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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."

— U.S. Treasury Department, Office of Foreign Assets Control,
Foreign Assets Control Regulations for the Financial Industry (2003)

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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IN THIS ISSUE
- ***OFAC Asset Blocking Programs***

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.[2] 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.[3] These sanctions regimes were imposed pursuant to the authority of wartime and national emergency powers of the President.[4] 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-

2. *See* Cuban Assets Control Regulations (CACR), 31 C.F.R. Part 515 (2003); Iranian Transactions Regulations (ITR), 31 C.F.R. Part 560 (2003); Libyan Sanctions Regulations (LSR), 31 C.F.R. Part 550 (2003); and Sudanese Sanctions Regulations (SSR), 31 C.F.R. Part 538 (2003).
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.
4. OFAC is responsible for enforcing sanctions under the following statutes: Trading with the Enemy Act of 1917 (TWEA), 50 U.S.C. App. §§ 1-44 (2002); International Emergency Economic Powers Act (IEEPA), 50 U.S.C. §§ 1701-06 (2001); Iraq Sanctions Act of 1990 (ISA), 104 Stat. §§ 2047-55; United Nations Participation Act (UNPA), 22 U.S.C. § 287c (2001); International Security and Development Cooperation Act (ISDCA), 22 U.S.C. § 2349 aa-9 (2001); Cuban Democracy Act, 22 U.S.C. §§ 6001-10 (2001); Cuban Liberty and Democratic Solidarity (LIBERTAD) Act, 22 U.S.C. §§ 6021-91 (2001); and Antiterrorism and Effective Death Penalty Act (AEDPA), enacting 8 U.S.C. § 219, 18 U.S.C. §§ 2332d and 2339b (2001).

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tions and objectives, which may shift over time, each program is unique.[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.[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.[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.[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.[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.[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.[11] Under this procedure, a person may seek

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.
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.
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).
8. *See* U.S. Department of State, Office of Counterterrorism, *The United States Terrorist Assets Designation Process Background Sheet* (February 28, 2002) (*hereinafter "Designation Fact Sheet"*), available at <http://www.state.gov/s/ct/rls/fs/2002/8565.htm >.
9. *Id.*
10. *See* 31 C.F.R. § 501.806 (2003).
11. *Id.* at § 501.807.

administrative reconsideration of the designation.[12] 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

12. *Id. See also*, *Designation Fact Sheet*, supra note 7.
13. *Id.*
14. 31 C.F.R. Part 560 (2002).
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.
21. 31 C.F.R. Part 501, Subpart C (2003).
22. *Id.* at § 501.601.
23. *Id.* at § 501.602.

description of the action and copies of any relevant documentation.[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 September 30 of each year.[25]

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 sophisticated 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 sanctions 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 companies can face substantial fines, since OFAC penalties can be imposed for inadvertent violations.

SPECIAL CONSIDERATIONS FOR FINANCIAL INSTITUTIONS

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

General prohibitions on "facilitation" under the sanctions laws prohibit U.S. financial institutions from facilitating financing of any transaction with a sanctioned country or SDN. Accordingly, even if the financial institution does not come into control of property or funds that may be blocked or rejected, it cannot enter into an agreement to provide financing in a transaction in which a sanctioned country or person has any interest. As this suggests, financial institution ICPs must provide comprehensive procedures to detect potential OFAC violations in virtually 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 transactions 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 connections. 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.

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 financial institutions, however, it is critical to ensuring compliance with asset blocks and associated economic sanctions. A well-designed ICP can prevent OFAC violations from occurring and mitigate the consequences of those violations 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. ■

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24. *Id.* at §§ 501.603 - 04.
25. *Id.* at § 501.604.