OFAC ASSET BLOCKING PROGRAMS

“Economic sanctions are powerful foreign policy tools. Their success requires the active participation and support of every financial institution. . . . Definite expectations exist with regard to the processing of transactions involving countries under sanctions.”


By Edward L. Rubinoff & Tamer A. Soliman*

Since 1995, the principal method by which the United States has sought to deny financial resources to terrorist organizations, and those who sponsor them or act on their behalf, has been the imposition of “asset-blocking” orders and related economic sanctions.1 While the application of these economic sanctions to non-state organizations is a relatively new development, the U.S. has for decades imposed asset freezes and associated economic sanctions against hostile regimes, and persons and entities deemed to be fronts for those regimes, on the basis of U.S.

foreign policy and national security interests. However, the events of September 11 significantly raised the public profile within the financial community of the role of financing in enabling terrorist activity, and of the increased priority that the U.S. law enforcement community has assigned to detecting and preventing the flow of funds to terrorist organizations and other targets of U.S. sanctions laws.

The agency with primary responsibility for administering and enforcing U.S. economic sanctions laws, the Treasury Department’s Office of Foreign Assets Control (“OFAC”), has made it clear that it expects financial institutions to take on the significant responsibility of monitoring and screening financial transactions for connections to countries, entities and persons that are the targets of its sanctions programs. In the financial war against terrorism, financial institutions have become the “front line” of defense, and accordingly, they must be acutely aware of

1. The implementing regulations for the individual sanctions programs are located at 31 C.F.R. Part V (2003). See infra, note 2 and accompanying text.

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both the compliance burdens and potential penalties associated with this role.

As this suggests, the need for an effective internal compliance program ("ICP") to avoid violations of the sanctions laws and regulations has increased exponentially in recent years. This article provides an overview of the OFAC asset-blocking regime and sets forth general principles that should be observed by financial institutions when constructing an ICP.

**OFAC AND THE JURISDICTIONAL REACH OF U.S. SANCTIONS**

OFAC, an agency of the U.S. Department of Treasury, administers comprehensive trade and economic sanctions against Cuba, Iran, Libya, and Sudan. In addition, OFAC also maintains sanctions against certain persons and entities designated as fronts for these countries or on the basis of involvement with activities of significant foreign policy or national security concern, such as terrorism, narcotics trafficking, or national or destabilization efforts. These sanctions regimes were imposed pursuant to the authority of wartime and national emergency powers of the President. As this suggests, OFAC’s discretion in implementing U.S. sanctions imposed against countries and persons deemed to be threats to U.S. national security is considerable. Because each sanctions program is based on specific foreign policy and national security considera-

3. OFAC has designated SDNs under each of the country-based comprehensive sanctions programs listed in note 2, infra, and continues to maintain sanctions against persons and entities designated under the comprehensive program formerly in place against Iraq. OFAC also maintains regulations to implement sanctions targeted at other persons and entities designated as SDNs. See, e.g., Narcotics Trafficking Sanctions Regulations (Specially Designated Narcotics Traffickers or SDNTs), 31 C.F.R. Part 536 (2003); Western Balkans Stabilization Regulations, 31 C.F.R. Part 588 (2003); and Global Terrorism Sanctions Regulations, 31 C.F.R. Part 594.


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tions and objectives, which may shift over time, each program is unique.\textsuperscript{5}

Although OFAC is not a regulator of banks or other financial institutions, it works closely with federal regulators in ensuring that financial institutions comply with U.S. sanctions laws. In particular, the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration are all charged with examining a financial institution’s compliance with these laws.

OFAC’s jurisdiction extends to U.S. citizens and permanent residents, U.S. companies and their foreign branch offices, and under some sanctions programs, to foreign subsidiaries of U.S. companies. As this suggests, all U.S. financial institutions (including banks, credit unions, broker/dealers, depository institutions and other members of the financial community) are required to comply with these laws, regardless of the size of the institution or the level of its exposure to international transactions.

**Asset Blocking Under OFAC Sanctions Regulations**

OFAC’s sanctions programs fall into two broad categories: asset freezing or blocking programs, and trade and commercial embargoes. Asset freezes prohibit transfers of assets of the target country, entity or person that are subject to U.S. jurisdiction, or in the possession or control of U.S. persons.\textsuperscript{6} Frozen assets cannot be paid out, withdrawn, set off, or transferred in any manner without an OFAC license. Asset-blocking programs may also impose related financial sanctions, such as prohibitions on bank lending. Separately, OFAC may also impose broader trade and commercial embargoes that prohibit export and import transactions and the provision of any goods or services or the performance of any contracts involving the target of a sanctions program. Some or all of these options may be combined to effect a comprehensive sanctions program.

Asset blocks are intended to prevent the use of funds and property in which a sanctions target has an interest, thereby hindering the ability of these persons and entities to engage in objectionable actions or to support objectionable policies.\textsuperscript{7} Designations of persons whose U.S. assets are blocked are based on a review process that involves a number of agencies, including the Departments of Treasury, State, Justice, the FBI and the intelligence community.\textsuperscript{8} The final determination on designation is forwarded for decision to the National Security Council, upon whose recommendation the Secretary of Treasury issues a designation and blocking order to be implemented by OFAC.\textsuperscript{9}

Unlike asset seizure and forfeiture, asset blocking does not generally involve the transfer of legal interest in blocked property. In other words, without further legal process, the legal interest in blocked property remains with the person who holds that interest at the time of blocking, such as a bank that maintains an account for a designated person. OFAC has authority to license, on a case-by-case basis, release of some or all of the funds in a blocked account.\textsuperscript{10} For example, an undesignated person who holds a joint interest in an account with a designated person may apply to have a proportional share of the funds released. Moreover, OFAC has an established practice for reconsideration of designations and, where appropriate, removal of designated persons (individuals or entities) from the lists under its various designation programs.\textsuperscript{11} Under this procedure, a person may seek

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\textsuperscript{5} See e.g., the Sudanese Sanctions Regulations, 31 C.F.R. Part 538, which explicitly provide that “[d]iffering foreign policy and national security contexts may result in differing interpretations of similar language among [the various OFAC sanctions programs].” Id. at § 538.101(a) (2003). As this language indicates, OFAC has broad discretion to interpret the sanctions regulations based upon domestic and international political developments impacting the U.S. policy towards the target of a sanctions program.

\textsuperscript{6} See, e.g., 31 C.F.R. § 515.201 (2003), imposing an asset freeze on all property subject to U.S. jurisdiction in which Cuba or its nationals have any interest.

\textsuperscript{7} As a general matter, the regulations define the terms “property” and “interest” extremely broadly to include money, checks, drafts, bullion, bank deposits, chattels, deeds of trust, real estate and any interest therein, accounts payable, judgments, patents, trademarks or copyrights, annuities, pooling arrangements, contracts of any nature whatsoever, “and any other property, real, personal or mixed, tangible or intangible, or interest or interests therein, present, future or contingent.” See, e.g. 31 C.F.R. § 550.314 (2003) (Libya).


\textsuperscript{9} Id.


\textsuperscript{11} Id. at § 501.807.
Removals are typically based on mistaken identity or a change in the circumstances that resulted in the designation, and typically involve a detailed exchange of information between the party petitioning for removal and OFAC, in consultation with other agencies.13

**ASSET BLOCKING V. REJECTING TRANSACTIONS**

As indicated above, each sanctions regime may consist of one or more types of economic sanctions, depending on the particular foreign policy and national security objectives. Financial institutions should be aware of a basic distinction between programs that require blocking and programs that require rejection of financial transactions. While most programs entail asset blocking, some programs, such as the Iranian Transactions Regulations, require only rejection of transactions involving the target country or person.14

Under a blocking program (i.e., a program that imposes an asset freeze on any property or property interest of the sanctions target), a financial institution is required to accept funds that come into its possession and place them in a “blocked” or “frozen” interest-bearing account so that these funds cannot be withdrawn or otherwise transferred.15 Banks are required to report all blockings to OFAC within 10 days of each occurrence.16 In contrast, a program may simply prohibit certain transactions without imposing an asset block. Under those situations, a bank is required to “reject” a transfer or other transaction, and return the funds to the sending institution.17

**SCREENING TRANSACTIONS**

OFAC maintains a list, known as the master list of “Specially Designated Nationals,” or SDNs, of persons and entities designated as fronts for embargoed countries or on the basis of ties to terrorist or narcotics trafficking organizations.18 These persons and entities must be treated as targets of OFAC’s sanctions programs and their assets blocked according to the rules of the relevant sanctions program under which they were designated.19 The SDN list is updated regularly and includes aliases and other identifying information.20

As a practical matter, because penalties for violations of the sanctions laws may be imposed on a strict liability basis, the sanctions laws effectively require financial institutions to screen and monitor all financial transactions they perform in order to detect those involving embargoed countries, persons or entities. The banking industry has developed special software to “interdict” illicit funds transfers. Interdiction software may be developed by in-house computer programmers or purchased from a variety of commercial vendors. In general, the software allows the computer to scan customer, transaction, or contract databases for names and locations that could point to a possible contact with a sanctioned country, transaction, or SDN. More sophisticated programs also check for misspelled names that may be SDNs or sanctioned country locations and can filter out search terms that consistently provide false “red flags.” As an additional benefit, OFAC SDN changes can now be electronically integrated into an interdiction system via “delimited” and “fixed file” formats, rather than being entered manually into these programs.

**REPORTING AND RECORDKEEPING OBLIGATIONS**

OFAC imposes certain reporting and recordkeeping obligations in connection with its economic sanctions programs.21 First, every person engaging in a transaction that is subject to OFAC sanctions regulations, including any financial institution that blocks or rejects a transaction, must maintain a “full and accurate record” of each such transaction for five years.22 OFAC may require submission on demand of any books of account, contracts, letters or other papers connected with such transactions and subject to the custody or control of the party receiving the request.23 Moreover, whenever a financial institution blocks or rejects a prohibited transaction, it must report its action to OFAC within 10 days, including a

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12. Id. See also, Designation Fact Sheet, supra note 7.
13. Id.
15. 31 C.F.R. §§ 500.205(a) - (b).
16. See text accompanying notes 17 - 21 infra.
17. Id.
18. The list is available at OFAC’s web site at <http://www.treas.gov/ofac>.
19. See infra note 3.
20. See supra note 17.
22. Id. at § 501.601.
23. Id. at § 501.602.
description of the action and copies of any relevant documenta-

tion.\textsuperscript{24} Finally, any institution that blocks and
holds blocked property must file with OFAC an annual
report of blocked property held as of June 30 by Septem-
ber 30 of each year.\textsuperscript{25}

\section*{WHAT IS AN ICP AND WHY IS IT NECESSARY?}

An ICP is a set of formalized policies and procedures
developed on an institution-specific basis to detect and
prevent violations of applicable regulatory regimes, in this
case the U.S. sanctions laws. Given the broad scope of the
OFAC sanctions programs, financial institutions serve as
a priority target for OFAC enforcement efforts. Even
small, regional banks may find themselves at great risk for
OFAC violations, as their customers often lack a sophisti-
cated understanding of OFAC regulations, increasing the
possibility that they will submit prohibited transactions
for financing.

OFAC’s regulations do not require financial institutions
or other types of businesses to establish an ICP to prevent
sanctions violations. However, failure to develop an ICP
can lead to severe consequences. Depending on the sanc-
tions regime, maximum civil penalties for violations of the
sanctions laws range from $11,000 up to $1,000,000 per
violation, while maximum criminal penalties range from
10 to 30 years imprisonment and from $250,000 to
$10,000,000 in fines. Moreover, even well-meaning com-
panies can face substantial fines, since OFAC penalties
can be imposed for inadvertent violations.

\section*{SPECIAL CONSIDERATIONS
FOR FINANCIAL INSTITUTIONS}

Given the large number of transactions processed by finan-
cial institutions on a daily basis, an ICP is a particularly
fundamental requirement for any financial institution.

General prohibitions on “facilitation” under the sanc-
tions laws prohibit U.S. financial institutions from facili-
tating financing of any transaction with a sanctioned
country or SDN. Accordingly, even if the financial institu-
tion does not come into control of property or funds that
may be blocked or rejected, it cannot enter into an agree-
ment to provide financing in a transaction in which a
sanctioned country or person has any interest. As this sug-
gests, financial institution ICPs must provide comprehen-
sive procedures to detect potential OFAC violations in vir-
tually all transactions before they are processed and
executed.

Letter of Credit (“LOC”) and wire transactions pose
significant OFAC risks for financial institutions, since
these transactions are often used for international transac-
tions and involve multiple parties, each of whom may be
an SDN or connected with a sanctioned country. An ICP
should require an examination of every LOC or wire
transfer for possible SDN or sanctioned country connec-
tions. In the case of LOCs, the issuing, confirming, or
advising banks should be checked against the SDN list
and for sanctioned country connections. The underlying
LOC transaction and the LOC documents should also be
examined for evidence of potential OFAC issues, and the
shipper listed on the bill of lading must be checked against
OFAC’s list of prohibited vessels. For wire transfers, the
ICP should direct the wire transfer department to check
the intermediary bank and the bank of the beneficiary
against the SDN list and report any evidence that the
underlying transaction may be prohibited by OFAC.
Again, the use of interdiction software is preferred.

\section*{CONCLUSION}

An OFAC ICP is an important tool for any business in an
era of increasing globalization and heightened sensitivity
to terrorism-related economic sanctions issues. For finan-
cial institutions, however, it is critical to ensuring compli-
ance with asset blocks and associated economic sanctions.
A well-designed ICP can prevent OFAC violations from
occurring and mitigate the consequences of those viola-
tions that do occur. While there is no standard blueprint
for an ICP, certain principles and elements can be adapted
to a firm’s size, structure, culture, and business type to
produce an ICP that is both efficient and effective.

\textsuperscript{24} Id. at §§ 501.603 - 04.
\textsuperscript{25} Id. at § 501.604.