ‘message’ bills with no expectation that they will be taken up by the Republican-controlled Senate,” it added.

That prognostication meshes with what is expected from the Waters-led House committee. It is all but a given that top bank executives, and the regulators who oversee them, will be marched in to defend themselves.

More targeted efforts that are likely to rank high on the committee’s agenda will be Bank Secrecy Act reform, FinTech policy, data security, the SAFE Act (cannabis banking), the Community Reinvestment Act, housing, and GSE reform, ICBA predicts.

Perhaps most concerning to big banks as Waters takes charge is her reactionary calls to break them apart.

On Oct. 4, Waters announced the Megabank Accountability and Consequences Act. The legislation would demand that federal banking regulators review systemically important banks with more than $250 billion in assets for patterns of illegal activity or consumer abuses. Failing that assessment, repeated legal violations may lead to proceedings to either break up or wind down the institution.

Waters was asked whether Wells Fargo should be shut down if her bill is passed. “Oh absolutely,” she said. “I think that Wells Fargo has demonstrated patterns and practices that are so obvious they certainly qualify for being shut down.”

While Waters is expected to frequently yield her Committee’s subpoena powers (Deutsche Bank’s financial relationship with Trump means it is all but assured to be on her agenda), a party split among the House and Senate likely robs her of the Congressional Review Act, a tool that allows both chambers a vote to undo recent legislation and a process used frequently during the Republican-controlled Congress.

The news isn’t all bad for Republicans on the Financial Services Committee. Even hyper-partisan Rep. Jeb Hensarling (R-Texas) has conceded, as he steps down as chairman of the Committee, that Waters does occasionally exhibit a bipartisan streak.

For example, Waters and Hensarling worked together for the still-pending capital-formation legislation known as the JOBS and Investor Confidence Act of 2018 (also called JOBS Act 3.0). It consists of 32 individual pieces of legislation.

Hensarling, however, isn’t entirely conciliatory.

“The question is, will the House Financial Services Committee continue to be a beehive of legislative activity, or will the Committee basically be turned into a Spanish Inquisition or Star Chamber to harass the administration,” he said during a recent CNBC interview.

One thing is certain, Hensarling’s Financial CHOICE Act, a sweeping slate of regulatory reforms, is now all but dead. Its demise can be blamed on both the change in party leadership and his refusal to move forward with either bills cherrypicked for their odds of passage or changes needed to assure Senate passage.

Over in the Senate, Sen. Mike Crapo (R-Idaho) is likely to remain Chairman of the Banking Committee. If he accepts a different assignment, Sen. Pat Toomey (R-Pa.) could get the nod.

The Bureau of Perpetual Controversy

It is worth noting that former Consumer Financial Protection Bureau Director Richard Cordray was defeated in his run for governor in Ohio. Could that imply, despite all the hand-wringing by Democrats that its work is crucial for consumers, that the message fails to resonate?

Nevertheless, a priority for Waters, and likely many of her party peers, will be protecting the Bureau from Republican and Trump administration efforts to weaken it.

Waters, for example, sees a role for the agency in her bill to break up big banks with poor compliance track records. Compliance with consumer protection laws would be assessed using parameters developed by the CFPB under the proposed law.

In October, she also introduced the Consumers First Act, “a bill to block the Trump Administration’s anti-consumer agenda and reverse their efforts, led by Mick Mulvaney, Director of the Office of Management and Budget, to dismantle the CFPB.”

This legislation was co-sponsored by several Democrats on the Financial Services Committee.

The bill would limit the number of political appointees that may be hired and codifies the commonly used name of the Consumer Financial Protection Bureau amid Mulvaney’s efforts to rebrand it as the Bureau of Consumer Financial Protection. The bill also seeks to undo efforts to weaken fair lending enforcement, eliminate coordination with other agencies, back away from rules and enforcement to rein in payday lenders, eliminate routine supervisory exams for compliance with the Military Lending Act, and effectively terminate its Consumer Advisory Board of outside experts.

The future of the Bureau, and Democrats’ protection of it, may also depend on the still-unresolved Senate confirmation of Kathy Kraninger as the next director of the agency.

What about trade?

Democrats may be less energetic in efforts to interfere with the Trump administration’s trade policies, especially those that relate to national security (under an expanded CFIUS) or regarding China, aside from preserving U.S. corporate interests when it comes to technology transfer requirements and intellectual property protections.

A post-election PwC analysis offers perspective. "Democrats will likely push for new spending on reskilling of trade-affected workers and try to prevent the unwinding of Obama-era environmental protections and healthcare rules in U.S.-Mexico-Canada trade legislation," it wrote.

Democrats will also be likely to push back against tariffs and restrictive trade policies affecting the European Union, and any U.S. effort to weaken participation with the World Trade Organization.

Until these moving parts click into some certainty, PwC says that "companies must take immediate action to preserve operating margins and maintain regulatory compliance."

"Now is the time make 'no regrets' scenario plans and review pricing, sourcing, hedging, cash planning and manufacturing footprint decisions," its analysis says. "Companies need to frame a broader strategic response to the new trade environment. What does it mean for corporate structures and manufacturing footprints and supply chain networks?"

Environmental regulations

As for climate and clean energy champions, the elections are positioned as a bearer of good news.

Proponents now headed to Congress, statehouses and governors' mansions across the country mean that investors and companies "must ramp up their efforts to accelerate the transition to a low-carbon economy," says Anne Kelly, senior director of policy at the sustainability nonprofit organization Ceres, said. "States will once again continue to lead the way. Candidates on both sides included clean energy in their policy platforms, showing us that bipartisan support for building a clean energy economy is growing."

While state ballot initiatives for carbon pricing and renewable energy were defeated in Washington state and Arizona, voters embraced proposals to increase renewable energy standards in Nevada, ban offshore drilling in Florida, and fought off efforts to defeat a gas tax increase in California.

On the federal level, "even if Democrats will be hamstrung in their ability to tighten rules for financial institutions, the new House leadership will likely be able to block any further deregulatory initiatives and intensify criticism in oversight hearings of both the big banks and federal agencies attempting to draft administrative reforms," Kelly said.

High tech, high stakes

The technology sector was among the industries facing uncertainty both before and after the mid-term election. Most of the news coming out of Washington, in fact, may be downright scary for tech executives.

President Trump remains unrelenting with his anti-trust talk regarding Silicon Valley giants, notably Amazon. There is also the sticky wicket of hammering out national data privacy legislation and whether it will complement or preempt state laws.

Among the developments to watch is the successful reelection of Rep. Ro Khanna (D-Calif.). Working with Tim Berners-Lee, the creator of the World Wide Web, Khanna has unveiled an "Internet Bill of Rights," with 10 different assurances citizens should have when it comes to consenting to the collection and dissemination of their personal data. What makes his legislation all the more newsworthy is that he drafted the list at the request of Nancy Pelosi (D-Calif.) the once and (probably) future Speaker of the House.

Among the proposed rights: opt-in consent to the collection of personal data; by any party and to the sharing of personal data with a third party; obtaining, correcting, or deleting personal data controlled by any company and its third parties; and not to be unfairly discriminated against or exploited based on personal data.

Democrats may also try to undo the Federal Communication Commission's roll back of Obama administration "net neutrality" rules, which prohibited broadband providers from impeding online traffic or charging for faster bandwidth. ■

Life without Sessions

The elections not only served as a halfway mark for the Trump administration, but also an opportunity to do some "housecleaning."

Notably, as he has threatened to do for many months, the President finally got rid of Attorney General Jeff Sessions (a dead-man-walking from early on in his tenure for recusing himself from the ongoing Mueller/Russia investigation), replacing him with Matthew Whitaker, Sessions' chief of staff, as acting AG.

It is far too early to tell how Whitaker or his future successor will align or diverge from current Department's protocols and policies. Many in the corporate world, however, will be paying close attention to enforcement of the Foreign Corrupt Practices Act.

Sessions had pledged his unwavering support of the FCPA, even as enforcement numbers declined. "Under my leadership, the Department of Justice remains committed to enforcing all the laws," Sessions said during an April speech. "That includes laws regarding corporate misconduct, fraud, foreign corruption and other types of white-collar crime. One area where this is critical is enforcement of the FCPA."

Revised guidance to establish standards, policies, and procedures for the selection of corporate monitors, announced in October, could also come back into play. Under that policy, Criminal Division attorneys must consider a number factors, including the type of misconduct—such as whether it involved the manipulation of books and records or the exploitation of inadequate internal controls and compliance programs. Attorneys also will assess the pervasiveness of the conduct and whether it involved senior management.

In terms of whether a monitor is necessary, the policy directs staff to also consider both the financial costs to a company, as well as unnecessary burdens to the business's operations.

There is already evidence of that policy in action. In September, Telia Company AB, a multinational telecommunications company headquartered in Sweden, whose securities traded publicly in New York from 2002 until 2007, and its Uzbek subsidiary, Coscom, were charged with conspiring to violate the FCPA by paying more than $331 million in bribes to a government official in Uzbekistan. Under the terms of that settlement, no corporate monitor was required.

Sessions' departure had one immediate effect: driving up the stock price of companies in the new and burgeoning marijuana industry. The former AG was known for his vociferous objection to legalization efforts and pledged to maintain federal laws regarding the drug regardless of what state legislatures (often directed by ballot initiatives, as was the case regarding recreational marijuana in Michigan on Election Day) might do.

After the elections, Michigan became the 10th state—and the District of Columbia—to vote to legalize marijuana. Missouri and Utah voters supported legalization for medicinal use. State legalization could be yet another factor in the federal government easing up restrictions on banks that seek to do businesses in the marijuana industry, a potential bonanza for all involved as sales grow.

—Joe Mont

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