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Understanding and Complying with OFAC Regulations

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The U.S. Treasury Department's Office of Foreign Assets Control (OFAC) promulgates and implements regulations in connection with the economic sanctions programs established by the U.S. government. Sanctions are one of the primary means by which the U.S. government attempts to further its foreign policy goals and protect national security.

OFAC regulations are set forth in Chapter V of Title 31 of the Code of Federal Regulations (at 31 C.F.R. § 501.101 et seq.). The sanctions programs target specific countries, groups, individuals, and activities (generally speaking, narcotics trafficking and terrorism). Most U.S. sanctions programs involve asset blocking, restrictions on specific transactions, or both. These sanctions programs vary in scope. They can be comprehensive, blocking all transactions with a country or target, but more often are selective, prohibiting only specific transactions with a designated country or other sanctioned party.

In addition to the regulations themselves, the primary resource used by entities to ensure compliance with U.S. sanctions is the comprehensive list of Specially Designated Nationals and Blocked Persons (the SDN list) maintained by OFAC, which lists individuals, entities, and vessels with which U.S. persons are generally prohibited from conducting any business (SDNs).

It is important that any party engaged in or contemplating international business understand how to navigate the applicable statutes, regulations, lists, and agency directives and guidance so as to ensure compliance with its U.S. sanctions obligations. U.S. sanctions change frequently and sometimes abruptly. It is therefore essential to review the most current law and guidance on U.S. sanctions before proceeding with an international transaction.

This practice note is meant to provide an overview of U.S. sanctions—including applicability, targeted parties, prohibited actions, penalties, among other aspects—so as to assist readers in better understanding their compliance obligations, and will also offer best practices for implementing an OFAC compliance program.

Who Must Comply with U.S. Sanctions?

All U.S. persons must comply with OFAC sanctions. The term "U.S. person" is defined to cover the following:

- All U.S. citizens and permanent resident aliens, regardless of where located
- All persons and entities in the United States, regardless of nationality –and–
- All U.S.-incorporated entities and other organizations, including their foreign branches

In addition to U.S. persons, in certain instances OFAC regulations may also apply to foreign subsidiaries owned or controlled by U.S. entities or to foreign persons in possession of U.S. origin goods.

For these purposes, an entity is considered owned or controlled by a U.S. person if the U.S. person:

- 1 Holds a 50% or greater equity interest by vote or value in the entity
- 2 Holds a majority of seats on the board of directors of the entity –or–
- 3 Otherwise controls the actions, policies, or personnel decisions of the entity

What Parties and Activities are Targeted by U.S. Sanctions?

Targeted Nations and Activities

A number of nations are subject to sanctions programs. Similar sanctions are also in place against various targeted governments (or quasi-governmental organizations) and geographic regions. In addition, some sanctions programs apply to groups of people engaged in certain activities not based in a specific geographic region (for example, terrorism).

The sanctions programs targeting different countries vary widely in their scope but can be broadly divided into comprehensive and non-comprehensive (or selective) programs. Comprehensive programs involve blanket restrictions on trade and finance as well as strict asset-blocking requirements. Non-comprehensive programs tend to target specific areas of trade, contain narrower asset blocking requirements, and focus their restrictions on SDNs.

The sanctions programs targeting various disfavored activities are more similar to the non-comprehensive sanctions programs targeting individual countries in that they are narrowly focused on specific types of trade and activities, and the regulatory prohibitions are focused upon individuals and groups appearing on the SDN list. At present, such sanctions programs are in place with respect to the following activities:

- Narcotics trafficking
- Rough diamond trade
- Terrorism –and–
- Transnational criminal organizations

Detailed information and guidance with respect to regulations in effect for each of the above-listed sanctions programs can be found on the [U.S. Treasury Department's OFAC website](#).

As described below, the SDN list compiled by OFAC includes the names of specific individuals and entities who are affiliated with the nations and activities subject to sanctions programs listed in this section. The specific information pertaining to each sanction program must be consulted for greater detail and exceptions. Generally, the prohibitions in the comprehensive sanctions programs are not limited to transactions with SDNs but include any activity involving the government of or any person residing in such nations, whereas the non-comprehensive and activities-based sanctions programs listed above only prohibit interactions with the specific individuals and entities from such nations (or groups, etc.) who appear on the SDN list and/or specifically targeted areas of trade activity.

The sanctions programs are subject to constant review and revisions, and the most recent information should be consulted. [Registering](#) to receive e-mail updates about specific sanctions programs is a good way of staying informed about changes.

Specially Designated Nationals

The [SDN List](#) lists the names of individuals, entities, and vessels with which U.S. persons are generally prohibited from conducting any transactions. SDNs can be designated for multiple reasons, including:

- Pursuant to a country-specific sanctions program (e.g., a senior government official of a country against which the United States has imposed sanctions)
- For engaging in specifically prohibited activities (e.g., terrorism, drug-trafficking, nuclear, or cyber-related activities)
- Based on their ownership or control structure (e.g., an entity that is owned or controlled by an SDN) –or–
- Based on activities for or on behalf of a targeted country, group, entity, or individual (e.g., a party deemed to have supported a prohibited government's commission of human rights violations)

The assets of SDNs are blocked, or frozen, and U.S. persons are therefore generally prohibited from any dealing involving those assets, whether in the United States or abroad. Moreover, in the case of a bank or other party holding such assets, there are specific requirements that must be met in terms of blocking those assets and reporting the blocking to OFAC.

The SDN List is several hundred pages long, though many of the names are duplicates, as the list includes many aliases for the same designated party. Nonetheless, the SDN List is not an exhaustive list of blocked persons and entities, as OFAC also maintains other lists of restricted parties. These lists change from time to time and are typically developed based on a particular sanctions program. For example, OFAC currently maintains the [Foreign Sanctions Evaders List](#) (pertaining primarily to Iran), the [Non-SDN Iran Sanctions Act List](#) (also pertaining primarily to Iran), and the [Sectoral Sanctions Identifications List](#) (pertaining primarily to Russia).

In addition, the comprehensive sanctions programs in place targeting select nations (e.g., Iran) prohibit transactions with a far wider range of people and entities than those that appear on the SDN list. Furthermore, the non-comprehensive sanctions programs may prohibit activities not directly related to SDNs (e.g., importing goods from North Korea requires a specific license, regardless of whether the North Korean counterpart is an SDN.) Thus, a party considering any activity with targeted nations should carefully review the specific regulations applicable to that nation.

The 50% Rule

Further complicating things—and adding to the number of prohibited and restricted parties designated by OFAC—is the so-called 50% rule. Under this rule, if a U.S. person engages in a transaction with an entity owned 50% or more by one or more prohibited or restricted parties, OFAC treats that like a direct transaction with a prohibited or restricted party.

In addition, the 50% rule extends to indirect ownership (i.e., a situation in which a prohibited or restricted party owns an entity via a third party). Such ownership has a trickle-down effect. For example, if SDN 1 and SDN 2 each own 25% of Entity A, Entity A is considered to be an SDN because 50% or more of the entity is owned, in the aggregate, by SDNs. If Entity A, in turn, owns 50% of Entity B, Entity B is also treated like an SDN because Entity A is a blocked person that owns 50% of Entity B (i.e., SDN 1 and SDN 2 indirectly own 50% of Entity B).

It is important to note that the 50% rule considers ownership only, not control. An entity that is controlled, but not majority-owned, by one or more prohibited or restricted persons is not blocked pursuant to the 50% rule. That entity could, however, be subject to future designation. Moreover, although the entity itself is not blocked, transactions with the entity are prohibited if they involve any blocked persons or entities.

What Actions are Prohibited with Sanctioned Parties?

Both direct and indirect transactions with sanctioned parties can trigger liability and, as described below, lead to significant penalties. Common prohibited activities include importing goods from or exporting goods to a targeted nation, providing a loan or other financing to an SDN, or transferring funds to an SDN. In addition, while many sanctions violations occur because a U.S. person exports a physical item to a sanctioned party, the provision of services to a sanctioned party is also a violation. For example, it would be a violation of U.S. sanctions for a U.S. person to provide consulting services to the government of a sanctioned country or marketing services to a private business in a sanctioned country. Importantly, there is no minimum dollar amount required for a transaction to be subject to OFAC regulations. In maintaining its sanctions programs, the U.S. government essentially prohibits the provision of any benefit, whether in the form of a physical export, the provision of a service, or in virtually any other form to a sanctioned party.

For example, in 2014, Carlson Wagonlit Travel B.V. (CWT), a travel services company based in the Netherlands but majority U.S.-owned (and thus subject to U.S. jurisdiction), settled with OFAC for apparent violations of U.S. sanctions on Cuba. OFAC alleged that the company provided prohibited travel services to and from Cuba between 2006 and 2012. The company agreed to pay a fine of nearly \$6 million.

U.S. persons are also generally prohibited from facilitating any transaction by a non-U.S. person that would be prohibited if performed by the U.S. person or within the United States. In effect, this prohibition bars U.S. persons from taking any action to assist or support trading activity with a prohibited country, entity, or individual, unless specifically authorized.

Prohibited facilitation can come in many forms, including the following:

- Referring to a non-U.S. person's purchase orders, requests for bids, or similar business opportunities to which the U.S. person could not respond directly
- Approving, financing, or guaranteeing a transaction by a non-U.S. person that would be prohibited if performed by the U.S. person or within the United States
- Changing policies or operating procedures of a U.S. parent company, or its non-U.S. affiliate or subsidiary, in order to enable a non-U.S. entity to enter into a transaction that would be prohibited if entered into directly by the U.S. parent company or from the United States

As an example of how the facilitation provisions can get companies into trouble, in 2013, Ameron International Corporation agreed to pay \$434,700 for apparently facilitating prohibited transactions with Iran. Ameron approved expenditure requests by two foreign subsidiaries to purchase supplies to fulfill orders for a project in Iran and referred business opportunities for the sale of goods to Iran to its foreign subsidiaries, both of which Ameron could not have directly performed due to prohibitions under the Iranian sanctions regulations.

Any activity that supports, authorizes, or otherwise assists in the conduct of a transaction by a non-U.S. person, where that transaction would be prohibited if conducted directly by a U.S. person, constitutes prohibited facilitation.

However, some activities related to otherwise prohibited transactions are permitted under certain circumstances. For instance, activities of a purely clerical or reporting nature are not considered prohibited facilitation, so long as they do not further trade or financial transactions with a prohibited country or party. A U.S. parent company may, for example, report on the results of its subsidiary's authorized trade with a sanctioned party, but may not finance or insure that trade or warrant the quality of goods sold by the subsidiary to that sanctioned party.

To avoid potential facilitation liability, U.S. parent corporations should ensure that their non-U.S. subsidiaries act independently with respect to all transactions and activities relating to countries and parties subject to U.S. sanctions laws. In particular, with respect to business of a non-U.S. subsidiary in a sanctioned country, a U.S. parent corporation should not engage in business and legal planning, decision making, designing, ordering or transporting goods, or financial, insurance, and other risk response.

Additional guidance on prohibited activities related to specific industries is available on the [OFAC website](#). The industry groups covered are the corporate registration industry, credit reporting, exporters and importers, the financial sector, insurance, money service businesses, and nongovernmental organizations and nonprofits.

How Do Parties Apply for Sanctions Licenses?

Certain activities that would otherwise be prohibited under the OFAC regulations may be permissible if the U.S. party involved has a license for such activity. OFAC issues both general and specific licenses. A general license essentially functions as an exemption to sanctions prohibitions and authorizes certain transactions that would otherwise be prohibited under the corresponding sanctions program. For instance, OFAC has issued general licenses to authorize U.S. persons to engage in humanitarian activities that would otherwise be prohibited under U.S. sanctions programs. General licenses are specific to each sanctions program, and many programs do not provide such licenses. U.S. persons do not need to apply for general licenses; such licenses are publicly issued by OFAC and can be taken advantage of by anyone so long as the requirements described in the license are strictly followed. Persons taking advantage of general licenses may be obligated by the terms of the license to report any activities related to the license to OFAC and/or to retain detailed records of their activities for a set period of time.

Specific licenses are granted to specific persons for specific activities or actions that would otherwise violate the terms of the applicable sanctions program. Unlike general licenses, specific licenses require application in writing and may only be utilized by the person to whom the license has been issued and for the specific purposes set forth therein. For example, a medical equipment manufacturer may wish to export a vital medical device to a targeted country where a blanket prohibition on exports otherwise applies—such an action would require a specific license from OFAC in order to not violate OFAC regulations.

A specific license may be requested by submitting an application via [OFAC's website](#). While the required information varies depending on the specific license sought, the application generally should include:

- A detailed description of the proposed transaction
- The names and addresses of all parties involved or interested in the transaction
- The applicant's taxpayer identification number –and–
- Any other information deemed necessary by OFAC per the specific sanction program

There is no guarantee that an application for a specific license will be granted. Moreover, it can take several months or more for OFAC to respond to an application for a specific license. As with general licenses, specific licenses frequently require the license holder to maintain records and/or submit reports with respect to the activities engaged in by the license holder pursuant to the specific license.

What Penalties Can Be Imposed for U.S. Sanctions Violations?

OFAC may impose civil and administrative penalties upon finding a violation of the various sanctions regulations. Civil penalties can range up to \$250,000 or twice the amount of the underlying transaction for each violation. (These penalties may be even higher based on changes under the Federal Civil Penalties Inflation Adjustment Act.)

In addition to these penalties, OFAC may make a criminal referral to the U.S. Department of Justice (DOJ) in the case of willful violations. The DOJ may impose penalties even when OFAC declines to do so, and other federal and state government agencies and international governments may pursue their own penalties. Willful violations can result in fines of up to \$20 million and imprisonment of up to 30 years.

To illustrate, in 2014, French bank BNP Paribas SA (BNP) [agreed to pay](#) \$8.9 billion for processing transactions through the U.S. financial system on behalf of entities subject to U.S. economic sanctions. BNP pleaded guilty to knowingly and willfully concealing nearly 4,000 prohibited financial and trade transactions on behalf of U.S. sanctioned parties routed through the U.S. bank system between 2005 and 2012. OFAC worked with federal and state agencies as well as French authorities to conduct the investigation and reach a settlement. BNP agreed to pay OFAC \$963 million as part of its \$8.9 billion settlement with OFAC, the DOJ, and other federal and state entities.

The following year, OFAC settled with two more banks for sanctions violations: Commerzbank AG [agreed to pay](#) OFAC \$258 million as part of its \$1.45 billion settlement with federal and state agencies, and Crédit Agricole Corporate and Investment Bank [agreed to pay](#) OFAC \$329 million as part of its \$787 million settlement.

While banks have suffered the highest sanctions penalties to date, other entities are subject to penalties proportionate to their dealings. For example, in 2013, Weatherford International Ltd. *settled* with OFAC for \$91 million for providing oilfield equipment and services in violation of various sanctions programs. According to the settlement documents, Weatherford conducted extensive oilfield service business, exported goods directly and indirectly, and facilitated transactions by U.S. persons with prohibited entities and countries. The company's \$91 million settlement with OFAC was part of its \$100 million criminal and civil penalty assessed by the U.S. Attorney's Office for the Southern District of Texas. In addition, Foreign Corrupt Practices Act (FCPA) violations related to these sanctions violations resulted in another \$152 million in fines to the DOJ and U.S. Securities and Exchange Commission (SEC) for a total of \$252 million owed to various federal agencies.

OFAC reviews the totality of the circumstances when assessing what penalties to apply. Mitigating factors include the quality of the entity's compliance program, whether the entity voluntarily disclosed the violation, and other steps the entity took to mitigate the violation, both upon discovery of the violation and on a continuing basis. See also *Responding to an OFAC Violation*.

What Activities are Permitted under U.S. Sanctions?

Each sanctions program differs both with regard to its prohibitions and its exceptions (i.e., general licenses). The most commonly permitted activities include the following:

- **Certain legal services.** Permitted legal services generally encompass situations involving the provision of advice or counseling on compliance with U.S. laws or representation in the U.S. courts regarding the imposition or enforcement of U.S. sanctions. In many cases, however, a specific license from OFAC is needed to get paid for the provision of such legal services.
- **Personal communications.** To promote the free flow of information to private persons in a sanctioned country, personal communications such as instant messaging, e-mail, social networking, and web browsing may be permitted. These services generally must be at no cost to the user and be personal and not commercial in nature.
- **Humanitarian efforts.** As noted above, certain transactions related to assisting humanitarian efforts and projects are permitted under some sanctions programs. These efforts are typically related to disaster relief and human rights of individuals in a targeted country.
- **Aircraft safety.** Certain transactions involving the promotion of civil aviation safety and safe operation of U.S. origin commercial passenger aircraft are permitted. Such transactions are limited to civil aviation and may not facilitate a military end use or involve a military end user.
- **Transactions ordinarily incident to a licensed transaction.** Most transactions that are ordinarily incidental to a transaction that OFAC has authorized by a general or specific license are likewise permitted.
- **Information and informational materials.** Most transactions relating to the creation and dissemination of informational materials are authorized. Informational materials include publications, films, posters, phonograph records, photographs, microfilms, microfiche, tapes, compact disks, CD ROMs, artworks, news wire feeds, and other information and informational articles.

What Are Best Practices for Complying with U.S. Sanctions?

Although all U.S. persons are required to comply with U.S. sanctions obligations, OFAC does not require companies to implement any specific compliance regime. OFAC expects companies to take a risk-based approach to sanctions compliance. In that regard, what constitutes an adequate compliance program will depend upon a company's size and the type and frequency of its global transactions. For a sample compliance policy see *OFAC Sanctions Compliance Policy*.

Despite the lack of a formal requirement, several factors make establishing appropriate controls of great importance, especially for entities with a higher risk for violations (e.g., banks, importers, businesses with a significant foreign presence, etc.):

- OFAC regulations essentially apply a strict liability standard. There are no "honest mistakes"—any person who engages in a prohibited transaction with an SDN, for whatever reason, in violation of the OFAC regulations is subject to penalties.
- Penalties for OFAC violations can be severe (see What Penalties Can Be Imposed for U.S. Sanctions Violations?).
- Although the existence of a strong compliance program is not a defense in establishing whether a violation occurred, it is taken into consideration by OFAC when assessing what penalties to impose for a violation.

In general, a good compliance program will reflect the following hallmarks:

- **Tailoring.** A sanctions compliance program should be based on a self-assessment of, and should be appropriately tailored to

address, a company's specific sanctions risk areas.

- **Tone at the top.** Senior management should convey to personnel, and to the public at large, that the company is committed to compliance with all applicable laws and will not tolerate illegal conduct by any personnel—including senior level management.
- **Policies and procedures.** A company should implement written policies and procedures to ensure personnel are aware of applicable laws and the company's approach to complying with them.
- **Training.** Personnel engaged in international business should receive regular training on applicable sanctions laws. Attendance should be documented, and attendance records should be maintained for at least five years.
- **Screening.** Companies should screen international business partners, including customers, agents, brokers, and other third-parties, against applicable U.S. prohibited parties lists. The lists that should be consulted will vary depending on the scope and type of international business that a company conducts but should include, at a minimum, the SDN List.
- **Transaction due diligence.** Prior to entering into any international business relationship, a company should conduct appropriate due diligence on the parties involved, including diligence on those parties' ownership and control. The company's compliance and legal departments should be involved to the extent necessary to review proposed transactions and ensure compliance with U.S. sanctions laws.
- **Compliance function.** OFAC expects companies to dedicate sufficient resources to their compliance functions. This often consists of hiring quality and experienced compliance personnel and providing them with appropriate compensation and promotion opportunities. Moreover, the function itself should be independent and employ an appropriate reporting structure. In many cases, this will mean that the compliance function will report directly to the legal department.
- **Hotline.** Companies should ensure that personnel are afforded a means to anonymously report sanctions violations by telephone and email. These reports should be reviewed and addressed by the compliance team within a reasonable period of time after submission. The sanctions training program, policies, and procedures should inform personnel of the available reporting mechanisms—and that there will be no retaliation for good faith reports of suspected violations.
- **Process to handle violations.** Companies should employ a consistent and well-documented process for investigating and responding to reported violations. The response should involve compliance and legal personnel, as appropriate.
- **Auditing / monitoring of compliance program.** As a company's global footprint changes over time, the company should periodically revisit its compliance program to ensure that it adequately responds to the company's actual sanctions risk profile.
- **Recordkeeping.** All records regarding a company's compliance program, policies and procedures, training, prohibited parties screening, transaction partner due diligence, and responses to reported violations should be maintained for a minimum of five years in a format that can be provided to OFAC promptly upon request.

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