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November 7, 2008

Office of Foreign Assets Control
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220
Attention: Request for Comment (Enforcement Guidelines)

Re: Economic Sanctions Enforcement Guidelines

Dear Sirs:

The Clearing House Association L.L.C. ("The Clearing House")[1] is pleased to comment on the Office of Foreign Assets Control's ("OFAC") interim final rule establishing the Economic Sanctions Enforcement Guidelines ("Guidelines") setting forth the general framework for the enforcement of the economic sanctions programs that OFAC administers.[2] The Guidelines were effective upon publication on the Federal Register and supersede the Economic Sanctions Enforcement Procedures for Banking Institutions ("Banking Procedures") that were published as an interim final rule in 2006[3] and the proposed Economic Sanctions Enforcement Guidelines ("2003 Guidelines") that were published for comment in 2003 but never adopted as a final rule.[4] OFAC developed the new Guidelines in response to the International Emergency Economic

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[1] The members of The Clearing House are: ABN AMRO Bank, N.V.; Bank of America, National Association; The Bank of New York Mellon; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

[2] 73 Fed. Reg. 51,933 (Sept. 8, 2008).

[3] 71 Fed. Reg. 1971 (Jan. 12, 2006).

[4] 68 Fed. Reg. 4429 (Jan. 29, 2003).

Powers Enhancement Act,[5] which amended section 206 of the International Emergency Economic Powers Act ("IEEPA")[6] to increase the penalties for violating OFAC's sanctions.

The Guidelines make several changes to the superseded Banking Procedures and 2003 Guidelines by

- Establishing "general factors" that OFAC will use to determine the enforcement response rather than the aggravating and mitigating factors that were in the superseded guidelines.
- Providing for the issuance of "cautionary letters" and "findings of violations."
- Distinguishing between egregious and non-egregious violations.
- Establishing new procedures for determining the penalty amount in the case of violations.

The Clearing House believes that a number of the Guidelines' features are helpful, particularly the emphasis on general factors affecting administrative action. Nonetheless, in many respects the more generalized approach taken in the Guidelines is a step backward. Most importantly, the new Guidelines fail to recognize "the unique role [of banking institutions] in the implementation of OFAC sanctions programs and the nature of the transactions in which such institutions engage,"[7] qualities that prompted OFAC to develop enforcement procedures specifically directed toward banking institutions. These procedures focused heavily on the compliance efforts that banking institutions have established to ensure that their activities are consistent with OFAC's rules and OFAC's close work with federal banking regulators to develop standards to evaluate these compliance programs.

OFAC appears to have stepped away from enforcement procedures specifically directed toward banking institutions and toward a more generalized approach that treats banks the same as all other organizations. While this approach may have the superficial appeal of treating all

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5 Pub. L. No. 110-96, 121 Stat. 1011-12 (2007).
6 50 U.S.C. § 1705.
7 71 Fed. Reg. at 1972.

organizations equally, in fact it results in treating banks unfairly precisely because it does not recognize the place that banks hold as intermediaries in global financial transactions and the vigorous compliance efforts that banks have undertaken to ensure that the U.S. financial system is not used to support the activities of sanctions targets, including terrorists and narcotics traffickers.

More broadly, by creating a more generalized approach, OFAC seems to have disregarded the most important principle that banks must address: managing risk. Under the OFAC provisions of the manual used by bank examiners to test a bank's compliance with anti-money laundering and related regulations, which were written with OFAC's substantial comment, banks are expected to establish an OFAC compliance program "commensurate with their OFAC risk profile (based on products, services, customers, and geographic locations)."[8] The new Guidelines do not acknowledge this risk-based approach, and, consequently, it is difficult to determine what role a bank's risk assessment of its operations and products will play in any determination under the Guidelines. In a risk-based approach, if a bank has assessed the risks of its operations and products in accordance with regulatory requirements, and its regulators are in agreement with the risk-assessment procedure and the resources placed to manage that risk, the Guidelines should recognize this as a significant factor in determining the appropriate response to an apparent violation of OFAC's rules.

We believe that OFAC should adopt the policy of its sister agency, the Financial Crimes Enforcement Network ("FinCEN"), which was summarized recently by its director, James Freis:

> We also do not pursue enforcement actions in instances where we may disagree with a financial institution's reasoned judgment in good faith regarding the development and implementation of its anti-money laundering program, under the risk-based approach. We consider enforcement actions only when a financial institution exhibits a systemic breakdown in BSA compliance that results in relatively significant violations of the reporting, recordkeeping and other obligations of the BSA.[9]

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[8] Federal Financial Institutions Examination Council, *Bank Secrecy Act / Anti-Money Laundering Examination Manual* 140 (2007).

[9] James H. Freis, Jr., Director, FinCEN, "The Objectives and Conduct of Bank Secrecy Act

For these reasons, we strongly urge OFAC to reinstitute the Banking Procedures, modified as recommended in The Clearing House's letter of April 25, 2006 (attached).

DEFINITIONS

Voluntary Self-Disclosure

Voluntary self-disclosure plays a very important role under the Guidelines. Voluntary self-disclosure will result in an automatic 50% reduction in the amount of the potential penalty,[10] and in non-egregious cases (which OFAC expects will be the majority[11]) the penalty will be capped at $125,000.[12] Yet the definition of voluntary self-disclosure set out in the Guidelines is very narrow and to some extent self-defeating.

The Guidelines define voluntary self-disclosure as "self-initiated notification to OFAC of an apparent violation by a Subject Person . . . prior to the time that OFAC . . . discovers the apparent violation . . . ."[13] But a self-disclosure is not considered to be voluntary if

> a third party is required to notify OFAC of the apparent violation or a substantially similar apparent violation because a transaction was blocked or rejected by that third party (regardless of whether or when OFAC actually receives such notice from the third party and regardless of whether the Subject Person was aware of the third party's disclosure) . . . .[14]

The Clearing House believes that a determination of whether a subject person has voluntarily self disclosed should focus exclusively on the actions of the subject person and should take no account of what another person might do or be required to do. Self-disclosure should be considered voluntary even when another party has already disclosed the violation.

Enforcement," Prepared Remarks for ABA/ABA Money Laundering Enforcement Conference, (Oct. 20, 2008), available at http://www.fincen.gov/news_room/speech/html/20081020.html.

10 73 Fed. Reg. at 51,940.

11 *Id.* at 51,935.

12 *Id.* at 51,940.

13 *Id.* at 51,936.

14 *Id.*

When a U.S. bank is an intermediary bank in a funds transfer, it will run the payment order it has received from its sender through its OFAC filter before it issues a corresponding payment order to the next bank (another intermediary bank or the beneficiary's bank). These filters are as good as the banks can make them, but no system is perfect and, inevitably, a filter will occasionally miss a transaction. However, each bank has built its own filter so there are small variations among banks in how they would treat individual transactions, and a transaction that is missed by one bank's filter may be caught at a subsequent bank, perhaps because of information that is available only to that bank. If Bank B catches a transaction that has passed through Bank A, it will often notify Bank A of its action. Bank A will then conduct an investigation to see what went wrong and report the violation and its remedial actions to OFAC. The delay in notifying OFAC is not due to any culpability on Bank A's part — it merely made an inadvertent error and had to make a thorough investigation to ensure that it had all of the facts so that it could give OFAC a complete report. We do not believe that it is fair to penalize a bank in this situation. Even where Bank B has already self-disclosed, Bank A's subsequent self-disclosure should be considered voluntary because that disclosure would give OFAC far more information about the transaction than OFAC would receive from the other person, including details of the bank's investigation, information on related transactions, and information on remedial actions that the bank has taken, including on how filtering terms might be improved.

OFAC should also realize that the narrow definition of voluntary self-disclosure could act as a deterrent to self-disclosure. Because a subject person would get no benefit from self-disclosure unless the disclosure is voluntary, it has no incentive to self disclose if the self-disclosure is not voluntary under the Guidelines. The definition of voluntary self-disclosure implies that if Bank A and Bank B both miss a transaction and one of them later discovers the error and reports it to OFAC, that self-disclosure could never be treated as voluntary because the other bank would have been under an obligation to disclose. Given the monetary penalties and significant reputational risk involved in being found to have violated OFAC's sanctions, the definition works as a disincentive to disclose if another party could be under an obligation to disclose unless or until OFAC or the bank's regulator discovers the violation.

In this regard, it is important to note that OFAC posts the details of settlements on its web page, and OFAC's description of the settlement typically includes a statement that "this matter was voluntarily disclosed to OFAC" or "this matter was not voluntarily disclosed to OFAC." If the bank disclosed the matter on its own initiative, but such disclosure was not considered "voluntary" because another person was also under an obligation to report the matter, then OFAC would incorrectly announce that the bank had not disclosed the matter on its own volition. This would be a misleading result and would damage the bank's reputation by creating the incorrect impression that the bank had not in fact disclosed the matter and had not cooperated with the U.S. government. In our member banks' experience, the press simply repeats whatever is published on the OFAC web site, thus causing further unwarranted damage to the bank's reputation.

We therefore strongly recommend that OFAC revise the definition of voluntary self-disclosure by removing the language quoted above at footnote 14.

GENERAL FACTORS AFFECTING ADMINISTRATIVE ACTION

Willful or Reckless Violation of Law

OFAC states that the type of enforcement action will depend on the nature of the apparent violation and the harm caused. "Generally, to the extent the conduct . . . is the result of willful misconduct or a deliberate intent to violate . . . the law, the OFAC enforcement response will be stronger."[15] We believe that OFAC should make it clear that conduct based on a reasoned analysis of the OFAC's regulations, with the assistance and review of counsel, will not be characterized as willful or reckless or determined to have been taken with the awareness of management that the conduct constitutes an apparent violation.

Awareness of Conduct at Issue

Reason to Know. OFAC states that "the greater the Subject Person's actual knowledge of, or reason to know about, . . . an apparent violation, the stronger OFAC's enforcement response will

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15 *Id.* at 51,937.

be."[16] If the subject person did not have actual knowledge, then OFAC will look to whether the person had reason to know or should reasonably have known, "based on all readily available information and with the exercise of reasonable due diligence."[17]

This provision appears to be an overly aggressive expansion of the concept of knowledge and would create a new duty to investigate. We believe that is inappropriate and should be deleted so that the focus is on facts known to a subject person without investigation beyond that required by applicable law and regulation.

Management Involvement. The Guidelines make it clear that in the case of an organization, the focus will be "on supervisory or managerial level staff in the business unit at issue, as well as senior officers and managers," with key questions centering on whether the transaction was "undertaken with the explicit or implicit knowledge of senior management," and, if not, whether there was "oversight intended to detect or prevent violations."[18]

The Clearing House believes that this focus is appropriate but that OFAC should make it clear that the actions of a rogue employee, even a rogue employee in a supervisory or managerial position, will not be attributable to the organization so long as the bank had in place reasonable policies and procedures to detect or prevent violations or OFAC's regulations.

Individual Characteristics

In determining what sort of administrative action to take, OFAC looks at the individual characteristics of the subject person. While we agree that this is appropriate, it would also appear that banks, especially large, globally active banks, would be especially vulnerable under the kinds of factors that OFAC would consider under this heading. Such banks are commercially sophisticated and experienced with OFAC and its enforcement program; they are large organizations with ample resources; and they will invariably have a history of sanctions violations. Yet this is the nature of the banks' business, serving as they do as a central clearing

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16 *Id.*
17 *Id*
18 *Id.*

point for the international payments system. Each day they handle hundreds of thousands of transactions, review thousands of them as possible prohibited transactions under OFAC's regulations, and correctly handle virtually all of those that should be blocked or rejected. It is inevitable that a small proportion of these transactions will be missed, which in the great majority of circumstances is due to the failure of a bank's OFAC filter to recognize a blocked party or due to an inadvertent clerical error, regardless of the amount resources of applied to filtering or training of staff. As a result, the banks will inevitably have a "history of violations." We believe it is important for OFAC to recognize that the majority of violations are related to software updates and human error.

We believe that OFAC should make it clear that in the case of banks, the key aspect that will be taken into account will be the quality and effectiveness of its compliance program, and if a bank's compliance program is deemed to be reasonable under the standards established by its primary federal regulator, the bank will not be subject to penalties for inadvertent violations of OFAC rules unless there are extraordinary circumstances.

Cooperation with OFAC. OFAC will also look at the "nature and extent of the Subject Person's cooperation with OFAC," including "[d]id the Subject Person agree to a statute of limitations waiver or tolling agreement?"[19] This section should be removed from the Guidelines.

OFAC generally cannot impose civil money penalties after five years from the date of the alleged violation unless the subject person agrees to waive the statute of limitations. There are strong public policy reasons for statutes of limitations, the most important being fairness to the subject person (it would be unfair to keep the threat of penalties hanging over the subject person over a long period of time to the point where anyone having personal knowledge of the circumstances surrounding the alleged violation has long since left the organization) and encouraging OFAC to act with dispatch. Allowing OFAC to threaten the subject person with being labeled as uncooperative and thereby subject to penalties in other actions if the person refuses to waive its rights is unfair and goes against these important public policies.

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[19] *Id.* at 51,938.

Sanctions Violation History. Another factor in determining the type of enforcement action to be undertaken is "[t]he Subject Person's history of sanctions violations, including OFAC's issuance of prior findings of violations or cautionary, warning or evaluative letters, or other administrative actions."[20] But cautionary letters are issued when "OFAC determines that there is insufficient evidence to conclude that a violation has occurred or that a finding of violation is not warranted under the circumstances."[21] If OFAC has concluded that no violation has occurred or a finding of violation is not warranted, then it seems axiomatic that the cautionary letter should not be considered in subsequent cases. We therefore recommend that Section III(D)(4) be amended as follows:

> The Subject Person's history of sanctions violations, including OFAC's issuance of prior findings of violations ~~or cautionary, warning or evaluative letters, or other administrative actions~~.

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We hope these comments are useful. If you have any questions, please contact Joseph R. Alexander, Senior Counsel, at 212-612-9234 or joe.alexander@theclearinghouse.org.

Very truly yours,

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20 *Id.*

21 *Id.* at 51,9387.

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April 25, 2006

Office of Foreign Assets Control
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Attention: Assistant Director of Records
Requests for Comments
(Enforcement and Procedures)

Re: Economic Sanctions Enforcement Procedures for Banking Institutions

Dear Sirs:

The Clearing House Association L.L.C. ("The Clearing House")[1] is pleased to comment on the interim final rule adopting Appendix A to 31 C.F.R. pt. 501, "Economic Sanctions Enforcement Procedures for Banking Institutions" ("Procedures").[2]

Under the Procedures, "OFAC will periodically evaluate a banking institution's apparent OFAC-related violations in the context of the institution's overall OFAC compliance program and specific OFAC compliance record."[3] After this review, OFAC will

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[1] The members of The Clearing House are Bank of America, National Association; The Bank of New York; Citibank, National Association; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; LaSalle Bank, National Association; UBS AG; U.S. Bank National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association.

[2] 71 Fed. Reg. 1971 (Jan. 12, 2006).

[3] Id. at 1972.

contact the bank regarding its preliminary assessment, and, after discussions with the bank, notify it of OFAC's proposed action with respect to each apparent violation for the period under review. If the proposed action includes a civil money penalty, current OFAC procedures will be followed.

The Clearing House believes that the new Procedures are a vast improvement over the ones that have been in place, and will create a more cooperative relationship between OFAC and the banks. We therefore strongly support OFAC's general approach. Nonetheless, we believe that some aspects of the Procedures are inconsistent with the cooperative approach that the banking industry and OFAC both seek and are detrimental to achieving that common goal.

Factors Affecting Administrative Action

The Procedures state that in making a decision regarding administrative action with respect to a bank, OFAC will consider a number of factors. While we agree with OFAC's proposal to consider a bank's overall OFAC compliance program and record, we find that some of the factors, or the application of some of these factors, cause us concern.

> *L. The level of OFAC action that will best lead to enhanced compliance by the banking industry.*
>
> *M. The level of OFAC action that will best serve to encourage enhanced compliance by others.*

As we understand these factors, OFAC may wish to impose a severe penalty on a bank, not because the bank's own actions justify it, but because OFAC desires the *in terrorum* effect the penalty will have on others. But setting a penalty to make an example of a defendant is fundamentally unfair, and The Clearing House and its member banks strongly object to incorporating this principle into the Procedures. If a bank's action or failure to act violates OFAC's rules, the penalty should be based solely on the bank's own culpability, not OFAC's desire to send a message. We find these factors to be in contradiction to OFAC's stated goal of "tak[ing]into account that each banking institution's situation is different and that its compliance program should be tailored to its unique circumstances."[4]

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[4] Id.

Paragraphs L and M should be removed from the Procedures.

J. Applicability of a statute of limitations and any waivers thereof.

OFAC cannot impose a penalty if the statute of limitations governing the action under review has expired. Why, then should the waiver of a statute of limitations come into play in determining what the penalty should be? The answer appears to be that large banks that are active in international payments frequently have penalty actions pending before OFAC, and OFAC will look favorably on those that routinely waive their rights under the limitations statutes and punish (in the form of higher penalties) those who do not routinely waive these rights. Nevertheless, because of the nature of the international payments business, large international banks know that they will always have to go before OFAC again in the future. Knowing that OFAC will take their willingness to waive any applicable statutes of limitations into account when it determines future penalties will force large international banks into waiving the statute in virtually all cases.

Statutes of limitations exist for a reason. They promote fairness by limiting actions after a period of time when memories fade and evidence may not be available; they also promote certainty in legal relations. For these reasons, it should be against public policy for a government agency to penalize those who decline to give up the protection that statutes of limitations afford. We therefore recommend that this paragraph be removed from the procedures.

E. The voluntary disclosure to OFAC of the apparent violation or violations by the banking institution.

F. Providing OFAC a report of, or useful enforcement information concerning, the apparent violation or violations. Providing a report, but not a voluntary disclosure, of the apparent violation or violations will generally be accorded less weight as a mitigating factor than would provision of a voluntary disclosure.

The Federal Register notice makes it clear that "a voluntary disclosure . . . does not include a disclosure when another party

is required to file a report concerning the same transaction . . ." even if the other party never actually files the report.[5]

Like the previous section, these points affect the essential fairness of the Procedures. None of our member banks knowingly violates OFAC sanctions. If a bank does execute a payment order involving a blocked entity, it is because the bank's filter did not recognize the blocked party or because a clerk made a mistake. If the next U.S. bank identifies the transaction as involving a sanctioned entity, blocks the transfer, and notifies OFAC, it will usually inform the bank that missed the transaction out of courtesy. The bank that missed the transaction will then file its own report to OFAC. We believe that this report should also be counted as a voluntary report or, if regarded as involuntary, receive the same credit in the Procedures as a voluntary report.

Because these infractions are inadvertent and not intentional, it makes no sense to penalize banks for not reporting them before another party has become aware of them. If there is a persistent pattern of missed transactions, this may be evidence that a bank is using outdated intercept technology or that there are some other failures in its compliance program. In such a case, OFAC may be justified in taking action on the basis of these failures. But the fact that the bank itself reported these missed transactions after they have been brought to its attention should not in itself be a factor in determining the penalty.

A. The institution's history of sanctions violations.

While we do not object to OFAC using an institution's compliance history in general, the emphasis here seems to indicate that a bank can never escape its history with OFAC. Again, these are inadvertent violations, not willful ones. Missed transactions ought to be balanced against the transactions that have been handled correctly as a measure of the effectiveness of the bank's compliance program. This is the point of items B and C on the Procedure's list of factors affecting administrative action. In order to ensure that missed transactions are not accorded undue weight, we suggest that items A, B, and C be combined into a single item, with A and B relegated to glosses on the last part of the present item C, the bank's "history of compliance with OFAC regulations."

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[5] Id. at 1973.

Annex B—Sound Banking Institution OFAC Compliance Program

Testing. OFAC states that except for low-risk institutions, "a banking institution should have a periodic test of its OFAC program performed by its internal audit department or by outside auditors, consultants, or other qualified independent parties . . . at least once a year."[6] This requirement is overly burdensome. Generally accepted practice is to have the compliance function do a self-assessment once per year and have the bank's internal or outside auditors review the program when appropriate, based on an assessment of the program's risks. This is the norm that has been acceptable to bank regulators, and there is no reason to follow a more rigorous audit schedule for OFAC compliance.

OFAC also states that "[i]f violations are discovered, they should be promptly reported to both OFAC and the banking institution's banking regulator."[7] If violations are discovered, they should be reported to OFAC because that is what OFAC's regulations require. If a sanctions violation also appears to reveal a possible violation of law, the bank may also be required to file a suspicious activity report ("SAR"). Neither regulation, however, requires a bank to report to its regulator. This requirement thus goes beyond the relevant regulations and should be deleted. If it is not deleted, regulatory agencies will be deluged with reports of violations that are merely the result of a transaction not being picked up by the bank's filter or a mistake by a clerk in the bank's wire room. We do not believe that there is any good reason for a bank to notify its regulator in these circumstances.

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[6] Id. at 1976.

[7] Id.

We hope these comments are useful. If you have any questions, please call Joseph R. Alexander, Senior Counsel, at 212-612-9334.

Very truly yours,