



# Audit Report



OIG-07-048

FOREIGN ASSETS CONTROL: Actions Have Been Taken to Better Ensure Financial Institution Compliance With OFAC Sanction Programs, But Their Effectiveness Cannot Yet Be Determined

September 20, 2007

Office of  
Inspector General  
Department of the Treasury



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## Abbreviations

FBA	federal banking agencies
FDIC	Federal Deposit Insurance Corporation
FFIEC	Federal Financial Institutions Examination Council
GAO	Government Accountability Office
IRS	Internal Revenue Service
MOU	memorandum of understanding
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OFAC	Office of Foreign Assets Control

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OIG	Office of Inspector General
OTS	Office of Thrift Supervision
RFPA	Right to Financial Privacy Act
SDNs	Specially Designated Nationals and Blocked Persons
SEC	Securities and Exchange Commission

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*The Department of the Treasury  
Office of Inspector General*

September 20, 2007

Adam Szubin  
Director, Office of Foreign Assets Control

This report presents the results of a follow-up audit we conducted to determine whether the Office of Foreign Assets Control (OFAC) had taken action to improve its ability to ensure that financial institutions are complying with OFAC sanctions. In April 2002, we reported that OFAC was limited in its ability to monitor financial institution compliance. We recommended at the time that OFAC inform Congress of legislative impairments which prevent OFAC from conducting its own examinations of banks or having access to their financial records.<sup>1</sup>

OFAC administers and enforces economic and trade sanctions against targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. Although not required to have an OFAC compliance program by specific law or regulation, financial institutions are required to block or reject any transactions involving targeted individuals, companies, or other organizations with a link to these entities. OFAC has direct administrative and enforcement authority over regulated institutions, but compliance examinations of banks and other financial institutions are generally conducted by the five federal banking agencies (FBAs) and other federal financial regulators.<sup>2</sup> The

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<sup>1</sup> Treasury Office of Inspector General (OIG), *Foreign Assets Control: OFAC's Ability to Monitor Financial Institution Compliance Is Limited Due to Legislative Impairments*, OIG-02-082 (Apr. 26, 2002).

<sup>2</sup> The FBAs are, within Treasury, the Office of the Comptroller of the Currency and Office of Thrift Supervision, and external to Treasury, the Federal Deposit Insurance Corporation, Board of Governors of

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regulators manage their compliance examinations independently from OFAC.

We performed our fieldwork on this follow-up audit from January 2005 to December 2006. During this period, we also performed audits at the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) pertaining to their OFAC compliance examination programs. A description of audit objective, scope, and methodology is included as appendix 1.

## Results in Brief

OFAC has not sought legislative change to improve its ability to ensure financial institutions comply with OFAC sanctions. OFAC management is satisfied with the current system. Management believes, as it did in our prior audit, that there is a high degree of compliance with its sanctions programs based on required blocking and reject reports filed by financial institutions, the results of OFAC's follow-up on those reports, information received by OFAC outside the system of required reporting, and the examinations of financial institutions conducted by FBAs.

In response to our April 2002 report, OFAC did agree that (1) regulator information sharing could be improved and (2) increased oversight and detailed account reviews by regulators could be beneficial. Since our prior report was issued, two significant actions have occurred.

As the first action, in April 2006 OFAC entered into a Memorandum of Understanding (MOU) with the FBAs to improve information sharing so as to mitigate the risk of not being made aware of financial institution noncompliance issues. Although it is too early for us to evaluate its effectiveness, the MOU caveats that FBAs share information with OFAC "to the extent permitted by law, including the Right to Financial Privacy Act (RFPA)." OFAC had previously indicated that a technical amendment to the RFPA might be needed and that Treasury was reviewing the possibility of

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the Federal Reserve System, and National Credit Union Administration. Other federal financial regulators include the Securities and Exchange Commission, Commodity Futures Trading Commission, and Internal Revenue Service.

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such a change. OFAC currently believes that RFPA only minimally impacts its ability to obtain information from regulators and financial institutions. Accordingly, no changes to the RFPA have been made or proposed.

As the second action, with regard to regulatory oversight, in June 2005 the Federal Financial Institutions Examination Council (FFIEC)<sup>3</sup> issued the *Bank Secrecy Act/Anti-Money Laundering Examination Manual* (FFIEC manual). The FFIEC manual provides comprehensive guidance for the FBAs to follow when conducting OFAC compliance examinations.<sup>4</sup> Based upon audits at OCC and OTS by our office and audits by the Federal Deposit Insurance Corporation (FDIC) Office of Inspector General (OIG) and National Credit Union Administration (NCUA) OIG of their respective agencies, this guidance was clearly needed. But as a matter that is not addressed by the FFIEC manual, the four audits also found that examination documentation did not provide persuasive evidence that financial institution OFAC compliance programs were adequate. In response, the four FBAs agreed to improve OFAC examination documentation going forward.

Recognizing that these recent actions need time to mature, we are recommending that OFAC monitor whether the OFAC-related examination information the FBAs provide is sufficient to assess compliance at specific institutions and for the overall banking industry. If necessary, appropriate action should be taken, such as seeking modification to the April 2006 MOU or requesting from Congress an amendment to the RFPA. We also are recommending that OFAC determine whether MOUs should be established with other federal financial regulators and self-regulatory organizations<sup>5</sup> for sharing information on financial institutions for which they have OFAC oversight responsibility.

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<sup>3</sup> The FFIEC, established under title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the examination of financial institutions by the federal bank regulators. The Financial Services Regulatory Relief Act of 2006 added a representative state regulator as a full voting member.

<sup>4</sup> The FFIEC manual was updated in 2006 and 2007.

<sup>5</sup> Self-regulatory organizations are non-government organizations that have statutory responsibility to regulate their own members, such as the New York Stock Exchange and National Association of Securities Dealers.

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Our April 2002 report also included six recommendations to improve other aspects of OFAC sanction program administration. We found that OFAC has taken or is in the process of taking appropriate corrective actions as described in appendix 2.

In response to our draft report, OFAC reiterated its previously stated position that the information it obtains from mandatory blocking and reject reports and from other sources, complemented by information shared by the FBAs under the MOU, enable it to adequately assess compliance at specific institutions and for the overall banking industry. According to OFAC, RFPA is a minor hindrance because OFAC has sufficient authority and access to violation and examination information. OFAC, however, will continue to monitor the situation to assure the usefulness of information from financial institution examinations. Regarding information sharing with self-regulatory organizations and the Internal Revenue Service (IRS), OFAC said it shares information with the Securities and Exchange Commission (SEC) and self-regulatory organizations, and is in process of establishing an MOU with IRS. OFAC will monitor the efficiency and effectiveness of the procedures established with SEC and the self regulatory agencies and make adjustments as necessary. OFAC has also signed MOUs with 17 state banking agencies. OFAC's response is included in this report as appendix 3.

## **Background**

### **OFAC Mission**

The mission of OFAC, an office within the Department of the Treasury's Office of Terrorism and Financial Intelligence, is to administer and enforce economic and trade sanctions, based on U.S. foreign policy and national security goals, against targeted foreign countries, regimes, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. OFAC acts under presidential wartime and national emergency powers, as well as authority granted by specific legislation, to impose controls on transactions and freeze foreign assets under U.S. jurisdiction.

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Economic sanctions are intended to deprive the target of the use of its assets and deny the target access to the U.S. financial system and the benefits of trade, transactions, and services involving U.S. markets. To prohibit commercial or financial transactions involving sanctioned countries, entities, or individuals, OFAC primarily relies on delegations of authority made pursuant to the President's broad powers under the Trading With the Enemy Act and the International Emergency Economic Powers Act. OFAC currently administers 30 economic sanctions programs pursuant to presidential and congressional mandates. Though 8 of these 30 programs have been terminated, they still require residual administrative and enforcement activities.

As part of its enforcement efforts, OFAC publishes on its web site a list of individuals and companies controlled by, or acting on behalf of, targeted countries. It also lists individuals, groups, and entities, such as terrorists and narcotics traffickers designated under programs that are not country-specific. Collectively, such individuals and companies are called Specially Designated Nationals and Blocked Persons (SDNs).

### **Financial Institution Responsibilities**

In order to ensure that a transaction is not processed in violation of OFAC sanctions, financial institutions by necessity should have systems to adequately monitor their financial transactions. When a transaction is found to match an entry on OFAC's listings, the transaction must either be blocked or rejected. A blocked transaction immediately imposes an across-the-board prohibition against transfers or dealings of any kind regarding the account.<sup>6</sup> A rejected transaction is one that does not contain a blockable interest,<sup>7</sup> but nonetheless cannot be processed without violating

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<sup>6</sup> The blocked funds are placed in an interest-bearing account by the financial institution and are not to be released without an official OFAC license authorizing the release of the funds. OFAC does not take possession of any funds that are blocked.

<sup>7</sup> As an example cited in OFAC literature, the Sudanese Sanctions Regulations prohibit transactions in support of commercial activities in Sudan. Therefore, a bank would have to reject a funds transfer between two companies if the transfer involves an export to a company in Sudan even if the companies are not SDNs. Because Sudanese Sanctions would only require blocking transactions with the Government of Sudan or SDNs, there would be no blockable interest in the funds between the two

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OFAC prohibitions. When a financial institution blocks or rejects a transaction, the institution is required to file a report with OFAC within 10 business days.

OFAC can impose civil penalties, criminal penalties, or both for noncompliance with the established sanctions. Civil penalties can range from \$11,000 to \$1 million per infraction, and criminal violations can result in corporate and personal fines of up to \$10 million and imprisonment for up to 30 years.

### **Role of Regulators**

OFAC generally relies on regulators to ensure that financial institutions implement appropriate programs to help ensure that the financial institutions do not process transactions in violation of OFAC sanctions. OFAC's access to information held by the FBAs is restricted under RFP. Specifically, information obtained by FBAs involving an account of an individual on the books of a U.S. financial institution cannot be shared with anyone other than another financial regulator. In this regard, RFP does not define OFAC as a regulator; therefore, this subset of information can only be shared in redacted form. OFAC can request and receive this information directly from the financial institution using its own authorities.

### **GAO Audit**

In September 2004, the Government Accountability Office (GAO) issued a report that recommended that Treasury seek legislative authority, if necessary, to enhance OFAC's ability to ensure financial institution compliance with sanctions by allowing regulators to share complete information from their examinations with OFAC.<sup>8</sup> Treasury responded by maintaining that it was uncertain whether legislative changes were necessary to enhance information sharing between OFAC and regulators. Treasury stressed that it had confidence in the manner and level of

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companies. However, because the transactions would constitute support of Sudanese commercial activity, which is prohibited, the bank can not process the transaction and must reject the transaction.

<sup>8</sup> GAO, *Foreign Regimes' Assets: The United States Faces Challenges in Recovering Assets, but Has Mechanisms That Could Guide Future Efforts*, GAO-04-1006 (Sept. 14, 2004).

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compliance and monitoring that occurred in the current system and stated that comprehensive arrangements would be in place shortly to enhance information sharing between OFAC and regulators.

## Findings

### Finding 1 **OFAC Did Not Seek Additional Legislative Authority, But Has Signed an MOU With Regulators to Share Information**

In our April 2002 report, we recommended that Treasury inform Congress that OFAC lacks sufficient authority to ensure that financial institutions comply with OFAC sanctions requirements. OFAC did not agree that its monitoring efforts were hampered by a lack of legislative authority and asserted, both in response to our earlier report and today, that there is a high degree of financial institution compliance with OFAC sanctions. Although OFAC did not seek legislative change, OFAC management agreed that it could benefit from regulators sharing more information with OFAC. As a means of achieving this end, the five FBAs and OFAC signed an MOU in April 2006 to facilitate the sharing of OFAC-related examination results.

While it is too early to evaluate the effectiveness of the MOU, OFAC offered several examples of how the MOU has facilitated communication with the FBAs. Even with the MOU in place, RFPA-related restrictions involving accounts of individuals at U.S. financial institutions exist. OFAC believes the restrictions are minimal and do not affect information sharing.

#### **OFAC Believes its Authority is Sufficient**

In response to our April 2002 report, OFAC asserted that it did not need additional legislative authority to ensure that U.S. financial institutions are complying with OFAC sanctions. OFAC's position, which has not wavered, is that the overall compliance level is very strong and the monitoring that occurs under the current system is sufficient. In addition, according to OFAC, the banking industry has developed a heightened awareness of OFAC regulations and prohibitions on dealing with targeted entities and extensively uses interdict software to identify illegal transactions. Furthermore,

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OFAC believes that testing of transactions at the tens of thousands of financial institutions would duplicate the work of regulators and require a massive new OFAC bureaucracy, while not having a significant effect on compliance.

Our April 2002 report did not recommend or suggest that OFAC establish a new bureaucracy to duplicate the work of regulators. However, we believed then, as we do now, that by relying primarily on third parties to assess financial institutions' compliance with OFAC requirements, OFAC may be at risk of not knowing of noncompliance issues.

Specifically, both OFAC and regulators are barred by statute from sharing certain information about accounts of individuals at U.S. financial institutions. To make such information sharing easier, OFAC had previously indicated that a technical amendment to the RFPA might be needed and that Treasury was reviewing the possibility of such a change. OFAC currently believes that the RFPA is only minimally restrictive and access to financial institution information is generally satisfactory. Thus, no changes to the RFPA have been made or proposed.

### **Effect of MOU on Sharing of OFAC-Related Compliance Examination Results Are Not Fully Known**

In April 2006, OFAC and the five FBAs (OCC, OTS, FDIC, Board of Governors of the Federal Reserve System, and NCUA) signed an MOU that established procedures for the exchange of certain information between OFAC and the regulators. The MOU's purpose is to address RFPA-related restrictions that have prevented OFAC from obtaining OFAC-related examination results from the regulators. However, based on the terms of the MOU, the information exchange may still be restricted by RFPA.

The FBAs are to notify OFAC promptly of any apparent, unreported sanctions violations discovered in the course of an examination. In addition, they are to notify OFAC when significant deficiencies are discovered in a financial institution's policies, procedures, and processes for ensuring compliance with OFAC regulations. Finally, in cases in which OFAC-related deficiencies have been identified, OFAC may make a written request for information relating to the

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examination or the supervisory findings regarding a financial institution's policies, procedures, and processes for ensuring OFAC compliance. The FBAs are to provide the examination information and other information specified in the MOU to the extent permitted by law, including the RFPA. Since no change has been made to the RFPA statute, it is unclear how restrictive this caveat will be. However, OFAC believes that the caveat will not have a significant effect on information sharing.

Furthermore, because the MOU was recently signed, it is too soon to assess its effectiveness in improving information sharing between examiners and OFAC. However, OFAC believes the MOU has been beneficial. OFAC said FBAs have provided information in response to OFAC requests or in problematic situations where the regulator did not have responsibility. In addition, OFAC said it had requested that they perform examinations where a financial product appeared risky. We did not verify this information.

We believe the restriction on sharing information related to individual accounts maintained at U.S. financial institutions could reduce its effectiveness. As mentioned before, the provisions of the MOU are subject to constraints imposed by RFPA. Although OFAC believes that RFPA imposes minimal constraints, the MOU's effectiveness in improving the sharing of information remains uncertain and untested at this point. Also, the MOU may be terminated by OFAC or any of the FBAs with 30 days written notice.

In December 2006, OFAC informed us that it was working with the Council of State Bank Supervisors to enter into MOUs with state supervisory agencies. In its September 2007 response to our draft report, OFAC stated that it now has MOUs with 17 state agencies. It should be noted that in addition to state-regulated banks, OFAC requirements impact self-regulatory organizations regulated by SEC and the Commodity Futures Trading Commission and certain industries regulated by the IRS.<sup>9</sup> Accordingly, OFAC needs to determine whether MOUs should be established with these agencies as well.

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<sup>9</sup> Industries regulated by the IRS for Bank Secrecy Act and OFAC compliance include casinos, money services businesses, insurance companies, and jewelers.

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## Finding 2

### **New OFAC Compliance Examination Guidelines Could Ensure Consistent Coverage**

In an effort to implement uniform Bank Secrecy Act and OFAC examination procedures among the FBAs, in June 2005 the FFIEC released the *Bank Secrecy Act/Anti-Money Examination Laundering Manual*.<sup>10</sup> OFAC partnered with the FBAs to create the OFAC examination section of the FFIEC manual.

The FFIEC manual states that, as a matter of sound banking practice and in order to ensure compliance, a bank should establish and maintain an effective, written OFAC compliance program. The program should identify high-risk areas, provide for appropriate internal controls for screening and reporting, establish independent testing for compliance, designate a bank employee or employees as responsible for OFAC compliance, and create training programs for appropriate personnel in all relevant areas of the bank. Part of the FFIEC guidance prescribes that a fundamental element of a sound OFAC program is the bank's assessment of its specific product lines, customer base, and nature of transactions and identification of the high-risk areas for OFAC transactions. A bank's OFAC program should be commensurate with its respective OFAC risk profile.

According to the FFIEC manual, FBAs are to examine financial institutions to determine the adequacy of each institution's OFAC program and the effectiveness of its risk management program. Based on the risk determination of the institution under examination, as well as a review of prior examination reports and internal audit findings for the institution, the examiners then select which policies and procedures to verify.

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<sup>10</sup> Among other things, the Bank Secrecy Act, as amended, requires financial institutions to report certain currency transactions and suspicious financial activity to Treasury. Financial institutions are also specifically required to maintain a Bank Secrecy Act compliance program. Treasury's Financial Crimes Enforcement Network, a Treasury bureau under the Office of Terrorism and Financial Intelligence, is the administrator of the Bank Secrecy Act.

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The FFIEC manual also states that examinations should include transaction testing.<sup>11</sup> However, examiners may generally limit transaction testing to only those high risk areas identified in the bank's risk assessment. For OFAC, depending on assessed risk, the examiners may choose to use transaction testing to evaluate, among other things, the bank's handling of new accounts, controls over the use of interdict software, handling of blocked transactions, and/or the resolution of "hits."

We believe the FFIEC guidance was needed. Prior to the guidance being issued, each FBA implemented its own examination steps to assess compliance with OFAC sanctions programs. Transaction testing was discretionary, and based on our reviews of OCC and OTS examination workpapers and interviews with examiners, was a procedure rarely done during examinations.

We do have a concern in that the FFIEC manual does not address how OFAC compliance examinations are to be documented. When reviewing examinations conducted by OCC and OTS, we found that the available examination documentation was generally insufficient for us to determine whether examiners adequately assessed OFAC program compliance. As a result, we were unable to provide OFAC with reasonable assurance that the examination results regarding OFAC compliance were valid and reliable.<sup>12</sup> OCC and OTS officials stated that their procedures did not require the examiners to fully document results when they found OFAC compliance programs adequate. In response to our recommendations, both regulators agreed to better document examination results going forward.

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<sup>11</sup> As provided in the FFIEC manual, examiners perform transaction testing to evaluate the adequacy of the bank's compliance with regulatory requirements, determine the effectiveness of its policies, procedures, and processes, and evaluate suspicious activity monitoring systems. Transaction testing is an important factor in forming conclusions about the integrity of the bank's overall controls and risk management processes and must be performed at each examination. The extent of transaction testing and activities where it is performed is based on various factors, including the examiner's judgment of risks, controls, and the adequacy of the independent testing by the bank's internal audit section.

<sup>12</sup> Treasury OIG, *Foreign Assets Control: Assessing OCC's Examination of OFAC Compliance Was Hampered by Limited Documentation*, OIG-06-033 (Jul. 31, 2006); and *Foreign Assets Control: Assessing OTS's Examination of OFAC Compliance Was Hampered by Limited Documentation*, OIG-06-044 (Sept. 26, 2006).

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While our audit work at OCC and OTS covered OFAC examinations performed before the FFIEC manual was issued, audits by the FDIC OIG and NCUA OIG covered examinations after the manual was issued and also found documentation issues. In this regard, FDIC OIG issued an audit report in December 2006 which found that FDIC could improve its approach to OFAC compliance by monitoring and tracking sanction violations, compliance deficiencies, and enforcement actions. FDIC OIG also cited the need for better documenting of workpapers for examination planning and contact with OFAC, completing core exam procedures, and concluding on the adequacy of the OFAC compliance programs and interdiction systems. These measures could assist OFAC and FDIC to address risks associated with OFAC noncompliance.<sup>13</sup> Similarly, the NCUA OIG reported in December 2006, that its efforts to evaluate and verify examiners' conclusions regarding OFAC compliance were hampered by a lack of information.<sup>14</sup> The OIG of the Federal Reserve System is also conducting an audit of OFAC compliance examinations performed by selected Federal Reserve Banks, but has not yet completed its work.

## Recommendations

We recommend that the Director of OFAC do the following:

1. Determine whether the OFAC-related examination information provided by the federal bank regulators under the April 2006 MOU is sufficient for OFAC to assess compliance at specific institutions and for the overall banking industry. If not, action should be taken to modify the MOU or request from Congress, through appropriate means, an amendment to the Right to Financial Privacy Act.

### Management Response

OFAC believes that information it obtains from mandatory blocking and reject reports and from other sources,

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<sup>13</sup> FDIC OIG, *FDIC's Supervision of Financial Institutions' OFAC Compliance Programs*, 07-001 (Dec. 2006).

<sup>14</sup> NCUA OIG, *Office of Foreign Assets Control Compliance Review*, OIG-06-09 (Dec. 18, 2006).

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complemented by the information shared by the FBAs under the MOU with OFAC, enables it to adequately assess compliance at specific institutions and for the overall banking industry. According to OFAC, the limitations on information sharing required by the RFPA are minor and do not hinder its ability to administer and enforce its sanctions programs. The regulators and OFAC notify one another of transactions and accounts that appear to involve violations of sanctions regulations and share covered material in redacted form. The regulators inform the banks they regulate about their obligations to contact OFAC directly. Both OFAC and the FBAs have their own authorities to obtain information from financial institutions. Any relevant information which is redacted can be obtained by OFAC directly from banks using its own administrative subpoena authority. OFAC will continue to monitor the situation to assure that the examination process provides useful information in evaluating institutions and their compliance with OFAC regulations.

#### OIG Comment

OFAC's commitment to monitor this area addresses the intent of our recommendation.

2. Determine whether MOUs should be established with self-regulatory organizations and the IRS for sharing information on financial institutions for which they have OFAC oversight responsibility.

#### Management Response

Earlier this year, the Under Secretary for the Office of Terrorism and Financial Intelligence delegated authority to the IRS to enable it to examine institutions for compliance with OFAC regulations where it has examination authority for Bank Secrecy Act compliance. An MOU is currently in process to enable greater information sharing between IRS and OFAC. OFAC will monitor the effectiveness of the arrangement and make adjustments as necessary.

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OFAC now has MOUs with 17 state agencies as well as with all of the FBAs and a separate MOU with the FDIC's Division of Resolutions and Receiverships.

According to OFAC, it enjoys an open dialogue and free exchange of information with SEC and the securities industry self-regulatory organizations. SEC shares information with OFAC on an as-needed basis through the use of "Access Letters." OFAC said that whenever such letters have been sent by OFAC based on its dialogue with the SEC, detailed case information has always been timely forthcoming. OFAC said it will continue to monitor the efficiency and effectiveness of these procedures and make adjustments as necessary.

#### OIG Comment

OFAC's actions, if implemented as described, satisfy the intent of our recommendation.

## **Other Matters Reported by FDIC OIG**

In its December 2006 report, the FDIC OIG noted, as a matter for congressional consideration, that a more comprehensive statutory and regulatory framework exists for ensuring compliance with the Bank Secrecy Act than for OFAC compliance, although both laws address national security and law enforcement concerns.<sup>15</sup> In this regard, Executive Order 13224 expanded the scope of U.S. sanctions against international terrorists and terrorist organizations, and OFAC's authority related to such, but there was no statutory change to recognize OFAC's expanded authority. Additionally, the Order did not address the FBAs' authorities related to OFAC examination coverage or enforcement. The FDIC OIG report provides an extensive analysis of this matter.

FDIC OIG also noted that our office, in our April 2002 report, and GAO, in its September 2004 report, concluded that OFAC is limited in its ability to monitor financial institution compliance with

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<sup>15</sup> FDIC OIG, *FDIC's Supervision of Financial Institutions' OFAC Compliance Programs*, 07-001 (Dec. 2006).

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sanction requirements and does not have the authority to conduct examinations or proactively monitor financial institutions for compliance. In written comments provided to FDIC OIG, OFAC disagreed that its authority to investigate and conduct compliance reviews is impaired.

Included in OFAC's response to our report is its response to the FDIC OIG on this matter. See appendix 3.

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We would like to extend our appreciation to OFAC personnel for the cooperation and courtesies extended to our staff during the reviews. If you have any questions, please contact me at (617) 223-8640, or Stephen Syriala, Audit Manager, at (617) 223-8643.

/s/  
Donald P. Benson  
Director

Our objective was to follow up on a 2002 OIG audit report and review current Office of Foreign Assets Control (OFAC) monitoring efforts to ensure financial institution compliance with OFAC sanctions programs. We interviewed OFAC officials and staff in OFAC's Office of Compliance, Civil Penalties Division, and Licensing Division to determine what changes had been made to the program since 2002 and the current status of their efforts.

We reviewed and confirmed that OFAC had taken action to address six of the eight recommendations from the 2002 OIG audit report by developing new policies and procedures or by implementing replacement programs. (See appendix 2 for a summary of the recommendations and OFAC actions.) OFAC did not agree with the other two recommendations in the prior report. As a result, we focused on issues related to these two recommendations, which involved OFAC's ability to monitor financial institution compliance with OFAC sanction programs.

We reviewed data reported by the Office of Compliance regarding the number of blocked and rejected financial transactions and the identity of the institutions involved in those transactions. We identified and reviewed OFAC penalty cases and warning letters issued.

We also reviewed the provisions of the April 2006 Memorandum of Understanding pertaining to the exchange of examination results between OFAC and the various regulators and the sections of the June 2005 Federal Financial Institutions Examinations Council *Bank Secrecy Act/Anti-Money Laundering Manual* (FFIEC manual) relating to OFAC. The FFIEC manual, which provides comprehensive guidance for the federal bank regulators to follow when conducting OFAC compliance examinations, was updated in 2006.

As part of our OFAC coverage, we separately audited the coverage provided by the Office of Comptroller of the Currency and Office of Thrift Supervision examiners in assessing financial institutions' OFAC policies and procedures and issued reports on these audits. We also coordinated with the Federal Deposit Insurance Corporation OIG, the National Credit Union Administration OIG, and

the Federal Reserve Board OIG when they were planning similar audits at their respective agencies.

We conducted our audit from March 2005 to December 2006. We performed our review in accordance with generally accepted government auditing standards.

Our April 2002 report included six recommendations related to Office of Foreign Assets Control (OFAC) sanction program administration. Specifically, we recommended that OFAC

- Establish processing procedures for financial transactions reported.
- Develop a standardized form to be used when reporting blocked and/or rejected transactions.
- Review its Blocked/Rejected Transactions database to identify and remove duplicates.
- Research the feasibility of developing procedures to reconcile the Annual Blocked Property Report to the Blocked/Rejected Transactions database.
- Ensure that the licensing database is updated.
- Adhere to its penalty guidance when establishing accounts receivable.

In response to the recommendations, OFAC implemented a Blocked/Rejected Transactions database and is in the process of implementing a uniform electronic response which banks will use to report such transactions. OFAC adopted new procedures that ensure that duplicate entries are identified and addressed. OFAC also updated the database throughout the licensing process for each record within the new system. With respect to developing procedures to reconcile the Annual Blocked Property Report to the data, OFAC decided that the reconciliation would require far too many resources and there were no material advantages to carrying out the reconciliation. We assessed OFAC'S reasons and agree with its decision. Furthermore, we found that OFAC now includes all the relevant information in a new form when setting up accounts receivable for penalty amounts due the government.



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

FAC No. MUL-366143a

SEP - 4 2007

MEMORANDUM FOR DONALD P. BENSON  
DIRECTOR  
OFFICE OF INSPECTOR GENERAL

FROM: Adam Szubin *AS 9/4/07*  
Director  
Office of Foreign Assets Control

SUBJECT: Agency Response to OIG Report entitled "Actions Have  
Been Taken to Better Ensure Financial Institution  
Compliance with OFAC Sanctions Programs, But Their  
Effectiveness Cannot Yet Be Determined"

The Office of Foreign Assets Control ("OFAC") appreciates all the hard work and analysis that went into the preparation of the report on financial institution compliance with OFAC sanctions by your office. We also appreciate the courtesies and cooperation extended to our staff during the Office of Inspector General ("OIG") audit.

Page 12 of the report reserves two placeholders for a management response to the OIG's recommendations. Please incorporate the following replies into your final document:

*Recommendation 1 – Determine whether the OFAC-related examination information provided by the federal bank regulators under the April 2006 MOU is sufficient for OFAC to assess compliance at specific institutions and for the overall banking industry. If not, action should be taken to modify the MOU or request from Congress, through appropriate means, an amendment to the Right to Financial Privacy Act.*

**Management Response:** Based on its experience to date, OFAC already believes that the information it obtains from mandatory blocking and reject reports and from other sources, complemented by information shared by the bank regulators under their MOUs with OFAC, enables it to adequately assess compliance at specific institutions and for the overall banking industry. It does not find that minor limitations on information sharing required by the Right to Financial Privacy Act hinder its ability to administer and enforce its sanctions programs. The regulators and OFAC notify one another of transactions and accounts that appear to involve violations of sanctions regulations and share covered material in redacted format. The regulators inform the banks they regulate about their obligations to contact OFAC directly. Both OFAC and the banking agencies have their own authorities to obtain information from financial institutions. Any relevant information which is redacted can be obtained by OFAC directly from banks using its

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own administrative subpoena authority. We will continue to monitor the situation to assure that the flow of information from the examination process provides data useful in evaluating institutions and their compliance with OFAC's regulations.

***Recommendation 2*** – Determine whether MOUs should be established with self-regulatory organizations and the Internal Revenue Service for sharing information on financial institutions for which they have OFAC oversight responsibility.

***Management Response:*** Earlier this year, the Under Secretary for the Office of Terrorism & Financial Intelligence delegated authority to the IRS to enable it to examine institutions for compliance with OFAC regulations where it has examination authority for Bank Secrecy Act compliance. An MOU is currently in process to enable greater information sharing between the IRS and OFAC. We will monitor the effectiveness of the arrangement and make adjustments as necessary.

OFAC has come a long way with regard to State Supervisors since the OIG concluded its fieldwork in December 2006. It now has MOUs with 17 state agencies as well as with all of the Federal Banking Agencies and a separate MOU with the Division of Resolutions and Receiverships of the Federal Deposit Insurance Corporation ("FDIC").

OFAC also enjoys an open dialogue and free exchange of information with the Securities and Exchange Commission ("SEC") and the securities industry Self-Regulatory Organizations. The SEC shares information with OFAC on an as-needed basis through the use of "Access Letters." Whenever such letters have been sent by OFAC based on its dialogue with the SEC, detailed case information has always been timely forthcoming. We will continue to monitor the efficiency and effectiveness of these procedures and make adjustments as necessary.

Finally, pages 12-13 of the OIG's analysis reference matters reported by the Office of Inspector General of the FDIC and mention that OFAC provided written comments addressing the FDIC Inspector General's findings. We respectfully request that you incorporate those written comments in your document. A copy of the comments is attached to this memo as Appendix A.

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Appendix A



DEPARTMENT OF THE TREASURY  
WASHINGTON, D. C. 20220

FAC No. GEN-311474

Mr. Russell A. Rau  
Assistant Inspector General for Audits  
Office of Inspector General  
Federal Deposit Insurance Corporation  
3501 Fairfax Drive  
Arlington, VA 22226

NOV 27 2006

RE: Draft Audit Report Entitled, FDIC's Supervision of Financial Institutions' OFAC Compliance Programs (Assignment No. 2006-017)

Dear Mr. Rau:

On behalf of the Department of the Treasury's Office of Foreign Assets Control ("OFAC"), I would like to provide the following comments on the above-captioned audit report (the "Draft Audit Report").

The Draft Audit Report contains a section entitled "Matter for Congressional Consideration – Authorities for Supervision of OFAC Compliance" (Draft Audit Report at page 11), which recommends that Congress consider whether to amend the statutes administered by OFAC or the Federal Banking Agencies ("FBAs") to provide examination and enforcement authority with respect to OFAC requirements. We would like to clarify an important point with respect to OFAC's own compliance-related authorities. The Draft Audit Report incorrectly states that OFAC has limited authority to conduct reviews for compliance with the economic sanctions programs it administers. Specifically, the Draft Audit Report states that, although "OFAC can review an institution's compliance with its regulations and sanctions in response to an apparent violation and take enforcement action," OFAC "does not ... have examination authority . . ." (Draft Audit Report at page 12). In fact, OFAC has authority to investigate and conduct reviews for compliance with OFAC-administered economic sanctions programs, and we ask that you revise the Draft Audit Report accordingly.<sup>1</sup>

The statutes governing the economic sanctions programs that OFAC administers, including the Trading With the Enemy Act, 50 U.S.C. app. §§ 1 et seq., the International Emergency Economic Powers Act, 50 U.S.C. §§ 1701 et seq., and the Foreign Narcotics Kingpin Designation Act, 21 U.S.C. §§ 1901 et seq. (collectively referred to here as "governing statutes"), grant extremely broad authority to "investigate, . . . regulate, direct and compel, nullify, void, prevent or prohibit" acts or transactions including the holding of, dealing or transacting in, or the exercise of "any right, power, or privilege" with respect to "any property in which any foreign country or a national thereof has any interest." See, e.g., 50 U.S.C. § 1702(a)(1)(B). The statutes provide this authority to the President or the Secretary of the Treasury. The President has delegated his economic sanctions powers to the Secretary of the Treasury for purposes of implementing specific

Appendix 3  
Management Response

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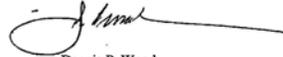
programs, see, e.g., Exec. Order 13224, § 7, 66 Fed. Reg. 49,079, 49,081 (Sept. 25, 2001), and the Secretary of the Treasury has in turn delegated his powers in this area to the Director of OFAC, see, e.g., 31 CFR §§ 594.802 (global terrorism), 598.803 (foreign narcotics kingpins). These extremely broad grants of authority allow OFAC to review for compliance with OFAC-administered economic sanctions programs.<sup>2</sup>

The authority to "investigate" is the authority to actively probe the actions of U.S. persons, including for the purpose of conducting a compliance review. This term arguably constitutes an even broader grant of authority than would the term "examine." In addition, the authority to "prevent" and "prohibit" is the authority to require that U.S. persons take action to avoid sanctions violations, the authority to "direct and compel" allows OFAC to act affirmatively to require certain actions, and the broad authority to "regulate" encompasses the authority to review for compliance. Moreover, nothing in the governing statutes limits OFAC to exercising its authority to review for compliance only upon notification of a potential violation. To the contrary, the mere "holding" of any property in which any foreign country or a national thereof has any interest is grounds to investigate and regulate, 50 U.S.C. § 1702(a)(1)(B); 50 U.S.C. app. § 5(b)(1)(B).

In addition to the authority to review for compliance, the governing statutes provide OFAC with the authority to require "any person" subject to U.S. jurisdiction to maintain records, produce records, and report, relative to (a) any property in which a foreign country or national has an interest; (b) "acts" and "transactions" involving any such property interest; or (c) "as may be otherwise necessary to enforce" the relevant authorities. 50 U.S.C. § 1702(a)(2); see also 5 U.S.C. app. § 5(b)(1).

Thank you for offering OFAC the opportunity to review the Draft Audit Report and to provide comments on an issue of great importance to OFAC. If you would like to discuss these comments or if you have any questions, please telephone Christine Del Toro of our Office of Chief Counsel at (202) 622-1790.

Sincerely,



Dennis P. Wood  
Assistant Director  
Compliance Outreach & Implementation  
Office of Foreign Assets Control

<sup>1</sup> To the extent that the report of the Treasury Department Office of Inspector General entitled, Foreign Assets Control: OFAC's Ability to Monitor Financial Institution Compliance Is Limited Due to Legislative Impairments (April 26, 2002), or the report of the General Accountability Office entitled, Foreign Regimes' Assets - The United States Faces Challenges in Recovering Assets, but Has Mechanisms That Could Guide Future Efforts (GAO-04-1006, September 14,

Appendix 3  
Management Response

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2004), may be understood to conclude that OFAC's authority to conduct compliance reviews is impaired, we respectfully disagree.

<sup>2</sup> Although OFAC has the authority to conduct compliance reviews, we have endeavored to leverage the manpower and resources of other government agencies to help conduct such reviews on a broad scale. To this end, we have asked the FBAs to include OFAC compliance reviews in their examinations and have signed a Memorandum of Understanding governing information-sharing with the FBAs.

Appendix 4  
Major Contributors to This Report

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Stephen Syriala, Audit Manager  
Thomas Mason, Auditor-in-Charge  
Horace Bryan, Referencer

**The Department of the Treasury**

Under Secretary, Office of Terrorism and Financial Intelligence  
Assistant Secretary, Terrorist Financing and Financial Crimes  
Office of Strategic Planning and Performance Management  
Office of Accounting and Internal Controls

**Office of Foreign Assets Control**

Director

**Office of Management and Budget**

OIG Budget Examiner