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The increasing relevance of internal compliance programmes in India

Ameeta Verma Duggal outlines how, as it seeks to boost its economy and exports, the government of India is exploring internal compliance programmes as a means to smooth the path for exporters.

Over the last five years, India has witnessed a rapid change in the regulatory regime surrounding sanctions and export controls. While legislation governing exports of dual-use goods, services and technologies has been in place at least since 2010, the regulatory policy around the existing legislation has started coming into shape with India's membership of the multilateral export control regimes, beginning with the Missile Technology Control Regime in June 2016, Wassenaar Arrangement in December 2017, and the Australia Group in January 2018, which came about in quick succession. Since India has been an adherent to the Nuclear Suppliers Group since 2008, it is also committed to its obligations thereunder. India has always exercised restraint and demonstrated its position as a responsible member of the international community while safeguarding its national security. Hence, India's commitment to ensuring world peace is well established and recognised through its memberships of these multilateral regimes.

With the memberships came an increased awareness of the requirement for export authorisations and a quick churning out of amendments/ modifications in the regulatory regime around these authorisations. For an aspect of foreign trade that had largely gone unnoticed for years, suddenly there was a sense of omnipresence and omniscience encompassing it.

Running parallel to India's obligations under the multilateral regimes is the country's dream of becoming a $5 trillion economy, and a defence export target worth $5 billion in the next five years.

In pursuit of these ambitions, the government is focusing on cutting India's import bill and turning India into a net exporter, not a net importer.

INDUSTRY PERCEPTION

The awareness regarding the need to obtain export authorisations for exports, transfers, re-transfers, brought-in-transit, transhipment of, and brokering of dual-use goods, as listed in the Special Chemicals, Organisms, Materials, Equipment & Technologies ('SCOMET') List, resulted in an anomalous situation.

There was (and is) a perception that the regulators are moving towards a 'licensing' environment, which would adversely impact global trade and hinder India's dream of becoming an export-centric economy. The parallel drawn was to the state of the Indian economy prior to 1990, which was popularly known as the 'Licence Raj': a system hampered by excessive need for licences or permissions, with the accompanying red tape required to set up a business.

Until almost two years ago, there was a basis to this perception, with the licensing authorities taking several months to grant a shipment specific authorisation. Businesses had a legitimate concern of not being able to meet their contractual obligations.

This industry perception ran contrary to the government's buzzword schemes like the 'Make in India' and 'Ease of Doing Business'. The regulators have tried to counter this anomaly by rolling out enabling policies and a rationalised, liberal licensing regime to make licensing less onerous for industry while continuing to be fully compliant with India's international obligations and its commitment to non-proliferation, international peace and security. Since the regulatory changes are usually a reaction to the issues that the regulators confront with the applications being filed for authorisations, it will not be misplaced to say that the Indian export control laws are a fragmented work in progress, akin to a large jigsaw puzzle with the scattered pieces gradually coming together.

RECENT POLICY DEVELOPMENTS

The SCOMET List falls within the purview of three different licensing authorities. While the overall regulation of the SCOMET List is vested with the Director General Foreign Trade, Ministry of Commerce ('DGFT'), exports of nuclear materials and nuclear-related materials, equipment and technology (Categories 0 and 1) are authorised by the Department of Atomic Energy ('DAE'), and exports under the Munitions List (Category 6) are authorised by the Department of Defence Production, Ministry of Defence ('DDP').

Some of the recent developments in the regulatory regime focus on dispensing with pre-shipment authorisations and/or inter-ministerial authorisations. Instead, there is an attempt to move towards single-window authorisations and *post-facto* intimations to the larger inter-ministerial working group.

THE REGULATORS ARE TRYING TO EASE OUT THE PROCESSES AND GENUINE EFFORTS ARE BEING MADE TO FACILITATE EXPORTS. THE HARSH REALITY IS THAT IT IS TOO LITTLE, TOO SLOW AND TOO FRAGMENTED.

Towards this end, DGFT has recently issued public notices concerning authorisations for (i) repeat orders, (ii) stock and sale purposes, particularly with respect to post re-transfer/reexport reporting obligations to pre-approved countries and other countries, (iii) export of imported SCOMET items for replacement/repair and for replacement/repair of indigenous exported SCOMET items; (iv) temporary exports intended for demo/display/exhibition/tenders/request for proposal/request for quotation/notice inviting tenders; and (v) reexport or return of imported SCOMET items.

The regulators are promoting active and voluntary participation of industry, encouraging it to ensure safe and authorised export of munitions and dual-use items by putting in place internal checks and balances with a view to curtailing any unauthorised export of SCOMET items, taking steps to sensitise and train their employees to the export control requirements, and leading this awareness in companies from the top down.

Despite the periodic changes and the attempt to simplify procedures, the fundamental premise of the export authorisations continues to be that they are 'shipment-specific' and 'time-specific'. Generally, export authorisations for the SCOMET List are valid for a period of two years with a permissible extension of up to 12 months. There is, therefore, a compelling need to evolve procedures that are less cumbersome and document-heavy, not only for the exporters but also for the regulators who lack the wherewithal to efficiently and effectively process and monitor the ever-growing number of applications seeking export authorisations.

GROWING SIGNIFICANCE OF ICPs IN INDIA

The persisting challenge to process the increasing number of applications, monitor exports and reduce approval times is pushing the regulators to take a closer look at rolling out licence conditions that are governed by the globally accepted principles of self-management and self-declaration. Accordingly, there is a visible shift towards moulding authorisations on the basis of the existence of internal compliance programmes ('ICPs') being maintained by the applicant companies themselves, or in cases of multinational conglomerates, by their parent companies.

Guidance from international practices

Indian regulators have been guided by the practices being followed in other countries:

- **European Union**: in some countries – e.g., the Netherlands, Belgium, Germany and Luxembourg – a global export licence requires an ICP, which is not the case for an individual or general export licence.
- **Japan**: for a special general bulk export licence, special bulk export licence, special bulk export licence for repair or replacement, it is mandatory to have an ICP. Japan also requires fulfilment of 'Standards for Exporters' for an effective self-management control. Hence, while establishment of an ICP is not mandatory, a registered ICP with METI (Ministry of Economy, Trade and Industry) automatically satisfies the standards for exporters.
- **Singapore**: for a bulk permit, there is a requirement for an exporter to implement an effective ICP. Companies must notify Singapore Customs within 14 days of any changes made to the ICP, company structure, internal process or trade compliance team/SGCO.

Recent changes

Guidance from these international practices has resulted in some of the most recent policy changes announced by DGFT and DDP, particularly with respect to intra-company transfers where the fundamental requirement for the issuance of the relevant authorisations is the existence of an approved/certified ICP.

Global authorisation for intra-company transfer issued by DGFT

The DGFT issued a public notice, dated 24 July 2019, notifying the procedure for global authorisation for intra-company transfer ('GAICT').

The grant of GAICT will be for SCOMET items/software/technology, excluding items falling under Category 0,[1] 1B,[2] 1C,[3] 3A401,[4] 5[5] and 6[6], in respect of intra-company reexport of items imported against licence exception granted by the export control licensing authority of the country of the parent company. This does away with pre-authorisation for reexport of imported SCOMET items/software/technology, provided the following conditions are satisfied:

a. Reexport must be an intra-company transfer from an Indian subsidiary to its foreign parent company or to subsidiaries of the parent company for reexport of imported SCOMET items.

b. The items, software, technology to be reexported by the Indian subsidiary should have been imported into India against a licence exception available in the country of the parent company or subsidiaries of the parent company outside India. Further, the licence exception must specify the control list classification equivalent to the SCOMET classification and whether such exception is applicable to the subsidiaries abroad.

c. Reexport must be pursuant to a master service agreement/contract between the parent company and the Indian subsidiary for carrying out services like design, encryption, research, development, delivery, validation, testing and the item, service or technology must not undergo any change in functionality or classification.

d. The Indian subsidiary must make a declaration of end use of the reexport; agree to allow on-site inspection and either furnish a certified/approved ICP or demonstrate compliance with the parent company's ICP.

e. Post-shipment details of each transfer/consignment of exports under GAICT in a particular quarter must be made to the SCOMET division, DGFT by the end of the month following that quarter.

The GAICT would be valid for three years from issue of licence, and also subject to the earlier of the validity of the (i) licence exception for the product or the parent company abroad; or (ii) master service agreement/contract. Subsequent reexport by the parent company or its subsidiary would be subject to export control regulation of that country.

Standard operating procedures ('SOP') issued by DDP

The extant SOP dated 1 November 2018 issued by the DDP provides that for grant of approvals for intra-company

transfer of technology/software for design, development, manufacturing, training, maintenance services, upgrade and overhaul of Munitions List (Category 6 of the SCOMET List), the respective companies should be permitted to submit end-use certificates ('EUCs') signed by their parent companies. EUCs must also include their ICP and technical compliance programme, in line with the best practices recommended under the Wassenaar Arrangement. EUCs must also detail the type of services the Indian subsidiary is providing by attaching a letter of explanation regarding the outsourced work/service contract.

Open general export licences ('OGEL') issued by DDP

Most recent are the two notices issued by DDP, both dated 21 October 2019, notifying the procedure for issuance of OGELs for exports to Belgium, France, Germany, Japan South Africa, Spain, Sweden, UK, USA, Canada, Italy, Poland and Mexico ('Specified Countries') of:

1. parts and components under categories 6A003.a.;[7] 6A003.c.;[8] 6A005;[9] 6A010;[10] 6A013[11] (OGEL1); and
2. Intra Company Transfer of Technology under categories 6A021[12], 6A022[13] (OGEL2).

OGEL1 requires the applicant to:

1. Have a valid importer-exporter code.
2. Appropriate certified/approved ICP or ECP of its own or to be compliant with an ICP of its subsidiary/principal abroad to which the parts or components are to be exported.
3. An agreement to receive an on-site inspection by DDP for the auditing/verification of an ICP.
4. Compliance with post-shipment reporting, including annual report to the Export Promotion Cell of DDP of exports made against the OGEL1, giving details of all consignees, end-users, technical specification and destination countries for each consignment; and quarterly and year-end reports to DDP on all transactions under the OGEL1.
5. Declaration that the exporter has internal controls in place to prevent transfer of goods to United Nations Security Council-sanctioned countries/ entities.
6. Declaration that the end-user will allow for further checks, if necessary, by the Indian government representatives.

OGEL2 is applicable to intra-company transfer of technology to its foreign parent company and/or to subsidiaries of the foreign parent company situated in the Specified Countries subject to the items/software/ technology being exported:

1. having been imported from the country of the parent company abroad or from subsidiaries of the parent company abroad;
2. being based on a master service agreement/contract between the parent company and the Indian subsidiary for carrying out certain services (including design/encryption/ research/development/ delivery/validation/testing),

provided, the services carried out by the Indian exporter do not result in the items/software/ technology undergoing any change in functionality and classification and the exporter declares that the exported items/ software/technology will be used for the intended purposes by the parent company and/or its subsidiaries.

OGEL1 and OGEL2 ('OGELs') further provide that a comprehensive set of internal controls must be in place to ensure that the company does not export, transfer or share any items without the necessary authorisations and procedures requiring (a) proper classification and marking prior to export; (b) items are not transferred or shared with a denied party in contravention of any embargo, sanction, debarment or denied party designation maintained by any government or union of states; and (c) robust access controls to protect the items from unauthorised access.

The OGELs are valid for two years and mandate record keeping for a period of five years.

Significantly, any change in the ICP, company structure, internal process, or trade compliance team must be notified to the DDP within 15 days.

WHAT NEXT?

While the regulators are trying to ease out the processes and genuine efforts are being made to facilitate exports, the harsh reality is that it is too little, too slow, and too fragmented. Each amendment/ modification that is announced by the regulators is almost a knee-jerk reaction to the requests being filed with them. This is inevitable since one cannot foresee every possible situation. However, while the policy can be tweaked based on situations as they arise, the overall structure must be thought through, discussed and put in place. This mandates a unanimity of approach between the various licensing authorities such that there is a uniform policy governing the SCOMET List categories with respective customisations restricted to the extent necessary.

To achieve this, regulators can begin by rolling out the constituents of an ICP that would be acceptable to them. In all the recent announcements giving recognition to the ICPs maintained by companies, the requirement is that of an 'approved/certified' ICP. There is, however, no guidance on the acceptable body who will approve/ certify the ICP and which would be recognised by the regulators. Pending such guidance, businesses may not want to invest in the setting up of a detailed ICP, which the regulators may not agree with.

More importantly, businesses must be incentivised to invest in setting up detailed and effective ICPs. There must be an ease in the process and validity of the authorisations for exporters who have 'approved/certified' ICPs in place. Further, the document overload can also be reduced on the strength of such 'approved/ certified' ICPs.

There have been discussions around this in the corridors of power and the coming months may reveal the requisite guidance in this regard. Meanwhile, there is no denying the fact that India is progressing, albeit slowly, in the direction of self-management for effective enforcement of export controls.

LINKS AND NOTES

1. Nuclear material, nuclear-related other materials, equipment and technology.
2. Chemicals permitted only to states party to the Chemical Weapons Convention.
3. Chemicals permitted to be exported without prior authorisation to specified countries.
4. High explosives.
5. Aerospace systems, equipment, including production and test equipment, related technology and specially designed components and accessories therefor.
6. Munitions List
7. Ammunition and fuse setting devices as specified and specially designed components therefor.
8. Fuse setting devices specially designed for ammunitions specified by 6A003.a.
9. Fire control and related alerting and warning equipment and related systems, test and alignment and countermeasure equipment specifically designed for military use and specially designed components and accessories therefor.
10. Aircraft, lighter-than-air vehicles, UAVs, aero-engines and aircraft equipment, related equipment and components specially designed or modified for military use.
11. Armoured or protective equipment, construction and components.
12. Software, as defined.
13. Technology, as defined.

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