Financial Market Authority
Liechtenstein

FMA Communication 2024/2 - Risk management regarding foreign sanctions law

Communication regarding risk management in relation to foreign sanctions law

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1. General information

This notice is addressed to all natural persons and legal entities that are subject to the laws and legal requirements relating to risk management specified in Art. 5 para. 1 FMAG (hereinafter: "supervised entities"). The notification concerns in particular:

- Banks according to BankG
- Investment firms pursuant to BankG
- Payment service provider according to ZDG
- Electronic money institutions according to EGG
- Insurance undertakings pursuant to VersAG
- Asset management companies in accordance with the VVG
- Management company pursuant to UCITSG
- Management company according to IUG
- Alternative investment fund managers pursuant to the AIFMG
- Pension funds in accordance with PFG
- Trustees and trust companies pursuant to TrHG
- Auditors according to WPG
- Service providers according to TVTG

International sanction and embargo provisions can, in principle, affect all areas of financial intermediation. Therefore, all other financial intermediaries are also advised to take the key principles of this Communication regarding the protection of the Liechtenstein financial centre into account.

This Communication, in general, concerns foreign sanctions law, which is not covered by the International Sanctions Enforcement Act (ISA). Many individual countries have enacted very different national sanctions. It is, therefore, up to the addressees of this Communication to assess and determine for which foreign sanctions this notice will be applied to in light of the company in question's specific business model and the resulting risk potential (in terms of reputation, operational, and legal risks).

Sanctions imposed by the US Treasury Department's Office of Foreign Assets Control (OFAC) clearly harbour a high risk potential. This Communication therefore applies to OFAC sanctions in any event, which is why these are also mentioned as examples below.

2. Reputation, operational and legal risks

In accordance with the relevant supervisory laws, the above-mentioned supervised institutions are obliged to ensure sound corporate governance, which in particular includes appropriate and effective risk management. The basic principles of risk management as well as the decision competence and procedure for authorizing risky transactions must be set out in regulations or internal guidelines and must be anchored operationally in processes and the internal control system (ICS). In this context, supervised institutions must also record, limit, and monitor reputation, operational, and legal risks.

The FMA points out that the majority of Liechtenstein supervised institutions are dependent on access to foreign markets and, in particular, on access to international payment transactions for their business activities. Risks that jeopardize this access and thus the continuation of business operations are, therefore, among the most important legal risks (subcategory of operational risks) that must be identified, limited, and monitored as described above.

In the event of violations of foreign sanctions (e.g. OFAC sanctions), the parties involved face the threat of serious measures. Against this backdrop, international correspondent banks in particular are very careful not to commit any offences when executing transactions for their clients via foreign financial systems (e.g. the financial market infrastructure of the United States through transactions in US dollars) and to mitigate

the associated risks. It is, therefore, essential for Liechtenstein banks, that they leave no doubt ("zero tolerance") with regard to the compliance with foreign sanctions regulations in the context of their correspondent banking relationships. Otherwise, access to these financial markets, e.g. to USD clearing and the US financial market infrastructure, which is vital for institutions and their clients, could be jeopardized.

3. Applicability of foreign sanctions

Foreign sanctions are not directly applicable in Liechtenstein. However, as explained above, non-compliance with foreign sanctions in certain cases harbours serious reputational, operational, and legal risks for the supervised entity. These include, in particular, the risk that a supervised entity itself is sanctioned, thereby restricting or preventing its access to payment transactions and subsequently jeopardizing its continued economic existence. The materialization of such risks is also enormously damaging to the reputation of the financial market and the country of Liechtenstein.

Due to the consequences described above, foreign sanctions must be taken into account as part of risk management. Of particular importance in this context are the sanctions provisions of the EU[1] and the OFAC sanctions, which are of great significance not least due to the central role of the United States in the global financial market infrastructure.

4. Organization of risk management

Supervised institutions must have procedures in place to identify, record, assess, manage, control, monitor, and report the legal, compliance, and reputational risks arising from sanctions. These procedures must be reviewed regularly and updated if necessary.

An appropriate and effective risk management includes considerations of the risk-bearing capacity with regard to capital (e.g. regulatory capital), liquidity, and reputation[2] as well as the definition of a risk appetite by the top management body and the establishment of internal control procedures. The risk appetite is part of the internal framework and thus creates a basis for appropriate decision-making as to whether the respective client or business relationship fits the strategy, is sufficiently covered by the risk cover funds (i.e. the capital available to offset any losses), and the institution does not expose itself to a disproportionate reputational risk.

The key to effective risk management is to involve the highest governance body (i.e. Board of Directors/Supervisory Board) appropriately in the monitoring. The highest governance body bears overall responsibility (i.e. definition, authorization, and monitoring) for the general risk strategy, risk appetite, and risk culture.

The scope and level of detail of the organization of risk management is determined by the specific risk exposure in the area of international sanctions of the respective supervised entity.
The following risk exposures are of particular importance when organizing risk management:

- Clients from countries or territories that are already subject to sanctions or have an increased risk of sanctions;
- politically exposed or economically influential persons from sanctioned countries (including family members or other related parties);
- Clients operating in sanctions-sensitive sectors (e.g. energy, transport, defence industry, commodities, financial services, etc.); this also includes the exclusive distribution or brokerage of sensitive services and products;

[1] When EU citizens are involved in business relationships and transactions, it should also be noted that EU citizens are sometimes personally obliged to comply with EU sanctions provisions (including when working for a non-EU employer); see, for example, Art. 13 lit. c of Council Regulation (EU) No. 833/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine.

[2] The reputational risks must be weighed up both for the institute and for the Principality of Liechtenstein.

- Cooperation with intermediaries/consultants who are known to advise or broker politically exposed or economically influential clients from sanctioned countries/territories or countries with an increased risk of sanctions.

In the case of business relationships that have points of reference to the OFAC sanctions mentioned in section 1, the FMA considers the immediate termination of such business relationships to be the only suitable means of appropriately limiting these risks due to the particularly high operational and legal risks. Due to the existential risks to the continued existence of the company, less severe mitigation measures are not sufficient.

With regard to the organization of risk management, reference is also made to the explanations in Chapter 17 of the FMA Guidance 2018/7 (Chapter 17 "Special obligations for persons subject to due diligence in the area of international sanctions"). The measures explained there and in connection with sanctions ordinances under the International Sanctions Enforcement Act (ISG) are also useful analogously in the area of foreign sanctions and embargo regimes (in particular OFAC sanctions).

Supervised entities must establish an appropriate governance framework to ensure that the policies, procedures, and controls for the implementation of sanctions are adequate and effectively implemented. Responsibilities may also be delegated to the persons responsible for compliance with the DDA or ISG obligations. However, the person designated must have adequate time and personnel resources available for this purpose. These must be proportionate to the number of clients, the inherent risk, and any other responsibilities of the designated person. The procedures and controls to ensure compliance with sanctions can also be integrated into the existing instruction system and the control processes in place for the implementation of the DDA or ISG obligations.

When assessing risk exposure and determining the risk appetite media coverage of global political developments in connection with certain regions and countries should also be continuously monitored as part of a forward-looking and sustainable approach in order to be able to react to a changing sanctions landscape at an early stage.

In addition to organizational measures, an important element of risk mitigation in connection with international sanctions (in particular sanctions that are not directly legally effective in Liechtenstein) is, among other things, to take contractual precautions (e.g. general terms and conditions) so that there is no conflict between civil law obligations and compliance with foreign sanctions law.

5. Final provisions

This notice was issued by the Executive Board of the FMA on 3 September 2024 and enters into force on the day of publication (4 September 2024).

FMA Communication 2024/2 was issued in German. Any inconsistencies or differences arising in the translation are non-binding. If any questions arise about the accuracy of the content in the translated version, please refer to the original German version of this Communication.