UK FINANCIAL SANCTIONS: LAW FIRM FAQS

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A selection of frequently asked questions (FAQs) relating to financial sanctions and their practical application to law firms.

by *Robin Lööf*, Fountain Court Chambers

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SCOPE OF THIS NOTE

This note considers frequently asked questions by law firms about the UK financial sanctions regime as it applies to law firms authorised by the Solicitors Regulation Authority (SRA) in England and Wales and individuals working within those firms.

For an overview of the UK financial sanctions regime and the implications for law firms to consider, see *Practice note, UK financial sanctions: law firm compliance*. For a flowchart showing the key stages for law firms seeking to comply with the UK financial sanctions regime, see *Flowchart, UK Financial Sanctions: law firm compliance addressing sanctions risk.*

For further information and resources on sanctions, see *Practice Compliance & Management legislation, regulation and guidance tracker* and *Russia Sanctions and Related Considerations Toolkit.*

HOW DO WE KNOW IF OUR EXISTING CLIENTS HAVE BECOME SANCTIONED?

The most reliable way is to subscribe to a continuing monitoring service which runs daily checks of all names entered into your client database against all relevant consolidated sanctions lists.

If you do not subscribe to an automated monitoring service, by signing up to *OFSI updates* you can ensure that you receive email notifications as and when the UK adds individuals and entities to the sanctions lists (as well as other useful updates from OFSI). This requires individuals or a team within the firm to be assigned the responsibility for reviewing these notifications immediately when they come in and cross-checking any new entries against the firm's client database. These checks should be run against all entries in the database, including adverse and related parties.

Whether you employ an automated system or rely on manual checks, the firm needs to have in place an established process for internal escalation if there is a sanctions match with a name in the firm's client database. The lawyer responsible for the client relationship needs to be notified immediately, as well as the requisite person (such as the firm's compliance officer for legal practice (COLP) or the money laundering reporting officer (MLRO)) or team with oversight of sanctions compliance and the accounting and billing teams responsible for managing disbursements, invoicing and client funds.

If you represent entities, a difficulty may arise where someone in the ownership chain is designated. Best practice is again to escalate internally pending an ownership and control analysis.

For more information on UK financial sanctions and law firm compliance, see *Practice note, UK financial sanctions: law firm compliance: Sanctions lists checking and Ongoing monitoring.*

HOW DO WE WORK OUT IF OUR CORPORATE CLIENT OR POTENTIAL CLIENT IS OWNED OR CONTROLLED BY A SANCTIONED PERSON? CAN WE CHARGE FOR WORKING IT OUT?

OFSI has outlined the rules and guidance for analysing the ownership and control provisions in sanctions regulations in its note on financial sanctions (see *Practice note, Financial sanctions: ownership or control*). In addition, given the EU origins of the UK sanctions framework, *EU guidance* is persuasive and, in some respects, more granular.

Whether, in principle, you think it appropriate to charge for what amounts to client due diligence is a business decision. From a sanctions perspective, you can charge for it but payment would be "at-risk". If the outcome of the analysis is that the client is owned or controlled by one or several designated persons, that work would need to be included in a licence application and the licence granted before payment could be received. For more information on "at-risk" work, see *What work can we do for a sanctioned client?.*

WE HAVE MONEY ON ACCOUNT FOR A SANCTIONED CLIENT; CAN WE USE IT TO PAY FOR WORK DONE BEFORE THE DESIGNATION?

No, such funds have to be frozen from the moment of designation and cannot be "dealt with" for any purpose.

WE RECEIVED MONEY FROM A SANCTIONED CLIENT IN PAYMENT OF AN INVOICE ISSUED BEFORE THE DESIGNATION; WHAT DO WE DO?

The money received must be frozen on receipt into the client account and a frozen assets report made to OFSI.

If the money was received after 15 June 2022, the firm is in principle civilly liable for a violation of the asset freeze, whereas criminal liability is highly unlikely in these circumstances. See *What financial sanctions offences can be committed by the firm or individuals working for or at the firm?*.

WE HAVE MONEY FROM A SANCTIONED CLIENT IN OUR CLIENT ACCOUNT; HOW DO WE "FREEZE" IT?

Most law firms will have client accounts in which client money is pooled, but subject to an obligation to account for each client's money in a separate ledger (see rule 8, *SRA Accounts Rules*). For more information on checks to demonstrate compliance with the SRA Accounts Rules, see *Checklist, SRA Accounts Rules compliance tests*.

As a practical matter, the "freezing" of funds occurs at the ledger level. The ledger needs to record that the relevant client funds are frozen, and no transactions with those funds are to occur (subject to licence).

All frozen funds need to be reported to OFSI, and so the ledger accounting needs to be clear and auditable. It is also advisable to notify your bank that you keep frozen funds in the account and, possibly, provide them with copies of your correspondence with OFSI relating to those funds.

WHAT WORK CAN WE DO FOR A SANCTIONED CLIENT?

The SRA has stated that "The financial sanctions regime prevents law firms from doing business or acting for listed individuals, entities or ships (without a licence)" (*SRA: News release, The importance of complying with Russian financial sanctions (Updated 7 March 2022)*). This is somewhat overstating the legal position, although firms may wish to follow the SRA guidance as a risk management practice.

As a preliminary matter, you are not prevented from managing the situation and performing courtesies when your client is designated provided that you do not intend to charge for such services. For example, corresponding and speaking with your client, opponents in litigation, counterparties in transactions, courts and tribunals is not prohibited.

On substantive work, the guiding principle is that if you do work for which you intend to charge, you need a licence. Generally, that means you need a licence before you do the work because you cannot do work on credit (extending credit being a form of making funds available to a sanctioned person). In its guidance, OFSI states: "In most cases, you can provide legal advice to or act for a designated person without an OFSI licence, however, you cannot receive any payment for that advice without first obtaining an OFSI licence," and that: "Generally, you won't be prohibited from providing legal advice under an asset freeze. However, the payment for legal services and the provision of legal services on credit do require an OFSI licence." (*OFSI UK Financial Sanctions General Guidance for Financial Sanctions Under SAMLA 2018*, sections 6.5 and 6.6.1 (OFSI General Guidance).)

Work conducted on the basis that it is only to be paid for if a licence is ultimately obtained is in principle possible, as long as it is genuinely at-risk. This means that there cannot be an agreement or understanding that if a licence is ultimately not obtained, payment would be made if or when the designation of the client is lifted, or that any portion of fees incurred which OFSI ultimately refuses to license on the basis that it is not "reasonable" will be paid at such a time. Work on such terms would amount to the extension of credit (that is, making funds available) and therefore be prohibited.

There are perhaps two main categories of at-risk work: work done to put together a licence application and work necessary to preserve the client's legal rights, for example, filing a claim where a time limit is about to expire.

The major caution in relation to at-risk work is that the work can itself amount to making funds or economic resources available, directly or indirectly, to a designated person. If that is the case, the fact that you may not get paid would not prevent it from being a violation. So, for instance, lodging a Land Registry form which registers ownership over property may be the last thing you have to do in a property transaction pre-dating the designation of your client, but it arguably amounts to making an economic resource available to a designated person and so would be prohibited in and of itself. The same caution applies to pro bono work.

For this reason, it is prudent to keep at-risk work to the minimum necessary as the more substantive the work carried out, the higher the risk that it will amount to a sanctions violation.

Finally, you can only be paid for at-risk work if it is included in a licence application and a licence is subsequently granted by OFSI for the work.

WHAT SHOULD WE INCLUDE IN A LICENCE APPLICATION?

The central issue on a licence application is that the amount of the fees sought must be "reasonable". OFSI has published guidance (see *OFSI: Blogs, Reasonableness in licensing* and *Introduction to licensing*). More practical guidance can be found in OFSI General Guidance, pages 28-29.

Designated persons are not to be deprived of access to justice so, in principle, a licence should be issued for legal services required to defend legal rights and interests. Legal expenses are, however, less likely to be deemed "reasonable", and a licence therefore less likely to be issued, for legal services in support of purely commercial, optional transactions (divesting or reorganising the holding of assets, M&A activity and so on).

Putting together a *licence application* for "reasonable" legal expenses is like a mini-costs budgeting exercise. To be able to assess reasonableness, OFSI needs to know the nature of the work to be undertaken, the basis for calculating the fees to be charged, the amount to be licensed, and the likely timeframe for payment.

OFSI's guidance used to state that they aim to begin discussions with an applicant for a licence within four weeks of receipt of the application. However, soon after the recent expansion of the Russia-related sanctions following the invasion of Ukraine, it became apparent that OFSI could not manage the volume of licence applications within that timeframe. The guidance was amended to state that OFSI "aim to review all new licensing applications as soon as practicable" and that priority will be given to applications involving "issues of personal basic needs and/or wider humanitarian issues ... of material impact or urgency, or which are deemed to be of particular strategic, economic or administrative importance" (OFSI General Guidance, section 6.10). Delays may be such that applicants should be prepared for waits of over three months before OFSI engages on a particular application. There is then likely to be a period of discussions where OFSI verifies various aspects of the application, including pushing back on rates or amounts. It may therefore be six months or more between submission of an application and the final issuing of a licence.

Nature of work to be undertaken

If the mandate is well-defined (a particular transaction, a discrete piece of litigation and so on), the various stages to conclusion should be set out.

If the mandate is long-running, for example, a substantial litigation likely to take years, an application should only include as many stages for which costs can be anticipated with a reasonable amount of accuracy. In this case, the application should state that it will likely need to be complemented with subsequent, additional licence applications.

Basis for calculating fees to be charged

If the mandate provides for an hourly rate, the application should set out the number of hours per fee-earner involved and the applicable rates.

By way of guidance on what hourly rates are likely to be reasonable, OFSI General Guidance states that it "considers that the *Supreme Court Cost Guides* or the sums that could be expected to be recouped if costs were awarded, provide a useful starting point for assessing the reasonableness of legal fees and disbursements" (section 6.5). See also the *Civil Justice Council's Guideline Hourly Rates*. Departures from these rates need to be justified.

If the mandate provides for any other fee structure such as fixed fees or capped fees, the basis for the fee calculation needs to be set out (for example, fixed fee of £5,000 based on 20 hours' work at £250 an hour).

Any disbursements, such as counsel's fees, e-discovery platforms, printers should be included as well. These need to be reasonable. In relation to counsel's fees, the Supreme Court Cost Guides provide indicative amounts for brief fees and refreshers.

Amount to be licensed and timeframe

Finally, the application needs to add up the various cost items and set out a total amount for which a licence is requested. It is often appropriate to express this request in terms of "up to x amount", this would be the ceiling of what you can receive under a licence granted on those terms.

It is also likely that a licence will only be granted on a time-limited basis and so a proposed end or interim review date can be included, if appropriate.

Supporting documents

The licence application form requires the production of "evidence to support an application and demonstrate that all criteria of the relevant licensing ground (where applicable) have been met". For a legal services licence, this

would typically include evidence of the mandate and fee structure agreed (such as an engagement letter), sealed claim forms, and invoices or agreements related to disbursements.

A TRANSACTION OR LITIGATION IS BEING PUT AT RISK BY DELAYS IN RECEIVING A LICENCE; WHAT CAN WE DO?

If a client's legal interests are at risk, and you are prepared to take the necessary steps to preserve them on an at-risk basis, you can do what is necessary (assuming that you do not thereby deal with the client's assets or confer a benefit on them). It is likely to be advisable to make any such work the subject of an addendum to the pending licence application.

Bear in mind what is stated above that certain types of legal work, particularly advising on optional commercial transactions, risk not being licensed. It is also more likely to involve taking steps which are themselves sanctions violations. See *What work can we do for a sanctioned client?*.

Your obligation to comply with sanctions legislation trumps your duties to your client. In this regard, recall that section 44 of the *Sanctions and Anti-Money Laundering Act 2018* (SAMLA) protects you from any civil liability if your failure to carry out the client's instructions is as a result of a "reasonable belief" that it is required by the relevant sanctions legislation.

CERTAIN ACTIVITIES OF OUR SANCTIONED CLIENT APPEAR TO FALL UNDER AN OFSI GENERAL LICENCE; DOES THAT MEAN WE CAN DO CHARGEABLE WORK FOR OUR CLIENT?

This depends on the terms of the particular General Licence. For instance, OFSI General Licences providing for the winding down of commercial relationships generally contain a permission for any person to "carry out any activity reasonably necessary to effect [it]" which may include related legal services. As a general matter, great care should be taken when interpreting what is permitted under a General Licence.

If work is done under a General Licence, financial institutions, in particular banks, are likely to want to see independent legal advice to the effect that the payment of fees is permitted under the General Licence before processing any such payments.

WHAT FINANCIAL SANCTIONS OFFENCES CAN BE COMMITTED BY THE FIRM OR INDIVIDUALS WORKING FOR OR AT THE FIRM?

Criminal liability for sanctions violations is generally triggered by an act which violates a sanctions prohibition when the actor "knows, or has reasonable cause to suspect" that the act violates sanctions in the way proscribed. The main exception to this is the circumvention offence which requires intention to evade sanctions.

Considering the liability of law firms specifically, it is likely that the knowledge or suspicion (or intention) of any lawyer with authority independently to commit the law firm in relation to the particular act in question is sufficient to fix the firm with criminal liability.

In addition to criminal enforcement, OFSI has civil enforcement powers with respect to the same offences. As of 15 June 2022, civil liability for sanctions violations is strict, that is, there is no need for OFSI to prove knowledge or reasonable cause to suspect to hold a person civilly liable for a sanctions violation. This applies also to law firms. See *Civil liability*.

OFSI's *Enforcement Guidance* sets out the criteria OFSI will apply when deciding whether to enforce suspected sanctions violations civilly or refer for criminal enforcement.

Criminal offences by firms

This is an indicative, non-exhaustive list of activities by law firms which are likely to amount to criminal offences under sanctions legislation, in descending order of gravity:

Sanctions evasion

Law firms are often integral to transactions the object or effect of which is to evade or prepare for the evasion of sanctions. The intentional participation in such transactions amounts to the offence of "circumvention" (provided for in, for example, *regulation 19* of the Russia (Sanctions) (EU Exit) Regulations 2019 (*SI 2019/855*)). Such transactions also risk triggering the "arrangement" money laundering offence under *section 328* of the Proceeds of Crime Act 2002 (for which the mental element is mere knowledge or suspicion).

Recent joint guidance from the relevant enforcement authorities have emphasised the need for particular care in relation to corporate clients where the ownership and control situation is unclear by reason of, for example, opaque ownership structures or recent restructuring of ownership, particularly where these changes have come about in close temporal proximity with a relevant designation.

You may be equally responsible if acting for a non-designated party in a transaction amounting to sanctions evasion. Vigilance is therefore required also in relation to your clients' counterparties.

In this regard, OFSI cautions that:

> "where sanctions prohibit specific actions, e.g. restructuring of finance, you need to carefully consider whether your advice and support for the client is helping them comply with sanctions or is participating in or facilitating a breach. For example, if it is prohibited to raise capital on financial markets, providing advice on how this affects a business will be permitted. However, preparing documents to raise such capital may amount to an attempt to circumvent sanctions."

(*OFSI General Guidance*, section 6.6.1.)

Making assets available to a designated person

Given the wide definitions of funds and economic resources, the range of activities by a law firm which may amount to this primary sanctions violation is equally wide. Examples of seemingly innocent and low-input acts which may amount to such a violation are set out above: for example, working on credit and registering title with the Land Registry. Care should be taken particularly because activities which amount to making assets available to a designated person may seem innocuous.

As with sanctions evasion, you may be held liable for making assets available to third parties when acting for a non-designated client. Vigilance in relation to your clients' counterparties is therefore required also here.

Dealing with (frozen) client funds

If you have client funds in your client account, any transaction involving those funds is prohibited. The importance highlighted above of alerting accounting and billing teams as soon as a sanctions alert is raised is critical to prevent any violations by, for example, transferring funds to the firm account or paying third party invoices.

Receiving frozen assets from a sanctioned client

As soon as a sanctions alert is raised, accounting and billing teams must instruct the affected clients to halt any pending payments to the firm. As a general matter, violations of this kind are more likely in relation to corporate client owned or controlled by sanctioned persons as payments would need to "slip through" the likely highly sophisticated checks by the banks involved. In any event, this emphasises the importance of halting any activity which risks violating sanctions legislation pending the outcome of ownership or control analyses.

It is highly unlikely that a firm would be criminally liable for receiving funds from a sanctioned client given the likelihood that it was due to a mistake. However, civil liability is a risk.

Criminal offences by individuals

While it should not be excluded, direct individual liability for acts committed by a firm is unlikely. However, senior individuals within the firm are generally made criminally liable if the offence by the firm was committed with their "consent or connivance", or was "attributable to any neglect" by them (see, for example, *regulation 81* of the Russia (Sanctions) (EU Exit) Regulations 2019).

While such derivative liability is a risk mainly for partners, compliance officers and firm MLROs are potentially at risk of individual liability on this basis if their neglect or wilful blindness contributed to the firm's sanctions violation.

Civil liability

The need to ensure that firm processes are apt to prevent even inadvertent violations of sanctions legislation has become critical since strict civil liability for sanctions violations was introduced on 15 June 2022. Previously, genuine mistake was a defence to liability, both criminal and civil. Now it is at best a factor which OFSI may rely on not to take formal enforcement action and, at worst, mere mitigation.

However, in this context it is worth emphasising that OFSI is unlikely to consider genuine mistake a reason not to take enforcement action in relation to firms which have now been operating in an environment where sanctions are prevalent for a considerable amount of time. If the violation was due to an absence of, or a failure to put in place, reasonable systems and controls to prevent sanctions violations, the fact that it was a mistake is unlikely to enable a firm to escape liability.

For more information on civil liability for a sanctions violation, see *Practice note, Monetary penalties for breach of financial sanctions under the Policing and Crime Act 2017: Power to impose monetary penalties.*

WE EMPLOY EU AND/OR US NATIONALS AS FEE EARNERS; ARE THEY AT RISK BY WORKING ON MATTERS WHICH ARE LAWFUL IN THE UK BUT SUBJECT TO SANCTIONS IN THE EU AND/OR US?

In relation to EU nationals, this is a matter for EU law and, in addition, law and practice in the member states which would have potential jurisdiction to pursue the fee earners in question (which is by no means consistent). Equally, in relation to US nationals, this is a matter for US law.

If this is likely to be a recurring issue, it is a good idea to obtain advice from specialist counsel in the EU or the US.

DEFINITIONS

"Sanctioned": subject to an asset freeze pursuant to regulations adopted under the SAMLA.

"Designated": made the subject of an asset freeze pursuant to regulations adopted under SAMLA.

"Designation": publication of the decision to make a named person the subject of an asset freeze pursuant to regulations adopted under SAMLA.