



THE ACH NETWORK AND OFAC COMPLIANCE

BACKGROUND:

The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") administers economic sanctions and embargo programs that require assets and transactions involving interests of target countries, target country nationals, and other specifically identified companies and individuals be frozen. For purposes of OFAC compliance, these entities are referred to as "Specially Designated Nationals and Blocked Persons." OFAC maintains and regularly updates a master list ("SDN List") identifying known "blocked parties."

All of the sanctions programs enforced by OFAC involve declarations of national emergency by the President of the United States. As with all payment mechanisms, the ACH Network is subject to the requirement to comply with OFAC-enforced sanctions policies.

Who is subject to OFAC? All U.S. citizens and permanent resident aliens, companies located in the U.S., overseas branches of U.S. companies, and, in some cases, overseas subsidiaries of U.S. companies fall under OFAC jurisdiction. In terms of the ACH Network, this means that all U.S. ACH participants, including Originators, Originating Depository Financial Institutions (ODFIs), Receiving depository Financial Institutions (RDFIs), Receivers and third-parties need to be aware that they can be held accountable for sanctions violations by the U.S. Government and must understand their compliance obligations.

NACHA rule change. In September 1997, the *NACHA Operating Rules* were amended to require that future Originator/ODFI agreements include an acknowledgment by the Originator that ACH transactions it originates comply with the laws of the United States ("NACHA Rule"). The effect of this rule change is to focus financial institution liability for inadvertent processing of a *domestic* ACH transaction in violation of OFAC-enforced sanctions policies on the financial institution holding the account of the blocked party.

With respect to "international ACH" transactions,¹ NACHA's understanding regarding domestic financial institution liability being limited to the institution holding the blocked account may not apply under U.S. sanctions policies. This is due to a number of factors, including (1) the lack of U.S. jurisdiction over one or more parties to the transaction, and (2) increased exposure to

¹ For the purposes of this compliance guide, an "international ACH" transaction is an ACH transaction for which (1) at least one processing financial institution or third-party is domiciled in the U.S. or otherwise under U.S. jurisdiction, and at least one party to the transaction is outside U.S. jurisdiction; or (2) most or all parties to the transaction are outside the U.S., but at least one processing financial institution is subject to U.S. jurisdiction (e.g., a foreign branch of a U.S. bank).

For example, international ACH transactions can include an ACH transaction where both the ODFI and RDFI are domestic institutions, but the transaction is initiated via a S.W.I.F.T. instruction received from a foreign party.

potentially “violative” transactions involving foreign accounts.²

IMPACT TO ACH NETWORK PARTICIPANTS:

Originators

Domestic Originators should be aware that they are subject to applicable U.S. law, including OFAC-enforced sanctions, when initiating ACH entries. Foreign Originators initiating transactions with an ODFI that is under U.S. jurisdiction similarly must be aware that their ODFI is subject to OFAC-enforced sanctions. Originators in either category should not be acting on behalf of, or transmitting funds to or from, any blocked party subject to OFAC-enforced sanctions. Agreements between ODFIs and Originators should include a statement that the Originator acknowledges that it may not initiate entries that violate the laws of the United States. Originators should be aware that they will be held to an obligation to originate only lawful ACH entries under such agreements with their ODFIs. Originators of ACH transactions should also be aware that their ODFI may from time to time need to temporarily suspend processing of a transaction (particularly an international ACH transaction) for greater scrutiny that might result in delayed settlement and/or availability.

ODFIs

ODFIs that choose to originate ACH entries on behalf of their customers should be aware that both they and their Originators are subject to the *NACHA Operating Rules* and applicable U.S. law when transmitting these entries. ODFIs should make this obligation clear in their agreements with Originators. ODFIs processing international ACH transactions may also find it beneficial to include in their agreements a reference to possible delays in processing, settlement and/or availability of these transactions where enhanced scrutiny may be necessary.

The NACHA Rule reflects the Know Your Customer principle that the ODFI will verify the Originator is not a blocked party and that a good faith effort will be undertaken to determine through the normal course of business that the Originator is not engaged in transmitting funds to, from, or on behalf of a party subject to a blocking action. If the ODFI encounters a transaction in the normal course of business initiated by an Originator that would violate OFAC-enforced sanctions, federal law requires the ODFI to comply with OFAC policies. Under U.S. law, the ODFI is responsible for freezing or rejecting the proceeds of illicit ACH transactions involving interests of blocked parties for whom the ODFI holds an account, or on whose behalf the ODFI is acting (which could include the Receiver or other parties to the transaction). As a depository financial institution, the ODFI should have a process in place to determine whether any of their account holders is identified as a blocked party in a current SDN List (see section on “**Account Screening**” below).

ACH processing issues: With respect to domestic ACH transactions, by addressing the issues above, the ODFI may rely on the RDFI for compliance with OFAC policies when it is the RDFI that holds the account or is otherwise acting on behalf of a blocked person.

² Most (but not all) blocked parties on the SDN List and their accounts reside outside the U.S.

With respect to international ACH transactions, the ODFI may find it necessary to apply greater scrutiny to transaction details, particularly information about the Receiver and/or RDFI identified in the transaction. To do this, the ODFI may need to process international ACH transactions through a separate process that facilitates detail entry scrutiny and minimizes disruption to general ACH processing, reconciliation and settlement. NACHA recognizes that this means potentially reduced efficiency and greater processing costs for international ACH origination since ODFIs would be engaging in transaction-level scrutiny rather than account-level scrutiny.

As noted above, the ODFI should address the Originator's obligation to comply with U.S. laws in its origination agreement. The ODFI should also recognize that when unbundling "on us" transactions (i.e., the ODFI is also the RDFI for a transaction) from files received for processing from an Originator, it will need to review these transactions with greater scrutiny since it is servicing both sending and receiving sides.

Handling of violative transactions. Each ODFI should be aware that if it inadvertently transmits an unlawful ACH credit entry to a Receiver that is subject to OFAC sanctions, the RDFI holding the blocked party's account is obligated to post the credit entry to the Receiver's account, freeze the proceeds, and report the transaction to OFAC. In the event that the ODFI inadvertently processes an unlawful ACH debit entry to a blocked account, the RDFI holding the blocked account (or an intermediary receiving point such as a correspondent or third-party processor able to identify the transaction), in compliance with OFAC policies, should return the entry in accordance with the *NACHA Operating Rules* using Return Reason Code R16 (Account Frozen), so that proceeds do not leave the blocked account and the ODFI is informed of the reason.

If the ODFI is instructed to originate an ACH debit entry that it has reason to believe would be a violative transaction, NACHA has been advised that OFAC would prefer that the transaction be transmitted so that, if not returned or rejected by the RDFI, the proceeds from the transaction can be captured by the ODFI, frozen and reported to OFAC.³ This process recognizes that the Receiver may not be on the SDN List (or have its account already blocked by the RDFI), but OFAC wants the funds blocked if any other party to the transaction is on the SDN List when this is known to the ODFI.⁴

See the section on "**BLOCKING & REPORTING**" below for more detail on the process required to block proceeds of a violative transaction and report to OFAC.

³ The ODFI should also endeavor to notify the RDFI that the transaction sent will be blocked by the ODFI and reported to OFAC upon settlement.

⁴ In the event the Receiver claims the debit transaction to be "unauthorized" under the *NACHA Operating Rules*, the operation of U.S. law in this case means that the RDFI (with knowledge of the blocking action by the ODFI) is under no obligation to re-credit the Receiver and cannot expect a return of the debit from the ODFI. The RDFI may, however, require information about the transaction for its own research and to share appropriate information about the transaction with its Receiver customer who might want to file with OFAC for a license to release the funds.

As blocked parties and related transactions may be difficult to identify in the normal course of business, ODFIs may wish to become familiar with how to locate and interpret lists of specially-designated nationals and blocked persons subject to U.S. sanctions to facilitate OFAC compliance and avoid liability for monetary penalties. Consultation with counsel, audit/compliance staff, and/or wire transfer operations personnel – in addition to visiting and becoming familiar with the OFAC website at <http://www.treas.gov/ofac> -- is recommended. There are also several vendors of online or database SDN identification services that can assist financial institution reviews at the account level, including the new account set-up phase or reviewing existing accounts when new blocked parties are added to the SDN List.

RDFIs

RDFIs should be aware that they are subject to the requirements of the *NACHA Operating Rules* and applicable U.S. law when processing ACH entries. This includes the need to comply with OFAC enforcement policies in the event that the RDFI receives an ACH transaction being made to, from, or on behalf of any party subject to OFAC sanctions. As a depository financial institution, the RDFI should have a process in place to determine whether any of their account holders is identified as a blocked party in a current SDN List (see section on “**ACCOUNT SCREENING**” below).

ACH processing issues: With respect to domestic ACH transactions, the RDFI is responsible for rejecting or freezing the proceeds of a transaction involving interests of a blocked party for whom the RDFI holds an account or on whose behalf the RDFI is acting. If the RDFI is receiving CBR/PBR entries, or international ACH transactions through a correspondent bank, (See “Third Parties” below), then it may find it necessary to review information about the Originator/ODFI available in the transaction before posting or making funds available to the Receiver (recognizing that information identifying the Originator by name for purposes of verifying against the SDN list may not be present).

Handling violative transactions. In the event that an ODFI (or Receiving Gateway Operator – “RGO” -- with respect to a CBP/PBR entry, or a correspondent bank with respect to a foreign-initiated ACH transaction) inadvertently transmits an unlawful ACH credit entry to a Receiver that is subject to OFAC sanctions, the RDFI holding the blocked party’s account should post the credit entry to the account, ensure the account is frozen, and report the transaction to OFAC. In the event that an ODFI (or RGO/correspondent with respect to an international ACH entry) inadvertently transmits an unlawful ACH debit entry, the RDFI holding the account, should return the entry in accordance with the *NACHA Operating Rules* using Return Reason Code R16 (Account Frozen), with advice that the entry was destined to a blocked account and will be reported to OFAC. See the section on “**BLOCKING & REPORTING**” below for more detail on the process required to block proceeds of a violative transaction and report to OFAC.

As blocked parties and related transactions may be difficult to identify in the normal course of business, RDFIs may wish to become familiar with how to locate and interpret lists of specially-designated nationals and blocked persons subject to U.S. sanctions to ensure compliance and avoid liability for sizeable monetary penalties. Consultation with counsel, audit/compliance staff, and/or

wire transfer operations personnel is recommended.

Receivers

Domestic Receivers (and those otherwise under U.S. jurisdiction) are subject to U.S. law, including OFAC sanctions, and should be aware that their financial institutions are subject to both U.S. law and the *NACHA Operating Rules* when handling ACH transactions on their behalf. This may involve delays in posting, settlement and the availability of proceeds -- particularly for ACH transactions initiated by parties outside U.S. jurisdiction -- when an RDFI may find it necessary to scrutinize a transaction in more detail. In rare cases where a violation of U.S. sanctions policies would appear to be the case, proceeds from an ACH credit may be frozen and therefore unavailable to the Receiver pursuant to a blocking action. For violative ACH debits, Receivers may have the proceeds debited from their account and frozen by either the RDFI or the ODFI pursuant to a blocking action.

Receivers wishing to dispute funds frozen in a blocking action should review the section on **“BLOCKING & REPORTING”** and/or the OFAC website for the procedures and form required to seek a release of funds [Form TD-F 90-22.54; *Application for the Release of Blocked Funds*].

Third-Parties

Third-parties (including processors and correspondent/respondent banks) should recognize that OFAC sanctions enforcement applies to their role as it would the party they are acting on behalf of. For example, A third-party acting on behalf of a number of downstream corporate Originators should recognize that its ODFI will hold it accountable for ensuring that ACH transactions it introduces into the domestic ACH Network comply with U.S. law. This means that the ODFI has to rely on the third party to police downstream parties for which it is acting.

Similarly, a domestic respondent bank/RDFI receiving ACH transactions through a correspondent bank should not automatically assume that its correspondent will have intercepted and frozen any violative transactions it has processed on the respondent's behalf. While there may be some attention focused on the correspondent in the event of a violative transaction being passed through, the correspondent serving the RDFI is not in much of a position to verify the identity of the RDFI's accountholder (or the ODFI's Originator) on a particular ACH transaction.

ACCOUNT “SCREENING:”

While for the most part outside the scope of this guidance, which deals specifically with the ACH Network, the issue of screening accounts for the purpose of identifying any account holding parties subject to a blocking action is nonetheless a critical one. Depository financial institutions and other enterprises with customers that make or receive financial or other trade transactions are accountable if their customers are blocked parties on the SDN List. OFAC makes the current SDN List available to the public through several accessible forms and channels (See **“FOR MORE INFORMATION”** below).

Some financial institutions have the capability to download this list directly into their account systems as changes are made to the list and/or on a periodic basis to ensure that the current version is being applied to review their account base and to verify new customers. There are also several vendors that have OFAC account-level screening solutions from which a wide range of services are available.⁵ Regardless of whether an internal or a third-party option is used, the objectives are the same:

1. Running existing or new accountholder information against the SDN List to identify those accounts that involve the interests of a blocked party (resulting in a “hit”);
2. Reviewing information about a “hit” to establish whether the identification is valid, if necessary contacting OFAC for verification (caution: more “false” hits than true hits are likely given close approximations in the names or aliases of individuals or companies on the SDN List with the names of legitimate individuals or companies); and,
3. Freezing and reporting to OFAC those accounts that are true hits.

BLOCKING & REPORTING:

Blocked accounts and proceeds associated with violative transactions should be held by the financial institution in an interest-bearing status. Transactions involving blocked parties should be reported via fax within ten days to OFAC’s Compliance Programs Division. The blocking report should include the name and telephone number of a contact at the reporting financial institution and, in the case of a frozen ACH credit, a copy of the payment instruction (e.g., the Company/Batch Header Record & Entry Detail Record).

Official OFAC reporting, recordkeeping and licensing procedures

Section VII of “Foreign Assets Control Regulations for the Financial Community” states:⁶

VII. Reporting and Procedures

Reporting and Procedures Regulations (31 C.F.R. Part 501) OFAC now has a uniform requirement across all of its sanctions programs that records be maintained for five years.

Reports have also been standardized:

⁵ It is not NACHA’s policy to identify specific examples of such providers or services, though any party interested in reviewing availability is encouraged to browse the Internet using the keywords “OFAC” and “Compliance”.

⁶ U.S. Department of the Treasury, Office of Foreign Assets Control, “Foreign Assets Control Regulations for the Financial Community,” July 3, 2002, pp. 29-30.

Reports on Blockings and Reject Items – Blocking reports must be filed within 10 days of blocking. They preferably should be tele-transmitted to OFAC's Compliance Programs Division at 202/622-2426 and must identify: the owner or account party, the property, the property's location, any existing or new account number or similar reference necessary to identify the property, actual or estimated value, the date it was blocked, a photocopy of the payment or transfer instructions (if blocking involves a payment or transfer of funds), a confirmation that the payment has been deposited into a new or existing blocked account which is clearly identifying the interest of, the individual or entity subject to blocking, the name and address of the holder, and the name and telephone number of a contact person from whom compliance information can be obtained. Reports on reject items must be filed within 10 days and include: the name and address of the transferee financial institution, the date and amount of transfer, a photocopy of the payment or transfer instructions received, the basis for rejection, and the name and telephone number of a contact person at the transferee financial institution from whom compliance information can be obtained.

Annual reports on Blocked Property – OFAC requires the filing of a comprehensive annual report on blocked property held as of June 30 by September 30 each year. The report is being filed using Form TDF 90-22.50 which is available from OFAC's fax-on-demand service or electronically by clicking on the GPO ACCESS button on OFAC's Home page or going directly to The Federal Bulletin Board and accessing OFAC's extended electronic information reading room, the FAC_MISC file library. Requests to submit the information in an alternative format or for an extension of the reporting deadline are invited and will be considered on a case-by-case basis by OFAC.

Reports on litigation, arbitration and dispute resolution proceedings - U.S. persons involved in litigation, arbitration, or other binding alternative dispute resolution proceedings regarding blocked property must: provide notice of such proceedings to OFAC Chief Counsel, submit copies of all documents associated with such proceedings within 10 days of their filing to OFAC Chief Counsel at U.S. Treasury Department, 1500 Pennsylvania Ave., NW – 3123 Annex, Washington, DC 20220, and fax information about the scheduling of any hearing or status conference to OFAC Chief Counsel at 202/622-1911.

Licensing requests – License applications are not accepted by fax or electronically, unless specifically authorized. Most applications may be submitted in letter format, with the exception of license applications for the unblocking of fund transfers. Applications for the unblocking of fund transfers must be submitted using TD-F 90-22.54, "Application for the Release of Blocked Funds," accompanied by two complete copies of the entire submission. The form, which requires information regarding the date of the blocking, the financial institutions involved in the transfer, and the beneficiary and the amount of the transfer, may be obtained from the OFAC Internet Home Page: <http://www/treas.gov/ofac> and the OFAC fax-on-demand service: 202/622-0077. Any person having an interest in a transaction or proposed transaction may file an application for a license authorizing the transaction. For individuals, if U.S., inclusion of a social security number is recommended but not required. For corporations or other entities, the application should include a principal place of business, the state of incorporation or organization, and, if U.S., a taxpayer identification number. Applications

should be sent to the Licensing Division, Office of Foreign Assets Control, 1500 Pennsylvania Avenue, N.W., Annex 2, Washington, D.C. 20220.

FOR MORE INFORMATION:

The OFAC compliance manual specific to the financial community is available on the OFAC website at: <http://www.treas.gov/offices/enforcement/ofac/regulations/t11facbk.pdf>

OFAC reporting forms -- including the appropriate forms for reporting blocked or rejected transactions, annual report of blocked property, and a request for release of blocked funds -- are available online at: <http://www.treas.gov/offices/enforcement/ofac/forms/index.html>

ACH Network participants are encouraged to check with OFAC regularly to determine whether blocked parties have been added to the SDN List, or whether other modifications to the sanctions programs have taken place. OFAC's Compliance Hotline may be reached at (800) 540-OFAC. OFAC also maintains a comprehensive website of compliance information, a current SDN List, and links to other information referenced above on its homepage at: <http://www.treas.gov/offices/enforcement/ofac/>.

Finally, OFAC now has an e-mail alert service advising recipients of changes as they are approved. To subscribe (no charge), go to: <http://www.treas.gov/offices/enforcement/ofac/subscribe.html> and enter your e-mail address to be added to the "OFAC Financial Operations Bulletin E-mail List."