U.S. Economic Sanctions & the Investment Industry

Investment Company Institute
Washington, D.C.
27 September 2012
Agenda

• OFAC Overview

• Risk factors in the investment sector

• Activities that could implicate sanctions

• Enforcement

• Compliance best practices
Who is OFAC?

Office of Foreign Assets Control (OFAC)
U.S. Department of the Treasury

OFAC administers and enforces economic and trade sanctions against targeted:

• Foreign governments
• Individuals
• Entities
• Activities
Jurisdiction

**Individuals**
- U.S. citizens and permanent resident aliens located anywhere in the world
- Individuals, regardless of citizenship, physically located in the United States

**Corporations**
- Organized under U.S. law, including foreign branches of U.S. companies
- Physically located in the U.S., including U.S. branches, agencies and representative offices of foreign corporations

OFAC operates under a principle of strict liability!
Comprehensive Programs
Cuba, Iran, Sudan, Syria

Limited Programs
Burma (Myanmar), Diamond Trading, North Korea

List-Based Programs
(Activity): Anti-Terrorism, Non-Proliferation, Counter Narcotics Trafficking, Transnational Criminal Organizations

(Regime): Balkans, Belarus, Cote D’Ivoire, Democratic Republic of the Congo, Former Liberian Regime of Charles Taylor, Iraq, Somalia, Lebanon, Libya, Syria, Zimbabwe
Risk Factors in the Investment Industry

- Conducting a risk assessment is crucial
- Evaluate your institution’s risk level and identify specific high risk areas
- Factors include:
  - Customer base
  - Size and location of the firm
  - Line of business
  - Involvement in areas with ties to sanctioned countries
  - Products & services offered
  - Agents/affiliates/intermediaries
Risk Assessment

Customer Risk  
+  
Product Risk  
+  
Demographic Risk  
-  
Compliance Controls  
=  
Risk Level
Examples

• Custodizing securities issued by a company owned by an SDN or located in a sanctioned country
• Omnibus account with securities beneficially owned by a person in a sanctioned country
• Managing a fund in which a blocked person is invested
• Examples (cont.)
  – Investing in a 3rd country fund that invests or otherwise deals exclusively in a sanctioned jurisdiction
  
  – Facilitating (financing, approving, etc) activity carried out by foreign persons if such activity would be prohibited by the U.S. person
Non-U.S. persons should also assess the risks of engaging in certain transactions and other activity that do not involve the United States.

Why?

Because such transactions may trigger U.S. sanctions against the non-U.S. person if the transaction is targeted by such programs as:

- Comprehensive Iran Sanctions and Divestment Act (CISADA);
- National Defense Authorization Act (NDAA); E.O. 13622;
- E.O. 13608 - Foreign Sanctions Evaders Executive Order.
I. Opening an Investigation

II. Gathering Information

III. Economic Sanctions Enforcement Guidelines

IV. Civil Penalties & Settlements
What triggers an OFAC Investigation?

- Reports of Blocked or Rejected Property
- Voluntary Self-Disclosures
- Ongoing / Existing Cases
- Referrals from Other Agencies
- Other publicly available information
- Informants
Information Gathering

- If OFAC determines that additional information regarding an apparent violation is needed, it may request further information from the Subject Person or third parties, including through an administrative subpoena issued pursuant to 31 CFR 501.602.

- **31 C.F.R. § 501.602** Every person is required to furnish under oath ... At any time as may be required ... complete information relative to any transaction ... subject to the provisions of this chapter or relative to any property in which any foreign country or any national thereof has any interest of any nature whatsoever, direct or indirect.
• 31 C.F.R. part 501, App. A
  – 74 Fed. Reg. 57,593 (Nov. 9, 2009)
    • with agency comments
  – www.treasury.gov/ofac

• Set forth General Factors that OFAC will consider in determining the appropriate administrative action in response to an apparent violation.
  – In addition to the required information set forth on Administrative Subpoenas, recipients are directed to the Guidelines, and invited to submit such additional information or evidence that may be deemed relevant to OFAC’s consideration of an apparent violation.
General Factor A: Willfulness or Recklessness

1. **Willfulness.** Did the Subject Person know that the underlying conduct constituted, or likely constituted, a violation of U.S. law at the time of the conduct?

2. **Recklessness.** Did the Subject Person demonstrate reckless disregard for U.S. sanctions requirements or otherwise fail to exercise a minimal degree of caution or care in avoiding conduct that led to the apparent violation?

3. **Concealment.** Was there an effort by the Subject Person to hide or purposely obfuscate its conduct in order to mislead OFAC, Federal, State, or foreign regulators, or other parties involved in the conduct about an apparent violation?

4. **Pattern of Conduct.** Did the apparent violation constitute or result from a pattern or practice of conduct or was it relatively isolated and atypical in nature?

5. **Prior Notice.** Was the Subject Person on notice, or should it reasonably have been on notice, that the conduct at issue, or similar conduct, constituted a violation of U.S. law?

6. **Management Involvement.** In cases of entities, at what level within the organization did the willful or reckless conduct occur? Were supervisory or managerial level staff aware, or should they reasonably have been aware, of the willful or reckless conduct?
General Factor B: Awareness of Conduct

1. **Actual Knowledge.** Did the Subject Person have actual knowledge that the conduct giving rise to an apparent violation took place?

2. **Reason to Know.** If the Subject Person did not have actual knowledge that the conduct took place, did the Subject Person have reason to know, or should the Subject Person reasonably have known, based on all readily available information and with the exercise of reasonable due diligence, that the conduct would or might take place?

3. **Management Involvement.** In the case of an entity, was the conduct undertaken with the explicit or implicit knowledge of senior management, or was the conduct undertaken by personnel outside the knowledge of senior management?
General Factors A & B: 
Willfulness/Awareness

US Investment Manager (“USIM”) manages a third-country investment fund (the “Fund”). Pursuant to a Management Agreement between USIM and the Fund, USIM has the authority to act as the Fund’s manager, investing and re-investing cash, securities and other property comprising the assets of the Fund. USIM contracts with its third-country subsidiary, USIM Overseas through an Investment Advisory Agreement, pursuant to which USIM Overseas provides investment advice and recommendations to USIM relating to the Fund, in return for a fee. The Investment Advisory Agreement authorizes USIM Overseas to carry out transactions as an agent of USIM in accordance with the investment policies and strategies adopted from time to time by the Fund. In 2007, pursuant to this delegated authority, USIM Overseas purchased approximately $3 million of shares for the Fund in a Cayman Islands company that invests exclusively in Iranian securities.
General Factor C: Harm to Sanctions

1. **Economic or Other Benefit to the Sanctioned Individual, Entity, or Country.** “...including the number, size, and impact of the transactions constituting an apparent violation(s), the length of time over which they occurred, and the nature of the economic or other benefit conferred.”

2. **Implications for U.S. Policy.** The effect that the circumstances of the apparent violation had on the integrity of the U.S. sanctions program and the related policy objectives involved.

3. **License Eligibility.** Whether the conduct constituting the apparent violation likely would have been licensed by OFAC under existing licensing policy.

4. **Humanitarian activity.** Whether the conduct at issue was in support of a humanitarian activity.
1. **Commercial Sophistication.** The commercial sophistication and experience of the Subject Person.

2. **Size of Operations and Financial Condition.** The size of a Subject Person’s business operations and overall financial condition, where such information is available and relevant.

3. **Volume of Transactions.** The total volume of transactions undertaken by the Subject Person on an annual basis, with attention given to the apparent violations as compared with the total volume.

4. **Sanctions History.** The Subject Person’s sanctions history, including OFAC’s issuance of prior penalties, findings of violations or cautionary, warning or evaluative letters, or other administrative actions (including settlements).
• OFAC will consult with a subject person’s regulator where OFAC has entered into an applicable Memorandum of Understanding.

• Even in the absence of an MOU, OFAC may seek relevant information from the institution’s regulator.

• Did the Subject Person discover necessary information to ascertain the causes and extent of the apparent violation, fully and expeditiously? Was senior management fully informed? If so, when?
General Factor G: Cooperation

Voluntary Self-Disclosure?
Provide all relevant information?
Promptly?
Voluntarily or in response to a subpoena?
Lookback?
Tolling Agreement?

In cases involving substantial cooperation with OFAC but no voluntary self-disclosure as defined herein, including cases in which an apparent violation is reported to OFAC by a third party but the Subject Person provides substantial additional information regarding the apparent violation and/or other related violations, the base penalty amount generally will be reduced between 25 and 40 percent. Substantial cooperation in cases involving voluntary self-disclosure may also be considered as a further mitigating factor.
General Factor H: Timing of Apparent Violation

General Factor I: Other Enforcement Action

General Factor J: Future Compliance/Deterrence Effect

General Factor K: Other Relevant Factors
Civil Penalties & Settlements: Statutory Maximum

Trading With the Enemy Act
$65,000

International Emergency Economic Powers Act
the greater of $250,000 or twice the value of the violation

Foreign Narcotics Kingpin Designation Act
$1,075,000

Anti-Terrorism and Effective Death Penalty Act
$55,000
Civil Penalties: Egregiousness

• In those cases in which a civil monetary penalty is deemed appropriate, OFAC will make a determination as to whether a case is deemed “egregious” for purposes of the base penalty calculation.

• OFAC generally will give substantial weight to General Factors A (“willful or reckless violation of law”), B (“awareness of conduct at issue”), C (“harm to sanctions program objectives”) and D (“individual characteristics”), with particular emphasis on General Factors A and B.

• The large majority of enforcement cases will fall in the non-egregious category.
Civil Penalties:
Voluntary Self-Disclosure

- Self-initiated & Prior to or at the same time that OFAC, or any other federal, state, or local government agency or official, discovers the apparent violation or another substantially similar apparent violation

- Will be considered in determining the appropriate agency response to the apparent violation, e.g. cautionary letter vs. civil penalty

- If a civil monetary penalty is deemed appropriate, a voluntary self-disclosure will lead to a base penalty amount at least 50% less than the base penalty amount in similar cases.
Civil Penalties:
Base Penalty

**Egregious Case**

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<th>Voluntary Self-Disclosure</th>
<th>Egregious Case</th>
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<tbody>
<tr>
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<td>No</td>
</tr>
<tr>
<td><strong>1</strong></td>
<td><strong>2</strong></td>
</tr>
<tr>
<td>One-Half of Transaction Value</td>
<td>Applicable Schedule Amount</td>
</tr>
<tr>
<td>Capped at $125,000 per violation</td>
<td>Capped at $250,000 per violation</td>
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<th>Voluntary Self-Disclosure</th>
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<tr>
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<td>Yes</td>
</tr>
<tr>
<td><strong>3</strong></td>
<td><strong>4</strong></td>
</tr>
<tr>
<td>One-Half of Statutory Maximum</td>
<td>Statutory Maximum</td>
</tr>
</tbody>
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Box 1 and Box 2 penalties are capped at $32,500 and $65,000 per TWEA violation, respectively.
• The base penalty amount may be adjusted to reflect applicable General Factors.

• Each factor may be considered mitigating or aggravating, resulting in a lower or higher proposed penalty amount.

• Neither the Base Penalty nor the Proposed Penalty will exceed the applicable statutory maximum amount.
• Common theme running through many of the risk factors and examples

• Complex, no easy solution, but area of interest for Treasury
  – Prominent in Libya2 sanctions
  – FinCEN guidance and proposed rulemaking

• Risk-based approach
• Tailor your compliance program to address the risks faced by your firm
  – Promotes appropriate, effective & economical measures
  – Ex: Combination of automated screening and deeper, manual due diligence on certain holdings/customers based on risk level

• Leverage work done in related areas, where appropriate
  – Ex: FinCEN customer due diligence requirements
• Importance of employee training, awareness & understanding of sanctions, especially in the complex investment sector

• Make clear your OFAC obligations to affiliates, customers, and counterparties
  – Disclaimers, contractual agreements, etc.

• When in doubt, contact OFAC
To get to OFAC’s website from the Treasury homepage, www.treasury.gov
Contact Information

**OFAC Compliance Division**
1-202-622-2490
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Questions?