

DEPARTMENT OF THE TREASURY



OFAC

Office of Foreign Assets Control

Risk Factors for OFAC Compliance in the Securities Industry

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Introduction

The U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") is charged with administering and enforcing U.S. economic sanctions programs, which include a range of sanctions against foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. The securities industry may be approached by terrorist organizations or other illicit actors desiring to exploit the relative lack of transparency that accompanies many securities transactions and investment vehicles, thereby creating opportunities for OFAC sanctions to be circumvented. For this reason, OFAC is actively engaged with the securities industry to help it understand and comply with U.S. sanctions programs. OFAC encourages the securities industry to develop proactive, risk-based compliance programs to ensure that it does not conduct transactions for the benefit of designated terrorists or other sanctions targets.

The cornerstone of an effective OFAC compliance program is an assessment of the risks presented by a firm's customer base, specific products/services, and the geographic locations in which it conducts business. Depending upon the circumstances, certain types of customers, transactions, products, and jurisdictions may present a higher risk for OFAC violations than others. These risks, as well as the policies and procedures to mitigate them, should be fully assessed by management and communicated throughout the organization.

Need for Due Diligence

OFAC violations can occur in a variety of circumstances. In most cases, OFAC regulations require the blocking of all property and property interests of sanctions targets, and they also prohibit all dealings with targets, including the facilitation, brokering, financing, or guaranteeing of any transactions involving them. Property is anything of value and property interests may be direct, indirect, present, future, or contingent. Both new and existing customers can expose a financial institution to regulatory risk, particularly when their transactions involve overseas business. Financial institutions should identify those products or services that may attract sanctioned countries, individuals or organizations. For instance:

- U.S. investment banks that provide underwriting services to a foreign issuer engaged in the business of oil exploration may be more likely to transact with customers or entities located in high-risk jurisdictions;
- A broker-dealer that serves as a prime broker for an offshore hedge fund should, before commencing the relationship, screen the names of the fund adviser, its principals, as well as any qualified hedge fund investors that it plans to introduce to its hedge fund clients; and
- An investment adviser managing a private equity fund that has a number of U.S. and non-U.S. investors, including a little known offshore trust, may need to exercise greater due diligence.

Therefore, securities firms — both regulated and unregulated — should develop comprehensive procedures to detect, monitor, and address potential OFAC violations that may arise before they conduct business on behalf of a customer, or prior to the execution of a transaction.

A risk-based approach might lead a U.S. financial institution to weigh several factors with regard to its due diligence review of a customer or intermediary, including but not limited to:

- The nature of the customer – its location, market, products and downstream customers;
- The type, purpose, and activity of the account;
- The nature and duration of the relationship of a foreign institution with the U.S. financial institution;
- Sanctions regulations and supervisory/enforcement regime (including AML/CFT) governing a foreign institution; and
- Information that can be obtained regarding the institution’s sanctions compliance record.

Cross-border relationships pose unique risks because they create situations in which a U.S. financial institution will be handling funds from a foreign financial institution whose customers are not transparent to the U.S. financial institution. In addition, securities firms need to be concerned about all of their affiliates, such as banks, insurance companies, investment advisers, or other broker-dealers. For any relationship, or for any given transaction, firms should know: (1) who is actually undertaking OFAC screening and other monitoring with respect to a transaction; and (2) who owns the customer relationship.

Possible Risk Factors

To assist the securities industry in adopting a more effective, risk-based approach to compliance, OFAC is providing the following list of risk factors that may warrant a heightened level of scrutiny. Please note that these risk factors are not intended to be comprehensive.

International transactions, including wire transfers:

- a) High number of international transactions, cross-border transactions, or investments in a foreign investment fund or on a foreign exchange;
- b) Presence of overseas branches or multiple correspondent accounts with foreign financial institutions, including correspondent accounts subject to enhanced due diligence under Section 312 of the USA PATRIOT Act.

Foreign customers/accounts:

- a) A large, fluctuating client base across a number of foreign jurisdictions involving a large number of security transactions;
- b) Customers located in or having accounts in high-risk jurisdictions, such as countries found to be of “primary money laundering concern” pursuant to Section 311 of the USA PATRIOT Act;
- c) Customers located in or having accounts in countries that are havens for money laundering or are inadequately regulated, including countries identified by the Financial Action Task Force as maintaining an inadequate AML/CFT regime;

- d) Customers located in or having accounts in countries where local laws, regulations, or provisions (such as privacy laws) prevent or limit the collection of client identification information;
- e) Customers located in an offshore financial center as identified by the U.S. Department of State;
- f) Accounts for senior political or government officials of a foreign government;
- g) Accounts of closely held corporations;
- h) Accounts for unregistered or unregulated investment vehicles;
- i) Accounts for non-resident aliens;
- j) Accounts maintained at an offshore bank.

Foreign broker-dealers who are not subject to OFAC regulations:

- a) Lack of information regarding beneficial owners of securities; and
- b) Foreign broker-dealers that act as introducing brokers.

Risks of Investments in Foreign Securities:

Practical exposure increases when investing in a foreign investment fund or foreign exchange, because of the risk that the securities are issued by a sanctioned country or party or otherwise in violation of OFAC sanctions, e.g., securities of an issuer that provides financing for a sanctions target. Other risk factors include:

- a) Cross-border settlements involving the interaction of different settlement systems and laws in different countries;
- b) Foreign securities that may be more prone to misidentification in the course of a trade, e.g., similar names between two foreign issuers;
- c) Foreign companies that issue shares in bearer form.

Personal Investment Corporations or Personal Holding Companies:

Beneficial ownership by a non-U.S. person that maintains a private banking account with a U.S. financial institution.

Very High Net Worth Institutional Accounts, Hedge Funds, Funds of Hedge Funds and Other Alternative Investment Funds (Private Equity, Venture Capital Funds) and Intermediary Relationships:

- a) Lack of transparency regarding securities/investments and beneficial owners;
- b) U.S. hedge fund with an offshore related fund where beneficial owners are offshore investors; and
- c) Subscription funds that originate from or are routed through an account maintained at an offshore bank, or a bank organized or chartered in an inadequately supervised and poorly regulated jurisdiction, or a foreign shell bank.

Omnibus Accounts/Use of Intermediaries:

- a) Potential for the use of code names to invest funds in the United States on behalf of sanctions targets, concealing the identities of the beneficial owners;
- b) Accounts for intermediaries held in street name that trade on behalf of third parties, such as other broker-dealers, banks, and mutual funds; and

- c) Cross-border trades executed for unregulated investment vehicles, e.g., hedge funds, private equity funds, and other private pools of capital.

Third-Party Introduced Business:

Business introduced by an overseas bank, affiliate, or other investor based in high risk or inadequately regulated countries.

Confidential Accounts:

Private banking accounts established or maintained for non-U.S. persons or services, including financial and related services, to wealthy clients who use offshore accounts for tax avoidance purposes.

