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Canadian sanctions laws: key considerations for loan transactions

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In response to the Russian invasion of Ukraine, many countries, including Canada, have rapidly imposed sanctions against Russia. A key component of sanctions is a prohibition on providing financial services to designated persons or entities in sanctioned jurisdictions. Such prohibition raises sanctions compliance risks for loan transactions involving entities whose operations may be subject to the sanctions. In this article, we discuss Canadian sanctions laws and issues that may affect parties to a loan transaction. Canadian anti-money laundering and anti-corruption requirements under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* and the *Corruption of Foreign Public Officials Act* will also be relevant but are outside the scope of this article.

Overview of Canadian sanctions laws

Canada has a broad range of economic sanctions laws targeting designated jurisdictions, individuals and terrorist groups. These laws apply to persons in Canada (including individuals and businesses) and any Canadians outside Canada (including Canadian citizens or corporations doing business outside of Canada). The general features of Canadian sanctions laws are

- prohibitions on dealing with designated persons or with certain jurisdictions or within specific sectors of certain jurisdictions (e.g., in the Crimea region of Russia, or in relation to oil and gas equipment with certain countries, etc.)[1]
- screening, reporting and asset-freeze obligations on prescribed entities (which may include banks, insurance companies, trust and loan companies and investment managers)
- exemptions by way of discretionary permits/certificates and blanket exemptions for the provision of goods and services which are otherwise restricted if for certain purposes (e.g., humanitarian relief)
- penalties including fines and prison terms

There are five main statutes under which Canada's sanctions are implemented: the *United Nations Act* (the UN Act), the *Special Economic Measures Act* (SEMA), the *Justice for Victims of Corrupt Foreign Officials Act* (the JVCFO Act), the *Freezing Assets of Corrupt Foreign Officials Act* (the FACFO Act) and the *Criminal Code*.

In addition, while not strictly sanctions laws, there are other Canadian sanctions-related statutes that may restrict or otherwise be relevant to a loan transaction, including

- the *Export and Import Permits Act*, which permits the Government of Canada to restrict exports and imports of specific goods and goods from specific jurisdictions

- the *Foreign Extraterritorial Measures Act* (FEMA), which is Canada's "blocking statute" with respect to the extraterritorial application of certain foreign laws

Practical considerations

Lenders must ensure that entering into a loan transaction will not violate Canadian sanctions laws. Given the generally broad application of Canadian sanctions, this concern will be particularly relevant where the loan transaction involves (i) a borrower who is, or whose corporate group contains, either a Canadian person or a non-Canadian person operating in Canada or (ii) a lender who is a Canadian person or a non-Canadian person operating in Canada.

Due diligence

To ensure that a loan transaction does not violate any sanctions (in particular, the prohibitions on providing financial services to sanctioned persons), lenders will need to conduct careful due diligence as part of their "know your client" and anti-money laundering procedures. At a minimum, this should involve consulting the lists of sanctioned persons under the various Canadian sanctions statutes.[2]

Representations/warranties and sanctions covenants

In addition to due diligence, sanctions compliance is typically addressed by way of customary representations and warranties and covenants in loan documents. Sanctions representations from a borrower typically confirm that

- (i) the borrower and any other relevant entities in its corporate group are in compliance with applicable sanctions and (ii) none of such entities or their respective directors or officers or, to the knowledge of the party giving the representation, any employee or agent thereof, are an individual or entity subject to any sanctions or organized or resident in a sanctioned jurisdiction
- for facilities with ongoing advances where representations and warranties are repeated on each drawdown, the borrower has not used the proceeds of any advance in violation of any sanctions

Sanctions covenants may include positive and negative covenants to

- comply with all applicable sanctions laws and maintain internal sanctions compliance policies and procedures
- not become a sanctioned person
- ensure that proceeds of the loan are not used to violate any applicable sanctions
- provide certifications or other evidence as the lender may request to confirm compliance with sanctions covenants

To ensure sanctions-related representations and warranties and covenants are sufficiently robust with respect to Canadian sanctions, definitions of "sanctions", "sanctions laws" or any equivalent term should include "applicable Canadian sanctions laws, including the *Criminal Code*, the *United Nations Act*, the *Special Economic Measures Act*, the *Justice for Victims of Corrupt Foreign Officials Act*, the *Freezing Assets of Corrupt Foreign Officials Act* and all regulations, orders, rules and interpretations thereunder or related thereto." Any reference to sanctions

enforcement authorities should also include the Government of Canada and, in particular, Global Affairs Canada, which are the primary Canadian sanctions enforcement authorities.

SEMA exemptions for certain loan transactions

Regulations under SEMA generally include exemptions for certain dealings in connection with loan transactions.[3] Typical exemptions include

- payments made by or on behalf of a listed person that are due under a contract that the listed person entered into before they became a listed person, provided that the payment is not made to a listed person or to a person acting on behalf of a listed person (e.g., pre-existing fees and interest payments)
- dealings with a listed person (e.g., a sanctioned guarantor) required with respect to loan repayments made to any person in Canada, or any Canadian outside Canada, for loans entered into with any person other than a listed person (i.e., a non-sanctioned borrower), and for enforcement and realization of security in respect of those loans, or payments by guarantors guaranteeing those loans
- dealings with a listed person (e.g., a sanctioned borrower or guarantor) required with respect to loan repayments made to any person in Canada, or any Canadian outside Canada, for loans entered into with that listed person *before they became a listed person* (i.e., only with respect to pre-existing loan obligations), and for enforcement and realization of security in respect of those loans, or payments by guarantors guaranteeing those loans

Saving provisions regarding asset freezes

Certain of the Canadian sanctions statutes permit the Government of Canada to order the seizure, freezing or sequestration of specified property of sanctioned persons. However, in the case of SEMA, the JVCFO Act and the FACFO Act, there are saving provisions with respect to existing secured and unsecured rights and interests in frozen property held by persons other than the sanctioned person.[4] For instance, the JVCFO Act's saving provision states that such rights and interests are entitled to the same ranking that they would have been entitled to had the freezing order not been made.

Foreign Extraterritorial Measures Act

Under FEMA, the Attorney General of Canada may, with the concurrence of the Minister of Foreign Affairs, by order, prohibit any person in Canada from complying with any measures of a foreign state affecting international trade or commerce of a kind or in a manner that has adversely affected, or is likely to adversely affect significant Canadian interests in relation to international trade or commerce involving business carried on, in whole or in part, in Canada, or that otherwise has infringed, or is likely to infringe, Canadian sovereignty.[5] A borrower that is, or whose corporate group includes, an entity that is subject to a blocking order under FEMA will need to review sanctions provisions carefully to ensure that such entities will be able to provide the requested representations and warranties and comply with the sanctions covenants.

Recent amendments

The Government of Canada recently passed amendments to sanctions laws to implement Canada's commitment as a member of the joint Russian Elites, Proxies and Oligarchs Task Force to "find, restrain, freeze, seize and, where appropriate, confiscate or forfeit the assets of those individuals and entities that have been sanctioned in connection with Russia's premeditated, unjust and unprovoked invasion of Ukraine."

Bill C-19 (*Budget Implementation Act, 2022, No. 1*), which received royal assent on June 23, 2022, amended SEMA and the JVCFO Act to redefine "property" to expressly include intangible or incorporeal assets, including digital assets and virtual currency, and grant the federal government a new power to apply for a forfeiture order of seized or restrained property. Notably for lenders, the bill amended the saving provisions in SEMA and JVCFO Act for secured and unsecured rights and interests in frozen or restrained property. Under the amendments, those interests will lose their pre-existing ranking if the property is forfeited to the federal government. However, the new forfeiture order provisions permit such persons to apply for a court order declaring that their interest or right is not affected by the forfeiture, declaring the nature and extent of the interest or right and directing the minister to pay to the person an amount equal to the value of their interest or right.

Conclusion

As discussed above, Canadian sanctions create significant compliance risks in loan transactions. Lenders and borrowers should be aware of the foregoing issues when conducting "know your customer" due diligence and negotiating loan documents. Osler's professionals are experienced in advising clients concerning sanctions-related matters in loan transactions.

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[1] Prohibited dealings typically include the provision of financial services and related services.

[2] The Government of Canada has a Consolidated Canadian Autonomous Sanctions List which includes sanctioned persons under SEMA and certain other statutes. While this list may not include all sanctioned entities and individuals, it is often a good place to start.

[3] Each applicable regulation under SEMA must be consulted as the terms vary between regulations and sanctioned jurisdictions.

[4] See subsection 5(3) of SEMA, section 13 of the JVCFO Act and section 17 of the FACFO Act.

[5] There are currently two blocking orders issued under FEMA. The broader of the two orders is the *Foreign Extraterritorial Measures (United States) Order, 1992*, which blocks the extraterritorial application of the United States embargo against Cuba and prohibits a Canadian corporation from complying with an extraterritorial measure of the United States in connection with any trade or commerce between Canada and Cuba, including the Cuban Asset Control Regulations issued by the United States Department of the Treasury. The other order is fairly targeted and relates to certain United States "Buy America" provisions in relation to the redevelopment of premises leased by the State of Alaska from the Prince Rupert Port Authority.