



Financial Services Management

Sanctions Reporting, Regulatory Risk

Cite

Office of Foreign Assets Control (OFAC), Interim Final Rule (IFR) and Request for Comment, Reporting, Procedures and Penalties Regulations

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Impact Assessment

- Expanded sanctions reporters and the reports required of them create additional regulatory and reputational risk, especially for financial institutions offering payment, banking, securities, trading, and credit housed in home-country regimes with different sanctions regimes.
- No advance warning was provided, likely increasing regulatory risk at all covered entities and especially for those previously outside the sanctions-reporting regime and/or without capacity to track transactions other than funds transfers.
- Significant enhancements in customer and transaction monitoring, internal decision-making, and reporting capacity will be required of all financial and non-financial entities that do anything other than routine retail finance or commerce and then only if they do so with low-risk domestic customers and have the operational capacity to ensure that this remains the case.
- The lack of advance warning of these new rules and short filing deadlines will put additional strain on sanctions-compliance systems and heighten regulatory and reputational risk.
- OFAC now indicates that it will generally provide sanctions reports in response to FOIA request, increasing transparency and thus reputational risk.

Overview

At a time during which the Trump Administration has dramatically increased its use of economic sanctions, OFAC has revised subject to comment its reporting, record-keeping, and licensing requirements, expanding these in numerous ways

likely to increase regulatory risk not only for cross-border financial and payment companies operating in the United States, but for investment banks, foreign-exchange traders, trade-finance advisers, and all entities engaged in goods and-services transfers in areas or with persons targeted by U.S. sanctions. Given the scope of civil and criminal penalties associated with sanctions violations and related reputational risk, this sudden change in U.S. sanctions reporting and related requirements is likely to require prompt, senior-management, and board action at all companies engaged in cross-border finance and/or commerce. Indeed, even small-dollar, seemingly-routine retail transactions could be subject to reporting if sanctioned persons or entities make use of any institution seen as ill-prepared to file required reports. As a result, most if not all financial institutions and many commercial companies will need to review internal controls and at the least ensure that customer selection, product choice, due diligence, and other policies are robust in the face of possible sanctions risk.

Impact

Nations subject now to U.S. sanction include Syria, Iran, North Korea, Cuba, and the Crimea region. Further, many entities and individuals in these nations and others (e.g., Russia) are also subject to sanctions and thus not only to blocked transactions, but also and far more frequently to rejected ones in the funds-transfer arena. Expanding the scope of rejected-transaction reporting to many other areas will thus cover several nations and many sanctioned persons and/or related entities, creating significant and immediate challenges for all individuals, entities, and financial institutions engaged in cross-border finance.

Foreign banking organizations (FBOs) and other finance entities housed in nations with different sanctions regimes may find OFAC's new policy particularly problematic. This may be Treasury's intent given ongoing disputes between the U.S. and European Union over the extent to which U.S. sanctions cover transactions with Iran and those with China related to North Korea.

Among the most significant changes in the IFR are those affecting rejected transactions. Because of the scope of sanctioned nations and persons, many transactions not subject to blocking are nonetheless rejected by financial institutions due to concern about possible sanctions violations even in the absence of clear evidence that a transaction warrants blocking. When such transactions are requested and then rejected is a gray area even in the relatively straightforward funds-transfer area. Expanding reporting as now required from many other financial and goods-and-service transactions will require considerable agility in defining "rejection," readying reporting systems, and otherwise ensuring effective compliance, internal control, and monitoring.

The need to file rejected-transaction reports could also offend customers whose transactions need not necessarily be rejected on clear sanctions grounds but where financial institutions exercise the abundance of caution conventional in this high-risk area. Rejection reports are filed only with OFAC, but the opportunity for these reports to come to public attention has sharply increased because OFAC now says that it will generally disclose sanctions reports to FOIA-request filers. This will lead not only to the already-acute reputational risk related to instances in which a company should have rejected a transaction, but also to business and reputational risks related to transactions that are declined and then reported as such. An entity subject to transaction rejection that is then portrayed as sanctioned is sure to suffer significant business or reputational damage that will create numerous risks for the entity that rejected and then reported the transaction.

What's Next

This rule was issued on June 21 and is effective as of that date. Comments are due by July 22.

Analysis

A. Covered Entities

Prior rules applied only to U.S. financial institutions. Now, reporting is required by "U.S. persons." This covers a wide range of entities including foreign financial institutions doing business in the U.S. and their branches and agencies. Nonbank financial institutions are covered as are even individuals and entities engaged in physical and electronic commerce.

B. Reports

1. *Blocked/Unblocked Property*

Blocked property is property that a covered person holds instead of transfers as requested or otherwise due in a transaction. Current reports on blocked properties are expanded and extended also to unblocking actions. Detailed requirements now cover initial and annual blocked-property reports, with the annual ones expanded to encompass additional data related to disaggregated accounts in omnibus accounts starting in 2020. Unlocking reports are due when required by OFAC and as noted contain much of the information required in the blocking reports in concert with the date and unblocking-germane information.

Although OFAC describes the requirements of these reports largely as clarifications intended to reduce requests for additional reporting and thus to alleviate burden, the scope of new information is extensive and is likely to pose data-gathering, cross-border privacy, and beneficial-ownership attribution challenges.

Blocking/unblocking information now will generally be subject to FOIA requests. Unlocking reports have not been required in the past, but those related to blocking have been considered privileged and confidential. The agency indicates that FOIA requests for information on all of these transactions under FOIA will generally be granted.

2. *Rejected Transactions*

Unlike blocked transactions, rejected ones are those that a covered person does not execute. OFAC rules generally require rejections in far more cases than demanded for blocking. As noted, the IFR extends these reporting requirements to all rejected transactions, not just funds transfers. These reports now also need to be filed within

ten days of rejection, creating significant challenges for entities not previously covered by these rules and for all entities engaged in cross-border financial or business transactions.

In many cases, blocking is not required because property is not transferred, but rejection now would be demanded in concert with extensive new reports. Rejected transactions may be covered even if only an offer and refusal are involved. The details of these reports and how they are to be filed are also revised. These reports are now also within FOIA's ambit.

C. Licensing

The process for filing licensing requests is revised to give OFAC additional discretion as to when it will penalize an entity with a license to engage in transactions that would otherwise be sanctioned if OFAC determines that terms of the license were violated.

D. Request for Comment

The only issue on which comment is solicited relates to paperwork burden. It seems likely that reporting will be significantly expanded and thus comment on this and on the complexities of handling rejected transactions may be of interest.