Old MacDonald of sanctions compliance and customer due diligence

If you are keeping score, it seems that sanctions compliance is a bit like the old nursery rhyme *Old MacDonald Had a Farm*. You know, "here a sanction, there a sanction, everywhere a sanction-sanction…."

Members of the anti-money laundering (AML) and sanctions compliance community should be aware of the economic sanctions programs put in place by the United States government. These programs are designed with two purposes. First to identify bad actors who are affiliated with rogue political regimes or with other individuals or organizations that are involved in all sorts of nefarious endeavors — including but not limited to — narcotics trafficking, transnational organized crime, terrorist organizations or the proliferation of weapons of mass destruction. Second they are designed to penalize those who enable business with those sanctioned entities. The U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) administers most of these sanctions programs. In recent years, the OFAC Specially Designated Nationals (SDN) List alone has averaged somewhere in excess of 70 updates annually. This is not even touching on the compliance universe represented by export control regulations, other U.S. government sanctions programs, or sanctions programs from other jurisdictions.

The U.S government has long sought to choke off funding to regimes, organizations and individuals that represent threats to U.S. interests, including Iran, Cuba and Syria, via enforcement of U.S. sanctions programs. Through record penalties and aggressive enforcement over the past several years, OFAC has tried to make the point crystal clear that enabling these bad actors, whether by intent or by circumstance, is simply not acceptable and is definitely not in anyone's best interest.

Sanctions laws and regulations, such as those promulgated by OFAC, have garnered considerable attention over the past several years, through major regulatory actions against global financial institutions including HSBC, Standard Chartered Bank, ING and Bank of Tokyo-Mitsubishi for violations of sanctions laws. Civil money penalties assessed against these four institutions ranged from US$258 million to $1.92 billion each — certainly attention getters — and examples of due diligence and process failures. Those institutions will certainly not be the last to run afoul of OFAC's regulations. This is especially true as there are conflicting laws in other jurisdictions that appear to directly clash with U.S. Treasury's regulations, thereby creating yet another "wrinkle" in the global sanctions compliance world.

Sanctions compliance is not for the faint of heart. While OFAC sanctions continue to grab headlines and advance the U.S. government's foreign policy agenda with well-publicized enforcement actions, other countries and regulatory bodies, including the United Kingdom, European Union and the United Nations, along with more than 60-plus other countries, have some sort of sanctions programs in place. This, to say the least, makes sanctions compliance a much greater challenge for both corporate and financial organizations. Compliance officers reading this are all too familiar with the anxiety that complexities of such regulations can bring to the forefront.

Knowledge of various sanctions programs and their intricate gradations is simply not enough. Understanding the art and science of exactly what data to examine, and when and how it should be examined is absolutely critical to success within the sanctions compliance process. Demonstrating a thorough grasp of the nuances of how filtering or screening processes function and knowing how to adjust aspects of the screening process, along with knowing what to do to verify or validate the match and how to perform necessary due diligence related to such matched entities, is equally vital to your success in making the screening process genuinely productive.

While corporations and financial institutions are contending with the ever-changing landscape of sanctions regimes both at home and abroad, and the increasingly "creative" measures that countries like Iran are employing to evade sanctions, the dawn of U.S. state-level sanction programs add even more complexity to the process; and may well increase your risks of heartburn as an unexpected consequence.

In recent years, the U.S. Congress has enacted legislation authorizing states to prohibit investments in, or divest assets from, Sudan and Iran. The Sudan Accountability and Divestment Act of 2007 authorizes states and local governments to adopt divestment or investment prohibition measures involving: (1) persons within state or local government determined to be conducting business operations in the Sudanese energy and military equipment sectors or (2) persons having a direct investment in or carrying on a trade or business with Sudanese entities or the Government of Sudan, provided certain notification requirements are met.

The Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA) which was enacted in 2010, includes provisions authorizing state and local governments to divest from those businesses making investments of US$20 million or more in Iran's energy sector after adequate investigation and notification have occurred. Both laws stipulate that a measure falling within the scope of the authorization is not pre-empted by any federal law or regulation.

So far more than two dozen U.S. state governments have, with much less fanfare than their federal brethren, implemented their own various sanctions laws, which are designed to prohibit state procurement as well as investment with companies doing business with certain countries or other entities that are under the scrutiny of sanctions by the U.S. government. Such laws are referred to as "divestment sanctions."

Increasingly state governments are penalizing parties for doing business with companies who in turn are doing business with sanctioned countries or prohibited parties. With the addition of such state-level laws, overall sanctions compliance can be more difficult than solving the Rubik's Cube puzzle while being blindfolded.

Another point of consternation and angst involves exactly how such state scrutinized organization lists are actually assembled and maintained. Frequently, such state lists may likely diverge from OFAC's List of Specially Designated List of Sanctioned Entities and Blocked Persons. Many business associations and others in the know have argued that state agencies lack the time, funding and subject-matter expertise to properly and accurately compile and maintain information on companies with business ties to sanctioned countries or entities. Without the resources and the interagency ties that OFAC has access to, states must rely upon open-source information obtained from news and media outlets, advocacy groups or other sources. The problem here is potentially one of informational quality concerning the targeted entity.

The advent of state sanction programs leaves financial institutions and other corporations to screen an ever-growing number of sanctions lists, adding yet another compliance headache to a field that seems to have no lack of them already. More information on state sanctions programs from the various state governments themselves may be found on various state government web sites, as well as the following site: http://www.fas.org/sgp/crs/misc/RL33948.pdf

Perhaps this discussion will spark both thought and action, not only about state sanctions list but also about the efficacy of your entire sanctions compliance program. When is the last time *your* organization had a truly independent review of your sanctions compliance program from top to bottom to make sure that your policies, procedures, information technology processes and day-to-day business operations are all fully aligned to meet your regulatory compliance needs in the *best manner possible?* If the answer is never, which happens much more often than many might admit, or if the answer is not for a while, then perhaps now is the proper time to take a look at these processes.

To be sure, there are a host of risks associated with doing business with bad actors that go beyond the scope of nationally or state sanctions programs. There are an equal number of risks associated with a program that may have the appearances of working well at first glance, but is off by "just a little" when the veneer is peeled back more closely for examination. But it is interesting to note that of the US$3.5 billion in civil money penalties assessed over the past 12-18 months by U.S. regulatory authorities, the largest penalty assessments all have sanctions program failures as core components of their regulatory issues.

Unfortunately, a good number of organizations have varying degrees of flaws in their sanctions compliance programs, but are happy "whistling by the compliance graveyard" because they have not been penalized for a program failure thus far. Often, the response to this suggestion is something like: "Thank you, but we have sound sanctions compliance policies in place." We all know that effective policies are one thing, but that implementation of proper, effective procedures is often another thing entirely.

If you were to ask any of the financial institutions that have recently been the recipients of civil money penalties whether they had sound policies in place, my guess is that their initial answer would be yes. The problem may not be policies but rather making sure the proper framework for execution of valid procedures is effectively in place. The next logical question seems to be: "What can I do about it?"

So…take a deep breath and take some time to make sure your sanctions compliance program and the related business processes that you have implemented are up to par in meeting sanctions regulations requirements associated with applicable state, national and international sanctions programs. An independent review and test of your program by parties who can look at your program in a truly objective manner might just be the next right move. A little proactive work on your part now can yield greater benefits and peace of mind within your organization tomorrow. A

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