ALERTS

Sanctions Update: Statutory Amendments and an Interim Final Rule Create Significant Implications for OFAC Sanctions Compliance

June 11, 2024

On April 24, 2024, President Joe Biden signed into law an emergency supplemental appropriations bill for foreign aid ("Supplemental Act"), which includes several sanctions-related provisions, such as the 21st Century Peace Through Strength Act ("21st Century Act"), which increases the statute of limitations for sanctions violations. Only a few weeks later, the US Department of the Treasury's Office of Foreign Assets Control ("OFAC") issued an interim final rule ("Interim Rule") to amend certain reporting requirements and procedures for sanctions compliance. Together, these statutory and regulatory amendments could require significant changes to US persons' sanctions compliance policies and procedures. In this *Alert,* we highlight the key provisions from the Supplemental Act and the Interim Rule and discuss potential implications for investment managers.

Statutory Amendments to National Security Programs and New Sanctions

Folded into the Supplemental Act, which provides funding to Ukraine, Israel and Taiwan, is the 21st Century Act, containing several sanctions and trade restriction provisions. Potentially the most impactful piece of the 21st Century Act are amendments to the International Emergency Economic Powers Act ("IEEPA") and the Trading With the Enemy Act ("TWEA"), which increase the statute of limitations for sanctions violations

from five years to ten years. The Supplemental Act and 21st Century Act also contain a number of other important provisions, including, among other things, authorization for the seizure of Russian sovereign assets and authorization for imposing sanctions on persons and entities currently sanctioned by the EU or UK that are not yet sanctioned by the US.

Statute of Limitations

The 21st Century Act provides for the immediate extension of the statute of limitations from five years to 10 years for any civil enforcement action or criminal prosecution brought under IEEPA and TWEA. Specifically, the 21st Century Act provides that "[a]n action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, under this section shall not be entertained unless commenced within 10 years after the latest date of the violation upon which the civil fine, penalty, or forfeiture is based," and further clarifies that pre-penalty notices and findings of violations are included within the scope of an "action, suit, or proceeding."[1] With respect to criminal prosecutions, the 21st Century Act provides that no person shall be "prosecuted, tried, or punished" for any offense under IEEPA or TWEA unless the indictment is filed or the information is brought "within 10 years after the latest date of the violation upon which the indictment or information is based."[2] As IEEPA and TWEA are the primary authorities for the Executive Orders and regulations that implement OFAC's sanctions programs, this change significantly increases OFAC's and the DOJ's sanctions enforcement authority by enabling them to look further back in time for potential sanctions violations. OFAC is also likely to amend its record retention requirements for transactions that are subject to OFAC's regulations to align with the new statute of limitations.[3]

The REPO Act

The Supplemental Act also contains the Rebuilding Economic Prosperity and Opportunity for Ukrainians Act ("REPO Act").[4] Based on the rationale that the Russian Federation should be responsible for the reconstruction of Ukraine and repaying other costs related to its illegal invasion, the REPO Act authorizes the President to seize Russian sovereign assets that are subject to the jurisdiction of the United States for the benefit of Ukraine. The Congressional findings enumerated in the REPO Act note that between $4 and $5 billion Russian sovereign assets are believed to be subject to US jurisdiction, which is a small fraction of the approximately $300 billion that has been immobilized by countries

around the globe.[5] Accordingly, before seizing Russian sovereign assets, the President must certify that he has coordinated with other G7 leaders to take similar actions, that seizure is in the interests of the United States, and that Russia has either engaged in a legitimate international mechanism to discharge its obligations to Ukraine or that Russia has not ceased its hostilities against Ukraine and has not otherwise provided full compensation for the invasion.[6]

The Russian sovereign assets subject to seizure include funds and other property of the Central Bank of the Russian Federation, the Russian National Wealth Fund, the Ministry of Finance of the Russian Federation (collectively, the "Covered Entities"), or any other assets owned by the Government of the Russian Federation and its subdivisions, agencies or instrumentalities.[7] Notably, while the Covered Entities are not subject to full blocking sanctions by OFAC, Directive 4 of the Russian Harmful Foreign Activities Sanctions program, issued in 2022 and amended on May 19, 2023 ("Directive 4"), prohibits US persons from transacting with the Covered Entities, which has effectively frozen any Russian sovereign assets in the possession or control of a US person. And as of June 18, 2023, US persons have been required to submit reports to OFAC on any such sovereign assets in their possession or control.[8] The REPO Act also prohibits the release of any Russian sovereign assets that are currently blocked or "effectively immobilized" until the President certifies that Russia has ceased hostilities with Ukraine and made full compensation for harms resulting from the invasion.[9]

Harmonizing US Sanctions with EU and UK Sanctions

The US's sanctions against Russia have been largely coordinated with its allies, including the European Union and the United Kingdom. The 21st Century Act, however, ostensibly seeks to close any gaps that may exist between US sanctions and EU and UK sanctions. Specifically, the 21st Century Act requires the President to submit a report to Congress on persons currently subject to EU and UK sanctions and any such persons that may meet the criteria for sanctions under the Global Magnitsky Human Rights Accountability Act, Executive Order ("E.O.") 14024, E.O. 14068, or E.O. 14071 (authorities under which many Russian individuals and entities are sanctioned).[10] Based on this report, the President may — but is not required to — impose sanctions on any person that is both sanctioned by the EU or UK and meets the criteria for US sanctions against Russian persons.[11]

Other Sanctions and Trade Restrictions

The Supplemental Act also contains several other sanctions, money laundering and trade restriction provisions. A few key highlights include: calling for sanctions on persons involved in trafficking the drugs fentanyl and captagon, authorization for imposing secondary sanctions on foreign persons engaged in oil or military technology-related transactions with Iran, authorization for sanctions against persons involved in cyber-attacks against the US and mandating the President to implement sanctions against persons that have sponsored or aided Hamas and other terrorist organizations in the Middle East.

In addition, the Supplemental Act notably prohibits any entity from distributing, maintaining, updating, or providing internet hosting services for an application controlled by a foreign adversary of the United States.[12] For now, this law specifically targets TikTok and provides a 270-day period before taking effect, with the purpose of allowing TikTok's Chinese parent company, ByteDance Ltd., to sell TikTok. But other applications (defined as websites, desktop applications, mobile applications or other technology applications[13]) could be designated and banned by the President in the future, with a similar 270-day delay in effectiveness from the date of designation.[14]

OFAC Interim Final Rule on Reporting, Procedures and Penalties Regulations

On May 8, 2024, OFAC released an interim final rule that amends its Reporting, Procedures and Penalties Regulations.[15] The Interim Rule makes some notable changes to the reporting requirements for blocked property, allows OFAC to request information from US financial institutions on certain transactions, and clarifies several other procedures. The Interim Rule takes effect on Aug. 8, 2024.

Use of OFAC's Reporting System Now Required for Certain Filings — OFAC has, to date, accepted initial blocked property reports, annual reports of blocked property and reports of rejected transactions by mail, email or through its electronic reporting platform, the OFAC Reporting System ("ORS"). The Interim Rule now requires the use of ORS for all such reports, unless the submitter can "provide evidence of unique and extraordinary circumstances that would not permit the electronic filing of reports … subject to a presumption of denial" for requests to file by other means.[16]

OFAC May Require Reports From Financial Institutions For Transactions Believed to Involve Blocked Property — Pursuant to existing regulations, OFAC may demand from any person "information relative to any act or transaction, regardless of whether such act or transaction is effected pursuant to license or otherwise, subject to the provisions of this chapter or relative to any property in which any foreign country or any national thereof has or had any interest of any nature whatsoever, direct or indirect."[17] The Interim Rule does not change this authority, but clarifies in a note to this provision that if "OFAC has reason to believe an account or transaction … may involve the property or interests in property of a blocked person, OFAC may issue an instruction to one or more financial institutions" requiring information regarding such transactions, and may require further action if OFAC determines that a transaction involves blocked property.[18]

New Reporting Requirement For Any Blocked Property That is Unblocked or Transferred —OFAC's existing regulations only require reports on the unblocking of property if "made a condition of a general or specific license."[19] The Interim Rule makes such reports mandatory, which must be submitted within 10 business days from the date that blocked property is unblocked or transferred, including when performed "pursuant to a valid order issued by a US government agency or US court," though the Interim Rule notes that this reporting requirement is in addition to the obligation to notify OFAC of any litigation that may affect blocked property.[20] US persons do not need to file unblocking or transfer reports for debits to blocked accounts for permissible service charges.[21] Unblocking reports, unlike blocked property reports, may still be submitted to OFAC by email.[22]

Scope of Reporting Requirement For Rejected Transactions — The Interim Rule explains that OFAC received a number of public comments in response to a 2019 interim final rule asking for clarification on what types of rejected transactions need to be reported under OFAC regulations, who must file reports, and the scope of information that needs to be included in reports. In response, the Interim Rule clarifies that the term "transaction" means wire transfers, trade finance, transactions related to securities, checks or foreign exchange, and sales or purchases of goods or services.[23] The Interim Rule also provides that submitters of rejected transaction reports need only provide information required under the regulations "to the extent the information is available … at the time the transaction is rejected."[24] OFAC also notes in the supplementary

information section of the Interim Rule that the rejected transaction regulations apply to all US persons, not just US financial institutions.[25]

Procedures for Unblocking Property Blocked in Error — The Interim Rule amends regulations concerning procedures for unblocking property that is believed to have been blocked in error. The procedures for unblocking such property now extend not just to property blocked due to mistaken identity, but also to property blocked due to "typographical or similar errors."[26] OFAC is also limiting the availability of these unblocking procedures (a "Compliance Release") to only persons who originally filed a blocked property report in error.[27] Previously, any person who was a party to a transaction relating to blocked property could request the release of funds blocked in error. Non-reporting parties may still seek release of blocked property by applying to OFAC for a specific license.[28]

Additional Changes — The Interim Rule includes several other amendments to provisions in the Reporting, Procedures and Penalties Regulations, including updates to regulations governing the availability of information under the Freedom of Information Act, and clarification on who may submit petitions for administrative reconsideration for seeking removal of a person or property from the Specially Designated Nationals and Blocked Persons ("SDN") List, as well as technical and conforming edits to the regulations.

OFAC is requesting public comments on the Interim Rule, which may be submitted in writing on or before June 10, 2024.

Takeaways

Statutory Changes

The increase in the statute of limitations for sanctions violations is potentially the most significant sanctions development of the last few months. In particular, it may be prudent, if not necessary, to amend record retention policies regarding any transactions subject to OFAC regulations to cover the ten-year statute of limitations period. Relatedly, firms should consider changing the scope of transactional due diligence (particularly for mergers and acquisitions) and amend representations and warranties to account for the increased statute of limitations.

From an enforcement perspective, the longer statute of limitations may give OFAC and the DOJ more flexibility to investigate sanctions evasion

violations that involve complex transaction structures or ownership chains with multiple entities. OFAC and the DOJ may also apply the new statute of limitations to any potential violations for which the old five-year period has not already run.

The Supplemental Act also includes authorizations and mandates for imposing new sanctions, such as terrorism- and narcotics-related sanctions and imposing sanctions on Russian persons that have already been designated by the EU and UK. Firms should review their exposure to any investments or transactions that fall within the scope of these criteria for sanctions designation and consider whether they might need to comply with any new sanctions obligations as more entities and individuals are added to the SDN List later this year.

Firms should also review their holdings to determine whether they have any Russian sovereign assets in their possession or control and ensure that they are up to date with respect to their OFAC reporting obligations under Directive 4, since such assets could be subject to further scrutiny if the US government moves forward with plans for seizing these assets. Pursuant to Directive 4, US persons have been prohibited from transacting with Covered Entities, but the REPO Act further prohibits the release or mobilization of Russian sovereign assets, so such assets should remain frozen.

Interim Final Rule

OFAC's amendments to its reporting requirements and other procedures have less far-reaching implications than the increase in the statute of limitations, but US firms should be mindful of whether they need to make any changes to their sanctions compliance policies and procedures in light of the Interim Rule. Firms that need to file an annual report on blocked property this year should take note that the requirement for using ORS to file blocked property reports takes effect Aug. 8, 2024, ahead of the Sept. 30, 2024 due date for annual reports.[29] Firms should also review their sanctions compliance policies to ensure their procedures for reporting rejected transactions conform to the Interim Rule — and include policies for reporting rejected securities transactions and rejected transactions involving goods or services, not just rejected wire transfers. And as always, it is important to continually monitor the SDN List for any changes, but firms will now need to take note of any *removals* from the SDN List, not just additions, to ensure compliance with their reporting obligations when they unblock property.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] 21st Century Peace Through Strength Act, Pub. L. 118-50, Div. E, Title I, Sec. 3111(a)–(d) (codified at 50 U.S.C. §§ 1705(d), 4315(d)).

[2] *Id.*

[3] Current record retention regulations require "every person engaging in any transaction subject to the provisions of this chapter [to] keep a full and accurate record of each such transaction engaged in … and such record shall be available for examination for at least 5 years after the date of such transaction." 31 C.F.R. § 501.601. This provision also requires maintaining records of blocked property until at least 5 years after the property is unblocked. *Id.*

[4] Pub. L. 118-50, Div. F.

[5] *Id.* at Sec. 101(a)(8).

[6] *Id.* at Sec. 104(a)–(c).

[7] *Id.* at Sec. 2(6).

[8] OFAC, Directive 4 (as amended) Under Executive Order 14024 (May 19, 2023), available at https://ofac.treasury.gov/media/918806/download?inline.

[9] REPO Act, Pub. L. 118-50, Div. F., Sec. 103(a). Notwithstanding this provision, the REPO Act sunsets five years after its enactment. *Id.* at Sec. 104(l)(1).

[10] Pub. L. 118-50, Div. G, Sec. 1(a).

[11] *Id.* at Sec. 1(b).

[12] Protecting Americans from Foreign Adversary Controlled Applications Act, Pub. L. 118-50, Div. H, Sec. 2.

[13] *Id.* at Sec. 2(g)(3).

[14] *Id.* at Sec. 2(a)(2).

[15] OFAC, Recent Actions, Amendment of the Reporting, Procedures and Penalties Regulations (RPPR) (May 8, 2024), available at https://ofac.treasury.gov/recent-actions/20240508. *See also* Interim Final Rule, *Reporting, Procedures and Penalties Regulations*, 89 Fed. Reg. 40372 (May 10, 2024) (to be codified at 31 C.F.R. part 501), available at https://www.govinfo.gov/content/pkg/FR-2024-05-10/pdf/2024-10033.pdf.

[16] Interim Rule, 31 C.F.R. §§ 501.603(d), 501.604(d) (forthcoming).

[17] 31 C.F.R. § 501.602(a) (current as of Jun. 4, 2024).

[18] Interim Rule, Note 1 to 31 C.F.R. § 501.602 (forthcoming).

[19] 31 C.F.R. § 501.603(b)(3)(i) (current as of Jun. 4, 2024).

[20] Interim Rule, 31 C.F.R. §§ 501.603(b)(3), Note 3 to 501.603(b)(3) (forthcoming).

[21] *Id.* at § 501.603(b)(3).

[22] *Id.* at § 501.603(d).

[23] Interim Rule, 31 C.F.R. § 501.604(a)(3) (forthcoming).

[24] *Id.* at § 501.604(b).

[25] Interim Rule, Supplementary Information.

[26] Interim Rule, 31 C.F.R. § 501.806 (forthcoming).

[27] *Id.* at § 501.806(a).

[28] Interim Rule, Supplementary Information.

[29] 31 C.F.R. § 501.603(b)(2)(i) (current as of Jun. 4, 2024). Firms that submit their annual reports before Aug. 8, 2024, should still be permitted to submit them to OFAC by email.

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