

## OFAC Issues Interim Final Rule Extending Reporting Requirements for Rejected Transactions to Companies Outside the Financial Services Sector: Comment Period Expires July 22, 2019

July 19, 2019

### Key Points

- On June 21, 2019, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) issued and put into effect an Interim Final Rule (Interim Rule) that requires all U.S. persons and persons subject to U.S. jurisdiction (not only financial institutions) to report to OFAC any transactions (not only funds transfers) "rejected" for U.S. sanctions-related reasons.
- While this Interim Rule expands both the group of persons as well as the range of rejected transactions subject to reporting, it remains to be seen how OFAC may interpret and apply the provision in practice, and to what extent OFAC may issue clarifying guidance on limitations, if any, of the actual scope of reporting obligations applicable under the Interim Rule.
- OFAC has provided an opportunity for and encouraged interested parties to comment on the Interim Rule and specifically asked "[w]hether this collection of information is necessary for the proper performance of the functions of the agency, including whether the information has practical utility." Given the potential compliance burdens that could result from the new reporting provisions, companies should consider submitting comments to OFAC, either individually or as part of an industry coalition, by the July 22, 2019 deadline.

### Overview of Changes to "Rejected Transaction" Reporting Requirements

The Interim Rule, which became effective on June 21, 2019, amends OFAC's Reporting Procedures and Penalties Regulations (RPPR) in several ways,<sup>1</sup> notably, with respect to reporting of rejected transactions:

#### Old "Rejected Transaction" Reporting Requirement

1. Applied to financial institutions

#### New "Rejected Transaction" Reporting Requirement under Interim Final Rule

1. Applies generally to **all U.S. persons**, as well as **persons subject to U.S. jurisdiction** (e.g., subsidiaries of U.S.

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| <p>2. Applied only to rejected <b>funds</b> transfers</p> <p>3. Content of report to include details of underlying transaction</p> | <p>companies in the case of the Iran and Cuba sanctions programs)</p> <p>2. Applies to <b>any rejected “transaction”</b> which is non-exhaustively defined as including transactions “related to wire transfers, trade finance, securities, checks, foreign exchange, and <b>goods or services</b>” (emphasis added)<sup>2</sup></p> <p>3. Content of report to include details of underlying transaction <b>as well as supporting documentation</b> (e.g., related payment or transfer instructions)<sup>3</sup></p> |
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## Overview of Changes to “Blocked Property” Reporting Requirements

OFAC has long distinguished between “blocked” and “rejected” transactions.<sup>4</sup> Blocked transactions are those that involve blocked property or a blocked property interest. Typically, blocked property involves transactions with individuals or entities on OFAC’s Specially Designated Nationals (SDN) list. As has previously been the case, U.S. sanctions would require a U.S. company that receives funds from an SDN to *block* such funds by placing them into a blocked interest-bearing account and to report the blocked property to OFAC, pursuant to a separate provision of the regulations.<sup>5</sup> Among other changes to the existing regulations provided in the Interim Rule, initial and annual blocked property reporting now require more detailed information. Specifically, initial blocked property reports now require a copy of transfer instructions or other relevant documentation, and annual reports must now include a disaggregated list showing each blocked asset held, even if all blocked assets are contained within an omnibus account.<sup>6</sup> In other cases, however, an underlying transaction may not involve any blocked property or blocked property interest, but is still prohibited under a U.S. sanctions program. In these cases, the transaction must be rejected, or not processed.

## Scope of Rejected Transaction Reporting Obligations Under the Interim Rule

Since its publication, there has been discussion within the interested U.S. business community regarding the scope of and limitations on the rejected transaction reporting requirements under the Interim Rule. For instance, as indicated on the amended form of Report on Rejected Transaction published with the Interim Rule, a U.S. company (or other entity subject to U.S. jurisdiction) that rejects a transaction with persons designated under the Sectoral Sanctions Identifications (SSI) List—a list which does not trigger any blocking requirements—must now report this rejected transaction to OFAC within 10 business days, as well.

An important question that has been raised by interested companies is whether the Interim Rule also extends the rejected transaction reporting requirement to solicitations, proposals or discussions regarding *potential* business transactions. For example, if an employee of a U.S. company proposes a sale to Iran and the company’s compliance department provides guidance that clarifies that the transaction cannot be entered into because it would violate sanctions, consistent with the company’s compliance policy and/or practices, it is unclear whether this could be viewed as a “rejected transaction” under the OFAC reporting requirement.

In OFAC FAQ 42, published in 2005, the agency states: “You might think of the analogy of a bouncing ball. Once the ball starts moving, you must stop it if it comes into your possession.”<sup>7</sup> In other words, one must still first conclude there is an actual “transaction” (i.e., a moving ball) and only then can the “transaction” be rejected and therefore subject to the reporting requirement. Accordingly, a balanced and reasonable reading of the Interim Rule and current OFAC guidance would be that the determination to **decline to enter into a transaction** in order comply with U.S. sanctions would not, by itself, amount to a “rejected transaction” because no “transaction” had yet occurred—at that point, there is only an inquiry. OFAC FAQ 53, published in 2015, supports this reading: “If...a customer simply asks “Can I send money to Cuba?” there is no blockable interest in the inquiry and the bank can answer the question or direct the customer to OFAC. The same logic applies to cases where the transaction would be required to be rejected under OFAC regulations. There is not technically a “reject” item until the bank receives instructions from its customer to debit its account and send the funds.”<sup>8</sup> In other words, where a person has only received a proposal or request (and not instructions under a pre-existing contractual arrangement), existing guidance indicates that there is no “transaction” to reject.

Importantly, OFAC used the term “transaction” in the Interim Rule rather than “activities” or “dealings”, which are terms that OFAC has used in other contexts to describe broader ranges of actions. Consistent with its use of the term “transaction”, and the guidance in OFAC’s published FAQs, this can be understood to indicate something akin to a contract (with an offer, acceptance, and consideration), while an “activity” or “dealing” might be interpreted to include merely an offer or inquiry.

## **Opportunity for Comments**

The practical application of the Interim Rule raises issues, among others, regarding the proper scope of the actual reporting obligations, the compliance burden it imposes on affected companies, questions of confidentiality and privilege, and questions regarding the scale of the administrative burden it will create for OFAC. Unless OFAC issues an amended Final Rule, or until OFAC publishes limiting or clarifying guidance, U.S. companies are advised to ensure that they have appropriate procedures and mechanisms in place to become compliant with the language of the Interim Rule.

The deadline to submit comments on the Interim Rule is July 22, 2019. OFAC specifically asked interested parties to comment on “[w]hether this collection of information [under the Interim Rule] is necessary for the proper performance of the functions of the agency, including whether the information has practical utility.”

Please do not hesitate to contact Akin Gump if you have any questions on this matter.

<sup>1</sup> In addition to the changes regarding blocked property and rejected transaction reports, the Interim Rule also explicitly explains the application of FOIA to such reports, and also amends certain technical provisions relating to specific licenses.

<sup>2</sup> Under the Interim Rule, “[a]ny U.S. person (or person subject to U.S. jurisdiction), including a financial institution, that rejects a transaction that is not blocked under the provisions of this chapter, but where processing or engaging in the transaction would nonetheless violate a provision contained in this chapter, shall submit a report to the Office of Foreign Assets Control (OFAC).” 31 CFR 501.604(a)(1).

<sup>3</sup> Reports for rejected transactions are due to OFAC “within 10 business days of the rejected transaction.” Under the Interim Rule, the reports for “rejected transactions” must include, among other information, (1) a description of the rejected transaction, and any persons, including financial institutions, participating in the transaction and their respective locations; (2) the associated sanctions target(s) whose involvement in the transaction has resulted in the transaction being rejected (and, “if known, and, if not evident,” a narrative

description of the interest(s) of the target(s) in the transaction)” (3) the legal authority under which the transaction was rejected; and (4) a copy of any related payment or transfer instructions, check, letter of credit, accompanying bill of lading, invoice, or any other relevant documentation received in connection with the transaction. Such reports can be emailed to OFAC or sent via postal mail, pursuant to 31 CFR 501.604(d).

4 OFAC Sanctions Compliance FAQ #36 (1/15/2015).

5 31 CFR 501.603.

6 31 CFR 501.603.

7 See OFAC FAQ 42 (4/6/2005).

8 See OFAC FAQ 53 (1/15/2015).

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