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Iran-Related OFAC Settlement May Have Broader Impact on Future Investments

On May 21, 2012, the U.S. Department of the Treasury's Office of Foreign Assets Control (OFAC) announced a $112,500 settlement involving international securities investments. This settlement may have broader significance than the relatively low dollar amount. The U.S. investment manager for a Channel Islands fund allegedly violated the Iranian Transactions Regulations (ITR), 31 C.F.R. part 560, when its British subsidiary, acting as its agent, made a $3 million investment in a Caribbean-based fund that invested exclusively in Iranian securities.

Genesis Asset Managers LLP (GAM US) is the investment manager of a Guernsey-organized investment fund, Genesis Emerging Markets Fund (GEMF), and GAM US appears to have outsourced at least some of its core investment responsibilities to a foreign subsidiary. According to a brief statement issued by OFAC, GAM US had a contractual relationship with its London-based subsidiary, Genesis Investment Management LLP (GIM UK), through which GIM UK was authorized to carry out transactions as an agent of GAM US. In 2007, pursuant to its arrangement with GAM US, GIM UK bought about $3 million of shares for GEMF in First Persian Equity Fund, a Cayman Islands company that invested exclusively in Iranian securities.[1]

OFAC's settlements do not reflect a final agency determination that a violation has occurred, and the specific legal theory of the alleged ITR violation is not explained in OFAC's announcement. Three possible theories seem most likely:

1. GAM US, through the actions of its foreign agent, ran afoul of prohibitions on new investment in Iran or in property owned or controlled by the government of Iran. *See* 31 C.F.R. §§ 560.207, 560.316.

2. GAM US indirectly provided a service to Iran or the government of Iran. *See* 31 C.F.R. § 560.204.

3. GAM US facilitated a transaction by a foreign person (its agent GIM UK, its principal GEMF, or both) that would have been prohibited had GAM US engaged in the transaction directly. *See* 31 C.F.R. § 560.208.

OFAC identified several aggravating factors, including GAM US's alleged failure to exercise "a minimal degree of caution or care in the conduct that led to the apparent violation" and the lack of any OFAC compliance program. OFAC also identified mitigating factors, including that this appeared to be GAM US's first offense, and other factors discussed below.

1 About two years later, in 2009, OFAC imposed additional sanctions against First Persian Equity Fund pursuant to U.S. nonproliferation authorities, *see* 31 C.F.R. part 544, for the fund's links to Iran's Bank Melli. OFAC appears to have alleged only violations of the ITR, and not of part 544, relating to GAM US.

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

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Other noteworthy aspects of the settlement:

- ***Penalty Amount***. The $112,500 settlement is a relative bargain compared to the amount of the potential penalty. The maximum civil monetary penalty for a violation of the ITR is the greater of $250,000 or twice the value of the transaction that is the basis for the alleged violation. Based on OFAC's statement that the underlying investment was valued at $3 million, GAM US could have faced a $6 million penalty.

- ***Importance of Self-Disclosure and Further Cooperation***. The settlement amount seems likely to have been dramatically reduced because of the mitigating factors noted by OFAC. Chief among these was that GAM US voluntarily self-disclosed the apparent violation, which under OFAC's Enforcement Guidelines yields a 50 percent discount in the penalty amount. OFAC also likely gave GAM US significant credit for substantial cooperation. OFAC's announcement suggests that simply agreeing to settle the case counts as "substantial cooperation."

- ***Vicarious Liability and Facilitation Risk***. OFAC did not assert that the foreign entities — GEMF or GIM UK — violated the ITR, just the U.S. entity. GAM US's liability is apparently due to the conduct of its agent. The focus on the U.S. entity may reflect the fact that the foreign entities did not use accounts at U.S. financial institutions or other property subject to U.S. jurisdiction to make the investment in First Persian. Under the ITR, an independent foreign subsidiary of a U.S. firm may engage in transactions that are otherwise prohibited by the ITR, provided the subsidiary is truly independent and does not involve any U.S. personnel or resources. Had the London subsidiary simply invested in First Persian on behalf of the Guernsey investment fund, with no involvement of GAM US or U.S. personnel, there would seem to have been no U.S. jurisdiction over the investment and therefore no alleged OFAC violation to attribute to GAM US. Yet given the prior organization of the Genesis entities, GAM US likely would have violated the ITR directly if it had altered its procedures to permit GEMF, the Guernsey fund, to make this investment through other channels. OFAC's Iran regulations have long explained that a U.S. person violates the ITR if it "[c]hanges the operating policies and procedures of a particular affiliate with the specific purpose of facilitating transactions that would be prohibited by [the ITR] if performed by a United States person or from the United States." 31 C.F.R. § 560.417.

- ***Legislative Trends***. Coincidentally, also on May 21, the U.S. Senate approved legislation that would, among other things, impose vicarious liability on a U.S. entity that owns or controls a foreign entity if that foreign entity engages in transactions with Iran or with entities that are subject to Iran-related sanctions (such as the First Persian Equity Fund), provided such transactions would be prohibited if engaged in by a U.S. person.[2] If this legislation became law, a company such as GAM US could be penalized for the investment by its controlled entity (such as GIM UK), whether or not the controlled entity was acting as its agent. This is consistent with recent trends in U.S. sanctions legislation, particularly with respect to Iran.

Transactions involving Iran, even those occurring five years ago by non-U.S. companies, likely will continue to be scrutinized by OFAC and other parts of the U.S. government. Businesses in regulated industries or with significant international components may want to review existing arrangements to ensure that their affiliates are aware of and, where appropriate, abiding by U.S. economic sanctions. Should such a review identify potential violations, businesses can minimize any potential civil penalty by promptly self-disclosing the facts to OFAC and cooperating closely with the agency.

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2 This provision is section 213 of the Senate version of H.R. 1905, which was approved by a voice vote in the Senate on May 21. The legislation will next return to the House of Representatives for its consideration.