ALLEN & OVERY

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Distorting mirrors: UK sanctions and Brexit

Introduction

The UK's various sanctions regimes are currently very strongly correlated, although not completely aligned, with those of the EU. This position arises, in part, from the direct applicability of certain EU laws within EU Member States (e.g. via EU regulations). Much of this EU law would cease to apply within the UK should the UK leave the EU without any new agreement being established to govern the future EU-UK relationship.

Should the UK leave the EU without any new deal being put in place, or come to the end of any implementation period following the UK's exit without further agreement, the UK will look to re-establish all of the EU sanctions that were in place as at the time of the UK's departure. The UK has already created a suite of legislation (much of which is not yet in force) to effect this. More fully, it has enacted the Sanctions and Anti-Money Laundering Act 2018 (**SAMLA**) and the European Union (Withdrawal) Act 2018 (**EUWA**), as well as creating various pieces of secondary legislation under those acts. Together, this legislation would create a fully-fledged and independent UK sanctions regime.

We consider below a number of issues that would arise for the UK and EU businesses in either no-deal scenario.

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UK sanctions on a hard Brexit

In a hard Brexit scenario, on Brexit day, both the UK sanctions regimes created under SAMLA and EUWA are expected to come into force. The resulting newly established UK regime should be very similar, but not identical, to that as is currently in place in the UK as a consequence of it being an EU Member State. In particular, and in terms of similarities, the same broad categories of sanctions as are currently established through each of the EU's various regimes will be retained in UK law. That said, although the new UK sanctions on Brexit day will broadly mirror those which are in place in the EU, there will be some important differences.

General applicability

Perhaps most obviously, there will be a natural change in the general applicability of the UK's sanctions regime. Broadly speaking, while the EU's sanctions regimes have applicability within the territory of the EU and to any EU nationals and EU incorporated entities/bodies with regard to their activities anywhere in the world, the new UK sanctions regimes will have applicability only within the territory of the UK and to UK nationals and UK incorporated entities/bodies with regard to their activities anywhere in the world. Such change will result in the UK's sanctions regimes having a significantly narrower jurisdictional applicability.

Changes in persons targeted by the EU's "Article 5" sanctions

The EU's Russian sectoral sanctions target not only 11 designated Russian entities, but also any legal persons established *outside of the EU* who are themselves more than 50% owned by the same (amongst others). From the perspective of the EU-27s's sanctions regime following a hard Brexit, it is worth noting that UK subsidiaries who are majority owned by any of the 11 designated Russian entities would fall within these parameters.

The new UK sanctions regime would similarly target the same 11 designated Russian entities. It would also target any legal person established *under the law of a non-UK country* (our emphasis) who is more than 50% owned by the same (amongst others). From the perspective of the UK's sanctions regime post-Brexit day, it is worth noting, therefore, that subsidiaries incorporated in the remaining EU-27 Member States who are majority owned by the 11 designated Russian entities would be targeted by the UK's provisions.[1]

Treatment of subsidiaries of sanctions targets

The EU's asset freezing sanctions restrict the provision of funds, directly or indirectly, to persons who are targeted by such measures. EU guidance associated with these sanctions confirms that, if a (non-listed) legal entity is "owned" or "controlled" by a listed person, the making available of funds or economic resources to such non-listed legal entity will, in principle, be considered as the same as making them *indirectly* available to the listed person (and therefore be prohibited) *unless* it can be reasonably determined, on a case-by-case basis using a risk-based approach, that the funds or economic resources concerned will not be used by or be for the benefit of the listed person.

The new statutory instruments created under SAMLA remove this rebuttable presumption test and replace it with the principle that, a reference to making funds available indirectly to a sanctions target includes, in particular, a reference to making them available to a person who is owned or controlled directly or indirectly by the designated person. As associated guidance puts it: "*If [the ownership and control] criteria are met, and the person who owns or controls the*

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[1] In relation to this point, see also our previous publication on this issue here: http://www.allenovery.com/publications/en-gb/Pages/Brexit-and-the-Creation-of-UK-sectoral-sanctions-targets.aspx

[non-listed] entity is also a designated person, then financial sanctions will also apply to that entity in its entirety […]. The prohibitions on making funds or economic resources available directly or indirectly to a designated person, also prohibit making them available to an entity who is owned or controlled, directly or indirectly, by the designated person".[2]

Clarifications of "ownership" and "control" concepts

Linked to the previous point, the EU's asset freezing sanctions do not themselves contain "ownership" and "control" concepts. Instead, these are established through associated EU guidance. In contrast, the new statutory instruments created under SAMLA contain "ownership" and "control" tests, establishing the same on a legislative footing. The instruments also add considerably more detail around how such concepts should be interpreted. For example, they clarify (amongst other things):

- how the principles should apply when looking through chains of multiple companies;
- how assets held by nominees should be treated; and
- that, where a share is held jointly by more than one person (i.e. joint ownership), each of the joint owners should be treated as holding that share.

Licencing developments

Various EU sanctions contain licencing derogations. Such derogations can typically only be used, however, where the underlying activity to be licenced falls within certain narrowly defined parameters. The new UK sanctions regimes created under SAMLA broadly reflect the same licencing grounds as exist in the EU's sanctions regulations, but there is a notable difference in that they also establish a general power allowing the UK regulatory authorities to issue sanctions licences "*to enable anything to be done to deal with an extraordinary situation*" in relation to non-UN derived asset freezes.

A number of other new, but narrow, licencing grounds are also established, as is an ability for the UK's regulatory authorities to issue "general licences", which, if issued, would have potential benefit to any persons of a class as named within the same (i.e. as opposed to the more usual position where a licence is granted solely for the benefit of an applicant and, potentially, its affiliates).

Slightly separately, businesses should note that any sanctions licences that have been issued by a UK regulator (e.g. HM Treasury/OFSI) may no longer facilitate their compliance with the *EU-27's* sanctions regimes in a hard Brexit scenario. Similarly, sanctions licences issued by the remaining EU-27 Member States for purposes connected to the *EU's* sanctions regimes pre-Brexit may not act so as to cover activities which are otherwise regulated by the UK's new sanctions regime post-Brexit day.

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[2] The guidance is available here: https://www.gov.uk/government/publications/post-eu-exit-financial-sanctions-general-guidance

Wider observations

The new UK sanctions regimes being created under SAMLA also contain a number of further technical differences. For example:

(a) **UK regulator's designation powers**: The new SAMLA-related regimes provide the UK's authorities with a broad set of designation powers in the context of asset freezes. In particular, they provide the UK's authorities with the ability to make:

(i) Magnitsky-style designations (i.e. designations to promote compliance with international humanitarian and human rights laws); and

(ii) "semi-publicised" designations where certain restricted publicity conditions are met (e.g. where a proposed asset freeze target is believed to be under the age of 18, or there are otherwise compelling national security reasons). In such circumstances, the UK's regulators may not add the asset freeze target to HM Treasury's "Consolidated List of Financial Sanctions Targets in the UK", but may inform only such persons as they consider appropriate.

(b) **Reporting obligations**: Certain EU financial sanctions regimes contain language which imposes a general duty on *all* EU persons to supply any information which would "facilitate compliance" with sanctions to their home Member State's competent authorities. The new UK sanctions regimes being created under SAMLA do not contain an equivalent duty. They do, however, marginally extend existing mandatory reporting requirements for certain regulated sector businesses where these wish to avail themselves of a number of asset freezing exemptions.

A softer Brexit? UK sanctions at the end of an Implementation Period

On 22 October 2019 the UK Government obtained the House of Commons' approval, in principle, for the new Withdrawal Agreement it agreed with the EU on 17 October 2019 (the **Withdrawal Agreement**). Assuming that the Withdrawal Agreement comes into effect, the UK will enter an implementation period during which it is intended that its future relationship with the EU will be negotiated (the **Implementation Period**). For the duration of that Implementation Period, EU law will continue to apply in the UK. It is envisaged that the Implementation Period will end on 31 December 2020, but it may be extended further. However, at the end of that period, if no further agreement is reached, the UK will once again face the prospect of a Hard Brexit. The European Union (Withdrawal Agreement) Bill (the **WAB**), which is intended to implement the Withdrawal Agreement in domestic law, provides for this eventuality by creating a mechanism so that the new laws created in preparation for Brexit, including the new UK sanctions laws made under the SAMLA, may come into force at the end of the Implementation Period.

Closing thoughts

The position of the new UK sanctions regime in a hard Brexit scenario is expected to broadly mirror that which is in place in the EU. That said, there would be key differences. Businesses should be alert to these differences, and should plan accordingly.

In particular, they should:

(a) consider the potential applicability of the new UK sanctions regimes to their operations;

(b) reflect on whether their standard form contractual documentation needs to be updated to account for the new UK sanctions regimes;

(c) assess whether any of their counterparties could become targeted as a consequence of a hard Brexit;

(d) update their existing processes and procedures to account for the immediate divergence of the EU and UK sanctions regimes (e.g. checks on the UK's sanctions lists may no longer pick up all of the persons who are on the EU's sanctions lists and vice versa); and

(e) double-check their existing sanctions licences to ensure that the same will continue to provide the requisite cover following Brexit.

In the medium to long term, we may well see a material divergence in approach between the UK and EU sanctions regimes. Whether or not this divergence does in fact materialise will be heavily dependent on a number of factors including, most importantly, which of the UK's political parties is in government and how the UK's international trade policy develops (including, importantly, the nature of the relationship that is ultimately established between the EU and the UK post-Brexit). For instance, the current opposition Labour Party would be expected to be much more sympathetic to countries such as Russia and Venezuela, and less willing to follow the US position, than is currently the case. Businesses should be prepared for this eventuality, and monitor the position closely.

If you have any questions in relation to any of the issues raised in this bulletin, please contact one of our specialists below or your usual contact at Allen & Overy:

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