

Mitigating Trade Compliance Risks: How to Build a Plane in Midair!

SCCE CEI

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About Me



- * Director and Managing Counsel - Global Compliance & Ethics for CNH Industrial
 - * \$30B company with 66,000 employees worldwide and operations in over 180 countries
 - * Third largest capital goods manufacturer in the world (agricultural and construction equipment, military vehicles, buses and engines).
- * Based just outside of Chicago at Company's North American Headquarters
- * Responsible for operation of global compliance program overall
- * Also serve as Legal Counsel for all global trade and anti-corruption matters as well
- * 22 years of in-house practice
- * Certified Compliance and Ethics Professional (CCEP)

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Trade Compliance Basics

- * Three Primary Areas of Trade Compliance:
 - * Economic sanctions/denied parties
 - * Countries/companies and people we are not allowed to sell to or may need an OFAC license to sell to
 - * Exports (sending goods or services to other countries)
 - * If your good is controlled, cannot sell without a BIS or DOS license
 - * May be subject to a retaliatory tariff from another country (e.g.China)
 - * Imports (bringing goods or services into your home country)
 - * May be subject to tariffs

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Hypothetical



- * You are hired as the company's first trade compliance person, or
- * You are a corporate compliance professional and are asked to "also handle" trade compliance, or
- * You are a corporate compliance professional and something goes very wrong in trade compliance and you are asked to "fix it" and make recommendations for future improvements

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Where Do I Start?

- * You can't "stop" the business while you figure things out
- * You have to build your program while the business continues to operate
 - * "Build the plane while flying!"



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Step 1: Know Your Company

- * What do we buy?
 - * What supplies/products/services do we buy?
 - * Where do we buy from?
 - * Where do we use what we buy?
- * What do we sell?
 - * What supplies/products/services do we sell?
 - * Where do we make/offer them from?
 - * Where do we sell them to?
 - * How do we sell?
 - * Direct? Through agents? Through dealers/distributors?
 - * Do we use warehouses? If so, where?



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Know Your Flows: MAP IT!

- * Get yourself a large map
- * Pick a color-code for each “half” of the equation
 - * One color for what you buy
 - * One color for what you sell
- * Draw-out what you sell
 - * Where it originates with an arrow to where it is sold to and, if applicable, where it might be stored (warehouse)
- * Do the same for what you buy

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Mapping Exercise



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Step 2: Know Your Codes

- * Figure-out your high-level classifications
 - * Is what you are selling or buying a controlled good?
 - * Is what you are selling or buying a military good?
 - * Is what you are selling or buying a dual-use good?
 - * Are there rules around where you can/cannot sell your goods?
 - * Are there rules around to whom you can/cannot sell your goods?
 - * Do you need approvals or licenses to sell your goods to certain places or people?



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Know Your Codes

- * Every product/service is identified by a series of Codes:
 - * ECCN (Export Control Classification Number)
 - * HTS (Harmonized Tariff Code for imports)
 - * NOTE: These are not the same number
- * What are the classification numbers that apply to my goods/services?
- * Highly technical expertise needed to classify
 - * Engineering background a plus
 - * Consider outsourcing to law firm, trade consultant,
 - * Each new product/every new widget purchased, must have a classification

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Know Your Codes

- * Practice Tip:
 - * The Bureau of Industry and Security of the Department of Commerce is responsible for export classification numbers
 - * They publish classification information including classification requests
 - * Maybe your supplier or competitor has requested a verification of a classification on a similar product
 - * Publicly available

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Know Your Codes

- * Practice Tip:
 - * U.S. Customs and Border Protection also issues classification rulings to determine which Harmonized Tariff Schedule provisions apply to your goods
 - * Many of these rulings are also published publicly
 - * Worth checking!



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Country Chart

- * Check the Commerce Department's "Country Chart " to see if your good is controlled for export
 - * <https://www.bis.doc.gov/index.php/forms-documents/regulations-docs/14-commerce-country-chart/file>
- * [..\..\Trade Compliance\country chart.pdf](#)

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Step 3: Risk Assessment

- * Risk Assessment:
 - * Now that you know what/where your company is selling and buying things, you can conduct a risk assessment.
 - * Your company's trade compliance risk profile will be different than that of any other company
 - * Trade flows, product types, controlled status of goods will dictate different risk mitigation plans

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For Example

- * Business "A": Manufactures driverless tractors run remotely by controllers that are GPS and Satellite dependent



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Example Continued...

- * GPS is a controlled good
 - * Commerce Control List (Supplement No. 1 to Part 774)
 - * Specific rules about where/to whom it can be sold (Category 7, Navigation and Avionics)
 - * In some cases, subject to ITAR (International Traffic in Arms Regulations)

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For Example

- * Business “B”: Manufactures copy paper.
- * Copier paper is not controlled
- * EAR99
 - * “Catch-all classification for items subject to the Export Administration Regulations (“EAR”) but not specifically controlled, not on the Commerce Control List
- * Risk Profiles for each company will be very different

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Risk Methodology

- * I recommend using a “residual risk” methodology
- * Consider:
 - * Likelihood of occurrence (example)
 - * More likely than not to happen (More than 75% chance) = 5
 - * Might happen (50% chance) = 3
 - * Not likely to happen (Less than 25% chance) = 1



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Risk Methodology



- * Potential impact if it does occur
 - * Large Impact (over \$250,00) = 5
 - * Moderate Impact (between \$50,000 and \$250,000) = 3
 - * Low Impact (less than \$50,000) = 1
- * Mitigating Measures already in place
 - * Strong measures in place = -5
 - * Some measures in place = -3
 - * Weak/no measures in place = +5

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Risk Methodology

- * Likelihood x Impact – Mitigation
- * Event likely to happen with high impact but good mitigating measures in place:
 - * $5 \times 5 - 5 = 20$ points
- * Event likely to happen with high impact but no mitigating measures in place:
 - * $5 \times 5 + 5 = 30$ points

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Step 4: Mitigate Your Largest Risks First

- * U.S. Company who manufactures here and sells uncontrolled goods primarily to South Africa
 - * Highest risk might be OFAC denied party risk
- * U.S. Company manufacturing here and selling controlled military goods to Asia
 - * Highest risk likely export compliance risk/ITAR risk

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“Quick Win”: Trade Sanctions Risk Mitigation



- * “List of Lists”
- * Country-level sanctions/embargos
 - * For example, entire country of North Korea
- * Individual (person) or Entity (company) based sanctions
 - * DPL (Denied Party List)
 - * SDN (Specially Designated Nationals)
 - * <https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>

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Screening Program



- * The only way you can be sure you are not selling or shipping to a sanctioned party or person is to screen
- * Type/extent of screening solution will depend on your company’s specific business and risk appetite
- * Manual screening process can be used, but is it sufficient/efficient?
- * Many different tools out there to automate
- * Make sure you are re-screening at a regular cadence, lists change all the time!

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Invest in a Screening Tool

- * Multiple tools out there
- * Many integrate with popular ERM software
- * Screen each shipment at the time of shipment
- * Nothing leaves your dock unless it has been screened and released
- * Big “bang” for your proverbial buck
 - * OFAC enforcement has stepped up against non-financial institutions lately
 - * New OFAC compliance program guidance published
 - * Read it!

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Cross Reference Flows

- * Are you selling to countries subject to sanctions?
 - * If so, could a license be available or does an exception apply?
 - * If so, apply for a license or document exception
 - * If not, STOP!
- * Are you screening for individuals subject to sanctions?
 - * Are you using a screening system?
 - * Are you doing manually?
 - * Are you keeping records?
 - * Are you reporting – Note new reporting requirements for rejected transactions!

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New Reporting Requirements

- * Must report ALL rejected transactions
 - * Wire transfers
 - * Trade finance (letters of credit)
 - * Securities
 - * Checks
 - * Foreign Exchange
 - * Goods or Services
- * ALL parties subject to U.S. jurisdiction must report
 - * Previously only financial institutions



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PACCAR Case – Aug. 6, 2019

- * U.S. Company with Netherlands incorporated subsidiary
- * Subsidiary sold 63 trucks to customers in Europe it “knew or had reason to know” were ultimately bound for Iran
- * Sells through dealers
- * Dealer places order for trucks for Iranian company
- * Subsidiary responds saying “Sorry, can’t sell there.”
- * Later the same day, identical order with same specifications from same dealer bound for “Russia”
 - * OFAC Position: This was a red flag you should have seen

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PACCAR Case Cont...

- * Sub also sells trucks to a trader who resells to Iran
 - * Drafts of invoices provided to Sub specifically referenced buyers in Iran
- * Sub also sold trucks to dealer in Bulgaria. Dealer sold them to their rental company who sold to Iran.
 - * Sales manager ignored warning signs indicating they were destined for Iran, failed to take “reasonable steps” in response to the warning signs



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PACCAR Case Cont...

- * Base penalty amount: \$2,713,214
 - * No sanctions penalty in past 5 years
 - * Existing trade compliance program
 - * Language in all contracts prohibiting dealers from selling in violation of U.S. sanctions
 - * Sub took immediate action upon discovery – investigation, termination of employees involved, cancelling delivery of trucks, in-person sanctions compliance training to all affiliated companies
 - * Self-disclosed to OFAC with full cooperation
- * Final penalty reduced to: \$1,709,325



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Lessons Learned

- * Use PACCAR case as a case study!
- * Train your salespeople and sales administration staff to recognize red flags
- * Train your dealers
- * Audit your agreements to ensure language prohibiting sales to sanctioned countries/individuals is included
- * Check your warranty records – you may be surprised by what you find
- * Watch for “collar countries” and sales spikes there

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Import Risk

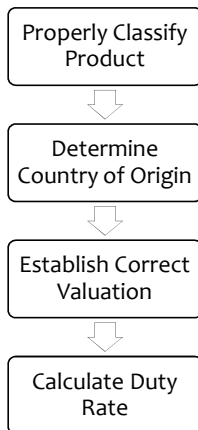
- * Bringing product or components into a country from another country
- * May be subject to tariffs or duties
- * May be subject to Anti-Dumping, Countervailing Duties
 - * e.g. Chinese Steel
- * May require certain certifications or conformity with U.S. regulations (e.g. engines)
- * Primary agency: U.S. Customs



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Import Process Overview



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Risk Area: Classification

- * All products imported into the United States must be classified using the Harmonized Tariff Code System (Often referred to as the HTS Code)
- * Different codes are subject to different duties depending on their country of origin (COO)
 - * 8701 Tractors (other than tractors of heading 8709):
 - * 8701.90 Other:
 - * 8701.90.10 Suitable for agricultural use
- * Duty is calculated using the value of the goods being imported



☆ **Compliance Tip:** Have an outside expert/broker/law firm audit your customs classifications on a regular cadence. Include country of origin marking requirements as part of your purchasing contracts and audit for same.

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Risk Area: Import Valuation

Customs duty is levied on the value of the goods at the time of import, which should include:



Commissions

Royalties & License Fees

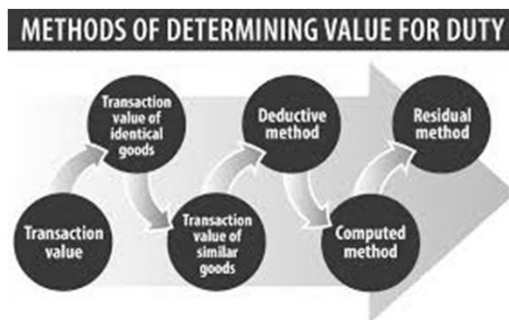
Assists

Packing Costs & Proceeds

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Valuation Methods



Key take-away: Hire yourself good customs counsel!

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Customs Basics:



* High-Level Best Practices:

- The importer of goods into the US is responsible for taking reasonable care to ensure the information declared to US Customs is accurate.
- Errors can lead to under and over payments of duty to US customs.
- US Customs can levy penalties and interest on errors and underpayments.
- Working closely with your third parties on key customs issues mitigates and reduces risk
- Country of Origin must be tracked and indelibly marked on most goods

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Export Control Risks



- * The US Government carefully controls the export of controlled US products and technology. Exports to vendors of technology or other assists may be controlled.
- Even if controlled, goods and technology may be exported with the appropriate license from the US Government. Conditions of the license may restrict certain activities once exported.
 - It is a good practice to review how third parties treat and handle controlled technology and whether further exports are being made.
 - Beware of re-export and diversion potential
 - Beware of “deemed exports”
 - Primary Government Agency: BIS (Bureau of Industry and Security at the U.S. Department of Commerce)

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What is “Controlled” Technology?



- * EAR = Export Administration Regulations (15 CFR §§730-774)
- * Also referred to as “Dual Use” technology
- * Determine the ECCN (Export Control Classification Number) of your item on the CCL (Commerce Control List)
 - * A five character number designates the type of product
 - * <https://www.bis.doc.gov/index.php/licensing/commerce-control-list-classification/export-control-classification-number-eccn>

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ITAR



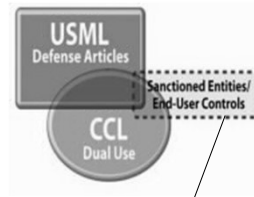
- * International Traffic in Arms Regulations
 - * United States Munitions List
- * Special export controls apply to all goods and services for military projects
- * Anything designed for military use
- * Any commercial design “modified” for military purpose or use
- * Skid Steer Example
- * TAA (Technical Assistance Agreement) required to provide information or services related to a military good or service

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EAR 99

- * Not on the CCL or USML?
- * Then it's EAR 99
- * Not “controlled” for export
- * Can be exported without obtaining a product-based license



REMEMBER, HOWEVER

**Trade Sanctions still apply
and may require a license**

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Deemed Export Risk

- * Controlled technology
- * Being manufactured here in the U.S.
- * Foreign employees who are not U.S. citizens or permanent green card holders work for you
- * Allowing them access to plans, technical information, engineering designs, is considered an “export” of controlled technology to their home country
- * U.S. employees sits next to employee from China. Opens plans to new encryption system on his desk and invites employee from China to review. Plans have just been “exported” to China without a license.



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Export License Decision Tree



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Location Based Export Risks



- * Where does your product or service originate from?
 - * Do any content rules apply?
- * Where is it now?
 - * Are there permits or licenses required by the country I'm exporting from?
- * Where is it going?
 - * Are there permits/licenses required by the country I'm shipping to?
 - * Are there country sanctions or boycotts that apply?

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Customer Based Export Risks

- * Who is the buyer?
 - * Is your buyer on any sanctions list?
 - * Have you checked for AML/KYC compliance?
 - * Is the buyer a government entity?
 - * Is the buyer in a high-risk country?
 - * Is the buyer a PEP?
- * Are they the end-user?
 - * Do you need an end-user certificate from them?
- * Will they be reselling your product/service?
 - * Due Diligence
- * How will they pay for their purchase?
 - * LOC language acceptable?



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Product Based Export Risks

- * What is the product?
 - * Is it controlled?
 - * Do I need a license or special permission to sell this?
 - * Does ITAR apply?
 - * Do I need State Department approval to sell this?
 - * Does it have Conflict Mineral content?
 - * Does REACH apply?
 - * Are there end-of-life requirements?
 - * Who will provide warranty service?
 - * Are there duties or VAT that apply?



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Export Control Reform Act of 2018

- * New requirement to identify “emerging and foundational technologies” (E&F Technologies) essential to U.S. national security
- * Interagency review process, Dept. of Commerce, Defense, Energy and State all involved in review
 - * Initial targets: Autonomous vehicles, 5G, hydrogen, robotics, artificial intelligence, machine learning, fuel cells

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Shipping/Logistics Risks



- * Who is the Exporter of Record?
- * Who is the Importer of Record?
- * Under which Incoterms are the items shipping?
 - * Who bears the risk of loss?
- * Who is responsible for clearing customs?
- * Are you using a freight forwarder or customs broker?
 - * Does your agreement with them indemnify you for their errors?
- * How are the good being transported? Air? Land? Sea? Intermodal?

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Incoterm Risks

- * Logistics “shorthand”
- * Not just for fun – do you know what you’re responsible for?
- * Real liability implications
- * <https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-rules-2010/>



Incoterms® 2010
by the International Chamber of Commerce (ICC)

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Sale of Services Risks

- * What are the services?
 - * Are they controlled?
 - * Does ITAR apply?
 - * Do you need a TAA?
- * Is there an intermediary, subcontractor or dealer involved?
 - * Where is the intermediary located?
 - * How are they being paid?



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Corruption Risks

* Corruption Perception Index published by Transparency International

https://www.transparency.org/news/feature/corruption_perceptions_index_2016



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Corruption Risks



- * Take special note of the Panalpina Case
 - * Freight forwarder allegedly paying bribes on behalf of (to the benefit of) their customers to get freight “through” foreign customs faster
 - * Mitigation Suggestion: Make sure the language of your agreements with your freight forwarders and brokers specifically includes anti-corruption language
 - * Ask for indemnification for violations committed in connection with your company’s goods!

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Backup

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Manufacturing Company Hypotheticals

Recommended Methodology:

- * Analyze the “flow” or “steps” in the transaction
- * Where are the risks?
- * What regulations do you need to know?
- * Are there areas of overlap?
- * How will you minimize your risk?

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Number 1



- * You are a U.S. manufacturer listed on the NYSE. You have multiple European manufacturing sites. One of your dealers is based in Turkey and has been your dealer for years. You have another dealer located in Dubai. You notice through warranty records that some of the products sold to the Turkish Dealer are being transferred to the dealership in Dubai. What potential International Trade Compliance issues do you see and how can you mitigate them?

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Risks/Issues

- * Sanctions avoidance
- * Diversion
- * Money Laundering
- * Things to ask:
 - * Is there U.S. or EU content?
 - * Are the dealers related? Who are the UBO's of these dealers?
 - * Which banks are they using?
- * Potential Mitigation:
 - * Get end-user certifications
 - * Perform diligence on both dealers



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Number 2



- * Your company produces buses. You order certain sub-assemblies for your buses from China. These sub-assemblies are needed to keep your U.S. manufacturing line “up” and running and in order to meet your manufacturing schedules so you can meet customer delivery dates. The sub-assemblies are stopped at the border between the U.S. and Canada due to issues with the wooden crates the sub-assemblies were shipped in. Can this issue be mitigated? How can you avoid it from happening again?

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Risks/Issues



- * U.S. Customs rules require that any wood products to enter the United States, including shipping pallets and containers, must have been fumigated to kill potentially invasive pests
- * If wood materials aren't stamped indicating certification, they can't enter the U.S. and neither can the products being transported on/in them
- * Solution:
 - * Return products to the vendor, have them re-ship at their cost
 - * Does your supply agreement have indemnification for this issue?
 - * Who covers cost of idled production line?

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Number 3



- * Your sales department wants to ship a 3D Printer from the U.S. to a consignment company in the Middle East. When you ask why, the consignment company tells you the in-region distributor wants to speed-up the delivery process and the end-user customer is in a big hurry and needs the equipment immediately. What potential International Trade Compliance issues do you see and how will you mitigate them?

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Risks/Issues

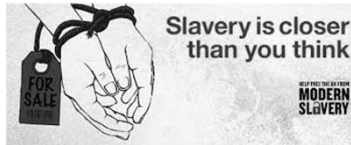


- * Hiding of end-user
- * Is end-user subject to sanctions?
- * Is the product going to be diverted or re-exported to a sanctioned country?
- * Potential Mitigation:
 - * Demand end-user certificate
 - * Demand compliance certification from all parties involved in the transaction

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Number 4



- * You work for a big-box retail company that internationally sources many of its goods and sells everything from tires to oranges. You receive service of process for a lawsuit filed against your company in California. The case has been filed by a group of individual consumers seeking to certify as a class. They claim the chocolate you sell in your stores is grown and harvested in South America using slave labor in direct contravention of statements made by your company in its annual sustainability report. What do you do?

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Risks/Issues



- * Could there be merit to the allegations?
- * Do you do business in the UK? (Modern Slavery Act)
- * Are you “doing business” in California? (California Transparency in Supply Chain Act) What about Australia? (New Act coming there in 2020)
- * Have you conducted a risk assessment?
- * Have you conducted diligence on your supply chain?
- * Are you supplying any of the chocolate to U.S. government department?
- * FAR and DFAR rules related to Human Trafficking

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Number 5



- * You work in the compliance department for a large multinational in the oil and gas industry. You are responsible for management of the company's helpline investigations. You receive an allegation of potential wrongdoing in the company's facility in the Netherlands. The allegation concerns pricing irregularities including the proper accounting for certain royalty payments. In addition there is uncertainty about from where some product is sourced. It is a small office with people often wearing multiple hats. How will you respond?

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Risks/Issues

- * If you aren't sure where product is sourced, customs duties calculations could be inaccurate
- * If you aren't including/correctly calculating royalty payments (assists) then your valuation is likely wrong
- * Duty underpayment?
- * Voluntary Self-Disclosure?
- * Audit?
- * Adequate compliance program?



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Number 6



- * You are on a deal-team working on the potential acquisition of a battery and light bulb manufacturing company in South Korea by a U.S. company. The target sources raw materials from multiple countries. One of their biggest suppliers is a mining company based in Indonesia that provides lead for the batteries. They also source chemicals from Japan, Germany and Brazil. The target exports finished goods to Japan, the UK, Myanmar, Vietnam, Taiwan and China. What potential International Trade Compliance issues do you see and how will you mitigate them?

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Risks/Issues

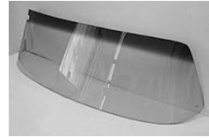


- * Conflict Minerals?
- * Human Trafficking?
- * REACH?
- * Export licensing requirements from South Korea?
- * Import duties/licensing requirements from customer countries?
- * UK – Brexit impact?

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Number 7



- * You are a U.S. manufacturing company listed on the NYSE with offices and manufacturing sites around the world. You receive a call from someone working on one of your manufacturing plants in Nebraska. He tells you he received an email from a large customer (another U.S. company) asking them to find a different supplier of glass components because they “can’t” sell products with that glass in the Middle East. What issues do you see with this? How do you address?

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Risks/Issues



- * Is glass marked with a country of origin?
- * Is the country of origin Israel?
- * U.S. Antiboycott regulations apply
- * Cannot make changes to products or suppliers based on Middle East’s boycott of Israel.
- * Request must be disclosed and reported in a Quarterly Boycott Request Form
 - * <https://www.bis.doc.gov/index.php/enforcement/oac>

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Number 8

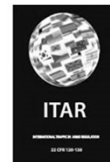


- * You manufacture delivery vans. The U.S. Army asks to order 500 of these vans but they want to increase the horsepower of the engines to 425 hp and they want them painted in CARC paint (camouflage paint) and also ask that a special reinforcement be built around the gas tank to protect it from gunfire and IEDs. What issues do you see? What will you need to do to be compliant?

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Risks/Issues



- * Military customer
- * Military modifications? Do these changes serve a “military purpose?”
- * ITAR registration
- * Government Contract – Human Trafficking Compliance Requirements in the FAR and DFAR
- * TAA needed?
- * Deemed export risks
- * Export license exception for sale to U.S. government in foreign locations

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Number 9



- * You work for a Midwest manufacturing company in the U.S. A large and prestigious University has just reached-out to your engineering group and asked them to participate in a research and development project relating to autonomous “self driving” vehicles. The University has received a federal research grant and wants to partner with your engineers on the development of new satellite guided vehicles. Your engineering group is excited about this high profile opportunity. What do you need to be concerned about?

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Risks/Issues



- * Is the technology to be developed likely to be controlled technology?
- * Is the University private or public?
- * What are the terms of the grant?
- * Are any of the engineering team non- U.S. persons?
- * Are any of the students or professors who will be working on the project non U.S. persons?
- * Will an export license or TAA be required?

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Number 10



- * Your company decides to centralize its purchasing function and have all components purchased through a central team in Europe. Among the components that are purchased are metal washers and connectors used to build one of your products. Your purchasing function purchases components from all over the world to minimize the potential risks associated with “sole sourcing”. After these parts are purchased by the European team, they are held in a centralized warehouse and then shipped out to the various manufacturing sites around the world. What issues might there be with this?

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Risks/Issues

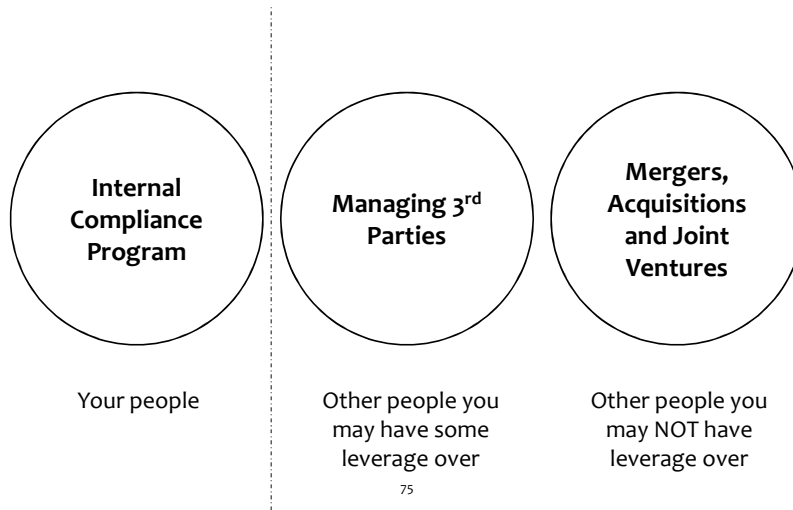
- * Warehouse rule?
- * Free Trade Agreement Qualification?
- * Country of Origin Requirements?
- * ADCV Issues?



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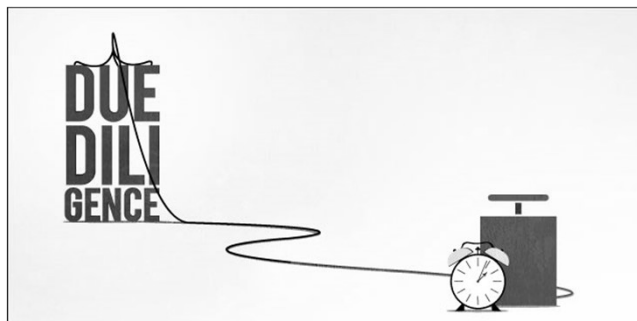
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International Trade Considerations



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Due Diligence



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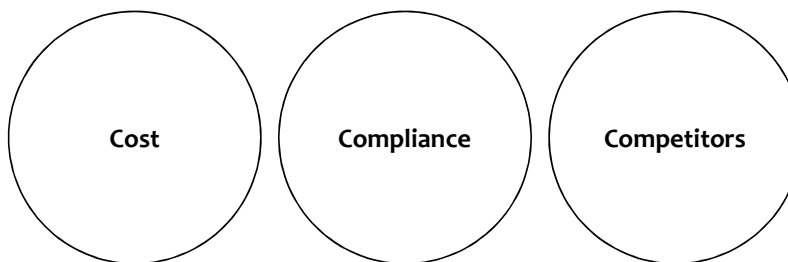
A Note About Third Party Management

It is critical that there are processes and controls to manage your 3rd parties, both on the sale and on the purchasing side.

Process Category	Process Description
1. Identification & Qualification	1.1 Company has a process in place for identifying potential at risk 3rd parties
	1.2 This identification process is cross-functionally validated
	1.3 A formal due diligence process is in place that includes a 3 rd party risk ranking based on likelihood of government interaction, region, size, nature of service. The due diligence includes sanction screening, adverse media search, whether the 3 rd party has government affiliations when required.
	1.4 There is a function or person responsible for overseeing risk based due diligence
2. Contracting & OnBoarding	2.1 Company uses standardized contracts that include terms and conditions that include anti-bribery and corruption provisions, trade compliance, anti-money laundering and right to audit and assignment clauses.
	2.2 Deviations from standard contracts are reviewed by Legal and Finance if necessary.
	2.3 The on-boarding process is automated, captures key information related to the third party.
3. Monitoring & Oversight	3.1 Company has assigned persons to manage the 3rd party relationship.
	3.2 There are KPI's to evaluate the 3rd party.
	3.3 Contracts are properly retained either electronically or manually.
4. Renewals	4.1 There is a contract renewal process in place.
	4.2 Contracts have a renewal date that requires 3 rd parties to go through a assessment.
	4.3 As part of the renewal process, the appropriate risk-based due diligence is performed on the 3 rd party as deemed necessary. This would include sanction screening, adverse media search and government affiliations.

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International Trade Considerations



Consider the “Homeowner” Analogy

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Solution?

- * Detailed Risk Assessment
- * Specific to:
 - * Your company
 - * Your markets
 - * Your products
 - * Your customers
- * GAP Analysis
- * Prioritize “fixes” over multi-year plan



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Questions?

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