Cassels

Regulatory Pressures – Clear, Present and Looming Dangers

Brenda C. Swick

August 12, 2024

Following the Russian invasion of Ukraine - and the more recent developments in the Middle East - Canada, the United States, and its NATO allies have issued numerous economic sanctions against Russia, the occupied regions of Ukraine, Belarus, and Iran, amongst others.

The escalating breadth of Canadian sanctions continue to pose even more legal challenges for funds, portfolio companies, and investors. These sanctions are very broad in their application to individuals and businesses in Canada, Canadian corporations and their non-Canadian subsidiaries operating abroad.

Sanctions have, and will continue to, play a central role in private equity as we move through 2024. Funds must consider their exposure to sanctions violations when operating in jurisdictions which are, or may become, the target of sanctions and should also prepare if existing or potential investors are or may become subject to sanctions. They must also consider that the sanctions law of several jurisdiction, all of which are different, may apply to parts of any proposed transaction.

Sanctions are driven by foreign policy considerations, such that the landscape can change quickly and in the most unpredictable ways. If firms find themselves exposed to sanctioned investors, sanctionable activities or investments in their portfolios, they will have to navigate the complexities involved in removing or isolating sanctioned investors and the entities they own and control, and possibly isolating and removing sanctionable activities from any proposed transaction. If the sanctions laws of several countries are applicable, then the compliance and risk mitigation strategies are made even more challengeable.

Firms which are in possession of any property including assets, shares or cash received from a sanctioned investor are required to immediately freeze the assets and report them to the RCMP. Banks have similar reporting obligations.

The firm is thereafter prohibited from dealing with the frozen property of the sanctioned investor, and is also prohibited from making any goods or property available to the sanctioned investor, including any distributions.

Compliance measures may also result in ceasing to fund the investment; ceasing distributions to the sanctioned person; forcing the sale of a sanctioned investor’s interest; and freezing a sanctioned investors’ interest and reporting such to the relevant government authority. Once frozen, further action cannot be taken without the appropriate governmental authorization. Canada has introduced measure to seize and forfeit the assets of sanctioned individuals or transactions.

While no comprehensive ban on trade with Russia exists under Canadian sanctions, PE firms must ensure that business with parties in Russia is conducted in a consistent manner with Canadian, and other applicable, sanctions.

For example, Canada not only prohibits dealing with sanctioned persons or entities those owned or controlled by them, but also prohibits dealing in new securities and debt; dealings/exports/imports in the oil and gas, petroleum, mining, chemical, aerospace and defense sectors; the direct import of diamond and diamond-related products originating from Russia; the provision of restricted goods and technology to Russia; the provision of a broad range of services to a host of industries in Russia. As such, screening counterparties in Russia, their ultimate beneficial owners, and their financial institutions against the Canadian, US, EU, UK sanctions list is critical.

Further, sanctions exposures may also impact a fund's ability to enter credit facility agreements, as lenders have grown risk averse to sanctions violations (for both legal and reputational reasons).

As the geopolitical climate continues to incite governmental trade controls, PE firms must be prepared to react in a timely fashion and avoid inadvertent infringements.
