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EBF COMMENTS ON THE EU BLOCKING REGULATION

I. PURPOSE, SCOPE AND UNINTENDED CONSEQUENCES OF THE BLOCKING REGULATION

1. Purpose of the Regulation and need for an EU enforcement approach

The EU Blocking Regulation adopted in 1996[1] (hereinafter "the initial Regulation") requires EU persons to refrain from complying with some extraterritorial laws that are explicitly listed in the Annex to the Regulation.

Following the US withdrawal from the Joint Comprehensive Plan of Action (JCPOA) in May, the EU has stressed its commitment to preserving the JCPOA, maintaining and expanding economic ties with Iran. On 6 June 2018, the Commission adopted a delegated Regulation amending the Annex to the Blocking Regulation to include in the scope of the latter certain US sanctions on Iran with the aim to protect Iran-related business interests of EU companies and individuals (hereinafter "the updated Regulation"). The updated Regulation is due to enter into force on 6 August 2018.

The European Banking Federation (EBF) understands that the Commission will issue implementing guidance to accompany the introduction of the updated Regulation (hereinafter "the Guidance"). The Guidance must be subject to careful scrutiny and consultation. Given enforcement of the Regulation will be undertaken at EU Member State level, the EBF strongly urges that an EU enforcement approach is agreed and included in the Guidance. It should make clear that the Regulation is not aimed at punishing those who would have to comply with the US sanctions.

[1] Council Regulation n°2271/96 of 22 November 1996 protecting against the effects of extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom.

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2. Risk/ business considerations and global group policies

It is crucial that the Regulation does not challenge the ability for any EU person to take decisions on risk grounds and to adopt a restrictive policy position towards Iran. This policy may include the presence of internal/ global group policies, procedures and risk appetite statement. Banks should be allowed to make a risk-based decision not to do business with Iran and need to be able to do their own internal risk assessment.

Business opportunities and costs are other factors that EU persons and entities, including banks, should be able to consider before doing an Iran deal. Before doing business with Iran, an EU entity will have to undertake significant efforts such as:

- Examining all relevant US regulations;

- Hiring and training dedicated staff and putting in place appropriate procedures to screen any transactions with Iran;

- Developing detailed databases and other information sources to screen Iranian counterparties.

Therefore, a decision not to do a transaction with an Iranian nexus should not be interpreted by EU authorities as *de facto* proof that the EU entity is trying to comply with US sanctions.

The EBF strongly urges that the above EU enforcement approach includes a clear and concise statement which does not compel any EU person to facilitate activity which would fall outside assessed risk-based criteria. It must state very clearly that the intention of the Regulation is not to prevent EU persons from adopting a risk-based approach towards their business dealings with Iran. Factors that may influence commercial decisions may include a range of assessed risk parameters, including credit risk, anti-money laundering and counter-terrorist financing factors and wider compliance and business transparency considerations. Accordingly, more certainty is needed regarding the terms "comply with any requirement or prohibition" in Article 5 of the Regulation which should not be interpreted as referring to decisions based on general risk considerations, AML and EU sanctions, reputation, overarching operational risks, costs, etc. EU persons' freedom of doing business should not be challenged.

3. Potential impact of the Regulation on EU entities/persons in the US

Article 11 provides that the Regulation shall apply to any legal person incorporated within the Union. However, we are concerned by the potential impact it may have on European banks with subsidiaries or branches incorporated outside the Union.

The EBF suggests that the Guidance should clarify that the Regulation is not applicable to:

- ***Branches of EU incorporated entities located outside the Union;***
- ***Subsidiaries of EU incorporated entities located outside the Union;***
- ***Nationals of EU Member States located outside the Union.***

4. Impact of the Regulation on US Persons

The scope of the Regulation includes EU incorporated subsidiaries and registered branches of US companies, US natural persons located in the EU and EU nationals who are staff of US companies in the EU on whom the Regulation may have a dramatic impact.

Under the JCPOA, the US maintained its primary sanctions, including those applying to non-US incorporated subsidiaries of US entities, but removed the threat of secondary sanctions for non-US persons wishing to trade with Iran. The US also introduced a General License – 'GL H' – which permitted non-US subsidiaries of US entities to trade with Iran. However, this was permitted under strict conditions (including a prohibition on any touchpoint with the US financial system) which many non-US subsidiaries could not meet. Even when the US was party to the JCPOA, it was always the case that US natural and legal persons, including non-US incorporated subsidiaries, were prohibited by primary sanctions from engaging with Iran, unless licenced by the US Treasury's Office of Foreign Assets Control (OFAC) under very stringent conditions.

The EBF calls for the Commission to recognise in the Guidance that it would appear disproportionate to require US natural persons resident in the EU, e.g. those who are hired as European bank employees, and US legal persons operating in the EU or EU incorporated subsidiaries of US entities, to support trade relationships with Iran if they were prevented from doing so when the US was an active partner in the JCPOA.

The Guidance should recognise that US persons are required to comply with the primary US sanctions laws and regulations administered and enforced by OFAC. The scope of US persons under OFAC regulations includes all US citizens and permanent resident aliens, regardless of where they are located, any natural person located in the US and all US incorporated entities, including their branches located outside the US. OFAC regulations, including the Iranian Transactions and Sanctions Regulations, impose a strict liability standard for violations, and non-compliance may lead to civil and/or criminal penalties for US persons. Failure to comply with the instruments specified in the Annex would risk serious damage to the interests of the following categories of US persons, whose compliance with US primary sanctions laws cannot be characterised as extra-territorial, since US laws and regulations apply directly to US persons:

- ***Branches of US incorporated entities located in EU Member States, together with their employees, and others acting for or on their behalf;***
- ***Overseas subsidiaries in the EU of US entities;***
- ***Nationals of EU Member States who hold dual US nationality;***
- ***Nationals of EU Member States who hold US permanent resident alien status;***
- ***Nationals of EU Member States present in the US;***
- ***US citizens located in any EU Member State;***
- ***US citizens employed by, or acting for or on behalf of, companies or organisations incorporated under the law of any EU Member State.***

5. Legal uncertainty resulting from the Regulation

The initial Regulation and its recent update have never been considered by the industry as offering any protection against US secondary sanctions. Instead, they are adding a further dimension of legal complexity, legal uncertainty and cross-border compliance challenges for European banks.

An example illustrative of the situation is given by international syndicated loan contracts which very often include sanctions clauses, e.g. by reference to US sanctions laws, providing:

- a section on Definitions, where sanctions are understood as EU, US, or other sanctions issued by the competent authorities;
- a section on Representations, in which parties agree to comply with the sanctions;
- a default clause, according to which, if a party does not comply with the sanctions, the loan can be cancelled, and repayment has to be made by the borrower.

In some anti-boycott laws, Member States prevent banks from making such representations in contracts, in case they also imply compliance with US or any other sanctions law that is not in line with the EU Blocking Regulation. To avoid a breach of the anti-boycott law, European banks help out with "carve-out clauses".

This helps out to be not in breach with the law, but there remains an enhanced credit risk. If one of the syndicate declares the default case because of a US sanctions breach by the borrower and requests repayment, a party located in the above EU Member State could not request repayment and might be facing a default, because the requesting party gets all the money available by the borrower.

The EBF recommends the Commission to reiterate in the Guidance Recital 8 of the Regulation which refers to the PESC decision 96/668 of 22 November 1996, according to which Member States must take the necessary measures to protect persons whose interests are affected by extraterritorial laws or actions based on these laws, if these interests are not protected by the Regulation.

6. Threat of a ban from the US financial system

In the context of the US Iran sanctions, any EU or other non-US person could be targeted by US secondary sanctions if they have been assessed to have:

- knowingly facilitated certain significant transactions for or on behalf of, or otherwise provided material support to, natural or legal persons on the Specially Designated Nationals (SDN) list designated under US Iran sanctions (as well as any property owned 50% or more by an Iranian SDN); or
- determined to be conducting certain activities that are targeted by US secondary sanctions as defined by the US Iran sanctions.

Secondary sanctions may be imposed on non-US persons for conduct that occurs entirely outside the US jurisdiction, i.e. the sanctionable conduct need not involve any US person. Secondary sanctions do not purport to prohibit any conduct or impose any mandatory compliance requirements, but instead put pressure on third parties (i.e. EU banks and corporates) to stop their activities with the persons or countries targeted by US sanctions.

They are enforced through US persons, for example by prohibiting US financial institutions from transacting with any third party designated under the secondary sanctions.

In the years leading up to the JCPOA, the EU and the US worked towards a harmonised sanctions policy approach towards Iran. As a result, many regulators both within the US and the EU encouraged financial institutions to adopt global sanctions policies towards Iran. Companies that are publicly traded in the US are required by law to report their Iranian dealings in the Securities and Exchange Commission (SEC) public filings. US regulators could punish banks that will not respect their extraterritorial laws through measures that will have very significant financial impacts, such as heavy pecuniary or administrative sanctions (restrictions, bans on access to correspondent banking services, withdrawal of a banking license, registration on the list of SDN, denial to the US capital markets etc).

The EBF recommends the Commission to clarify in the Guidance that EU companies which are traded on US exchanges are not in breach of the Regulation if they report their Iranian dealings in these filings as required by US law.

7. Claim for damage compensation

Article 6 of the Regulation offers a route for EU persons to recover damages, including legal costs, caused to that person by the application of the specified US Iran sanctions. For example, an EU bank withdrawing from an Iranian exposed joint venture or closing an account due to US sanctions. Our assessment is that in comparison to pre-JCPOA days the risk of civil litigation under the updated Blocking Regulation has significantly increased. The risk of heightened civil litigation against EU entities is considered significant by European banks. A bank could indeed be held liable to civil action if it was unable to process an EU permissible payment to Iran, e.g. if it has been approached by a customer to send monies to Iran and it finds that its correspondent bank will not process the transaction.

The Guidance should provide acceptable comfort to EU persons and entities regarding the interpretation of Article 6. It would be a wholly unacceptable consequence if ultimately compliance employees who want to avoid that their bank incurs risks were held liable by third parties for doing their job.

II. MANDATORY NOTIFICATIONS OF ECONOMIC/FINANCIAL INTERESTS AFFECTED BY THE RELEVANT SANCTIONS

8. Scope of mandatory notifications

Article 2 of the updated Regulation requires legal persons incorporated within the Union (and their directors and managers) to inform the Commission if their economic and/or financial interests are affected, directly or indirectly, by the extraterritorial statutes listed in the appendix or by actions based on them or arising therefrom.

The EBF suggests that the Guidance should clarify that a legal person incorporated within the Union should inform the Commission if it suffers any reasonably quantifiable economic and/or financial losses as a result of the US extraterritorial sanctions in the specified instruments, or as a result of actions

taken by third parties that it can reasonably demonstrate were taken in order for such third party to comply with the US extraterritorial sanctions in the referenced instruments.

9. Persons liable for mandatory notifications

Article 2 amalgamates the responsibilities of the management bodies and those of the supervisory or controlling bodies of the management bodies.

The EBF recommends that the Guidance clarifies that the reporting responsibility rests with the governing bodies, which are the only persons authorised to act on behalf of the legal person. It should also provide that this responsibility can be delegated.

10. Retroactive application of mandatory notifications

It is unclear whether the provisions of the updated Regulation apply retroactively.

The EBF suggests that the Guidance provides clarification as to whether and under which conditions and modes of enforcement the provisions of the Regulation apply retroactively to agreements in place on or before the date of implementation of the amendments to the Annex.

11. Timeline and frequency of mandatory notifications

Article 2 provides that notification must take place within 30 days of the date on which a person has obtained the information that their economic and/ or financial interests are affected, directly or indirectly, by extraterritorial laws quoted or by actions based on or derived from them.

The Regulation should provide details of the criteria or events triggering the 30-day period and the frequency of notification. The Guidance should also clarify whether penalties may apply in case of late notification.

12. Penalties in case of non-compliance

The potential consequences of failing to comply with the Regulation vary significantly between Member States. There is a need for harmonisation in terms of enforcement, penalties and additional guidance to be provided at the level of each Member State in order to avoid the creation of competitive disadvantages for financial institutions according to their place of incorporation.

The EBF strongly recommends that the Guidance includes a policy statement which should clearly define each individual Member State competent authority and related enforcement approach, including penalties.

III. AUTHORISATION TO COMPLY WITH RELEVANT US SANCTIONS

13. Structure of the authorisation procedure

Article 5 of the updated Regulation provides for authorisation by the Commission for persons to comply fully or partially with the relevant US sanctions to the extent that non-compliance would seriously damage their interests or those of the Union. Under the current Regulation, a little-known procedure exists for an EU person to apply to the European Commission for authorisation to comply with US sanctions. Article 7 provides that it is for the European Commission, assisted by a committee, to grant the exemption provided for in Article 5 (2). Article 8 (2) of the Regulation states that this committee must be established in accordance with Article 5 of the Decision 1999/468/EC. This article generally defines the composition and functioning of the regulatory committee but, does not provide much detail on the procedure for granting the exemption.

Moreover, Article 5 (2) does not provide the conditions for an exemption. The EU Blocking Regulation appears to entrust the regulatory committee with the responsibility of defining the conditions for applying the exemption of Article 5 (2).

The question arises, in particular, whether this exemption may be granted in a general and permanent manner or whether the Commission must be seized on a case-by-case basis. This latter hypothesis should not, in our view, be preferred, because it would entail an administrative burden of processing exemption requests for both the banks and the Commission, which could quickly become unmanageable.

These inaccuracies could lead to significant litigation with the competent national authorities or customers of the banks as indicated below.

Moreover, the exemption seems to be granted only if non-compliance with extraterritorial laws would seriously damage the interests of a person or those of the EU. This concept and the methods of proving a serious injury to the interests of the person concerned are not specified in the EU Blocking Regulation, which is a source of considerable uncertainty. For example, there is no certainty that the risk of sanctions by US authorities is recognised as a serious injury to banks' interests.

In any case, the EU Blocking Regulation introduces an imbalance between the people who can benefit from the EU Blocking Regulation, who have only to justify that their economic and / or financial interests are affected, and the people who ask to benefit from an exemption from the application of the EU Blocking Regulation who, in turn, must justify that their interests would be seriously prejudiced if they apply this EU Blocking Regulation. Such a hierarchy between the economic interests of each other does not appear to be justified.

It is therefore requested an alignment of the conditions to be fulfilled to benefit from the exemption of the application of the EU Blocking Regulation on the conditions to be fulfilled in order to benefit from the EU Blocking Regulation.

The EBF would like to stress the importance of urgent dialogue with both the Commission and Member State competent authorities on how they envisage this authorisation process will be structured following the updated Regulation. In addition to the general question on the process to apply for such authorisation, the EBF recommends that the following questions be addressed in the Guidance:

- ***Is it a contradictory procedure?***
- ***Which is the time of instruction of the application?***
- ***How are decisions made?***

- ***Which would be the composition of the specific committee?***
- ***Is there a possibility for appeal?***
- ***Is the decision made public? Our view is that it should not be, because the publicity of the decision would, indirectly, allow the US authorities to know which bank will not apply US sanctions.***
- ***Can group heads apply for an exemption for all subsidiaries or branches in the EU?***

14. Scope of authorisation procedure and evidence to be provided by the applicant

We are unsure whether this mechanism has ever been utilised, but we understand that the applicant would need to provide evidence that non-compliance with relevant US sanctions would cause serious damage to a (legal or natural) person's interests or the interests of the EU. We also question the extent to which such an authorisation is needed when an EU person is choosing to refrain from conduct that is sanctionable under US secondary sanctions, given that US secondary sanctions are not a "requirement" or "prohibition" under Article 5.

The EBF suggests that the Guidance clarifies the circumstances in which an applicant would be likely to receive such an authorisation. The EBF notes that the enforcement of extraterritorial US sanctions implemented under the Iranian Transactions and Sanctions Regulations or Cuban Assets Control Regulations could cause particularly serious damage to the interests of a legal person incorporated within the Union that is owned or controlled by a US entity, or that has significant business interests in the US. The EBF's view is that a legal person organised in the Union, which demonstrates that it cannot practically avoid the risk of such damage if it fails to comply with a specified instrument, would have a strong likelihood of receiving an authorisation to comply fully or partially with such an instrument. Additionally, a legal person within the Union that is able to demonstrate that compliance with the Blocking Regulation would result in non-compliance by US persons with US primary sanctions, would have a strong likelihood of receiving an authorisation to comply fully or partially with such an instrument.

More globally, all situations that automatically lead to submission to the US laws should be considered to characterise a serious damage to a person's interests. This is the case:

- when a person executes transactions in dollars, has presence in the US, is engaged vis-à-vis the US authorities (federal or federated) through various instruments (deferred prosecution agreement, cease and desist order ...);

- for employees of US nationality, US business partners, US correspondent banks which are deciding on their business relationships with EU banks based on their level of activity in Iran, US investors (in case of USD bond issuance by EU banks in order to have USD liquidity), and US persons shareholders/ Board members.

15. Authorisation procedure *vs* possibility of compensation

The question is raised as to how the exemption procedure provided for in Article 5 (2) could be linked to Article 6 which provides that any person falling within the scope of this Act has the right to recover the compensation due for any damage caused to it by the application of extraterritorial laws or actions based on or derived from. For example, if a bank feels that it should refuse to support a company by invoking US sanctions on Iran, it will have to apply for an exemption on the basis of the Article 5 (2). But at the same time, it runs the risk of being held liable on the basis of Article 6. The EU Blocking Regulation does not provide that the bank's request for exemption entails the suspension of any proceedings that may be brought against it. It does not specify either any exemption from liability in the event of rejection of the application for exemption.

Clarifications on the exemption regime are requested because of the windfall effect of Article 6 for a number of companies that might be tempted to engage the responsibility of banks at the slightest refusal to accompany them in their activities towards Iran.

16. Grace period

Given that the FAQ will be published only a few days before the entry into force of the EU Blocking Regulation or concomitantly with the EU Blocking Regulation, the EBF calls for the Guidance to provide a grace period of 3 months during which the entities whose interests are seriously damaged can address their request for exemption while continuing to apply extraterritorial US laws.

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About the EBF

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