OFAC Compliance and IAT Transactions
Identifying and Mitigating Risk

NACHA, The Electronic Payments Association

October 3, 2012

NACHA
The Electronic Payments Association®

investing in you

Canandaigua
National
Bank & Trust

OFAC Obligations

- Overview of International ACH Transactions
- OFAC Processing Issue
- OFAC's Position
- Financial Institution Responsibilities
  – ODFI
  – RDFI
  – Gateway Operator
- Technical Standards and Mapping

NACHA
The Electronic Payments Association®

investing in you | Canandaigua National Bank & Trust

Overview of International ACH Transactions (IAT)

- International ACH Transactions (IAT)
  - International payments are credit and debit payment instructions that are exchanged across national borders
  - IAT focus is on where the financial agency that handles the ACH payment transaction is located and not where the Originator or Receiver is located
  - IAT's require OFAC review and additional must be included in the ACH record

NACHA
The Electronic Payments Association®

Investing in you | Canandaigua National Bank & Trust

IAT ACH Transaction Criteria

- The funding for the IAT transaction was transmitted to or received from a Financial Agency located outside the jurisdiction of the United States

- Payment instruction to create ACH transactions plus explicit funding for the ACH file

- Any part of the transaction is processed through the U.S. ACH network

- If your response to the criteria above is yes, than the transaction should be processed as IAT

NACHA
The Electronic Payments Association®

investing in you | Canandaigua National Bank & Trust

IAT =

Payment Transaction
(Instruction + Settlement)

+

Financial Agency

(Outside the Territorial Jurisdiction of the United States)

+

U.S. ACH Network

*Use of the IAT SEC code is required **IF** the transactions flow through the U.S. ACH Network at some point!*

=

IAT

*Location of the originator and beneficiary is **not** considered in the Identification of an IAT transaction.*

NACHA
The Electronic Payments Association®

Investing in you | Canandaigua National Bank & Trust

OFAC Risk Issue

- NACHA was advised by several Regional Payment Association (RPA) executives that some RDFIs are posting or memo posting incoming IAT transactions **before** completing a review of the transaction for OFAC compliance

  - Some bank software packages do not accommodate an OFAC review of transaction prior to posting

- NACHA contacted OFAC requesting clarification of OFAC's position on the potential risk to the RDFI

NACHA
The Electronic Payments Association®

investing in you

Canandaigua
National
Bank & Trust

OFAC Response Letter – GEN-594137

- "It is OFAC's position that a financial institution that performs its OFAC screening after having credited a beneficiary's account <u>increases its OFAC risk substantially</u>."

- "When a financial institution credits a beneficiary's account with the proceeds of a transaction that is in violation of OFAC regulations, <u>it has committed a violation by processing the transaction forward</u>."

- The <u>consequences of the violation can be mitigated</u> if the institution is able to prevent the beneficiary's access to the funds until the OFAC screening is completed, or is otherwise able to recover the funds prior to their being used by the beneficiary."

NACHA
The Electronic Payments Association®

investing in you | Canandaigua National Bank & Trust

NACHA Operating Rules

- Subsection 1.2.1 Effect of Illegality
  - 2012 changes to Subsection 1.2.1 do not prohibit an RDFI from reviewing an IAT transaction for OFAC compliance prior to posting the transaction
  - IAT transactions found to be <u>suspect</u> may be held as long as necessary to validate or clear the suspect item
  - IAT transactions that are <u>clean or not suspect</u> must be processed to comply with all other requirements of the Rules with respect to other Entries or other aspects of the same Entry, including the timely transmission of Return Entries and the availability of funds from Entries
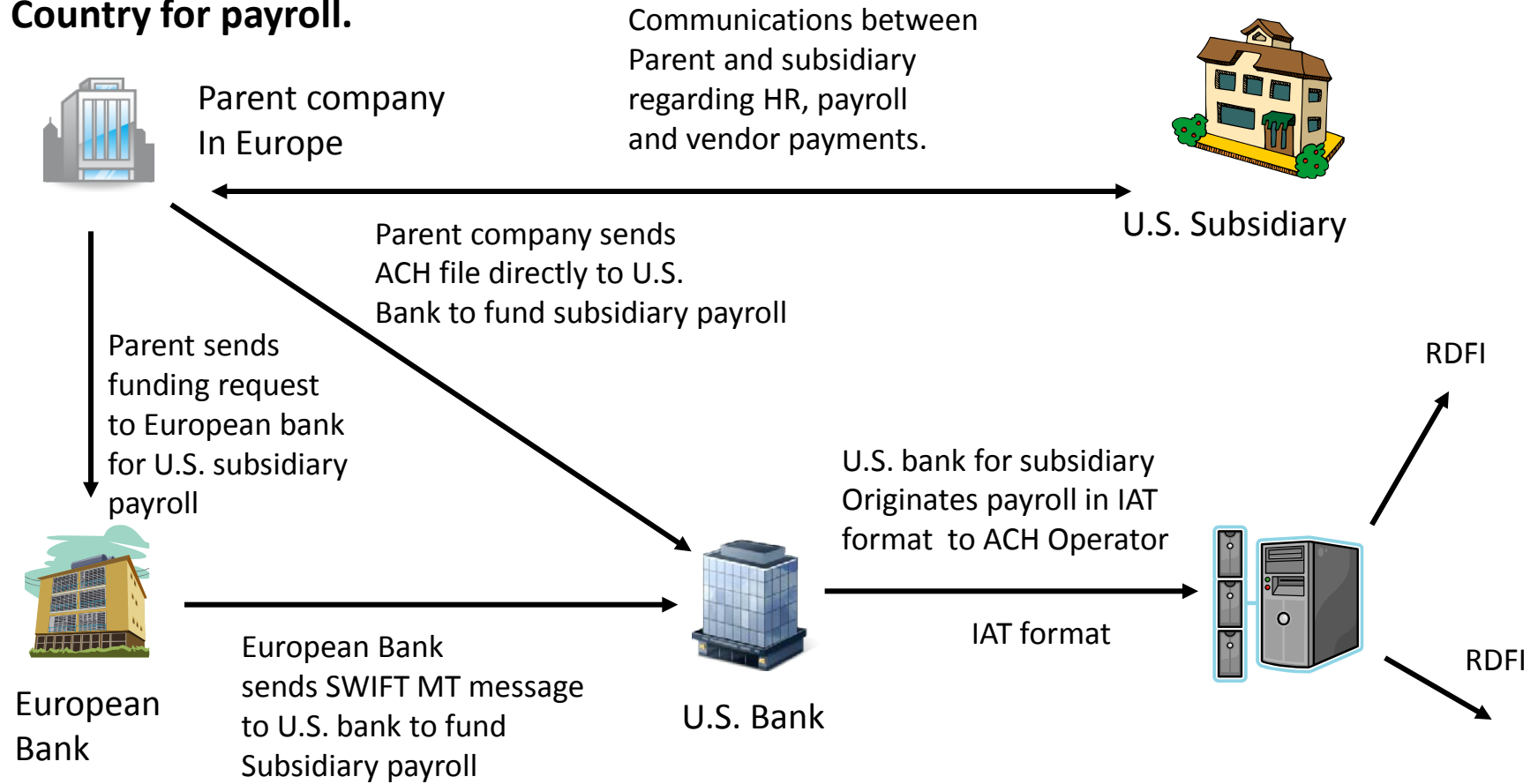
Comments from OFAC

Structuring the Formats for Compliance

- The IAT format will help RDFIs comply with their obligations under U.S. law by:

  - Carrying the additional data requirements included in the BSA's Travel Rule as requested by OFAC; and

  - Containing OFAC screening indicators to aid financial institutions in effective interdiction of unlawful transactions
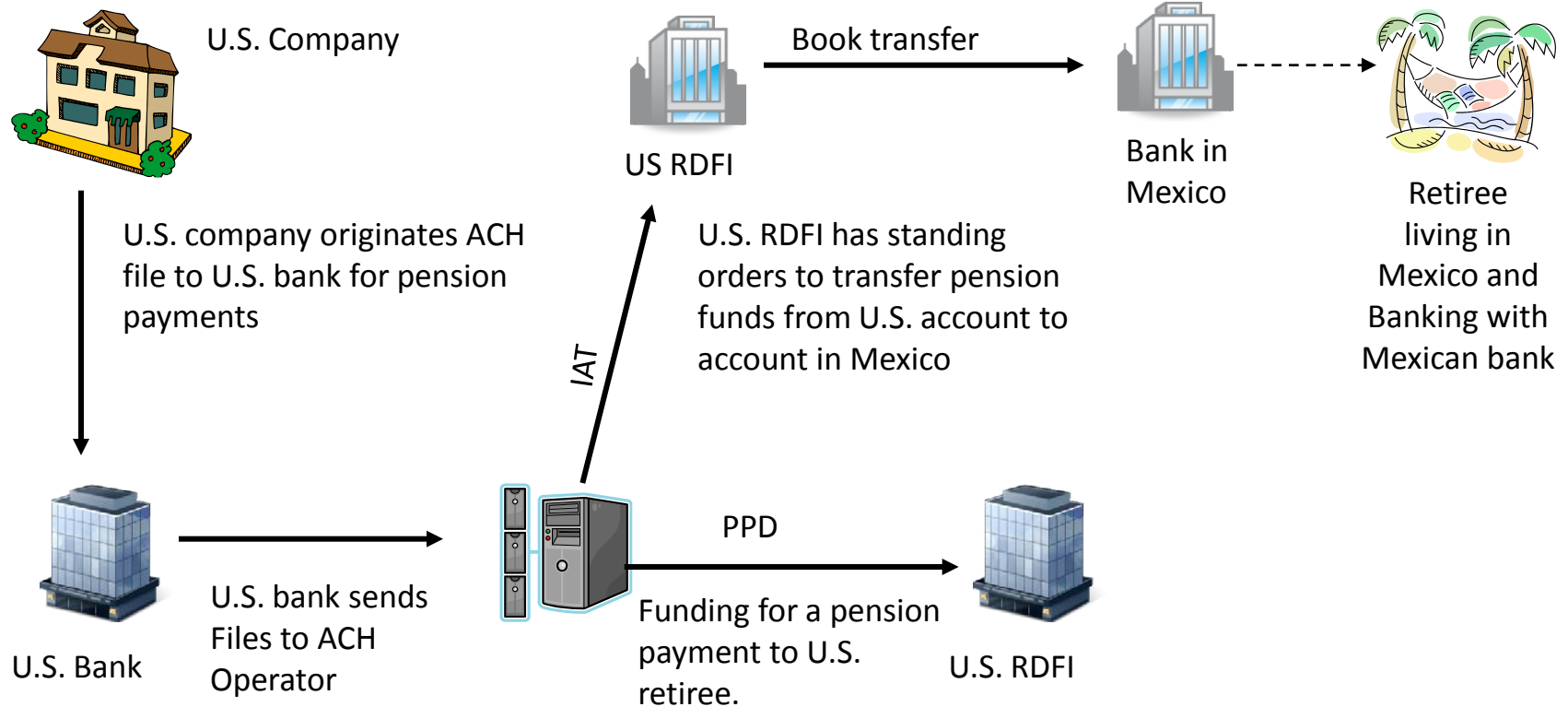
NACHA
The Electronic Payments Association®

investing in you

Canandaigua National Bank & Trust

IAT Transaction Chain

Inbound IAT Transactions – funding coming into the U.S. from another Country for payroll.

Parent company
In Europe

Communications between
Parent and subsidiary
regarding HR, payroll
and vendor payments.

U.S. Subsidiary

Parent company sends
ACH file directly to U.S.
Bank to fund subsidiary payroll

Parent sends
funding request
to European bank
for U.S. subsidiary
payroll

RDFI

U.S. bank for subsidiary
Originates payroll in IAT
format to ACH Operator

IAT format

RDFI

European Bank
sends SWIFT MT message
to U.S. bank to fund
Subsidiary payroll

European
Bank

U.S. Bank

NACHA
The Electronic Payments Association®

investing
in you

Canandaigua
National
Bank & Trust

IAT Transaction Chain

Outbound IAT Transactions – sending pension funds out of the U.S. to a financial institution outside the territorial jurisdiction of the U.S. for a non-resident pensioner

U.S. Company

Book transfer

US RDFI

Bank in Mexico

Retiree living in Mexico and Banking with Mexican bank

U.S. company originates ACH file to U.S. bank for pension payments

U.S. RDFI has standing orders to transfer pension funds from U.S. account to account in Mexico

IAT

PPD

U.S. Bank

U.S. bank sends Files to ACH Operator

Funding for a pension payment to U.S. retiree.

U.S. RDFI

NACHA
The Electronic Payments Association®

investing in you

Canandaigua National Bank & Trust

Office of Foreign Assets Control (OFAC)

- The U.S. Treasury Department's Office of Foreign Assets Control (OFAC) administers economic sanctions an embargo programs that require assets and transactions involving interests of target countries, target country nationals and other specifically identified companies and individuals to be frozen. These entities are referred to as "Specially Designated Nationals and Blocked Persons."

OFAC Obligations

- Financial institutions had to revise their ACH OFAC compliance polices to include the processing and handling of IAT transactions

- U.S. RDFI's and beneficiaries will continue to have an obligation to ensure that all aspects of transactions received, that originated outside the territorial jurisdiction of the U.S., are in compliance with OFAC regulations and to take appropriate steps to investigate, suspend, reject, block and report on transactions as necessary.

OFAC Obligations

- U.S. ODFI's and their Originators will continue to be responsible for ensuring that all parties to the transactions, a well as the underlying purpose of the transactions are not in violation of OFAC regulations, and they will need to take appropriate steps to investigate, suspend, reject, block, and report on transactions.

NACHA
The Electronic Payments Association®

investing in you | Canandaigua National Bank & Trust

Demonstrating OFAC Compliance

- To demonstrate OFAC compliance FI's should create a thorough ACH OFAC policy and procedures manual, educate and train their employees and ACH Originators and have a compliance system or procedure that allows for the proper handling of all transactions and customers.

ACH OFAC Policy Items

- Some OFAC Policy items:
  - Within your organization who has OFAC compliance responsibility;
  - How you manage the up to date listing of prohibited countries, organizations and individuals;
  - Handling of specific transactions;
  - What information is checked against the SDN list;
  - How to handle OFAC review of on-us transactions;
  - How your organization complies with OFAC reporting procedures;
  - Record retention; and
  - OFAC compliance audit.

NACHA
The Electronic Payments Association®

investing in you | Canandaigua National Bank & Trust

Blocking and Reporting ACH Transactions

- Proceeds associated with unlawful transactions from blocked accounts should be held in an interest bearing status

- Blocking reports must be filed within ten days of blocking

- OFAC requires the filing of comprehensive annual report on blocked property held as of 6/30 by 9/30 of each year

- Provided notice of proceedings for U.S. persons involved in such proceedings to OFAC chief Counsel

Corporate Originators

- Corporate Originators should be made aware that they are subject to applicable U.S. law, including enforced sanctions, when initiating ACH entries

NACHA
The Electronic Payments Association®

investing in you | Canandaigua National Bank & Trust

Gateway Operators

- An FI acting as a Gateway Operator for inbound IAT debit transactions should;
  - Review all inbound IAT debit transactions for OFAC compliance
  - Segregate any suspect transactions into OFAC review module or queue
  - Populate the Gateway Operator OFAC screening indicator
  - Rebalance original batch and file, if necessary
  - Send to ACH Operator
  - Investigate suspect transactions

NACHA The Electronic Payments Association®

investing in you | Canandaigua National Bank & Trust

Technical Standards and Mapping

- The details for the specific contents of various record formats and required code values and data elements are listed in the NACHA Operating Rules and Guidelines.

- NACHA and the U.S. Treasury developed special mapping for IAT transactions that can be used for payments from social security and any U.S. Government Agency

NACHA
The Electronic Payments Association®

investing in you | Canandaigua National Bank & Trust

Internal Processing

- What role do you play in the handling of IAT transactions?

- Which internal departments should be participate in the processing of IAT's

- Document procedures

- Compliant software

  - Software vendors

NACHA
The Electronic Payments Association®

investing in you

Canandaigua National Bank & Trust