PRIVILEGED AND CONFIDENTIAL

Date: 25 March 2024

From: Baker McKenzie LLP

Re: **European Banking Authority: Sanctions Consultation Response**

1. Introduction

1.1 In accordance with Article 23 of Regulation (EU) 2023/1113, the EBA is required to issue guidelines on the internal policies, procedures and controls payment service providers ("**PSPs**") and crypto-asset service providers ("**CASPs**") need to have in place to ensure compliance with EU and Member State restrictive measures in the context of transfers of funds and transfers of crypto-assets.

1.2 As a result, the EBA issued its draft guidelines for consultation, in conjunction with which it also issued corresponding guidance for financial institutions, also subject to consultation.

1.3 This paper provides comments to the proposed guidelines, dealing firstly with overarching themes shared by both guidelines and then commenting on the specific provisions of each in turn, which we are happy for the EBA to publish as part of the consultation process.

2. Background to Baker McKenzie

2.1 Baker McKenzie is a full-service international law firm with more than 70 offices in over 40 jurisdictions. Our London International Trade practice is the largest of its kind in the UK, comprising over 25 lawyers, and has been ranked as Tier 1 for Trade, WTO, Anti-Dumping and Customs in Legal 500 for more than 20 years. We act for a wide range of UK- and overseas-headquartered businesses, across all sectors, including significant portions of the FTSE 100, the S&P 500 and CAC 40.

2.2 Baker McKenzie has significant experience in advising EU and other financial institutions on sanctions and broader financial crime compliance, including significant experience in advising financial institutions on regulatory requirements and expectations around sanctions screening, and in formulating appropriate risk-calibrated sanctions screening programmes. Our EU International Trade practice commonly advises client on EU, US and UK sanctions compliance matters, and through our global network we assist our clients in obtaining advice on the sanctions of many other allied jurisdictions.

2.3 Accordingly, we are submitting the below responses based on our extensive experience advising clients with respect to sanctions exposure, and in particular in relation to issues of sanctions screening, alert analysis and ownership and control analysis.

3. Overarching comments on EBA draft guidelines

Introductory Comments

3.1 We agree that the EBA issuing guidelines is important for the financial sector, given the increasing complexity and range of financial sanctions measures that the EU has sought to introduce (in particular, following the increased sanctions imposed against Russia and Belarus). Furthermore,

financial institutions can be subject to significant financial and regulatory penalties for failing to comply with sanctions, and may be at a greater risk of enforcement action than other types of companies (for example, due to financial institutions being subject to enhanced reporting obligations to authorities, or due to increased supervision of financial institutions under money laundering and other related financial compliance areas).

3.2 We agree with the EBA's statement that "*[d]ivergent approaches by competent authorities make the adoption by financial institutions of an effective approach to compliance with restrictive measures regimes difficult*". Particularly in the context of EU sanctions imposed against Russia, we have seen EU authorities take clearly divergent positions on important issues relating to sanctions compliance matters, which can often leave financial institutions and companies alike in a difficult position.

3.3 Overall, the EBA's draft guidelines appears to support taking a risk-based approach to sanctions compliance, which we agree with, though noting the EBA's comments that there is no scope for a risk-based approach in respect of the identified risk exposure (please see our comments further below on this). There is no one-size-fits-all model for sanctions compliance, and different types of financial institutions will have different sanctions risk profiles (for example, due to the jurisdictions in which they operate, or the types of activities that they undertake), and it is appropriate for financial institutions to calibrate their sanctions compliance policies and procedures accordingly. In this sense, the EBA's risk-based approach is generally aligned with Baker McKenzie's own guidance on the Five Essential Elements of Corporate Compliance[1], which emphasises the importance of undertaking risk assessments and putting in place effective compliance leadership and tone from the top – which are elements of an effective compliance programme that are particularly emphasised by the EBA.

3.4 However, as a general matter, the EBA recommendations, particularly in respect of screening, are not sufficiently risk based nor do they acknowledge the practical realities of identifying red flags for sanctions at a transactional level (e.g. delays in screening data sets being updated following new sanctions packages and complex issues of ownership and control). While there is not an expectation for EBA guidelines to set out comprehensive diligence steps calibrated to hypothetical perceived sanctions risk levels, it would be helpful for the EBA to provide non-comprehensive scenario-based examples and, at the very least, acknowledge that it is appropriate for sanctions screening to be risk-led.

Implementation Date

3.5 The applicable date of the EBA draft guidelines in each case is proposed to be 30 December 2024. While we recognise that Regulation 2023/1113 applies from 30 December 2024 and that there are synergies between the measures proposed in the guidelines and the controls which are likely already in situ at a number of target organisations, as a result of the implementation of the guidelines, target organisations will nonetheless need to carry out some work to assess their current compliance frameworks, as well as existing policies, procedures and controls, carry out a gap analysis and design and implement new measures as necessary. We would therefore suggest that the EBA Guidelines provide for a further transition period of up to 24 months, during which target organisations can assess and uplift compliance programmes as needed.

[1] Available here: https://www.bakermckenzie.com/-/media/files/insight/publications/2018/05/guide_na_5eecc_may2018.pdf?la=en

Lack of clarity as to whether particular recommendations are specific to payment screening.

3.6 In our view, it is not fully clear based on the draft guidelines whether particular recommendations are focused solely on payment screening / circumstances where a transfer of funds takes places, or whether the recommendations are also intended to apply to customer onboarding screening. In our view, the EBA needs to make these points clearer.

3.7 It is also not clear to what extent the principles set out in relation to PSPs and CASPs should also be applicable to financial institutions in other contexts.

Too Broad Reporting Obligations

3.8 Both EBA guidelines include very broad reporting requirements, including in circumstances where there is suspected sanctions circumvention and unconfirmed screening alerts. These recommendations are too broad and would appear to have unintended consequences, for institutions, organisations and the regulatory authorities alike. In particular:

(a) we see a clear risk of overwhelming national crime agencies with unsubstantiated reports, diverting much needed resource away from true enforcement cases;

(b) it would be disproportionately burdensome for organisations to report in all circumstances suggested and drive inefficiencies in investigations (both internal and at the regulatory level), particular where internal investigations into alerts were still being conducted, not least because the organisation would likely need to keep the regulatory authorities appraised of findings (including where a false-positive is identified); and

(c) the suggested reporting requirements go beyond the reporting obligations generally included in EU sanctions legislation.

3.9 In consideration of the above, we would suggest that the guidelines limit reporting obligations to circumstances where there has been a breach of EU asset freeze measures or there is a mandatory reporting requirement in the underlying sanctions legislation. It would be detrimental for global commercial business to promote a culture of over-compliance, and contrary to the intended purpose of the "smart sanctions" approach adopted by the European Commission.

4. Comments on Financial Institution Guidelines

4.1 Rationale

(a) The EBA's guidelines appear to emphasise that financial institutions should undertake a "restrictive measures exposure assessment", which we understand refers to a risk assessment. We agree with this statement, and conducting a risk assessment helps financial institutions to identify the areas of their compliance programme where they should allocate the most resources (for example). The importance of risk assessments and adopting a risk-based compliance programme has been recognised and supported by authorities across the world, in the sanctions space and also in other financial crime areas.

(b) The statement in the EBA's guidelines in section 3.2 at paragraph 10 (c) that a "*restrictive measures exposure assessment cannot result in applying a risk-based approach towards the compliance with restrictive measures*" appears to contradict this well-established compliance principle, and does not align with other statements made in the EBA's consultation (for

example in section 4, where the EBA states that policies, procedures and controls "*should be effective and proportionate to the size, nature and complexity of the financial institution, and to its restrictive measures exposure*"). We would recommend that this sentence is deleted or amended.

4.2 **Subject Matter and Scope of Application**

(a) If the intention of the EBA is that the guidelines applies to financial institutions in all circumstances in which a bank operates, and is not just limited to the transfer of funds, we would suggest that the EBA guidelines expressly state this.

4.3 **Definitions**

(a) In our view, the definition for "*restrictive measures*" could be clearer as to whether it is intended to just be focused on designated person / asset freeze restrictions, or whether it is also intended to capture other types of restrictive measures (e.g. trade / sectoral sanctions measures).

4.4 **Governance Framework and the Role of the Management Body**

(a) In our view, the statements regarding what group parent companies should do in particular scenarios are unclear in terms of scope, and the extent to which the obligations are intended to apply to non-EU group parents or subsidiaries.

(b) For example, the statement in 4.1(7) that "*[w]here the financial institution is the parent of a group, the group management body should ensure that the group entities perform their own restrictive measures exposure assessment […] in a coordinated way and based on a common methodology*" would not generally be appropriate for non-EU group entities, given that the definition of "*restrictive measures*" is tied to EU sanctions, and it would not generally be appropriate for non-EU entities to have to conduct risk assessments in respect of EU sanctions compliance.

The role of the management body in its management function

(c) Paragraph 4.1.2(12) states:

"*Where the financial institution is the parent undertaking of a group, the management body of that parent undertaking should ensure that the above tasks listed from a) to i) are also performed at individual levels and that policies and procedures entities put in place are aligned with the group's procedures and policies, to the extent permitted under applicable national law.*"

(d) In line with our comments above, we consider that this imposes a disproportionate burden on the management body of the parent company, and it may not necessarily be appropriate in all context for the management body to be subject to this expectation of involvement in the policies and procedures of its subsidiaries.

The role of the senior staff member

(e) The EBA's draft guidelines appears to be heavily influenced by the regulatory governance environment arising under anti-money laundering and counter terrorism financing legislation.

Accordingly, we consider it important that – where possible – the EBA guidelines leverages the governance frameworks expected in those contexts.

(f) Accordingly, we consider that there needs to be clarification in respect of references to "*the senior staff member*". In particular, it is unclear whether the EBA is suggesting that "the senior staff member" is a new regulated role which would be authorised and accountable to the competent authority, equivalent, for example, to the AML / CFT Compliance Officer. If it is the EBA's intention that the specific accountability framework for the senior staff member should be driven by national law requirement, it would be helpful to reflect this in the EBA guidelines.

(g) The EBA guidelines outline broad expectations that the senior staff member will "*report all suspensions of execution of transfers of funds and freezing measures as well as identified breaches of restrictive measures to the relevant national authorities competent for the implementation of restrictive measures and/or to the competent supervisory authority as per national requirements*". The requirement to report "*all suspensions of execution of transfers of funds and freezing measures*" goes beyond existing requirements and may lead to NCAs becoming inundated with irrelevant reports and information on false positives that were subsequently resolved.

4.5 **Conducting a Restrictive Measures Exposure Assessment**

(a) As a general matter, we consider that there are synergies between the proposed restrictive measures exposure assessment and certain existing risk assessments derived under certain regulatory regimes of other jurisdictions, for example the risk assessments that firms are required to carry out to comply with AML/CTF requirements. Accordingly, the implementation of a standalone restrictive measures exposure assessment might result in additional financial and resource burdens on the financial institution, disproportionate to the policy objective. In recognition of the fact that financial institutions might already have in place policies, procedures and controls equivalent to those expected by the EBA guidelines in order to conduct the restrictive measures exposure assessment – and to avoid unnecessary additional burden - we would suggest the EBA to include a statement to the effect of "*In completing the restrictive measures exposure assessment financial institutions may leverage findings and/or policies, procedures or controls elsewhere available as a result of compliance with similar regulatory requirements, for example in relation to AML/CTF (and irrespective of whether such requirements arise under EU law or otherwise)".*

(b) In our view, the EBA guidelines highlight some key factors that may feed into a financial institution's risk profile. However, given the increasing complexity of EU and other sanctions regimes, in our view the guidelines could provide more guidance on specifically how different factors may increase sanctions risk for a financial institution.

(c) We note the statement that financial institutions "*should consider whether retroactive screening of their customer database and past transaction records could be useful and proportionate in this context. This may be the case where the financial institution has identified or has reasonable grounds to suspect that its previous screening system was inadequate or ineffective*". As a general matter we consider that, where financial institutions have limited compliance / financial resources, it is generally most helpful to focus those

resources on enhancing the financial institution's framework going forward. It is unlikely to be proportionate for firms to carry out significant "look back" exercises in most cases.

(d) The inclusion of "trigger" events upon which financial institutions ought to refresh the restrictive measures exposure assessment is helpful. However, in the interests of ensuring that compliance with the guidelines is not disproportionately burdensome, we would suggest that the EBA includes wording recognising that organisations may take a risk-based approach to refreshing its restrictive measures exposure assessments, including for example, that there is no expectation for an institution to undertake a comprehensive restrictive measures exposure assessment at each trigger event in circumstances where it considers it would be appropriate to consider the sanctions implications and any necessary impact to the exposure assessment in isolation.

4.6 **Effective Restrictive Measures Policies and Procedures**

(a) As a general point, the EBA guidelines on effective restrictive measures policies and procedures appear to more clearly apply to those sanctions under which a person is added to a "list". Further guidance in relation to expectations arising as a result of sectoral or other sanctions measures which are not "list-based" would be helpful. In particular, scenario examples as to what an effective screening solution would include in order to address sanctions exposure arising as a result of non-list based sanctions would be helpful.

(b) The EBA guidelines states "*[p]olicies, procedures and controls for the implementation of restrictive measures will be effective if they enable the financial institution to fully and properly implement restrictive measures without delay*"; and "*processes to update applicable lists of restrictive measures regimes as soon as they are published*". It is not clear what is meant by "without delay"/ "as soon as published". In the first instance, the EBA guidelines fail to take into consideration:

(i) financial institutions may often rely on third party screening providers to provide automated regular screening of customer bases. There is therefore an inherent delay between a person first being designated, the third party screening provider processing this information and updating their systems and an automated alert being generated by the system at the financial institution;

(ii) once an alert is triggered financial institutions require time to (i) assess the alert and determine whether there is a true match (particularly when taking into consideration issues of ownership and control); and (ii) trigger corresponding internal controls; and

(iii) that the impact of sanctions restrictions are not assessed in a vacuum. Instead, financial institutions carefully balance a variety of regulatory requirements, competing regulatory regimes (particularly in circumstances where the institution itself, or the transaction in question is subject to the legal jurisdiction of multiple regimes) and commercial factors such as reputational and litigation risk, all of which may result in justifiable delays in updates to policy, procedures or controls.

We would urge the EBA to be mindful of these unavoidable practical realities so as to avoid any unrealistic expectations of the immediacy in which controls can be implemented. EBA might therefore temper references to "*immediately*" by replacing with "*as soon as reasonably practicable*".

(c) Paragraph 31 (g) states "*in cases of true positive matches, procedures for follow-up actions, including immediate suspension, freezing and reporting to competent authorities once the screening system generates an alert of a possible match pursuant to the Guidelines on internal policies, procedures and controls to ensure the implementation of Union and national restrictive measures under Regulation (EU) 2023/1113*".

(d) The underlined portions of this paragraph appear contradictory. It is therefore unclear whether the expectation is for a report to be made to a relevant authority as soon as a possible match is identified or only after such match is identified as a positive match. We would suggest that reporting should only be triggered (subject to our comments in relation to the use of "immediate" above) once an assessment has been carried out and a determination made that a report is so required so as to avoid unnecessarily overwhelming the national authorities and financial intelligence units / crime agencies of the relevant jurisdictions, particularly against the backdrop that certain false positive alerts might be generated as a result of 'negative media' articles unrelated to sanctions concerns.

5. Comments on PSPs and CASPs Guidelines

5.1 Subject Matter and Scope of Application

(a) The scoping statement of the EBA guidelines states "*These guidelines specify the internal policies, procedures and controls payment service providers (PSPs) and crypto-asset service providers (CASPs) should put in place to ensure the effective implementation of Union and national restrictive measures when performing transfers of funds and crypto-assets as defined in Regulation (EU) 2023 /1113 […]*". The EBA guidelines then more generally include references to "*PSPs and CASPs [putting] in place [measures] to identify subjects of restrictive measures*".

(b) Our understanding on this basis is that it is the intention of EBA for this guidance to apply to both domestic and international payments. If that is indeed the case, we note that this position is contrary to the well-established practices to date under which domestic payments are commonly not subject to sanctions screening / diligence measures, and it would be very onerous to impose such screening requirements to domestic payments as part of these guidelines.

(c) We note that certain types of funds transfers have been excluded from the scope of Regulation 2023/1113 – for example, card payments that meet certain conditions. We would welcome clarity from the EBA as to whether such payments (e.g. card payments) are also outside the scope of these guidelines, consistent with the scope of Regulation 2023/1113.

5.2 Definitions

(a) Our view is that the definition of "*Sectoral restrictive measures*" is not clear as to the scope of the sanctions intended to be covered i.e. whether only those measures which target specified individuals or entities (except designated persons), for example Article 5aa of Regulation (EU) 833/2014, are in scope or whether measures targeting a 'class' of persons, for example, "any natural or legal person, entity or body in Russia", would also be captured.

(b) On the basis of the intended application of the guidelines, which includes ensuring that PSPs and CASPs "*do not carry out financial transactions or services prohibited by sectoral*

restrictive measures", and in recognition of the fact that EU sanctions measures target more than individually identified persons l, it would seem sensible to conclude that measures which target 'classes' of people were within scope.

(c) We would therefore suggest that EBA amends the definition of sectoral restrictive measures to clarify this position. If helpful, we would be happy to suggest wording if the EBA confirmed the intended scope.

5.3 **Defining the set of data to be screened**

(a) The EBA guidelines states that "*PSPs and CASPs should define in their policies and procedures the types of data they will screen for each type of restrictive measure".* It would be helpful for EBA to provide further guidance on the types of data it considers appropriate to screen in each case, even if on a non-exhaustive basis.

(b) Throughout the EBA guidelines reference is made to "*beneficial owner or proxy*", in this regard:

(i) Given the EU sanctions framework has a well-established test of "ownership and control" in the context of designated person restrictions, we consider that it would be appropriate for the EBA guidelines to reflect this ownership and control test throughout (i.e. rather than referring to beneficial owners) so as to ensure consistency between the regulatory exposure and the mitigatory guidelines.

(ii) EU sanctions legislation does not include a concept of "*proxy*". We would therefore suggest, in the first instance, that EBA deletes references to "*proxy*" and replaces with the well established concepts included within EU sanctions legislation as appropriate, for example "*persons exercising control over an entity*" or "*persons acting on behalf of or at the direction of another*". To the extent EBA does not agree with this suggestion, we consider that it would be most helpful to include a definition of "*proxy"*, as well as the criteria for establishing when one is acting as a "*proxy*".

(c) With regards to references in this EBA guidelines to "*immediately*", we note the comments made above with respect to the practicalities of timing delays which we consider would equally apply in this context.

5.4 **Screening the Customer Base**

(a) We welcome the more granular guidance on the particular information that should be screened. We do however note the following:

(i) the guidance appears to apply only to customers. It would be helpful for EBA to confirm its expectations for screening any third parties involved in the transaction e.g. any independent beneficiaries (though noting access to information concerning unrelated third parties might be difficult to obtain and therefore expectations here should reflect this practical difficulty);

(ii) we would suggest that it would be superfluous to screen against date of birth. The benefit of obtaining information concerning date of birth is that it may be used in

order to validate or discount a screening match. We would therefore recommend that EBA clarify information that an organisation should obtain and information which it should screen;

(iii) the inclusion of name variations, alias, nicknames etc. may return high volumes of false positives to the extent the name is generic. Similarly, a requirement to screen terms in their original spelling and other alphabets would be operationally difficult in where the relevant language capability is not present in a team and is more effectively dealt with using "fuzzy logic" parameters. We would therefore suggest the inclusion of a note to the effect that such information is not required to the extent it would produce such false results; and

(iv) we note our above comments in relation to utilising EU sanctions principles of "*ownership and control*".

5.5 **Screening of Transfers of Funds and Crypto-Assets**

(a) As a general matter, it would be helpful for the EBA to confirm that in the context of transaction screening, it is sufficient to only screen those parties which are not otherwise subject to screening for example as a result of customer screening.

5.6 **Reliance on Third Parties and Outsourcing**

(a) As a general comment, we would suggest that reference to "third party service providers" is also included in this section on the basis that there are arrangements under which third parties might provide screening services but which fall short of 'outsourcing' arrangements. The guidelines state that intra-group outsourcing should be subject to the same regulatory framework as third party outsourcing. However, in our view it should be recognised that intra-group outsourcings do not always present the same risks as third party outsourcings given the specifics of an intra-group relationship. We consider that it should be made explicit that institutions may adapt the level of requirements that are applied to intra-group outsourcings to take account of the group nature of the relationship.

5.7 **Due Diligence Measures for Alert Analysis**

(a) As general best practice, institutions will generally request or assess further information as part of the process of assessing whether a sanctions alert is a true match. Accordingly, we would suggest the EBA guidelines expressly acknowledge that institutions might obtain further information in order to assist with their assessment of an alert..

(b) In our view the language "*PSPs and CASPs should refrain from providing financial services to a person prior to coming to an informed decision"* is unclear. For example, there may be circumstances whereby the services are in train at the time an alert is generated. In such circumstances, there are potentially damaging consequences that could flow from suspending business where there is a potentially high chance that a match constitutes a false positive. Accordingly, we consider that the guidelines should recognise that firms need to weigh the risks of continuing to proceed with providing services whilst they investigate whether a match is true positive, given the prohibitions contained within restrictive measures and their other legal and regulatory obligations which may require a degree of discretion to be exercised by firms

5.8 **Suspending the Execution of Transfers of Funds or Crypto-Assets and Freezing Funds or Crypto-Assets**

(a) The guidelines say that policies and procedures should be in place to "suspend, without delay" operations where the screening system generates an alert of a "possible match" (see para 47). The same paragraph of the guidelines goes on to say that where the analysis of the alert confirms the match as a true match, then without delay there should be freezing of funds/crypto-assets or suspension of execution. It should be clarified that suspension is triggered only by there being a confirmed/true match, and that there is no obligation to suspend at the point of a possible match – we suggest therefore deleting the word "possible" from para 47.

(b) More generally, it may be helpful for the guidelines to also include some specific examples of the expectations regarding different types of transactions and payment systems (e.g. payment card transactions, inter-bank transactions, etc).

5.9 **Controls and Due Diligence Measures to Comply with Sectoral Restrictive Measures**

(a) The EBA guidelines indicate that it is for PSPs and CASPs to determine which attributes of transaction records will be screened. However, we consider that it would be helpful for EBA to provide guidance as to the types of transactions records that it thinks would be most beneficial to screen in each instance of sectoral restrictive measures.

(b) Subject to EBA clarifying whether its intention was for non-list based sanctions to be within the scope of the definition of 'sectoral restrictive measures', given the breadth of these restrictions, guidance as to how screening might be utilised in these circumstances so as to avoid overly burdensome results would be imperative. For example, given the comprehensive nature of EU sanctions targeting Russia, if a Russian national resident outside of Russia were involved in a transaction, the screening would return "sectoral restrictive measures" hits on "Russia", even in circumstances where none of the underlying prohibitions were engaged.