NATIONAL FOREIGN TRADE COUNCIL, INC.

1625 K STREET, NW, WASHINGTON, DC 20006-1604

TEL: (202) 887-0278 FAX: (202) 452-8160

November 7, 2008

Adam J. Szubin
Director
Office of Foreign Assets Control
Department of the Treasury
1500 Pennsylvania Avenue, NW – Annex
Washington, DC 20220

Re: Request for Comments – Economic Sanctions Enforcement Guidelines

Dear Mr. Szubin:

The National Foreign Trade Council ("NFTC")[1] herein provides comments on the Office of Foreign Assets Control's ("OFAC") interim final rule Economic Sanctions Enforcement Guidelines ("September 8 Guidelines"). As you know, the NFTC advocates an open, rules-based world economy. Some 300 member companies, many of them major US exporters, participate in the NFTC. We appreciate OFAC's efforts to align its written procedures with its existing practices and to provide a "transparent" road map for how OFAC determines whether a violation of the sanctions regulations has occurred and what enforcement action, if any, is appropriate.

Nonetheless, the NFTC requests that OFAC modify the September 8 Guidelines in four ways. Although OFAC's efforts to create a single set of Guidelines applicable across all industry sectors is understandable, it appears that at least two sets of Guidelines would be more appropriate: one for the financial sector and a second for entities engaged in the trade of goods. Second, to the extent that OFAC seeks to encourage greater dialogue and cooperation with the private sector, we believe it would be more beneficial to affirmatively promote risk-based compliance programs and to expand voluntary self-disclosure mitigation to include all parties to a transaction who have self-reported in good faith – regardless of when each such party filed its disclosure. Finally, we propose refining the criteria whereby agreeing to a tolling of the statute of limitations is an indication of cooperation only in certain circumstances.

Industry Specific Guidelines

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[1] The NFTC and its affiliates now serve some 300 member companies through offices in Washington, D.C. and New York

First, the September 8 Guidelines are intended to cover all industries. In line with the Economic Sanctions Enforcement Procedures for Banking Institutions ("Enforcement Procedures"), which were industry-specific, and OFAC's own website which provides industry-specific guidance,[2] the NFTC respectfully submits that it would be more appropriate to have at least two sets of Guidelines: one focused on traditional financial institutions and a second set focused on entities engaged in the trade of goods. The need to distinguish between the two sectors lies largely in the fact that financial institutions maintain a business model necessarily distinct from traders in goods. Moreover, financial institutions are primarily governed by bank regulators. U.S. traders in goods maintain a vastly different business model from traditional financial institutions and must tailor their respective compliance programs accordingly. We believe that adopting two sets of regulations will avoid ambiguities and enable companies to better comply.

Risk-Based Compliance Program

The September 8 Guidelines state in the preamble that they supersede the Enforcement Procedures. By superseding the Enforcement Procedures, the risk matrices included as appendices to the Procedures also are removed from OFAC's regulations. These risk matrices were taken from the Federal Financial Institutions Examination Council's Bank Secrecy Act Examination Manual and provided that a financial institution should rate its products, services, customers and geographic reach as low, medium or high risk. Once the assessment was complete, the Enforcement Procedures provided that the financial institution should develop an appropriately risk-based compliance program. While the September 8 Guidelines make no reference to risk assessments and corresponding risk-based compliance policies and procedures, we nonetheless note that OFAC has not removed the risk matrices for the charities sector and financial institutions from its industry-specific website guidance.[3] Moreover, on November 6, 2008 OFAC published on-line guidance for the securities industry, including a risk-matrix. Accordingly, it appears that OFAC intends to foster compliance programs based on a firm's internal assessment of sanctions risk, leading to the implementation of risk-based compliance policies and procedures. If this understanding is accurate, we request that, in its final Enforcement Guidelines, OFAC explicitly confirm that risk-based compliance policies and procedures remain appropriate. Such a clarification would specify that low-risk entities (e.g., those that have few international transactions or transaction types not raising sanctions issues) do not require the same level of compliance safeguards as those with heavy international involvement and risk and will reassure Subject Persons that OFAC's staff will apply a risk-based test to their circumstances if a violation should occur.

Further, we understand from informal discussions with OFAC personnel that the risk-based approach has not been eliminated and was instead intended to be incorporated into

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[2] See *OFAC Information for Industry Groups*, available at http://www.treas.gov/offices/enforcement/ofac/regulations/index.shtml.

[3] See e.g., Risk Matrix for Charitable Sector, published at http://www.treas.gov/offices/enforcement/ofac/policy/charity_risk_matrix.pdf. This Guidance states in relevant part that OFAC has encouraged charities to develop risk-based compliance programs.

the September 8 Guidelines. Nonetheless, we request that OFAC clarify whether it remains appropriate for entities engaged in the trade of goods to engage in a risk-based assessment of customers, products, and geographic reach in developing appropriate risk-based compliance policies and procedures. This clarification is particularly relevant to this industry group since, unlike the financial institutions who are currently required to maintain risk-based compliance policies and procedures under the Bank Secrecy Act Regulations, there is no corresponding benchmark in OFAC's published guidance as to appropriate processes through which to establish a compliance program. We request that the appropriateness of the risk-based approach and the risk matrix be clarified in the new final rule – particularly as it applies to traders in goods.

Finally, we request that OFAC follow the lead of its sister agency, the Financial Crimes Enforcement Network ("FinCEN"), in recognizing that even with an appropriately risk-based compliance program, an entity will nonetheless "suffer from minor and isolated compliance deficiencies."[4] Where such isolated incidents occur, FinCEN has stated it will not assess penalties. We request that OFAC adopt a consistent approach.

<u>The Definition of Voluntary Self-Disclosure</u>

The September 8 Guidelines announce that a "voluntary self-disclosure" results in a 50-percent or more reduction the base penalty amount – but only where the voluntary self-disclosure meets the Guidelines' technical definition of "voluntary." As in the Enforcement Procedures, a notification to OFAC does not receive 50-percent or more mitigation where (1) a third party is required to notify OFAC of the apparent violation; (2) the disclosure contains false or misleading information; (3) the disclosure is materially incomplete; (4) the disclosure is not self-initiated; or (5) the disclosure is made without management knowledge or authorization.[5]

Practically speaking, because of criterion (1), a U.S. entity engaged in the trade of goods will almost never qualify for the 50-percent mitigation. In almost every scenario, the U.S. exporter will be using a U.S. financial institution to process the related payment transaction. U.S. financial institutions are required under OFAC's regulations to file blocking or reject reports. See 31 C.F.R. Part 501.603 and 501.604. Thus, the Guidelines have established what purports to be a generally-applicable criterion for mitigation of penalties but defined the entire import-export sector out of its use.

Additionally, independent companies along the chain of a particular transaction may have separately created appropriately risk-based compliance programs – and all should be eligible for "voluntary self-disclosure mitigation" if each notifies OFAC of a potential violation. Because each entity will have independent audit or "look-back" procedures, it is foreseeable that each will conclude its review according to its own pace. It would appear to be in OFAC's interest that each U.S. company faced with a possible sanctions violation conduct a thorough review using its policies and procedures – but the "race to

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4 Prepared Remarks of FinCEN Director James H. Freis, Jr. "The Objectives and Conduct of Bank Secrecy Act Enforcement" delivered at the ABA/ABA Money Laundering Enforcement Conference, October 20, 2008, published at http://www.fincen.gov/news_room/speech/pdf/20081020.pdf.

5 See 71 Fed. Reg. 59133, 51936.

OFAC's door" scenario created by permitting only one entity to achieve true voluntary self-disclosure mitigation eliminates this incentive. We believe strongly that this "gotcha" approach serves no public purpose, and will degrade the quality of information flowing to OFAC that we believe procedures under the Guidelines were intended to enhance.

As currently drafted, the voluntary self-disclosure criteria provide little incentive for an otherwise compliant U.S. exporter who, in conducting a routine audit, discovers a transaction involving a prohibited party, to report it to OFAC – either because the exporter believes his financial institution is obligated to report it or another party along the chain may have already done so. As a result, we recommend that OFAC re-visit the criteria for providing 50-percent mitigation and provide such mitigation to any party who self-reports – even where other entities have either already reported or are required to file such reports.

The policy basis for this denial of the 50-percent relief is not stated in OFAC's Supplementary Information. It appears to reflect a judgment that a third-party blocking or rejection report, combined with an investigation under OFAC's administrative subpoena authority, will provide a better outcome for sanctions administration to one based on voluntary self-disclosure. If our understanding is correct, we believe this approach is counterproductive on at least four bases. First, we believe OFAC obtains more complete and useful information from the Subject Person than from mandatory third-party reports on blocked or rejected transactions. A third party (such as a bank receiving a payment instruction) cannot provide OFAC information on the background to the transaction, any exemptions or licenses that might be applicable, or other relevant mitigating (or aggravating) factors. Second, creating a competition for mitigation among the actors in a potentially problematic transaction discourages the cooperation among the actors that could provide OFAC with better and more timely information and fewer false alarms. We believe that the Guidelines should provide incentives ensuring OFAC the most complete and accurate information in the shortest period of time. We suggest that OFAC encourage Subject Persons to come forward with voluntary self-disclosures by providing in the Guidelines a 50-percent reduction for so doing. Such an approach will also require fewer OFAC staff resources than reliance on the administrative subpoena process. In an agency with limited resources,[6] promoting a more resource-intensive approach to the investigative process seems counterproductive to OFAC's own and the taxpayers' interests. Third, where a blocking or rejection report is mandated but not made by a third party, the Subject Person's voluntary self-disclosure becomes the sole source of information to OFAC. In that situation, we believe the Guidelines' denial of the full 50-percent reduction in a civil penalty is arbitrary and without any basis in public policy.

Another impact of the September 8 Guidelines' definition of "voluntary self-disclosure" is the reputational harm done to Subject Persons in the eyes of the public when OFAC uses its unexplained, idiosyncratic definition of "voluntary" to state on its website that a penalized person "did not voluntarily disclose this matter to OFAC." Unless this term is

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[6] OFAC's resource issue is evident in the Guidelines' general equating of "cooperation" with a Subject Person's unconditional waiver of the statute of limitations and entry of tolling agreements.

explained in detail on OFAC's postings, this has the effect of penalizing firms that cooperate in full good faith – the behavior we believe OFAC desires and expects from them.

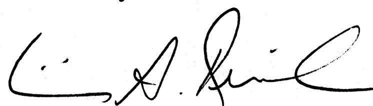
For all of these reasons, we request that OFAC define "voluntary self-disclosure" to include all timely self-disclosures that are not made in response to a subpoena or other enforcement process, and where the circumstances do not indicate a lack of good faith or an attempt to conceal the disclosed information. We believe the benefits to overall compliance with economic sanctions would more than outweigh the loss of perhaps ten-percent of the revenue from an affected civil penalty (from a 40-percent mitigation for cooperation to the 50-percent mitigation for voluntary self-disclosure). This would also make OFAC's posting of penalty information as to whether an apparent violation had been "voluntarily disclosed" accord with the common English meaning of the word "voluntary".

Cooperation with OFAC and Tolling Agreements

OFAC has indicated that it will evaluate cooperation with an OFAC investigation, in part, based on whether the Subject Person agreed to a statute of limitations waiver or entry of a tolling agreement. While the September 8 Guidelines indicate that this will be "particularly" important in cases in which the apparent violation was "not immediately notified to or discovered by OFAC", the language of the Guidelines nonetheless establishes this factor as a general consideration. We respectfully submit that this factor, as written, is a denial of Subject Persons' statutory rights. We suggest that this criterion be dropped. If retained, we believe it should be revised to make waiver of the statutory limitations period a factor in evaluating cooperation only where the timing of the notification or discovery has, in fact, created a situation that, as of the time of OFAC's request for a waiver, currently threatens resolution within the 5-year limitations period.[7] Further, we request that this criterion for cooperation, if retained at all, be tied to a Subject Person's unwillingness to extend OFAC's time to deal with the apparent violation to at maximum a 5-year period from disclosure or discovery, absent extraordinary circumstances involving the Subject Person's behavior.

We would be happy to discuss any of the comments in greater detail. Please contact the undersigned at 202-887-0278 or at breinsch@nftc.org.

Sincerely,



William A. Reinsch
President

[7] We have reports of OFAC requests for a waiver several years before the limitations period would expire.