OFAC: OFFICE OF FOREIGN ASSET CONTROL

# Oh! FAC Oh! FAC

L. Burke Files, CDDP

Yep, that is how a number of bankers and business managers are now pronouncing OFAC, an acronym for the US Treasury's Office of Foreign Asset Control.

OFAC administers and enforces economic and trade sanctions based on US foreign policy. The US is not alone in using economic sanctions against whom they perceive to be "undesirable". Many OFAC sanctions are based on international mandates, are multilateral in scope, and involve close cooperation with allied governments. There are also similar lists issued by other nations, as well as organizations such as the EU and UN. Sanctions programs often vary from one jurisdiction to the next. While many entities and countries are common to all "lists", each country may have its own unique sets of sanctioned entities and countries.

Why are OFAC and Sanctions Compliance in the News? Because OFAC has increased its effort to find an fine violations:

- *Apr 2009 - DHL Fined $9.4 million*
- *Dec 2009 - Credit Suisse fined $536 Million*
- *Aug 2010 - Barclay's fined $176 Million*
- *Aug 2011 - J.P. Morgan Chase fined $88.3 million*
- *Feb 2012 - Online Micro fined $1.9 million*

*"No worries… I am not a big multinational bank or company. I know my customers."* In the past, maybe, but no more. Criminals are more creative in the art of deception and OFAC' investigative abilities are much better. Other companies penalized by OFAC in the past few years include: Teledyne, Lanier Marine Liquidators, Commerzbank AG, New York Branch, Zurigo Trading, Inc., Flowserve Corporation, and the Richland Trace Homeowners Association!

What these fines represent are a clear disconnect between the front office of operations and the back office on compliance. These "disconnects" between the front office and compliance is not unique, as it is pervasive throughout all industries.

In a recent survey fully 27%[1] of Senior Managers in many industries admitted to compliance failures. Our experience shows that over 70% of companies have compliance failures. So why such a disconnect between how businesses are functioning yet are remain blind as to what is prescribed and/or prohibited by law?

One reason is obvious - too many rules, regulations and laws. The 2009 edition of the US Code of Federal Regulations was the largest ever, encompassing 163,333 pages in 226 individual books. That is in just one year! Anymore it is hard to walk down a street or conduct business without breaking a law. It would just be nice to know which law I was breaking so I could feel wicked when I broke the law!

Companies greatly underestimate the risks associated with compliance failures. At a time when there are more regulations that ever, effecting both domestic but multinational operations, the odds of non-compliance grow. With fully 27% of Senor Executives admitting failures, how many more failures lurk below the level of current detection?

Internal communications between operations and compliance is often poor and confrontational. Compliance is viewed by many in operations of taking the attitude of "Make Wrong". It is poor management where one person is perceived to make another person in that organization wrong for what they did. No one wants to be wrong, or to be ever seen as wrong, thus communication breaks down.

Failures typically occur at the operation level - often in isolation and obscurity from the central offices. When such events are addressed at that operational level, the problems and solutions often never reach the company. Sometimes such solutions may not be in sync with corporate policies or regulatory requirements. Both circumstances deny broader organizational learning about risk and compliance failures. Why? Because operations does not want to be seen as having made an error or to have been "wrong". One learns little from success, we usually learn more from failures - share the lesson.

Perverse incentives and lack of understanding of systemic errors seem to round out the last of the problems. A perverse incentive is an incentive that seems to be correct - but in actuality incentivizes incorrect behavior. Example: If you have a reward program for the branch opening the most new accounts, they may tend to relax standards to make the numbers work in their favor. A more correct incentive would be to open as many new accounts as you can, and deduct two accounts for each bad account you find - with aligned incentives one is likely to increase the number of quality accounts opened. The second part of this is the damage of systemic errors – often one error in the process leads to disproportionate damage. A common characteristic of a systemic error is that one bad choice can wipe out a million good choices.

Compliance with sanctions programs, with the lists of all of the other sanctions from all of the countries and organizations that produce said lists are just one of many regulations, we in the financial services industry as a condition of our industry, must pay attention.

More recent developments in Sanctions and AML Compliance enforcement includes drilling ever deeper into beneficial ownership or control of an entity. How deep do we need to go? Deeper.

From the BSA Anti-Money Laundering Examination Manual, Examination Procedures - Office of Foreign Asset Control

Financial institutions must consider.... *The extent of, and method for, conducting OFAC searches of account parties other than accountholders, which may include beneficiaries, guarantors, principals, beneficial owners, nominee shareholders, directors, signatories, and powers of attorney.*

If you think your efforts have been comprehensive, the process has been very clear – regulators expect you to know and understand the role of all players in a transaction or relationship, whether their interest is direct or indirect, real or contingent. It is critical to identify risks with transaction counterparties and intermediaries; including each and every jurisdiction involved and IBC, Trust, Foundation, and Service Provider they can find to determine control, influence and beneficial ownership.

This regulatory stance and my understanding of how money moves, reminds me of Werner Heisenberg's uncertainty principle applied to finance...

The Heisenberg financial uncertainty principle implies that it is impossible to simultaneously assess the present position of a principal while also determining the future motion of the funds, or of any system of small entities in multiple jurisdictions to be able to perform a compliant OFAC assessment.

My apologies to the world of quants and quantums.

## So where does this leave us?

At times like this, I find it may be best resort to the back of the envelope solutions as a first screen.

*1. If neither our client nor our staff can understand a financial structure, pass on it. When a group of smart people cannot clearly figure out what a client is or may be doing - why bother? This has served us all very well.*

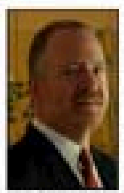
*2. When a mistake occurs, the mistake, in all it gory detail, is to be documented and shared within the enterprise; sharing details about the error, and what could have been done to prevent the error, or lessen the impact of the error once discovered.*

*3. All clients are to be vetted through an independent third party. Each client is told this upfront and pays an admission fee - cost of the due diligence. The fee is refunded if the prospective client is rejected. The explanation is - we want to make sure that our institution and all of our clients are free from trouble that could reflect badly on either the institution or our clients. I have found that prospective clients who are outraged at such a requirement are the ones who are likely to fail the screening.*

*4. Read the news and follow the OFAC, EU and UN updates. For example, right now Iran is courting favor in Latin America through Iranian investments in factories in Venezuela, an Iranian funded hospital in Bolivia and Iran in forging closer ties with Nicaragua, Ecuador and Cuba. Or in the case of Burma (Myanmar) emerging from isolation, it has become an attractive place to invest, except for the fact that their financial services providers are still on many of the world's sanctions lists.*

In the end, you need to learn to ask the right questions and get clear and comprehensible answers. Compliance with sanctions, will likely run parallel to self preservation. ~

[1] SAP Survey



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