Sanctions Overcompliance: What, Why, and Does It Matter?

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I. Introduction

Over the past two decades, economic and financial sanctions have become one of the most prominent instruments of U.S. foreign policy. Russia's invasion of Ukraine, Iran's nuclear program, Afghanistan's Taliban takeover, human rights violations in Venezuela—these are just some of the more than thirty national emergencies in connection with which the United States currently

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imposes sanctions. The relevant sanctions programs are complex, differ in many respects, change frequently, and have effects that often extend to non-U.S. persons and companies.

The recent evolution of U.S. sanctions reveals some broad trends. In sharp contrast with older comprehensive sanctions against Cuba, Iran, or Iraq, recent programs are more finely calibrated, generally targeting only certain persons and prohibiting only certain transactions.[1] Their implementation also relies extensively on private parties such as banks and multinational corporations. For example, the world's largest banks routinely check wire transfers against lists of U.S.-sanctioned persons and block prohibited payments. From the government's perspective, this development has two major advantages: these actors are subject to U.S. jurisdiction, so that securing their compliance is legally and practically straightforward; and they possess the capabilities to establish internal compliance procedures under which they effectively implement sanctions on its behalf.

These developments have raised concerns about overcompliance, that is, situations in which market participants apply sanctions beyond what is legally mandated. These concerns fall into three major categories. First, market participants may lose the benefit of legally permissible commercial relations with sanctioned countries or persons, either because essential intermediaries (such as banks) refuse to provide supporting services or because market participants themselves fear the potential consequences of any involvement with sanctioned countries or persons. Second, from the perspective of policymakers, widespread overcompliance may undermine the subtle design choices that inform targeted sanctions programs, effectively transforming them into something hard to distinguish from the old comprehensive sanctions. Finally, some have expressed concern that overcompliance may exacerbate the humanitarian impact of sanctions, for instance by making it impossible to use humanitarian exceptions embedded in sanctions programs.

The goal of this paper is to examine in more detail the phenomenon of sanctions overcompliance, starting from the perspective of market participants called upon to comply with

1 *See* Edoardo Saravalle, Note, *Recasting Sanctions and Anti-Money Laundering: From National Security to Unilateral Financial Regulation*, 2022 COLUM. BUS. L. REV. 550, 559–60 (2022).

sanctions programs under threat of civil or criminal enforcement. In this sense, this paper takes a "bottom-up" approach to understanding overcompliance. After defining the concept, it examines its causes, then turns to its consequences and whether they require a legal or policy response. It argues that market participants cannot and should not be expected to "optimize" sanctions compliance in the manner contemplated by critics of overcompliance. Overcompliance is a rational response to uncertainty in sanctions rules, which is itself a rational response by policymakers to the costs of providing additional clarity (which may include facilitating evasion). As a result, one cannot easily conclude that current levels of overcompliance are undesirable, at least from the standpoint of policymakers. The impact of overcompliance on innocent third parties, however, provides reason for alleviating uncertainty and facilitating certain categories of transactions.

II. What Is Overcompliance?

There is no authoritative definition of sanctions overcompliance. For the purposes of this paper, it will be defined broadly as a situation in which a market participant applies sanctions—that is, refrains from an otherwise desirable transaction or activity involving some connection with a sanctioned country or person—beyond what is legally mandated by the relevant regime.[2]

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2 For other definitions, *see* Emmanuel Breen, *Corporations and U.S. Economic Sanctions: The Dangers of Overcompliance*, RESEARCH HANDBOOK ON UNILATERAL AND EXTRATERRITORIAL SANCTIONS 256, 256 (Charlotte Beaucillon ed. 2022) ("[O]vercompliance may be defined as an individual conduct or a corporate process that adopts a stricter stance [than compliance] and goes beyond what is explicitly required to comply with the applicable laws and regulations."); Alena F. Douhan (Special Rapporteur on the Negative Impact of Unilateral Coercive Measures on the Enjoyment of Human Rights), *Secondary Sanctions, Civil and Criminal Penalties for Circumvention of Sanctions Regimes and Overcompliance with Sanctions*, No. U.N. Doc. A/HRC/51/33, ¶ 17 (Jul. 15, 2022) ("Overcompliance consists of self-imposed restraints that go beyond the restrictions mandated by sanctions, either as part of a de-risking process, to minimize the potential for inadvertent violations or to avoid reputational or other business risks, or as a means to limit compliance costs."); Tristan Kohl, *Unilateral and Extraterritorial Sanctions Symposium: Extraterritorial Sanctions – Overcompliance and Globalization*, OPINIO JURIS (Mar. 2, 2022), https://opiniojuris.org/2022/03/02/unilateral-and-extraterritorial-sanctions-symposium-extraterritorial-sanctions-overcompliance-and-globalization/[https://perma.cc/K8DW-TQ77] (describing overcompliance as "a situation in which companies take more extensive actions than strictly necessary to avoid risking a possible sanctions violation and hefty fine" and thus "effectively limit their economic

This concept may appear simple, and overcompliance is often described (or denounced) in general terms as if it consisted of a unitary phenomenon. In practice, however, overcompliance comes in several different forms, which may have different policy implications. While it may not be possible to establish a comprehensive taxonomy of overcompliance, a few forms are most salient. Because recent U.S. sanctions have generally taken a targeted approach, prohibiting transactions with certain persons rather than entire countries, the following discussion will focus on the extension of sanctions compliance beyond targeted persons rather than on countrywide sanctions.

In very general terms, U.S. sanctions imposed pursuant to the International Emergency Economic Powers Act (IEEPA)[3] (i) prohibit certain or all transactions or activities, (ii) involving a designated foreign person or such a person's property, (iii) by a U.S. person or a person in the United States.[4] As a result, overcompliance occurs where a market participant applies sanctions in a situation that is beyond the scope of the legal regime along one of these three dimensions.[5]

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activities beyond what is strictly necessary under an extraterritorial sanction").

3 35 U.S.C. §§ 1701-09.

4 The relevant statutory language, 50 U.S.C. § 1702(a)(1)(B), empowers the President to "investigate, block during the pendency of an investigation, regulate, direct and compel, nullify, void, prevent or prohibit, any acquisition, holding, withholding, use, transfer, withdrawal, transportation, importation or exportation of, or dealing in, or exercising any right, power, or privilege with respect to, or transactions involving, any property in which any foreign country or a national thereof has any interest by any person, or with respect to any property, subject to the jurisdiction of the United States." This power is typically exercised through the issuance of executive orders that designate, or authorize the Secretary of the Treasury or other executive officials to designate, certain persons and prohibit U.S. persons from engaging in certain transactions with them. *See, e.g.,* Exec. Order No. 13,661, 79 Fed. Reg. 15,535 (Mar. 16, 2014) (designating several Russian officials, authorizing the Secretary of the Treasury, in consultation with the Secretary of State, to designate others, and ordering that "[a]ll property and interests in property that are in the United States, that hereafter come within the United States, or that are or hereafter come within the possession or control of any United States person (including any foreign branch) of the following persons are blocked and may not be transferred, paid, exported, withdrawn, or otherwise dealt in"). Although the relevant language refers to "property and interests in property," it is understood by the government and practitioners to prohibit virtually all transactions involving sanctioned persons. The analysis in this article, unless otherwise indicated, is limited to sanctions imposed under the IEEPA, although much of it may apply to other U.S. regimes such as export controls, as well as foreign regimes such as EU sanctions.

5 *But see* Breen, *supra* note 2, at 258 (describing overcompliance more narrowly to

First, a market participant may apply sanctions to a target beyond the scope of transactions or activities that are prohibited. For example, a U.S. bank may terminate all business dealings with a Russian bank that is subject to so-called CAPTA sanctions, even though such sanctions only prohibit the provision of certain specific services—namely the maintenance of correspondent or pass-through accounts.[6] In such cases, the market participant disregards the policymaker's choice to limit the substantive scope of the sanctions applicable to a foreign person and instead treats that person as if it had been designated as a Specially Designated National (SDN), which prohibits U.S. persons from engaging in virtually any transactions.[7]

Second, a market participant may apply sanctions to a person that is not a target of the relevant sanctions at all. For example, a U.S. bank may terminate all business dealings with a Russian bank after one of its shareholders or senior executives has been designated, even though the bank itself—as a corporate entity—has not been designated and transactions with it remain permissible. More drastically, a U.S. company may terminate all its business activities in Russia or with Russian persons, even though none of its counterparties is a target.

Third, a market participant may apply sanctions to a target despite the fact that the participant is not legally bound to comply with the relevant sanctions regime. For example, European and other third-country banks may cut off business ties with Russian companies sanctioned by the United States, even though these participants are not U.S. persons, their Russia-related business has no territorial link with the United States, and their own jurisdiction has not designated the Russian companies as targets or prohibited

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mean "that a non-US person would agree to comply with US economic sanctions despite not being absolutely sure, from a strict legal point of view, that it is subject to US jurisdiction"). This description appears limited to the third scenario described here. It is unclear how it relates to the broader definition provided earlier, *see supra* note 2.

6 *See* OFF. OF FOREIGN ASSETS CONTROL, DIRECTIVE 2 UNDER EXECUTIVE ORDER 14,024: PROHIBITIONS RELATED TO CORRESPONDENT OR PAYABLE-THROUGH ACCOUNTS AND PROCESSING OF TRANSACTIONS INVOLVING CERTAIN FOREIGN FINANCIAL INSTITUTIONS 1 (Feb. 24, 2022).

7 *See* Specially Designated Nationals and Blocked Persons List (SDN) Human Readable Lists, OFF. OF FOREIGN ASSETS CONTROL (Apr. 14, 2023), https://ofac.treasury.gov/specially-designated-nationals-and-blocked-persons-list-sdn-human-readable-lists [https://perma.cc/HL3D-KAL7].

the relevant activities or transactions.

Two or more of these forms of overcompliance may be, and often are, combined. Following Russia's invasion of Ukraine, hundreds of multinational companies reportedly exited the Russian market within a matter of weeks.[8] These included U.S. and European companies subject to these jurisdictions' sanctions laws, but also third-country firms whose jurisdictions had not imposed sanctions;[9] many terminated all business activities in Russia, not just those that involved designated counterparties or prohibited types of transactions.[10]

This kind of broad response from market participants has sometimes been described as "de-risking," a term usually applied more narrowly to anti-money laundering and terrorist financing (AML/TF) compliance in the financial sector.[11] In that context, it describes practices whereby "a financial institution takes a decision to refuse to enter into, or to terminate, business relationships with individual customers or categories of customers associated with higher [A]ML/TF risk, or to refuse to carry out higher [A]ML/TF risk transactions."[12] Applied more broadly to encompass sanctions compliance, de-risking can describe "the act of terminating or restricting business relationships with certain categories of customers (nationals or residents of certain countries) or other financial institutions (such as remittance companies and local

8 Over 1,000 Companies Have Curtailed Operations in Russia—But Some Remain, YALE SCH. OF MGMT. (Apr. 15, 2023), https://som.yale.edu/story/2022/over-1000-companies-have-curtailed-operations-russia-some-remain [https://perma.cc/RMQ2-PSVS].

9 *See id.* (listing Air Astana, Azerbaijan Airlines, Industrial and Commercial Bank of China, Sinopec, Tata Motors, and Tata Steel among the foreign companies curtailing or suspending their activities in Russia).

10 *See* Richard L. Kilpatrick, Jr., *Self-Sanctioning Russia*, EJIL TALK! (May 11, 2022), https://www.ejiltalk.org/self-sanctioning-russia/ [https://perma.cc/S4CG-6NET].

11 *See, e.g.*, Eur. Banking Auth., Report on De-risking and Its Impact on Access to Financial Services, Doc. No. EBA/REP/2022/01, ¶ 1 (2022) [hereinafter EBA Report], *reprinted in* Eur. Banking Auth., Opinion of the European Banking Authority on "De-Risking," annex, Doc. No. EBA/Op/2022/01 (2022) [hereinafter EBA Opinion]; *De-risking in the Financial Sector*, WORLD BANK (Oct. 7, 2016), https://www.worldbank.org/en/topic/financialsector/brief/de-risking-in-the-financial-sector [https://perma.cc/35XV-2TLN]; *Are Global Banks Cutting Off Customers in Developing and Emerging Economies?*, WORLD BANK (May 1, 2018), https://www.worldbank.org/en/news/feature/2018/05/02/are-global-banks-cutting-off-customers-in-developing-and-emerging-economies [https://perma.cc/89P8-2LBT].

12 EBA Report, *supra* note 11, at 4.

banks) in order to limit the bank's exposure to regulatory risk."[13] Although the term may capture some important aspects of sanctions overcompliance, the policy concerns raised by "de-risking" in the sanctions context are not necessarily the same as for AML/TF, as will be discussed below.[14]

III. What Motivates Overcompliance?

From an economic standpoint, a market participant should engage in all net positive value transactions available to it. As seen above, modern IEEPA sanctions typically prohibit only certain transactions (those specified in the relevant executive order) by certain persons (usually U.S. persons) with sanctioned persons (those designated pursuant to the executive order). After sanctions are imposed, a market participant should continue to engage in all transactions it would have engaged in absent the sanctions, except those that are prohibited (assuming the expected cost of sanctions is sufficient to make all prohibited transactions unprofitable). In other words, in this simple model, market participants are expected to act as "sanctions optimizers," adjusting their set of activities to track precisely the boundaries set by the sanctions.[15] There should be no overcompliance as defined above. The challenge, then, is to explain why market participants do not "optimize" and instead forgo seemingly profitable transactions that are not prohibited.

A. Legal Uncertainty

The "sanctions optimization" paradigm assumes that the sanctions regime sets clear boundaries that market participants can track precisely. In practice, however, the application of sanctions to factual situations generates considerable uncertainty for market participants. Even with the assistance of counsel, whether a given transaction or activity violates sanctions and what steps, if any, must be taken to achieve compliance can give rise to sharp debate. This is true even for "core" IEEPA sanctions, where an individual or entity has been designated as an SDN and, as a result, transactions involving U.S. persons are generally prohibited. The situations in which complex questions arise are too numerous to discuss or even categorize, but examples can illustrate the point.

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13 Breen, *supra* note 2, at 257.

14 *See infra* notes 75-78 and accompanying text.

15 *See* Breen, *supra* note 2, at 268.

Since the 1990s, many U.S. companies have accessed the Russian market by setting up joint ventures with Russian partners. For example, a U.S. industrial equipment company might set up a joint venture to produce and sell machines in Russia. The joint venture is a Russian company, jointly held by the U.S. company and its Russian partner through offshore entities. The CEO of the joint venture is an American, as are several of its key technical and managerial employees. The U.S. company grants the joint venture licenses to use its patents and trademarks to manufacture and market its products in Russia.[16]

The first thing to note is that, even after Russia's invasion of Ukraine and the tightening of U.S. sanctions in the spring of 2022, none of the transactions involved here are directly prohibited. As long as the Russian partner is not a designated entity, maintaining the joint venture is permitted. The joint venture itself is a Russian entity and therefore not subject to U.S. sanctions—it can continue to do business with anyone in Russia, including designated entities, which might include some of its local customers, suppliers, and lenders, as well as the government itself.

Upon further reflection, however, problems and grey zones quickly multiply. The joint venture may not be a U.S. company, but its CEO is an American who is prohibited from engaging in any transaction with a designated person. From a contractual standpoint, the joint venture, not the CEO, is the counterparty to transactions with sanctioned Russian persons. But her participation in concluding such transactions would likely be sufficient to violate the IEEPA. Can she "recuse" herself from these transactions? If so, who else will conduct them, and would the "recusal" be credible to the U.S. Treasury's Office of Foreign Assets Control (OFAC) given that she ultimately has executive control of the company? What about the other American employees? Can they be legally insulated from prohibited transactions? Even if this could be done, the logistics will be daunting, perhaps impossible.

Even without U.S. executives or employees, doing business through joint ventures remains fraught with legal peril. In many cases, the U.S. company will sell merchandise to the joint venture, some of which may be resold to, or incorporated in goods sold to, designated Russian persons, raising questions as to whether its

16 I am grateful to Richard Dean for discussing a similar example in a prior conversation and panel discussion at the University of Virginia School of Law.

involvement might violate sanctions.[17] On some occasions, senior executives of Russian companies have been designated while the company itself was not, raising doubt about the legality of transactions in which these executives are involved.[18]

These are only a few examples of the questions faced by U.S. companies and persons that do business in countries or with persons targeted by U.S. sanctions. As soon as sanctions are imposed, these questions arise by the dozens, and clear answers are often hard to obtain. OFAC provides guidance, answers questions, and makes much of that output available online, but this process involves delays and cannot address all conceivable scenarios. In the meantime, business is disrupted, compliance costs mount, and companies come under pressure from executives and employees concerned about personal liability. Faced with such difficulties, many market participants may choose to err on the side of caution. In fact, several U.S. companies have chosen to exit the Russian market altogether, for instance by selling their joint venture interest to a third-country competitor.[19]

B. Enforcement Uncertainty

Because of the many legal uncertainties of sanctions,

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17 In respect of export prohibitions, OFAC has taken the position that a U.S. party that ships goods to a third country with "knowledge or reason to know" that they will be re-exported to a sanctioned country is liable. *See* Epsilon Electronics v. U.S. Dep't of the Treasury, 857 F.3d 913, 917 (D.C. Cir. 2017). *See also* Breen, *supra* note 2, at 259 (discussing a similar scenario).

18 For example, Herman Gref, the CEO of Sberbank, Russia's largest bank, was designated on March 24, 2022. *See* Press Release, U.S. Dep't of the Treasury, U.S. Treasury Sanctions Russia's Defense-Industrial Base, the Russian Duma and Its Members, and Sberbank CEO (Mar. 24, 2022), https://home.treasury.gov/news/press-releases/jy0677 [https://perma.cc/Z6NB-WY9G]. At that time, Sberbank itself was subject to CAPTA sanctions but not full sanctions. See Press Release, U.S. Dep't of the Treasury, U.S. Treasury Announces Unprecedented & Expansive Sanctions against Russia, Imposing Swift and Severe Economic Costs (Feb. 24, 2022), https://home.treasury.gov/news/press-releases/jy0608 [https://perma.cc/VMQ6-SZ87]. This raised complex questions of exactly what transactions with Sberbank might be off-limits to U.S. persons because of Gref's involvement. After all, the CEO of a company has authority over virtually everything it does. It is unclear that internal "recusal" procedures would be sufficient to avoid this problem, what these measures should consist of, whether Russian entities would be willing to adopt them, and who could verify them.

19 *See, e.g.*, *Factbox: Companies sell their businesses in Russia*, REUTERS (last updated Apr. 12, 2023), https://www.reuters.com/business/companies-sell-their-businesses-russia-2022-04-28/ [https://perma.cc/D9VT-WD2X].

enforcement decisions play a central role in shaping the environment in which market participants operate. Even if a business complies with what it believes to be the letter of sanctions, it faces the risk that enforcers such as OFAC or the U.S. Department of Justice will adopt a broader interpretation. Because of the wide deference agency interpretations enjoy in U.S. courts, which is even greater for statutes relating to national security and foreign relations, market participants have little recourse against perceived overreach.[20] As a result, enforcers enjoy substantial discretion to interpret sanctions so as to reach conduct or transactions they identify as impermissible.[21]

In addition to their wide and expansible substantive scope, sanctions statutes capture additional conduct through ancillary prohibitions. The IEEPA, for instance, provides that it is unlawful not only to "violate," but also to "attempt to violate, conspire to violate, or cause a violation of any license, order, regulation, or prohibition issued under this chapter."[22] OFAC and prosecutors routinely invoke these provisions in enforcement actions, including against parties that are not themselves U.S. persons subject to direct application of the sanctions regime. For example, many foreign banks have been penalized for sending instructions for U.S. dollar payments involving sanctioned countries or persons to U.S. correspondent banks for processing, on the theory that by doing so they caused the U.S. bank to violate sanctions.[23] In these cases, the foreign banks often "stripped" the payment messages of information identifying sanctioned countries or parties.[24] According to the banks, this was simply an effort at sanctions optimization; they argued that their overseas offices had already reviewed the payments for sanctions compliance and "stripping" was only intended to prevent them from being unnecessarily suspended by

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20 *See, e.g.*, United States v. Amirnazmi, 645 F.3d 564 (3d Cir. 2011) (upholding OFAC's narrow interpretation of the Berman Amendment, which exempts informational materials from IEEPA sanctions, and concluding that informational materials not in existence at the time of the transaction are not protected).

21 *See also* Breen, *supra* note 2, at 268 (pointing to OFAC's authority to take action against "apparent violations" as an additional source of discretion).

22 50 U.S.C. § 1705(a).

23 *See* PIERRE-HUGUES VERDIER, GLOBAL BANKS ON TRIAL: U.S. PROSECUTIONS AND THE REMAKING OF INTERNATIONAL FINANCE 124–37 (2020).

24 *See id.* at 125–26.

the U.S. bank's "OFAC filter."[25] These arguments did not avail, and many banks had to pay large fines.[26] The lesson seems clear: efforts as "sanctions optimization" can easily backfire, be interpreted by enforcers as attempts at evasion, and lead to greater penalties.

Sanctions statutes also contain "aiding and abetting" language that broadens their reach.[27] In a recent case, the Department of Commerce fined Federal Express for aiding and abetting export control violations, on the theory that it delivered packages containing controlled items to prohibited destinations such as Syria, the United Arab Emirates, and China.[28] FedEx's protests that it transports millions of packages every day and has no knowledge of their content were fruitless.[29] The D.C. Circuit ultimately held that the Department permissibly interpreted the Export Control Reform Act's prohibition on aiding and abetting to impose strict liability.[30] The decision puts an enormous burden on businesses such as FedEx, and in some cases, the only practicable way to control the risk of sanctions violations may be to exit the relevant market entirely. As a result, thousands of innocent packages may go undelivered to avoid processing the few that would violate sanctions.

In some cases, criminal enforcers such as the U.S. Department of Justice need not rely on sanctions statutes at all. The U.S. federal criminal code contains numerous offenses such as mail and wire fraud, bank fraud, and conspiracy, that can also be used to target perceived sanctions violations.[31] These statutes have many advantages for prosecutors: their language is very broad, conduct by employees can easily be attributed to their employers under the *respondeat superior* doctrine, and these crimes apply to non-U.S. persons and in situations with minimal contacts with the United

25 *See id.* at 127.

26 *See id.* at 8; Pierre-Hugues Verdier, *The New Financial Extraterritoriality*, 87 GEO. WASH. L. REV. 239 (2019).

27 *See, e.g.,* 50 U.S.C. § 1705(c) ("A person who willfully commits, willfully attempts to commit, or willfully conspires to commit, or aids or abets in the commission of, an unlawful act described in subsection (a) shall, upon conviction, be fined not more than $1,000,000, or if a natural person, may be imprisoned for not more than 20 years, or both.").

28 *See* Fed. Express Corp. v. U.S. Dep't of Commerce, 39 F.4th 756 (D.C. Cir. 2022).

29 Fed. Express Corp. v. U.S. Dep't of Com., 486 F. Supp. 3d 69, 76 (D.D.C. 2020).

30 *Fed. Express*, 39 F.4th at 767.

31 *See* 18 U.S.C. § 371 (conspiracy); § 1341 (mail fraud); § 1343 (wire fraud); § 1344 (bank fraud).

States.[32] As a result, the possibility that prosecutors might use them broadens the reach of sanctions and of what one might call the "safety zone" that market participants feel compelled to observe. Indeed, since 2008 prominent foreign banks have paid tens of billions of dollars in fines under such criminal charges in connection with benchmark manipulation and facilitation of tax evasion, an experience they no doubt remember.[33]

More recently, U.S. authorities have also pursued enforcement cases against foreign parties for conspiring to evade or violate sanctions, sometimes as a way to reach assets belonging to sanctioned parties but located outside the United States and outside the control of U.S. persons. In 2022, a yacht belonging to Russian oligarch Viktor Vekselberg was seized in Spain pursuant to a U.S. civil forfeiture order.[34] The order was based on charges that the foreign shell companies through which Vekselberg owned the yacht were parties to a series of transactions aimed at evading U.S. sanctions, thus exposing their assets to forfeiture. Similar criminal charges can reach other foreign persons who take part in transactions U.S. prosecutors interpret as efforts to evade U.S. sanctions.

Finally, for some important market participants, compliance obligations imposed by prior resolutions with U.S. enforcers may require them to implement U.S. sanctions beyond what is generally required by the statutes.[35] U.S. prosecutors have broad discretion to impose virtually any conditions as part of plea agreements, deferred prosecution agreements, or non-prosecution agreements, which dozens of foreign banks have ratified since 2008. For example, HSBC's 2012 deferred prosecution agreement with the U.S. Department of Justice, following a money laundering and sanctions evasion investigation, provided that the bank would "implement single global standards shaped by the highest or most effective anti-money laundering standards available in any location where the HSBC Group operates" and use OFAC sanctions lists "to conduct

32 *See* Verdier, *supra* note 26, at 252–53.

33 *See generally* VERDIER, *supra* note 23, at 41-107 (summarizing post-2008 enforcement campaigns for these crimes).

34 *See In re* Seizure and Search of the Motor Yacht Tango, 597 F. Supp. 3d 149 (D.D.C. 2022).

35 *See* Breen, *supra* note 2, at 261.

screening in all jurisdictions, in all currencies."[36] These commitments, on their face, apply to all HSBC affiliates, including those that are non-U.S. persons not directly subject to U.S. sanctions.

In sum, beyond the prohibitions imposed by the sanctions themselves, other U.S. statutes and enforcement practices create a wide penumbra of uncertainty in which many market participants may understandably fear to tread. This phenomenon discourages "sanctions optimization," especially since conduct that falls close to the line drawn by the sanctions themselves may be exactly that which market participants fear may be interpreted as evasion by enforcers and targeted using the tools described above. Thus, enforcement uncertainty is another source of overcompliance.

C. Anticipation of Future Expansion

In contrast with older comprehensive sanctions, which prohibited virtually all transactions with the targeted country in one fell swoop, new targeted sanctions programs are carefully calibrated to affect certain persons or sectors of the target economy.[37] From a foreign relations standpoint, a major advantage of this approach is that, while it mitigates the initial disruptive impact of the sanctions, including on market participants from the sanctioning state itself or from third countries, it also allows policymakers to respond to political developments by tightening or loosening sanctions. Again, sanctions against Russia provide a stark example, with numerous rounds of tightening since 2014 in response to the country's takeover of Crimea, intervention in Syria, and invasion of Ukraine.[38] In theory, threats of tightening, if credible, provide incremental deterrence, while promises of partial loosening of sanctions can provide incentives for the targeted state to take steps towards resolving the political dispute, even if those steps do not warrant full lifting of sanctions.

From the perspective of market participants, however, the

36 Deferred Prosecution Agreement ¶ 5(p), (z), United States v. HSBC Bank USA, N.A., No. 12-763 (E.D.N.Y. Dec. 11, 2012), ECF No. 3-2.

37 *See generally* VERDIER, *supra* note 23, at 112–16; *see also* Saravalle, *supra* note 1, at 559-60 (summarizing shift from trade sanctions to financial sanctions and from sanctions against states to sanctions against non-state actors).

38 *See* Don S. De Amicis & David P. Stewart, *Sanctions on Steroids: The Ukraine-/Russia-Related Sanctions*, 48 N.C. J. INT'L L. 379 (2023).

possibility that sanctions will expand or contract in response to unpredictable events provides another reason for prudence. Perfectly legal conduct today may become illegal tomorrow, potentially exposing a party to sanctions enforcement, and at the very least calling for costly adjustments and potential breach of contracts. Anticipating these problems, market participants may find it wiser to get ahead of them by circumscribing their activities beyond what sanctions formally require, at least today. This may mean, for example, cutting off business with Sberbank or other Russian banks not yet designated, for fear that they might soon be. For risk-averse companies, this may mean exiting the Russian market altogether.

D. Jurisdictional Uncertainty

For many market participants, an additional complicating factor in sanctions compliance is exposure to the sanctions regimes of multiple jurisdictions. Although the United States was and remains by far the most prolific user of unilateral sanctions, the European Union and other jurisdictions have become more active, adopting more elaborate sanctions regimes and applying them to a growing number of situations. Even where multiple countries agree on the underlying political objective, such as responding to Russia's invasion of Ukraine, the details of sanctions can differ considerably from one jurisdiction to another.[39] And of course, the application of each sanctions regime does not stop where the other begins—there are no choice of law rules that designate a single regime for each market participant or transaction. Each regime defines its own reach, and their rules often overlap, meaning that multiple regimes apply to a given situation.

As a result, market participants are placed in the unenviable position of anticipating the impact of multiple sanctions regimes on their conduct. In practice, this usually means that they must take a "lowest common denominator" approach, complying with the most demanding regime with respect to each transaction. In addition, overlapping sanctions regimes compound the impact of uncertainty, because participants must contend with the risk that any one of the potential enforcers may interpret its rules more broadly than anticipated, engage in more aggressive enforcement, or expand its

39 This is aggravated inside the EU by different interpretations of the sanctions by different member states. *See* Douhan, *supra* note 2, ¶ 38.

sanctions over time. Thus, multiple regimes generate overcompliance, at least relative to a world in which each market participant would only have to comply with a single sanctions regime.

In addition to regime overlap, secondary sanctions also contribute to overcompliance. Some U.S. sanctions regimes, for example, provide that foreign persons not subject to primary IEEPA sanctions may be penalized for engaging in certain transactions with sanctioned countries or persons.[40] These penalties typically do not take the form of direct civil or criminal enforcement, but instead may result in the foreign persons themselves being designated for certain U.S. sanctions or deprived of U.S. business or government opportunities.[41] These secondary sanctions are specifically designed to generate the third type of overcompliance described above, where persons not formally subject to U.S. sanctions regimes nevertheless cut business ties with sanctioned parties. Indeed, according to some commentators, secondary sanctions are the most concerning source of overcompliance.[42]

U.S. secondary sanctions have long attracted protests from third countries that do not share the United States' policy towards the target. These reactions have been strongest to secondary sanctions involving Cuba and Iran, where major U.S. partners, including Europe and Canada, have substantial economic interests and do not impose, or have lifted, their sanctions. While third countries have relatively few options to fight U.S. secondary sanctions, in recent years Europe has reactivated its Blocking Statute, which forbids European persons from complying with specific U.S. sanctions.[43] A close observer of sanctions compliance in Europe argues that, ironically, the Blocking Statute may exacerbate rather than reduce overcompliance.[44] European companies who fear U.S. enforcement may decide to comply with U.S. sanctions, but to avoid European enforcement under the Blocking Statute, they cannot formally apply U.S. sanctions or track them too closely in their business decisions.

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40 *See* Tom Ruys & Cedric Ryngaert, *Secondary Sanctions: A Weapon out of Control? The International Legality of, and European Responses to, US Secondary Sanctions*, BRIT. Y.B. INT'L L. 6–9 (2020).

41 *See id.*

42 *See, e.g.,* Douhan, *supra* note 2.

43 *See* Ruys & Ryngaert, *supra* note 40, at 81–99.

44 Breen, *supra* note 2, at 264–65.

Instead, they may withdraw from entire markets like Cuba and Iran and attribute their decision to reputational concerns, money laundering risks, or other factors—a phenomenon that has been dubbed "covert compliance."[45]

Finally, powerful targets have begun imposing "counter-sanctions" to deter market participants from complying with sanctions against them. Russia, for example, has adopted a range of counter-sanctions, including threats to seize the assets of foreign companies that close their business in Russia (including valuable intellectual property rights)[46] and to prosecute individual executives and employees who assist in closing down or transferring these businesses, and more recently, exacting a "voluntary contribution" on exiting companies.[47] The impact of these counter-sanctions on overcompliance is ambiguous. On the one hand, one of their objectives is to reduce overcompliance by incentivizing market participants who might have exited to remain in Russia. On the other hand, the prospect of counter-sanctions may have the opposite effect of rushing market participants to exit as soon as possible, before either sanctions or counter-sanctions are imposed.

E. Compliance Costs and Prudence

Apart from the uncertainty around sanctions, compliance costs may push market participants to cut off entire countries or categories of transactions. In other words, even if the scope of sanctions was perfectly defined so that market participants could achieve sanctions optimization by investing enough in due diligence and legal advice, it might not be economically viable to do so. Compliance is expensive, with major banks and multinationals spending hundreds of billions of dollars every year to review proposed transactions, monitor their employees, investigate potential violations, report them to government agencies around the

45 *Id*. at 261-65.

46 *See* Nikita Malevanny et al, *Russia Responds to International Sanctions* – An Overview of Russian Countersanctions and Further Measures against So-Called "Unfriendly States," GIBSON DUNN (May 2, 2022), https://www.gibsondunn.com/wp-content/uploads/2022/05/russia-responds-to-international-sanctions-an-overview-of-russian-countersanctions-and-further-measures-against-so-called-unfriendly-states.pdf [https://perma.cc/KGK8-JVRQ].

47 *See* Polina Ivanova & Anastasia Stognei, *Western Groups Leaving Russia Face Obligatory Donation to Moscow*, FIN. TIMES (Mar. 27, 2023).

world, and negotiate resolutions or defend enforcement actions.[48] For certain high risk jurisdictions and businesses, such as those linked to sanctioned countries or persons, they may rationally decide that the costs exceed the benefits, resulting in a blanket withdrawal and overcompliance.[49]

There is a broader point here that is worth emphasizing. The notion of "overcompliance" supposes that there is a bright line between what is prohibited and what is not, and that the function of compliance is to determine where the line is, whether a proposed transaction crosses it, and decide accordingly. But compliance professionals live in a world where uncertainty is omnipresent, many transactions must be reviewed with limited time and resources, and decisions inevitably must be based on broad assessments of risk. In that world, sanctions optimization is necessarily elusive. As Emmanuel Breen puts it in an insightful chapter, "[t]he line between compliance and overcompliance is very fine here, because prudence is an inherent component of any compliance programme, whether or not in the field of economic sanctions."[50]

F. Reputational Concerns

A final, and possibly major, source of overcompliance is reputation. Most sanctions target countries or persons engaged in unsavory activities such as terrorism, drug dealing, money laundering, human rights violations, or illegal use of force against another state. They are often imposed at a time where such activities by the target generate worldwide attention, such as Russia's invasion of Ukraine. Many market participants do not wish to be associated with such countries or persons, especially at such a time. They face pressure from consumers, civil society, international organizations, and many others to cut off their ties. It is unsurprising that, according to one prominent list, over 1,200 companies left Russia after the invasion, including famous brand names such as McDonalds, Hilton, Citibank, Prada, and Chanel.[51] In many cases,

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48 *See* VERDIER, *supra* note 23, at 1-39.

49 *See* EBA Report, *supra* note 11, ¶ 55.

50 Breen, *supra* note 2, at 262.

51 *See* YALE SCH. OF MGMT., *supra* note 8; *see also Yale CELI List of Companies Leaving and Staying in Russia*, YALE SCH. OF MGMT. (last updated Apr. 18, 2023), https://www.yalerussianbusinessretreat.com/ [https://perma.cc/NU29-UEQA].

withdrawal is not required by sanctions, and appears to be driven in large part by reputational concerns.[52] Indeed, the mere act of drawing such lists—which also feature companies that have failed to withdraw—is a form of "naming and shaming."

If this is true, then market participants are not necessarily intent on engaging in all profitable transactions that are not legally prohibited, and the sanctions optimization paradigm appears incomplete. It may be that, as my colleague Jay Butler has argued, multinational companies effectively act as independent enforcers of international law.[53] They might also respond more generally to bad behavior with which they wish to avoid being associated, or to the priorities of consumers, investors, or other pressure groups with leverage over them.[54] In any event, the more salient reputational concerns are in motivating business decisions on withdrawal from ties with sanctioned countries or persons, the less the details of sanctions policy may have to do with overcompliance.

IV. Is Overcompliance a Problem?

Much of the commentary on sanctions overcompliance is premised on the notion that it is undesirable. Upon closer examination, however, the question is a complicated one. Three potential harms from overcompliance emerge from the literature: first, to market participants; second, to policymakers' objectives; and third, to innocent third parties.

A. *Impact on Market Participants*

The first harm alleged to be caused by overcompliance is loss of business opportunities by market participants. Clearly, compared to perfect sanctions optimization, overcompliance means that some otherwise desirable (net positive value) transactions will be forgone. Of course, market participants themselves decide to forgo these transactions. Consider the choices they face.

First, certain transactions are clearly prohibited by the

52 *See* Kilpatrick, *supra* note 10.

53 Jay Butler, *The Corporate Keepers of International Law*, 114 AM. J. INT'L L. 189, 200 (2020).

54 For a discussion of the range of motivations that guide such "corporate foreign policy," including ethical considerations, reputational risks, and consumer and investor demands, see Kish Parella, *Corporate Foreign Policy in War*, 63 B.C. L. REV. (forthcoming 2023).

applicable sanctions regime. For these, we can assume that the anticipated cost of violating sanctions eliminates any incentive to conduct them, at least for legitimate market participants. Beyond this core of clearly prohibited transactions, there is a penumbra of transactions for which market participants face uncertainty about the application of sanctions. This uncertainty is generated by the sanctions regime itself, in the form of legal and enforcement uncertainty, anticipation of future expansion, jurisdictional uncertainty, and compliance costs. Finally, there is a category of transactions from which market participants refrain due to reputational concerns, and would do so even absent the sanctions. For example, even if the United States and Europe had not imposed sanctions on Russia, public opinion might have led many businesses to cut back their ties with the country. While this is a form of overcompliance, it is not directly generated by features of the sanctions regime.

Thus, the cases of overcompliance we are most concerned with are those in which a market participant forgoes a transaction that is not clearly prohibited and that it would otherwise have engaged in (despite any reputational costs), because of the risk that it might be deemed to violate sanctions.[55] How do market participants make that choice? Clearly, they cannot—and in fact do not—forgo all transactions that could conceivably be characterized as violations under the most expansive possible interpretation of sanctions rules. Nor do they systematically avoid any contact with countries subject to sanctions. Many foreign businesses, including U.S. businesses, still have substantial ties with Russia.[56]

A simple economic framework would suggest that market participants assess whether to engage in transactions or activities by comparing the expected benefit (absent the sanctions) with the expected cost of sanctions (namely, the anticipated penalty discounted by the market participants' estimate of the probability of successful enforcement.) In other words, while market participants

55 *See* Kohl, *supra* note 2 (criticizing overcompliance because it "cuts operators off from potential value-creating economic activities that would in effect not be a violation of any extraterritorial sanctions").

56 *See* Liz Alderman, *Leave Russia? A Year Later Many Companies Can't, or Won't*, N.Y. TIMES (Mar. 2, 2023), https://www.nytimes.com/2023/03/02/business/russia-companies-exit.html [https://perma.cc/T282-CB5T] ("[A] year into the war, hundreds of Western businesses are still in Russia, including blue-chip and midsize companies from Europe and the United States.").

may not be "optimizing" sanctions compliance in the sense described above (by engaging in every net positive value transaction that is not prohibited), they are optimizing in the economic sense (by engaging in every net positive value transaction, taking into account the expected cost of sanctions given uncertainty about their application).

The heart of the problem, from the market participant's standpoint, is uncertainty.[57] The more uncertainty there is, the less precisely it can estimate the probability of enforcement for a given transaction. Instead, it must attribute vague estimates to broad categories of transactions based on rough proxies, such as the nationality or location of the counterparty. For some high value transactions, it may be worth investing in additional due diligence, retaining legal advice, or contacting OFAC for guidance. But often this is not practicable or worthwhile. As a result, uncertainty likely generates substantial overcompliance.[58] With greater clarity, market participants could estimate the expected cost of sanctions more precisely, and would therefore engage in more transactions—a straightforward improvement from their perspective. It is therefore unsurprising that market participants tend to complain about uncertainty and overcompliance.

This, however, tells us nothing about whether, from a social perspective, more precision and less overcompliance would be an improvement. After all, overcompliance could be eliminated entirely by ending the sanctions, thus allowing market participants to enter into all net positive value transactions—the optimal outcome from their standpoint. But that would obviously come at the cost of renouncing whatever objectives policymakers are pursuing by imposing the sanctions. On the other hand, if

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57 *See* Kohl, *supra* note 2 (describing research showing that "uncertainty about the formal and informal institutions governing international markets in which companies operate, raises their cost of doing business and limits their ability to engage in these markets").

58 *See* Breen, *supra* note 2, at 262. As Tristan Kohl points out, certain smaller firms may exit the relevant market altogether because they lack the resources and scale to make compliance cost effective. *See* Kohl, *supra* note 2. This is consistent with law and economics scholarship showing that legal uncertainty generally leads to compliance above the level ostensibly set by the legal rule. *See, e.g.,* Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J. L. ECON. & ORG. 279, 298–99 (1986); John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965, 979–83 (1984); ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 340–42 (2004).

overcompliance harms both market participants and sets back the policymakers' objectives, then it appears much more clearly destructive. The question then becomes whether overcompliance is also unproductive from the policymaker's standpoint.

B. Harm to Policymakers' Objectives

At first glance, it might seem that overcompliance is a problem unique to sanctions. After all, one could hardly object to companies observing higher environmental, worker safety, or anti-corruption standards than required by law.[59] Upon reflection, however, this cannot be true. In many areas of regulation, including the ones mentioned above, policymakers aim at controlling the risks posed by economic activity without stifling it.[60] If market participants withdraw massively from an economically important activity (e.g., mining iron or operating wind turbines) or from doing business in certain countries or regions despite regulations that would allow (at least some) of these activities to continue, the regulatory regime may impose unintended economic costs that exceed its benefits. If overcompliance comes from uncertainty about the application and enforcement of the regime, it may be that reforms that enhance certainty would improve outcomes.

In other words, the possibility of overcompliance is pervasive across many areas of economic regulation, and policymakers must anticipate it as part of the process by which they design, apply, and enforce regulations. In many areas, it may be that perfect clarity would be optimal, and that policymakers should strive to reduce uncertainty as much as feasible. In this simple model, the policymaker conducts a cost-benefit analysis to determine what substantive rule would most efficiently achieve the regulatory objective (e.g., what type of filter must be installed to capture emissions of certain chemicals from a certain type of plant). The policymaker then strives to make the rules as clear as possible, providing additional guidance where needed, so as to generate the type of "optimization" described above and eliminate

59 *See* Breen, *supra* note 2, at 256 (arguing that "in many areas other than economic sanctions, overcompliance is hardly ever a problem" and giving, as examples, anti-corruption, environmental protection, and work safety).

60 On cost-benefit analysis of regulation, see generally MATTHEW D. ADLER & ERIC POSNER, NEW FOUNDATIONS OF COST-BENEFIT ANALYSIS (2006); CASS R. SUNSTEIN, THE COST-BENEFIT STATE: THE FUTURE OF REGULATORY PROTECTION (2002).

overcompliance. For example, the policymaker would not want a company to refrain from building a plant because it is unclear whether the filter is needed or not and the cost of installing it makes the project unviable.

In the context of sanctions, a similar analysis plausibly applies. Policymakers set the desired type and level of sanctions by balancing the benefits of more sanctions (e.g., greater impact on the targets and contribution to achieving political objectives) and their costs (e.g., lost business and compliance expenses, humanitarian impact, resistance by third states, disruption of important international markets, risk of escalation). The greater use of ever more finely tuned targeted sanctions in recent years suggests that policymakers are engaged in such a calculus. Unlike older comprehensive sanctions, targeted sanctions allow policymakers to cherry-pick specific targets and transactions that will achieve the greatest impact at the least cost. It allows them to avoid imposing sanctions that are useless or even counterproductive, such as those that harm vulnerable populations or those too likely to anger the sanctioner's own friends and allies. If, however, market participants respond with overcompliance, the entire strategy may be undermined.

It might seem, then, that we are back to square one. Like in other areas discussed above, overcompliance caused by uncertainty undermines achievement of the policymakers' objectives, and they should therefore try to eliminate it as much as possible. Yet, it seems clear that sanctions policymakers and enforcers generate and tolerate a substantial degree of uncertainty and overcompliance. Are they simply mistaken? Or are these reasons why, in the context of sanctions, uncertainty might be inevitable or even desirable?

First, policymakers may simply be satisfied with the degree of "optimization" that occurs under sanctions regimes as they currently exist. For high value activities and transactions, market participants can choose to invest in compliance programs, due diligence, and legal advice, and to consult OFAC or other agencies where needed. Their ability to do so mitigates the cost they bear compared to comprehensive sanctions, which ban all activities and transactions regardless of their value or importance. By the same token, it mitigates the harm to policymakers' objectives that come from private sector resistance, excessive disruption of world markets, and third country complaints. To be sure, greater investment by government agencies in more precise rules and guidance would allow more and lower-value activities and transactions to continue. But from the policymakers' perspective, the benefits may not be worth the costs. At the very least, it is hard to gauge whether the current level of uncertainty is optimal. The mere fact that overcompliance occurs, even on a large scale, tells us little in this regard.[61]

Second, unlike most economic regulators, agencies that design and enforce sanctions are centrally concerned with evasion. To be sure, market actors can and do try to evade environmental and other business conduct rules, requiring governments to invest in detection and enforcement. But sanctions generate not just sporadic noncompliance, but organized efforts at evasion that can draw on the economic, political, intelligence, and military resources of entire states. U.S. enforcers are engaged in a constant struggle to detect and counter efforts by Russia, Iran, and North Korea to evade sanctions, not to mention the many other actors around the world eager to make vast covert profits by helping them, and the many terrorist organizations and organized crime syndicates that engage in the same tactics. In this context, precision can come at a considerable cost if it provides a roadmap for sanctions evaders.[62] Policymakers may reasonably think that a degree of uncertainty serves their purposes by allowing them to crack down on evasion schemes without having to anticipate the details in advance.

Finally, there may also be a less savory, public choice explanation for sanctions uncertainty. It may be that government agencies, consciously or not, respond to the demands of influential professional constituencies (lawyers, consultants, the compliance industry) that prefer vaguer rules that generate high compliance costs. Compared to a more precise set of rules, a vaguer regime drives more business to these constituencies, but generates overcompliance as a side effect: for activities or transactions whose benefits do not justify incurring these costs, market participants

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61 Some commentators have claimed that "the ambiguity of executive orders or of OFAC guidance is a form of economic and political manipulation by US regulators, deliberately used to encourage overcompliance to the detriment of sanctioned countries." Breen, *supra* note 2, at 263. *See also* Kilpatrick, *supra* note 10.

62 For an example of this concern, see John Bolton, *The US Needs a Sanctions Policy Revolution*, HILL (Dec. 1, 2022), https://thehill.com/opinion/international/3757034-the-us-needs-a-sanctions-policy-revolution/ [https://perma.cc/6UK9-XCAH] (criticizing policymakers who "provide explanations about sanctions that are little more than roadmaps for sanctions violators to follow").

"overcomply" by cutting off broad categories of activities or clients.

In sum, it is far from clear that overcompliance is unanticipated by policymakers or defeats their objectives.[63] This is an important point, and one that appears lost in some of the debate about overcompliance. Some critics of overcompliance seem to begin from the premise that the underlying sanctions themselves are illegitimate.[64] From this perspective, it inevitably follows that overcompliance is an evil, but it loses its distinctiveness. Worrying about "overcompliance" as a phenomenon only makes sense if one takes the policymakers' objectives seriously, so that there is a distinction between (desirable) compliance and (potentially destructive) overcompliance. Once one makes that distinction, however, it is hard to conclude with any certainty that current levels of overcompliance are undesirable.

C. Humanitarian Concerns

Even if overcompliance is efficient on the part of market participants and policymakers, it may be that its impact on third parties makes it an evil. Indeed, humanitarian concerns are at the heart of the debate on overcompliance. A recent U.N. Special Rapporteur report, for example, focuses on the impact of sanctions on human rights and asserts that "overcompliance exacerbates this harm."[65] More specifically, NGOs and commentators blame overcompliance for limiting access to essential goods, such as food

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63 In the case of the sanctions imposed on Russia following its invasion of Ukraine in 2022, policymakers were reportedly surprised by the extent and speed of private sector withdrawal and its impact on energy and food markets. See Adam M. Smith & Cody M. Poplin, *Keeping Sanctions "Smart": Calibrating U.S. Sanctions Policy to Overcome Overcompliance*, 48 N.C. J. INT'L L. 499, 522-23 (2023). Given the unprecedented scale of these sanctions, which targeted a major economic and military power for the first time in the twenty-first century, the market disruptions caused by the war itself (e.g., the temporary inability of grain shipments to leave Ukraine), and high reputational incentives to divest, it seems unsurprising that policymakers found it challenging to precisely calibrate the sanctions' impact and may have relied—and still be relying—on a "learning by doing" process. *See id*.

64 *See, e.g.,* Douhan, *supra* note 2, ¶ 87 (beginning the Special Rapporteur's recommendations by asserting that "the overwhelming majority of unilateral sanctions being applied today [violate international law] and should therefore be lifted" and that "the Special Rapporteur nonetheless makes the following recommendations to minimize overcompliance," which "shall in no way be understood or interpreted as legitimizing unilateral coercive measures from a legal perspective").

65 Douhan, *supra* note 2, ¶ 3.

and medicine, in sanctioned countries, including Iran, Syria, and Venezuela, and for making it harder or impossible for foreign organizations to conduct humanitarian relief efforts there.[66] Critics also link sanctions overcompliance with de-risking, a term that emerged in the context of AML/TF compliance to refer to financial institutions systematically terminating business links with broad categories of persons associated with a targeted state.[67]

The IEEPA itself contains an exception for humanitarian donations, and individual U.S. sanctions regimes typically include licenses that permit specific transactions, such as food and medicine imports, under certain conditions.[68] These exceptions reflect U.S. policy to minimize the impact of sanctions on innocent parties, and they also arguably serve to ensure compliance with international human rights obligations. Many commentators and critics, however, argue that these exceptions have proved too restrictive and difficult to use in practice.[69] In addition, banks reportedly often refuse to process payments involving sanctioned countries, even where these transactions are permitted by humanitarian exceptions.[70] This form of overcompliance is a legitimate concern. As they design and implement sanctions, policymakers may fail to internalize humanitarian costs. While humanitarian carve-outs suggest that policymakers consider these costs, they may be more concerned to mitigate bad publicity than to provide effective relief. Even if humanitarian costs figure in their calculus, they may discount them to some degree relative to the sanctions' immediate political and economic objectives.

If this is the case, external pressure—from other states, international organizations, and civil society—may incentivize policymakers to redress the balance. There is evidence that the U.S. government feels the need to respond to humanitarian criticism of sanctions. In December 2022, OFAC issued a series of new general

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66 *See id.* at 5–6; Breen, *supra* note 2, at 266–68.

67 *See supra* notes 10-11 and corresponding text.

68 50 U.S.C. § 1702(b)(2); for an example of such a license, see Afghanistan General License 14 (Authorizing Humanitarian Activities in Afghanistan).

69 *See* Breen, *supra* note 2, at 267; Justine Walker, *The Public Policy of Sanctions Compliance: A Need for Collective and Coordinated International Action*, 103 INT'L REV. RED CROSS 705 (2021); Grégoire Mallard et al., *The Humanitarian Gap in the Global Sanctions Regime*, 26 GLOBAL GOVERNANCE 121 (2020).

70 *See* EBA Report, *supra* note 11, ¶¶ 37-38.

licenses meant to ease humanitarian support and the activities of NGOs across U.S. sanctions programs.[71] An accompanying new FAQ specifies that, in assessing transactions for compliance with these new licenses, "financial institutions may reasonably rely upon the information available to them in the ordinary course of business, provided that the financial institution does not know or have reason to know that the transaction is outside the scope of the applicable GL."[72] By thus streamlining humanitarian exceptions and lightening the compliance burden on NGOs and market participants, the government hopes "to further enable the flow of legitimate humanitarian assistance supporting the basic human needs of vulnerable populations while continuing to deny resources to malicious actors."[73]

The impact of these measures remains to be seen. The analysis above suggests that, by mitigating uncertainty about the application of sanctions, the new guidance may facilitate transactions at the margin. For example, a bank may choose to process some additional payments related to humanitarian aid in sanctioned countries for which due diligence would previously have been too costly to make the transaction economically viable. This impact, however, is likely to be limited. The new exceptions allow market participants to process additional transactions, but do not compel them to do so. Most humanitarian payments may be so small that even moderate compliance costs make them unprofitable for the bank.[74] On the other hand, compliance costs cannot be eliminated completely without inviting evasion and undermining the sanctions program. Beyond adopting exceptions, the government may need to take further steps to encourage banks and other market participants to process humanitarian transactions. Such a policy might include

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71 *See* Press Release, U.S. Dep't of the Treasury, Treasury Implements Historic Humanitarian Sanctions Exceptions (Dec. 20, 2022), https://home.treasury.gov/news/press-releases/jy1175 [https://perma.cc/P48J-KBLF]. The press release claims that the United States was the first country in the world to implement U.N. Security Council Resolution 2664, which established a similar humanitarian exception for U.N. multilateral sanctions programs. *See* S.C. Res. 2664 (Dec. 9, 2022).

72 *Cross-Programmatic Compliance Services Guidance #1106*, OFF. OF FOREIGN ASSETS CONTROL (Dec. 20, 2022), https://ofac.treasury.gov/faqs/1106 [https://perma.cc/9PC2-JA8V].

73 Press Release, U.S. Dep't of the Treasury, *supra* note 71.

74 Especially if the bank has otherwise ceased doing business in or with the relevant country.

some form of subsidy for due diligence related to such transactions.

Finally, observers should exercise caution in extending the concerns raised about de-risking to economic sanctions.[75] While sanctions compliance has substantial similarities to AML/TF, the policies at stake have important differences. AML/TF involves screening large numbers of payments to identify and block those linked to crime or terrorism. There is no benefit to blocking a payment or terminating an account not so linked, and there is substantial harm to innocent parties. In that context, de-risking is concerning, because it threatens to deprive vast numbers of individuals of access to the banking system based on their nationality without advancing the underlying policy objective.[76]

By contrast, economic sanctions, for better or for worse, inherently involve inflicting economic pain on many persons associated with the sanctioned state or organization to pressure its leadership to change course. This is most evident with old-style comprehensive sanctions, but it is true of targeted sanctions as well. To be sure, some sanctions target culpable individuals, such as those determined to be "responsible for or complicit in . . . actions or policies that threaten the peace, security, stability, sovereignty, or territorial integrity of Ukraine."[77] But it would be hard to argue that all persons who "operate in such sectors of the Russian Federation economy as may be determined by the Secretary of the Treasury . . . such as financial services, energy, metals and mining, engineering, and defense and related materiel"[78] are directly complicit in reprehensible activities. Nevertheless, many are targeted as part of a strategy to weaken Russia's economy and ability to wage war. In this context, de-risking or overcompliance may increase the number of persons affected or the scope of the sanctions they must bear, but

75 For example, the U.N. Special Rapporteur's report on overcompliance quotes critiques of de-risking in the AML/TF context by the European Banking Authority and Ernst & Young in support of its argument against overcompliance with sanctions. *See, e.g.*, Douhan, *supra* note 2, ¶ 44.

76 *See* EBA Opinion, *supra* note 11, ¶¶ 8–9 (noting that de-risking "can lead to adverse economic outcomes or amount to financial exclusion," which is a concern because "access to at least basic financial products and services is a prerequisite for participation in modern economic and social life," while unwarranted de-risking "has a detrimental impact on the achievement of the EU's objectives, in particular in relation to fighting financial crime effectively").

77 *See, e.g.*, Exec. Order No. 13,660, 79 Fed. Reg. 13,493 (March 6, 2014).

78 Exec. Order No. 13,662, 79 Fed. Reg. 16,169 (March 20, 2014).

it does not expand sanctions from the guilty to the innocent, as AML/TF de-risking does.

V. Conclusion

This article has argued that overcompliance can be explained as a rational response by market participants to the uncertainty inherent in sanctions regimes, as well as to the reputational and other social costs of maintaining links with actors involved in widely condemned practices. Overcompliance makes sanctions less "targeted" or "smart" than they would be if market participants could perfectly optimize compliance, but such a goal is likely unrealistic. Policymakers must anticipate overcompliance and, where needed, can respond dynamically by providing more guidance or adjusting the scope or intensity of sanctions. The exception is where overcompliance imposes harm on innocent third parties. There, market participants and policymakers likely have insufficient incentives to mitigate the impact of overcompliance, and external pressure may help ensure that humanitarian costs are properly considered. There is thus some reason to worry about overcompliance, but less so than most commentary suggests.