

Preventing OFAC Violations: Account, Party & Transaction Screening/Conflicts of Law Situations

Presented by
Hal Eren

Institutional Investor's
3rd Annual Anti-Money Laundering & Counter-Terrorist
Financing Forum

October 29-31, 2008, New York City

Account, Party & Transaction Screening

Generally, appropriate screening requires:

- knowledge of the complete universe of OFAC sanctions targets
 - names on the SDN list do not represent the complete universe of sanctions targets
 - regulatory definitions, SDN stakes of 50% or more in, control over entities qualifies such entities as sanctions targets
- sufficient (complete) accurate information/data regarding the party or transaction that is subjected to screening

- technology/software

technology/software must also know the universe of sanctions targets, and have sufficient sensitivity and other capabilities to identify sanctions targets (names, geographic areas) – fuzzy logic, all key words (names, geographic areas, citizenship (Cuba))

- human intervention and analysis, and appropriate procedures for definitive determinations regarding items that are kicked out of the screening process

Account, Party & Transaction Screening

Universe of OFAC sanctions targets:

- persons (individuals, entities, groups) on the OFAC SDN List
- persons owned or controlled by or acting for or on behalf of the foregoing
- persons in or based in Cuba, Iran, Sudan, Burma
- governments of Cuba, Iran, Sudan, Burma
- persons owned or controlled by or acting for or on behalf of the foregoing governments
- Certain Cuban citizens
- property in which sanctions targets have an interest
- round logs, rough diamonds

Persons owned or controlled by or acting for or on behalf of sanctions targets – expanding the universe of sanctions targets:

ownership – 50% or more, control presumed (bright line)
(OFAC Feb. 2008 interpretation/guidance)

such entities are blocked even though not listed in Executive orders and not put on OFAC's SDN list

control – facts and circumstances test -- can have minimal ownership but exercise control, e.g., voting and non-voting share situations

acting for or on behalf – also a facts and circumstances test

Companies that have business in or with sanctions targets

- Can a US person invest in or do business with such companies?

Assumptions:

- third country company is not an OFAC sanctions target
- predominant portion of its revenues is not from sanctions targets

- injecting capital for general purposes generally OK
- injecting capital specifically to support a transaction with a sanctions target is prohibited
- secondary market trading in securities of such companies on recognized exchanges is generally OK
- if injecting capital results in control of such company, generally cannot engage in transactions of that company involving sanctions targets – would require OFAC license to continue or wind down such business

Account, Party & Transaction Screening

- Cannot inject capital into or do business with companies who are predominantly dedicated to business with a sanctions target (e.g., Iran) or that derive the predominant portion of their revenues from sanctions targets (e.g., Iran, Sudan, Burma)
- Common (not OFAC) definition of predominant:

prevailing: most frequent or common; overriding: having superior power and influence; the most common or widespread; prevalent; the most significant or important; dominant

Account, Party & Transaction Screening

Screening Accounts/Parties/Entities – at a minimum

New accounts/customers (at outset)

Existing inventory accounts/customers (periodically or upon law change/SDN List updates)

Screening Transactions/Transaction Counterparties – at a minimum

identity of individuals, companies (owners, beneficial owners)

purpose or predominant purpose of transaction/deal, use of equity or debt financing proceeds

shares of a sanctions target

shares of an entity that does business in or with Cuba, Iran, Sudan, Burma or other sanctions targets

Account, Party & Transaction Screening

Screening Accounts/Parties:

individuals (at a minimum)

name, address, citizenship(s), passport no. (false positives)

purpose of account

authorized access/powers of attorney

Preventing access to accounts

by sanctions targets (block or restrict accounts)

refuse to act upon instructions from a sanctions target or a communication sent from Cuba, Iran, Sudan and Burma

fax header numbers

on-line access to accounts from Cuba, Iran, Sudan and Burma (growing trend)

technology to identify geographic location of access point

Issue: US persons traveling to and temporarily in Cuba, Iran, Sudan and Burma

There are exceptions

Account, Party & Transaction Screening

Screening entities (at a minimum):

- owners
- beneficial owners of entity/those who have beneficial interest in the account
 - depends on the risk, must be reasonable under the circumstances (how far do you drill down?)
 - warranted usually in obscure situations and private investment company contexts
 - public company shares trade on legitimate public exchange
 - public company owners constantly changing
 - issues: anonymity, data protection, burden
- directors, managers (identity and in certain cases citizenship) (control over the entity)
- persons with authority (control) over the account – agents, managers, powers of attorney
- omnibus accounts – covenants/undertakings/condition of business

Account, Party & Transaction Screening

OFAC screening is only as good and effective as the screen and the information subjected to screening

Prudent Practice: Obtaining representations and warranties to the effect that accountholder is not an OFAC sanctions target, that account will not be used for a sanctions target (omnibus accounts)

Account, Party & Transaction Screening

Some Challenging Issues

Bearer shares – who owns the company?

Shares held by nominees Nominee company rather than the individual is registered owner. Need to know true interest, so obtain information for both AML and OFAC purposes

Requirement to notify any change in true beneficial owners?

Account, Party & Transaction Screening

Mergers and acquisitions

Special considerations:

Screening at least of:

- entity being acquired
- its assets/accounts
- business operations

Domestic or international acquisition? Protocol varies

Account, Party & Transaction Screening

Some elements of due diligence by firms/inquiries to make in the process of screening and assessing OFAC sanctions risk:

- *Is the customer regulated by a federal functional regulator, widely known, and/or listed on an exchange?*
- *Has the firm had any previous experience with the customer or does it have prior knowledge about the customer?*
- *Is the firm facilitating a U.S. person's investment in a foreign issuer/company that conducts business in a country subject to U.S. sanctions or other sanctions target?*
- *Is the customer located in a high-risk foreign jurisdiction that is considered to be poorly regulated or in a known offshore banking or secrecy haven?*
- *Is the customer located or does it maintain accounts in countries where local privacy laws, regulations, or provisions prevent the collection of client identification or beneficial ownership information?*

OFAC Guidance:

Notwithstanding the strict liability nature of OFAC's regulations, OFAC examines the functions that securities and futures firms perform and their relative use of customer information in order to determine their overall liability in the context of enforcement cases.

Every firm is encouraged to develop risk-based policies and procedures that properly monitor and mitigate sanctions risk; in fact, the development and implementation of a robust, risk-based OFAC compliance program often serves as a substantial mitigating factor in the event that an OFAC violation has occurred.

Account, Party & Transaction Screening

OFAC Risk Factors

OFAC risk and OFAC responsibility informs determinations regarding the level and intensity of due diligence for OFAC compliance. Some of these factors are:

the **location of the investment**

the **identity of transaction counterparties**

the **size and type of customer base**

Account, Party & Transaction Screening

the purpose for dealings with transaction counterparties

the U.S. firm's level of ownership in and/or control over the investment

,
the identity of the owners of the investment other than U.S. persons

the identity of the persons who control the entity or asset the U.S. firm will invest in

the investment's or the asset's involvement in international trade/finance, *e.g.*, exports from and imports into the United States, international transactions, international flights

Conflicts of Law Situations

OFAC's assertion of jurisdiction is not always easy to predict

Generally, US jurisdiction outside the United States includes US citizens, US permanent residents, and branches of US banks and other US companies, and, in the case of the Cuban embargo, foreign subsidiaries of US companies

Conflicts of Law Situations

The extra-territorial application of OFAC laws and regulations

The obligation of US banks operating outside the United States to, for example, block sanctions target property often conflicts with local laws

no such corresponding law – leading to lawsuits – liability for US banks

local laws to counteract extra-territorial application of OFAC laws and regulations, e.g., Canadian, UK, EU anti-blocking statutes which forbid their nationals from complying with OFAC regulations, orders (Cuba)

Conflicts of Law Situations

Resolving conflicts or potential conflicts

OFAC license to engage in otherwise prohibited transactions, reasons for licensing:

- no defense, liability for US banks
- unintended consequences
- comity
- de minimis (acquisition of accounts contexts - banks, insurance, portfolios)
- hyper technical application of law

Recusal from transactions – US managing director of a European company doing business with Iran

Abstain from and forego relevant transactions based on internal corporate policy – not OFAC obligation/requirement

Questions, More Information

For more information or questions, please contact:

Hal Eren

☎ + 1 202 429 9883

Washington, DC

hal.eren@erenlaw.com

Steven Pinter

☎ + 1 202 429 1881

Washington, DC

steven.pinter@erenlaw.com