ALERTS

OFAC Expands Reporting Obligations and Highlights Importance of Cooperation

November 21, 2019

In June 2019, the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") issued an interim final rule amending the Reporting, Procedures and Penalties Regulations ("RPPR"), 31 CFR Part 501 ("Interim Final Rule").[1] Most importantly, the Interim Final Rule, which became effective on June 21, 2019, imposes new requirements relating to who must file reports on rejected transactions with OFAC and what transactions must be reported. Most recently, at its Symposium on Nov. 12, 2019, OFAC emphasized the importance of these new requirements.

Expanding Reporting Requirements

The Interim Final Rule significantly broadens the reporting requirements under 31 CFR § 501.604 by expanding both (i) the transactions that qualify for reporting; and (ii) the category of persons required to report on rejected transactions. Specifically:

- The Interim Final Rule requires reporting of all "rejected transactions," which are defined broadly to include any transaction rejected because it would violate sanctions, including transactions "related to wire transfers, trade finance, securities, checks, foreign exchange, and goods or services."[2]

- The Interim Final Rule requires reporting by all U.S. persons and persons subject to United States jurisdiction.[3] Previously, only "financial institutions" ("FIs") were subject to that requirement.

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- In FAQ Number 36, OFAC has advised that transactions should be rejected where the underlying transaction may be prohibited, but there is no blockable interest in the transaction.[4] There is a lack of clarity in how this concept applies to the broader category of persons required to file rejected transaction reports under the Interim Final Rule. OFAC has indicated that it welcomes questions about whether a transaction should be blocked or rejected. We understand that OFAC has received questions seeking clarity on the impact of this rule, in particular, for non-FIs with respect to rejected transactions, and that, as a result, it is considering more precisely what kinds of rejected transactions need to be reported by non-FIs.

- These changes have potentially significant implications, and each company affected by this Interim Final Rule should review their sanctions compliance-related internal controls and practices to ensure that they are appropriately meeting the new and amended requirements.

Other Changes to the RPPR

In addition to expanding the scope of the reporting requirements, the Interim Final Rule expands the scope of the information required to be reported on initial and annual reports of blocked property, as well as in reports on rejected transactions, adding a list of new information to be included on each report.

OFAC also added a new requirement that goes into effect in 2020 for those U.S. persons who maintain blocked funds in omnibus accounts[5] and submit annual reports. The new regulation requires that annual reports contain a disaggregated list showing each blocked asset contained within an omnibus account.[6]

Further, OFAC has revised the regulations to allow for the submission of initial and annual reports of blocked property and reports of rejected transactions by "email, U.S. mail, or any other official reporting option, including electronic, as specified by OFAC on its website" and expressed a strong preference to receiving reports by email or electronically.

The Interim Final Rule also amends 31 CFR § 501.801 to require that applications for specific licenses to engage in transactions otherwise prohibited under 31 C.F.R. Chapter V, or sanctions programs administered

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by OFAC, be filed through OFAC's Reporting and License Application Forms page or by mail.[7]

The Interim Final Rule further clarifies that reports of blocked, unblocked and rejected transactions are subject to release under the Freedom of Information Act ("FOIA") upon receipt of a valid FOIA request, unless they are exempt from disclosure pursuant to an applicable FOIA exemption.

The Interim Final Rule expands OFAC's subpoena power to clarify that OFAC can request "electronic documents," such as videos or sound recordings, in addition to obtaining the testimony of witnesses and the production of any books, contracts, letters, papers and other hard copy documents relating to any matter under investigation.[8]

OFAC also revised 31 CFR § 501.701 to accurately describe the penalties imposed for willful violations of the Trading with the Enemy Act ("TWEA") to reflect the increases to the maximum term of imprisonment from 10 to 20 years under TWEA, as imposed under Section 107(a)(4) of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010.[9]

Enforcement Actions

Subsequent to the issuance of the Interim Final Rule, on Aug. 8, 2019, OFAC issued Findings of Violations to Southern Cross Aviation LLC ("Southern Cross") and DNI Express Shipping Company ("DNI") in cases involving alleged failures to properly respond to OFAC administrative subpoenas issued under the RPPR. As reflected below, these actions signal an aggressive approach by OFAC with respect to non-compliance with the RPPR.

Southern Cross

The Finding of Violation was issued due to Southern Cross's failure to provide complete information in response to an administrative subpoena.[10] The subpoena was issued for information regarding transactions and other dealings with Iran, in particular related to a potential sale of helicopters to Iran via an Iranian businessman based in Ecuador. In response to this subpoena, Southern Cross first denied knowing or conducting business with the Iranian businessman or otherwise dealing with Iran, then subsequently admitted that a Southern Cross representative in Ecuador sent technical details to an Ecuadorian group

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for the potential sale and produced no documentation other than a company manual relating to export management. OFAC then issued a second Administrative Subpoena, specifically requesting documents related to the potential sale; Southern Cross produced a number of documents, including email exchanges directly with the Iranian businessman, as well as other documents related to the potential sale. In determining to issue a Finding of Violation, OFAC considered Southern Cross's reckless disregard for its obligations under the RPPR by failing to provide accurate and complete information, its actual knowledge of the conduct and its failure to fully cooperate as aggravating factors. OFAC considered the facts that Southern Cross apparently did not complete the sale, as well as their small size and lack of prior sanctions history as mitigating factors.

DNI

OFAC issued a Finding of Violation to DNI for violations of the RPPR based on information that DNI provided through outside counsel to OFAC during an investigation.[11] More specifically, OFAC determined, after reviewing DNI's responses to an administrative subpoena, that the company's responses contained contradictory, false, materially inaccurate, materially incomplete and misleading information. This was the case even though OFAC reminded DNI of its obligations pursuant to the RPPR after its initial response to the administrative subpoena. In determining to issue a Finding of Violation, OFAC considered DNI's reckless disregard for sanctions requirements by failing to provide accurate and complete information, its shipment and attempted shipment of goods to Sudan, its failure to correct its responses despite being given an opportunity to do so by OFAC, and its failure to fully cooperate with OFAC's investigation to be aggravating factors. OFAC viewed the fact that DNI is a small business, has no sanctions history and responded through outside counsel as mitigating factors.

Read together, these recent enforcement actions relating to the RPPR and the new amendments to the RPPR highlight OFAC's insistence on receiving comprehensive and truthful information from individuals and companies subject to OFAC regulations.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] 31 C.F.R.§ 501, "Reporting, Procedures and Penalties Regulations," (June 21, 2019) available here.

[2] 31 C.F.R. § 501.604-4.

[3] 31 C.F.R. § 501.604-4.

[4] "Blocking and Rejecting Transactions," OFAC Frequently Asked Questions ("FAQ") no. 36, available here.

[5] Omnibus accounts are not defined in the regulation.

[6] 31 C.F.R. § 501.603.

[7] 31 C.F.R. § 501.801.

[8] 31 C.F.R. § 501.602.

[9] 31 C.F.R. § 501.701.

[10] U.S. Department of the Treasury, Press Release, "Enforcement Information for August 8, 2019," (Southern Cross) available here.

[11] U.S. Department of the Treasury, Press Release, "Enforcement Information for August 8, 2019," (DNI) available here.

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