PREPARED TESTIMONY
of
David L. Hall
Partner, Wiggin and Dana
Before the
Subcommittee on the Western Hemisphere
Committee on Foreign Affairs
United States House of Representatives

"Examining the Effectiveness of the Kingpin Designation Act in the Western Hemisphere"
November 8, 2017

Chairman Cook, Ranking Members, and Members of the Committee:

Thank you for the opportunity to appear before you today for this hearing "Examining the Effectiveness of the Kingpin Designation Act in the Western Hemisphere."

My name is David L. Hall, and I am a partner at the law firm of Wiggin and Dana LLP. Prior to joining Wiggin and Dana, I served as an Assistant United States Attorney with the Department of Justice for 23 years. I am also a retired naval intelligence officer, having served in the Navy for thirty years, active and reserve.

Opening Remarks

The Office of Foreign Assets Control ("OFAC") administers numerous sanctions programs focused on foreign countries, rogue regimes, terrorist organizations, criminal organizations, and other persons and entities that pose a threat to U.S national security and U.S. foreign policy objectives. While some of these programs place prohibitions on specified activities with persons and entities in targeted foreign countries, others, like the Foreign Narcotics Kingpin Designation Act (the "Kingpin Act") target individuals and entities involved in criminal enterprises such as narcotics trafficking. Collectively, these individuals and entities make up the Specially Designated Nationals and Blocked Persons List (the "SDN List"). The SDN List is a 1,054 page document identifying more than 5,000 individuals and entities blocked under an OFAC sanctions program.[1] With rare exceptions, U.S. persons are prohibited from engaging in transactions with any individuals or entities on the SDN List.

The objective of the Kingpin Act, as with other sanctions programs, is to cut off known bad actors (in this case foreign narcotics traffickers and their criminal organizations) from access to U.S. financial markets, thus crippling their ability to reap the rewards of their criminal actions and to weaken their ability to fund their criminal enterprise. The strength of these programs lies in the Government's ability to ensure that non-government actors in the United States, primarily financial institutions and U.S. businesses, act as gatekeepers to prevent these bad actors from moving funds, making investments, and purchasing goods and services. While law enforcement agencies are responsible for apprehending

[1] In addition to the SDN List, OFAC administers a list of persons and entities subject to Sectoral Sanctions (Russia/Ukraine Sanctions Program) and Foreign Sanctions Evaders. The Department of Commerce similarly publishes a list of entities and individuals subject to export restrictions regulated by the Bureau of Industry and Security ("BIS"). OFAC maintains a Consolidated Sanctions List which includes the following data files: Foreign Sanctions Evaders (FSE) List; Sectoral Sanctions Identifications (SSI) List; Palestinian Legislative Council (NS-PLC) List; The List of Foreign Financial Institutions Subject to Part 561 (the Part 561 List); Non-SDN Iranian Sanctions Act (NS-ISA) List; and the List of Persons Identified as Blocked Solely Pursuant to Executive Order 13599 (the 13599 List).

the bad actors and stopping the movement of narcotics into the United States, OFAC aims for the purse-strings of these criminal organizations.

From the perspective of U.S. businesses, the Kingpin Act does not impose compliance burdens substantially different from those of other sanctions programs. Today, I will address practical compliance challenges that U.S. businesses, in their role as gatekeepers, face in navigating U.S. sanctions programs overall, including those originating with the Kingpin Act.

As a former prosecutor and a former naval intelligence officer, I consider sanctions programs to be important arrows in the national security quiver. My comments are offered in the hope that the effectiveness and fairness of these programs can be improved.

Businesses face many challenges in sanctions compliance, and my testimony focuses on just two. First, I will address OFAC's "50 Percent Rule," which imposes significant burdens and undue risk on U.S. business – and also subverts the purpose of the rule itself. Second, I will attempt to shed some light on the practical challenges companies face in attempting to comply with U.S. sanctions programs, in order to demonstrate the pitfalls of a strict liability approach to violations of U.S. sanctions.

The OFAC "50 Percent Rule"

Property blocked pursuant to an Executive Order or regulations administered by OFAC is broadly defined to include any property or interest in property, tangible or intangible, including "present, future or contingent interests."[2] OFAC has taken the position that an entity owned 50 percent or more in the aggregate, directly or indirectly, by one or more blocked persons is itself considered to be blocked **even where that entity is not on the SDN List**.[3]

How is a widget manufacturer in Wisconsin supposed to deal with this? As you are aware, many sanctioned individuals -- including Kingpins – exert significant effort to become invisible, precisely in order to avoid the effects of U.S. sanctions. These bad actors often hide behind front companies, with complex and anonymous ownership structures. As a practical matter, most U.S. companies, particularly small businesses, do not have the resources to uncover the ownership structures of all their customers and business partners. This is particularly true when their customers – for good reasons or bad– want that information to be confidential.

Placing the burden on U.S. businesses to uncover these connections is not fair or practical. Through the 50 Percent Rule, which tasks U.S. businesses with determining whether any potential business transactions involve entities owned 50 percent or more by a blocked party, the government has outsourced a fundamental national security function to the private sector. This is effective in reducing government accountability, but is not effective as a means of accomplishing the goals of U.S. sanctions programs.

The 50 Percent Rule almost guarantees that the U.S. Government will fail in achieving its own objectives. U.S. businesses ordinarily do not have access to the kind of granular information that would

---

[2] *See* Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property are Blocked, Department of Treasury (Aug. 13, 2014) ("OFAC 50 Percent Rule Guidance"), available at https://www.treasury.gov/resource-center/sanctions/Documents/licensing_guidance.pdf. Specifically, the Kingpin Act defines blocked property to mean "any account or property subject to [a blocking action under the Act] held in [the name of a designated person], or in which a [designated person] has an interest, and with respect to which payments, transfers, exportations, withdrawals, or other dealings may not be made or effected except pursuant to an authorization or license from the Office of Foreign Assets Control authorizing such action." 31 C.F.R. § 598.301.
[3] OFAC 50 Percent Rule Guidance (Aug. 13, 2014).

enable them to determine 50 percent ownership of customers and business partners. Furthermore, even if a U.S. business is able to identify a secret owner of an entity, that information is not typically shared, so the rest of the private sector -- and the government itself – does not benefit from that discovery.

In addition to having access to the same publicly available information on which U.S. businesses must rely, the U.S. Government has access to intelligence and law enforcement information and resources dedicated to identifying entities and individuals acting for or on behalf of targeted countries and individuals. Since the government has more reliable and efficient means to identify downstream ownership, it should identify and sanction the appropriate parties.

Compliance Challenges and Strict Liability

The sanctions regime seems simple. The government publishes a list of names. U.S. businesses are charged with the duty of reading the list and blocking transactions with anyone on the list. And sometimes it is exactly that simple. But not always.

Search protocols frequently result in false positives or near positives.[4] This is particularly true in the case of common names, or in the case of names with multiple spellings. The situation is further exacerbated by foreign language and translation issues, including transliteration of names from non-Roman alphabets, identifying surnames versus given names, or cultural differences in naming conventions. A number of screening tools are available to businesses, which offer analytics and other support services to reduce uncertainty and provide more accurate results. However, in many cases, determining whether there is a true match between a potential customer or business partner and a designated party is based on a judgment call made with incomplete information. It is in these areas of uncertainty that businesses take on significant risk, which they cannot reduce by further research because they do not have access to the kind of information that would definitively resolve the matter. U.S. businesses are thus left with the question of how close is too close?

OFAC offers its own free search database, which allows users to search against several OFAC sanctions lists. Users can run searches for "exact matches" or employ fuzzy logic to capture a wider range of potential matches.[5] OFAC does not recommend any particular approach or search strategy, but rather advises that users "must make their own determinations based upon their own internal risk assessments and established practices."[6]

---

[4] A recent informal testing of several third party screening vendors resulted in vastly divergent false hit rates. The test involved a sample of over 100 entries consisting of a pre-determined mix of previously confirmed denied parties (SDNs) and unlisted persons. The likelihood of false positives (where an unlisted person appears as a potential match to an SDN) ranged from approximately 2% to 82%. The likelihood of false negatives (where an SDN match was missed) ranged from approximately 9% to 75%. The false hit rate increased dramatically when misspellings or common transliteration errors were introduced.

[5] OFAC has published frequently asked questions (FAQs) regarding how its search database works and how scores are calculated. These FAQs are available at https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/fuzzy_logic.aspx.

[6] *Id.* In some instances, a company may determine that its risk profile does not warrant implementing an expensive third party screening program. Even if that determination is made based on a good faith evaluation of the company's risk of doing business with prohibited parties, the company is still subject to heavy penalties. In a recent OFAC enforcement action, a retail jewelry business entered a settlement agreeing to pay $333,800 as a result of engaging in four transactions involving the shipment of jewelry to an SDN identified under the Kingpin Sanctions. *See* Enforcement Information for September 26, 2017, available at https://www.treasury.gov/resource-center/sanctions/CivPen/Pages/civpen-index2.aspx.

How does this work in practice? By way of illustration, Muhammad Ali – "the Greatest of All Time" -- is a 100% match. Another example: a very nice Georgetown bakery is an 84% match to an entity recently designated under the Kingpin sanctions. This does not mean that there is an 84% likelihood that the bakery and the Kingpin are connected, but rather that they have 84% similarity based on the algorithms of OFAC's search tool. What is the Wisconsin widget maker to do with this information? Further research might resolve the issue, as in the case of Muhammad Ali. But it might not, illustrating how easily a business can be faced with the conundrum of how, with incomplete information, to meet its responsibility to determine if a business partner is a bad actor.

Why is this such a big problem? Because a violation of OFAC regulations is a strict liability offense and the maximum penalties are substantial.[7] So, regardless of a company's good faith intention to comply with the law, it can be held liable for any transaction with a designated party, and subjected to severe penalties. In making penalty determinations, the government does consider mitigating factors such as an effective compliance program, the lack of willfulness, proactive disclosures to the government, and cooperation with an investigation. But the company is still liable, and, in the end, the penalty is up to the government.

In theory, it makes sense to impose a strict liability standard on a program designed to protect our national security. That's because national security is important, existentially so. But as a practical matter, the strict liability standard cannot itself guarantee enhanced national security. And it can be brutally unfair. Consider the small company that fails – after trying in good faith -- to determine that a sanctioned person is a 50 percent owner, through an anonymous front company, of one of its customers. Should that company be strictly liable for fines and penalties? I don't think so. I don't think that's fair.

Recommendations

I was trained in the Navy that every problem has a solution. In that spirit, I offer these recommendations:

- Abolish the 50 Percent Rule. Put the burden of identifying sanctioned individuals and entities on the government. Or, in the alternative, create a safe harbor where a company can submit names to the government for review.
- Create a good faith exception to the strict liability standard. This will allow compliant companies that are doing their best to satisfy the requirements of sanctions programs to avoid unfair penalties. And it will preserve the ability of the government to pursue penalties against companies that are not acting in good faith – which is the real problem the government should address.

Thank you very much for your attention.

---

[7] The maximum civil penalty for an OFAC penalty under the International Emergency Economic Powers Act ("IEEPA") is currently $289,238 (or twice the amount of the underlying transaction, whichever is greater). 82 Fed. Reg. 10434 (Feb. 10, 2017). The maximum civil penalty under the Kingpin Act is $1,437,153 per violation. 31 CFR 598.701.