Maintaining Sanctions Compliance in a Rapidly Changing Regulatory Environment

A Proactive Approach to the OFAC 50% Rule

White Paper

Every commercial relationship has hidden risks. When it comes to trade compliance, the "50% Rule" from the US Department of the Treasury's Office of Foreign Assets Control (OFAC) is especially problematic. This rule specifies how OFAC determines whether companies are considered blocked because they are owned by people or organizations who appear on the Specially Designated Nationals (SDN) or Sectoral Sanctions Identifications (SSI) lists — even if the company itself is not on the lists.

The financial penalties for violating the 50% Rule are high — higher than any other area of trade compliance. You don't want to get this wrong. The responsibility for compliance rests fully on the organization engaged in doing business, and compliance is very difficult.

> **In 2018, OFAC announced a $54 million settlement with Société Générale for processing transactions that failed to include references to OFAC-sanctioned parties in the information sent to US financial institutions that were involved in the transactions.[1]**
>
> **The transactions were with a company that was majority-owned by the government of Sudan, a sanctioned country. The company itself wasn't on any list, but its ownership put it in violation of the 50% Rule.**

When Are You Out of Compliance?

The OFAC regulations are complex, and the data you need to ensure compliance is extremely difficult to obtain.

OFAC has been around for a long time, acting as a regulator of US sanctions. Since its creation in 2008, the 50% Rule has steadily evolved, and it became significantly stronger in 2014. Under today's strict interpretation of the rule, if more than 50% of aggregated ownership by parties is subject to the same type of sanctions, the entire firm would be sanctioned. However, it isn't that straightforward.

The OFAC regulations are complex, and the data you need to ensure compliance is extremely difficult to obtain. There is no published list of companies and entities that fit the 50% Rule. The SDN and SSI lists, both of which identify entities you can't deal with, are published. There is also a published list of sanctioned countries. However, the regulations say that you also can't deal with any entity that is controlled or owned — 50% or more — by one of the companies on the SDN or SSI list, or by one of the sanctioned countries. Those relationships are not listed anywhere, and they change often.

You must actively pursue these nuances in the data to avoid immense and costly errors. You must look at combined ownership of a company across multiple entities, consider borderline cases that might change tomorrow, and look at controlling interests that might indicate a tipping point. OFAC has published guidance on issues that you need to understand and act on. This information is difficult to find and assess, and it will be looked at during an audit.

> **To send a strong message to potential violators, regulators often make the first fine a harsh one. In 2016, OFAC announced a $2.5 million settlement with Barclays as a penalty for Zimbabwe sanctions violations.[2] Again, this infraction was for doing business with entities that were owned 50% or more by sanctioned or denied entities.**

Do-It-Yourself May Not Be the Best Option

In a dynamic regulatory environment, where direction is not always explicit, it's extremely difficult to perform the due diligence needed to ensure proper compliance with the 50% Rule. It would be very challenging as an individual company to conduct your own research all over the globe. Such an effort would require a dedicated team and a substantial investment of time and resources. Even then, you still might not get it right because of the complexity in the relationships, the speed at which those relationships change, and the volume of the data.

Even under ideal circumstances, gaining the insight needed for compliance is hard because not all company information required is publicly available. In the US, for example, some states allow organizations to set up a business without easily identifiable ownership information. Determining ownership of international organizations can be even more challenging. Tracking down precise ownership details in these cases requires not only foreign language skills but also a deep understanding of subsidiaries and complex corporate structures in various regions and countries.

Governments seeking to evade sanctions are also playing an active role in obfuscating ownership. In 2018, the Russian government responded to harsh sanctions by passing a law that enabled it to limit access to legal entity registers, preventing firms in the US and the EU from gaining visibility into company ownership.

For example, Russia's Lukoil maintains 311 different corporate entities in its company's structure, many of which are purposely designed to be opaque and confusing. One of its Turkish subsidiaries is 99% owned by a German subsidiary — which is, in fact, wholly owned by Russia. Even when ownership information is available, the facts may not be what they seem.

> **What is the scope of the 50% Rule by the numbers? According to Thomson Reuters, OFAC sanctions include 20,229 total profiles, including:**
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> - **8,075 in Ukraine and Russia**
> - **4,800 in Iran**
> - **2,436 in Cuba**
> - **1,139 in narcotics trafficking**

In many ways, the single most important challenge for companies seeking to comply with OFAC is the fact that SDN, SSI, and sanction information is not publicly available. This is a key difference from other restricted entity lists — OFAC does not tell firms which parties and companies are of concern.

Keeping up with constant change is challenging as well, and it is a twofold process. Changes in the ownership data itself can happen daily and must be continuously monitored. At the same time, it's difficult to keep up with rule and regulation changes, as well as their enforcement.

Building a Proactive Partnership

The OFAC 50% Rule is one situation where it simply makes the most sense to partner with a trusted third-party expert to acquire the data you need to stay in compliance. Without the expertise of a skilled partner, even if you are able to acquire the data you need, you will still need to bring it in house and screen it against your business partners. This isn't a recipe for success. Automating this process is essential because the volume of data is simply too high to accomplish it manually.

Fortunately, technology is available that can help you mitigate these risks and keep your compliance program up to date. New developments in automation can help save your team time, and advanced search engines, together with data from third parties, can give you the data and insight you need to avoid running afoul of OFAC.

The most effective solution starts with a provider who can access rich data beyond that which is publicly available, and who uses a search engine that supports the complexity to effectively compare your business partners against the list of denied entities. The type of search technique that is most effective is often referred to as "fuzzy logic." This technique is in fact a very complex piece of software that applies sophisticated queries and multi-step algorithms to return the best possible results.

By using fuzzy logic, the search engine attempts to compare names and addresses, taking into account common reasons for mismatches. The magic of fuzzy logic is that it enables the search engine to account for anomalies like misspelled words, punctuation issues, common words, word order, abbreviations, and more. With this approach, the software is able to minimize false positives, but avoid missing actual hits.

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Tracking a Moving Target

To be truly effective, the solution you choose must be integrated into your business processes. Consider when, and how often, you screen for OFAC compliance. Some organizations perform their screening only when they place a purchase order or are preparing to ship to a customer, but in today's dynamic landscape, you need a more frequent, regular screening process. For example, if your system spots a violation just before you are about to ship, the results can be incredibly disruptive to your business. Internal tensions may rise as your supply chain team pressures you to move forward with the shipment while the trade compliance department insists that you cannot.

The best way to sidestep these pressures is to simply screen your supply chain partners regularly — on a daily basis, if possible. Your ability to frequently screen will be impacted by the number of supply chain partners you have and the volume of restricted party lists you are screening against. It's important to remember that even if your supply chain partners don't change, the lists often will.

Improved compliance starts with examining and understanding your own risk.

Take a Proactive Step Forward in Compliance

How can you get started on the path toward improved compliance? It starts with examining and understanding your own risk. Where are your biggest risks today and what do you need to block? Find a partner who can help you evaluate your level of risk and work closely with you to determine where the biggest compliance pitfalls lie — right now. Ideally, your partner should offer not only the data you need but also the automation and technology solutions necessary to put that data to work.

A robust software solution such as Thomson Reuters ONESOURCE™ Denied Party Screening can help you take proactive steps toward maximizing compliance. This advanced software-as-a-service (SaaS) solution screens more than 350 global lists for restricted persons, companies, and sanctioned or embargoed countries. Its sophisticated search engine can be fully tailored and configured to let you manage an appropriate level of risk for your company — minimizing false positives without missing actual hits.

It's designed to integrate smoothly with your existing systems and processes, pulling in data from your enterprise resource planning (ERP) system, spreadsheets, and other sources. You can get up and running quickly and be able to proactively use a rich feature set, including:

- Multiple screening options, allowing you to align the solution to your needs
- Support for escalation and routing to help you manage workflow
- Override capabilities and audit logs that explain decisions
- Reporting capabilities

Learn more about ONESOURCE Denied Party Screening and other global trade solutions at tr.com/onesource-dps.

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[1]https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20181119_33.aspx

[2]https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20160208.aspx

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