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BPE Global Hot Topic – February 2019

The 50 Percent Rule - Risk vs. Resources

Back in 2014 many firms scrambled to figure out how to address exports to Russia and OFAC's "50 Percent Rule" screening regulations. At that time firms really had nothing in place to address OFAC's requirement that "An entity is blocked if one or more Specially Designated Nationals (SDNs) each own shares of an entity that when added together, equal 50 percent or greater ownership of the entity."

Industry was surprised at the time to learn that this was not a "new regulation", but one that had been in place since 2008! The situation with Russia however brought this screening requirement to the forefront of the news, with the focus on "friends of Putin" who were SDNs.

Although the U.S. Government has updated the Russia/Ukraine-related sanctions many times, including OFAC's Sanctions Program Guide, FAQ, and licenses (check out their webpage!), they have provided very little guidance on exactly how industry is supposed to successfully execute processes which allow companies to meet the requirements of what is now coined "Sanctions Ownership Screening", or aptly "SOS" for short. BPE Global is regularly asked for insight into industry best practices on this aspect of trade compliance and provides guidance on how to address the OFAC 50 Percent Rule.

In 2014 many companies addressed sanctions ownership screening by putting a flag on all orders for Russia. Then each entity, and all of the parties to the transaction, were scrutinized for 50 percent ownership. Spreadsheets were developed, and personnel got busy doing internet research and combing credit reporting tools for ownership information, and then ran parties through GTM restricted party screening tools, which included the SDN list. Russia was difficult to research because of the Cyrillic script, and a general lack of public information on Russian entities and parties. Credit reporting firms admitted the information in their databases was dated, and if you wanted to obtain current information you had to pay for a fresh report which took weeks and longer to compile, while deals languished on the table. Depending on the volume of business in Russia, some companies found 50% ownership screening was a huge resource sink and potential deal breaker.

Fast forward five years, although OFAC has provided no real additional guidance on this concept nor content helpful for industry, databases have been built by GTM providers, content providers, and credit reporting firms that help vet entities and individuals against the 50 percent rule much more efficiently.

Some companies continue to manually do their 50 percent sanctions ownership research. Many companies now have added recently available Sanctioned Ownership Research content to their GTM screening packages. We find the focus by industry is still erroneously on Russia, and this is where there is a misunderstanding. 50 percent screening is not just for Russian entities, this kind of SDN screening requirement has been in existence for 11 years for entities and individuals from virtually every country in the world.

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We all lament that keeping in compliance with the regulations is becoming increasingly complex, and for every aspect of your trade compliance program your company should be looking at risk vs. resources. Sometimes tactical activities get the focus, however sometimes you need to step back and ask, "What must we do to address all the many regulations?". Is important to answer the question – "Do we have a risk-based strategy?".

For the 50 Percent Rule your focus should expand from screening Russian entities and individuals. Can you afford to have an export violation? What is your track record? Have you recently been visited by OEE, or been contacted by OFAC? Do you have a voluntary disclosure pending? Are you in the middle of a merger or acquisition? Are you a large well-known company with a bulls-eye on your back? Are you a small, rapidly growing company that is tracking toward an IPO? Sit down and talk to your General Counsel, CEO and CFO to determine what your current risk tolerance is.

One thing to do for the 50 Percent Rule is to look at who your customers are. Are they large or small companies? Where do they operate? What is their trade compliance history? Do a closer review of the OFAC SDN list. You may be surprised to see that the actual SDN list is 1263 pages of very small print with individuals and entities that are not just in Russia, but many in the Middle East, China, and in countries we consider friendly. Some parties are even located in the United States!

Once you determine your risk tolerance, then you decide when to conduct screening and how often. Do you screen parties at quote, purchase order, or shipment, or all three? How often do you screen once they've been brought on board initially? Do you do dynamic or periodic screening? All of these questions should be considered, and the risk picture then discussed with management.

We highly recommend once you decide the "Who?", "What?" and "When?", you give deep consideration to the "How"? Should company personnel spend cycles conducting internet searches to drill into ownership information if you can subscribe to sanctions ownership research content, or outsource the work to firms who have the expertise, methodology, and resources as a skill and core competency?

Order volume, and customer base should also be taken into account. Are you a high-volume operation? How many orders would be put on hold each day to conduct SOS? Do your customers and geographies change frequently, or is it a pretty static environment?

A best practice is to integrate to sanctions ownership research content, as part of your GTM solution. That said, companies should undertake their own risk analysis because it is all a matter of risk vs. resources.

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