

# Focus on Securities Industry Risks: How to Implement Strong Due Diligence to Limit Your Omnibus Accounts Risks

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# OFAC Enforcement Action - Clearstream Banking, S.A.

- Facts of the case
  - January 2014 – Clearstream settles with OFAC for \$152 million for apparent violations of sanctions against Iran
  - Related to Clearstream’s use of its omnibus account at a U.S. bank to hold assets totaling \$2.8 billion beneficially owned by the Central Bank of Iran
  - CBI’s interest in the securities not transparent to the U.S. bank due to the omnibus nature of the account



# OFAC Enforcement Action - Clearstream Banking, S.A.

- Facts of the case (cont.)
  - Clearstream's interaction with OFAC in 2007-2008, and subsequent free-of-payment (FOP) transfers of the securities to another European bank
    - Reason to know beneficial ownership was not changing
  - OFAC's analysis of the conduct at issue (General Factors Affecting Administrative Action):
    - Both aggravating factors (e.g., recklessness, awareness of conduct, sanctions harm) and mitigating factors (e.g., remediation, cooperation, proportionality)



# Clearstream Violations

- **§560.204 Prohibited exportation, reexportation, sale, or supply of goods, technology, or services to Iran.**
- ...the exportation, reexportation ... directly or indirectly, from the United States, or by a United States person, wherever located, of any ... services to Iran or the Government of Iran is prohibited...”
- **§560.410 Provision of services.**
- (a) The prohibition on the exportation, reexportation ... of services contained in §560.204 applies to services performed on behalf of a person in Iran or the Government of Iran or where the benefit of such services is otherwise received in Iran, if such services are performed:
  - (1) In the United States, or
  - “Clearstream maintained an account at a U.S. financial institution in New York through which the Central Bank of Iran (“CBI”) maintained a beneficial ownership interest in 26 securities.”
  - “Clearstream exported custody and related services from the United States to the CBI in apparent violation of the ITSR.”



# Clearstream Violations

- “The activity in question highlights the need for vigilance in the securities industry, where vehicles such as omnibus accounts—as well as the intermediated nature of the securities custody industry itself—can serve to obscure the beneficial ownership interests of sanctioned parties.”
- “OFAC encourages firms operating as securities intermediaries and custodians to implement measures to mitigate the risk of indirectly providing custody-related services to parties subject to U.S. sanctions, or dealing in property owned by parties subject to U.S. sanctions.”
  - While OFAC acknowledged that the relationship between the U.S. financial institution and the CBI was NOT transparent, they chose to warn intermediaries and custodians equally.
    - i.e. The risk applies to ALL parties in relationship or transaction



# After Clearstream: OFAC Implications

- OFAC issued several FAQs for financial institutions which operate in the securities industry regarding beneficial ownership. OFAC directed the FAQs both to financial institutions that hold the securities and those that act as intermediaries.
- OFAC issued a list of best practices financial institutions should follow including:
  - Informing customers/clients about U.S. sanctions obligations and having them indicate in writing to the financial institution that their accounts will not be used to violate OFAC sanctions.
  - Proper due diligence and Know Your Customer (KYC) regarding beneficial ownership. Identify potential high risk customers who may necessitate enhanced due diligence to protect against third party transactions or third party accounts.
  - Heightened restrictions regarding the use of certain products or services by high risk clients (e.g. limitations on the use of omnibus accounts).
  - Attempt to identify beneficial ownership of and purpose for certain accounts holding third party assets.
  - Monitor accounts for suspicious activity.

\*\*See Department of Treasury website regarding FAQs at OFAC <http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx#335>



# Potential Clearstream Impact

- U.S. financial institutions conducting securities transactions may need to implement processes and controls designed to identify sanctions concerns regarding omnibus accounts.
- Increased scrutiny of omnibus accounts by regulators.
  - U.S. financial need to be aware of the beneficial owners of the custodian accounts they hold for foreign institutions and not rely on the KYC performed by the foreign institution (i.e., increased due diligence and KYC).
- Increase in potential sanctions violations for both U.S. and foreign based financial institutions serving as custodians and intermediaries. \*\*
- Potential Regulatory penalties: Significant fines are being levied on financial institutions.
- Potential Criminal penalties: Clearstream under investigation by a grand jury in the Southern District of New York.\*\*\*
  - The investigation involved whether or not Clearstream took steps to benefit the Central Bank of Iran \*\*\*\*
  - Potential criminal violations listed in the subpoena issued upon Clearstream included money laundering and violations of Iran sanctions laws.

\*\*See International Securities Services Association Symposium

\*\*\*See <http://finance.yahoo.com/news/u-investigates-deutsche-boerse-unit-152743353.html>

\*\*\*\*See <http://www.reuters.com/article/2014/04/02/deutsche-boerse-iran-idUSL5N0MU1JX20140402>

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# Potential Challenges

- Definition of “omnibus”
- Identifying account types that fall under the definition
- Challenging best practices for U.S. Firms
  - How to structure transaction monitoring
  - If a client/counterparty states it is proprietary trading, is that sufficient?
  - Obtaining agreements/contractual representations from clients/counterparties with respect to their sanctions-related obligations where they do not have sanctions compliance programs as sophisticated or as far reaching as our own
- Beneficial Ownership Guidance
- 50% Rule





# Questions?

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