LESSONS FROM OFAC'S FIRST PUBLIC '50 PERCENT RULE' PENALTY

by Jeremy P. Paner, *Law360,* New York (February 19, 2016, 10:21 AM ET)

The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) administers and enforces economic sanctions on behalf of the United States. Until recently, the work of this small agency housed in the Treasury Building Annex was shrouded in mystery to all but a handful of specialists. Today, a majority of attorneys are at least familiar with the concept of economic sanctions. This understanding of sanctions is largely the result of media attention given to policy and regulatory changes, in addition to coverage of massive monetary penalties for noncompliance. News reports covering developments in Iran, Syria, North Korea, Russia and Cuba frequently refer to U.S. sanctions imposed upon those countries.

The White House works with OFAC to modify sanctions programs to address changing threats to the national security and foreign policy of the United States. Significant changes to the embargoes on Cuba and Iran and calls to increase pressure on North Korea, Syria and Russia have recently garnered substantial media attention. Ironically, one of the most important recent developments for compliance sanctions programs may have occurred in a settlement announcement that received virtually no attention: OFAC's first publicly announced "50 percent rule" penalty. Businesses should carefully consider this penalty when evaluating the effectiveness of their sanctions compliance programs.

Settlement with Barclays Bank

Last week, OFAC announced that Barclays Bank PLC agreed to pay $2,485,890 to resolve apparent violations of the Zimbabwe Sanctions Regulations (31 C.F.R. Part 541) arising from the provision of financial services through the United States. Similarly to many of the sanctions violations caused by other foreign financial institutions, Barclays sent transactions to U.S.-based banks, including its New York branch, which in turn processed financial transactions that should have been "blocked" pursuant to OFAC regulations. According to the announcement, these violations did not arise from intentional obfuscation of the originators or beneficiaries of the transactions. In 2010, Barclays settled violations of that nature for $176 million.

As explained by OFAC, between July 2008 and September 2013, Barclays' New York branch and other U.S. banks processed transactions for three corporate customers of Barclays Bank of Zimbabwe Limited. These customers were not specifically listed on the Specially Designated Nationals (SDN) List. They were, however, blocked as a matter of law, because they are owned 50 percent or more by the Industrial Development Corporation of Zimbabwe (IDCZ). OFAC designated IDCZ pursuant to Executive Order 13469 on July 25, 2008. According to the OFAC press release announcing the designation, IDCZ is a Zimbabwean state-owned enterprise that owns a large number of industrial companies. Once OFAC designated IDCZ, that entity's property and interest in property, including all entities it owned, were blocked.

For more information, please contact:

Jeremy Paner
202.654.6912
jppaner@hollandhart.com

Jeremy Paner is of counsel in Holland & Hart's Washington, D.C, office, and previously worked in the U.S. Department of the Treasury's Office of Foreign Assets Control.

OFAC determined that Barclays did not voluntarily self-disclose the violations. It appears that other financial institutions blocked and reported some of the transactions. These reports would have notified OFAC of "substantially similar apparent violation[s]," thereby precluding Barclays from receiving credit for voluntary self-disclosure. These disclosures significantly reduce the base amount of civil penalties. Self-disclosure of egregious violations result in a base penalty reduction equal to one-half of the applicable statutory maximum. Self-disclosure of nonegregious violations will result in a base penalty that is one-half of the transaction value, capped at a maximum base amount of $125,000 per violation.

50 Percent Rule

U.S. individuals and companies are generally prohibited from transacting or dealing with companies on the SDN List. The property and interests in property of these companies in the jurisdiction of the United States must be blocked and reported. OFAC's 50 percent rule is a logical extension of the prohibition on transactions and dealings involving blocked property, but it also adds the substantial burden of an enhanced due diligence exercise.

In 2008, OFAC provided interpretive guidance that an entity owned 50 percent or more by a blocked person is itself blocked as a matter of law. Following this announcement, sanctions compliance programs could no longer limit their efforts to screening against the SDN List and the countries against which the United States maintains partial or comprehensive sanctions programs. From that point on, sanctions compliance has required risk-based due diligence to investigate and unravel beneficial ownership. Although the 2008 guidance mandated additional due diligence by compliance programs, it did not account for ownership by multiple blocked parties. Compliance programs could therefore eliminate its application once they determined that no single blocked person owned 50 percent or more of an entity.

OFAC addressed the issue of aggregated ownership in the second articulation of the rule in August 2014. Under the revised guidance, "any entity owned in the aggregate, directly or indirectly, 50 percent or more by one or more blocked persons is itself considered to be a blocked person." OFAC has incorporated this guidance into the regulations for each sanctions program.

The aggregation of SDN ownership applies irrespective of the designation authority. This means that an entity owned 50 percent or more by persons blocked under different designation authorities is itself blocked by operation of law. For example, an entity is blocked as a matter of law if it is owned 30 percent by an individual designated under the Sergei Magnitsky Rule of Law Accountability Act and owned 20 percent by an individual designated as a Russian government official pursuant to Executive Order 13661.

The 50 percent rule also applies to entities owned by persons on the Sectoral Sanctions Identification (SSI) List. Sectoral Sanctions restrictions apply to entities owned 50 percent or more in the aggregate by one or more persons on the SSI List. Unlike the aggregation of SDN ownership, which is applicable across blocking programs, SSI ownership only aggregates among entities listed under the same directive.

50 Percent Rule Enforcement Factors

The settlement announcement provides three factors that may determine whether a civil penalty is appropriate for violations arising from the 50 percent rule. OFAC tailored its explanatory language for financial institutions, but the factors are readily applicable to all businesses.

1. A direct customer relationship for an entity that is not listed, but blocked by operation of law;
2. Failure to act on records that demonstrate ownership by a blocked person; and
3. Publicly available information about ownership by one or more blocked persons.

OFAC will likely impose civil penalties on businesses that provide services to entities identified by third-party vendors as being owned by blocked persons. The availability of public information will likely weigh heavily toward a civil penalty if the peers of the violating business act on that information.

Risk Mitigation Strategies

Compliance programs should identify direct relationships with entities potentially blocked by operation of law during the onboarding and ongoing customer due diligence phases. Existing procedures, including written questionnaires and interviews, should incorporate considerations for the 50 percent rule. Customer files that do not adequately address this compliance risk should be carefully reviewed and potentially "derisked." Like other aspects of compliance, businesses should take a risk-based approach to determining the beneficial ownership of their clients.

The factors relating to the failure to obtain or act on certain information highlight the importance of facilitating communication within compliance programs. Management should encourage staff to participate in brief, frequent, informal meetings with their direct supervisors, where they may raise issues and concerns. A program with a collaborative environment that encourages information sharing is significantly more likely to investigate, escalate and act upon derogatory information.

The 50 percent rule essentially creates an additional list of blocked entities. U.S. companies are prohibited from dealing with these entities, which are generally treated as if they appear on the SDN List. While third-party vendors can provide businesses screening tools that incorporate the results of their extensive ownership research, compliance is a nondelegable duty. Each businesses is ultimately responsible for their own compliance with sanctions regulations.