



OFFICE OF INSPECTOR GENERAL

Evaluation Report

2017-SR-B-003

The Board Can Improve Documentation of Office of Foreign Assets Control Examinations

March 15, 2017

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
CONSUMER FINANCIAL PROTECTION BUREAU

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Abbreviations

Board	Board of Governors of the Federal Reserve System
BSA	Bank Secrecy Act
BSA/AML	Bank Secrecy Act/Anti-Money Laundering
EWP	electronic working paper
FBA	federal banking agency
FBO	foreign banking organization
FFIEC	Federal Financial Institutions Examination Council
MOU	memorandum of understanding
NED	National Examination Database
OFAC	Office of Foreign Assets Control
OIG	Office of Inspector General
S&R	Division of Supervision and Regulation
SWIFT	Society for Worldwide Interbank Financial Telecommunication
Treasury	U.S. Department of the Treasury



Executive Summary:

The Board Can Improve Documentation of Office of Foreign Assets Control Examinations

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Purpose

We evaluated the Board of Governors of the Federal Reserve System's (Board) supervision activities for foreign banking organizations (FBOs) following high-profile enforcement actions related to Office of Foreign Assets Control (OFAC) violations. From 2010 to 2014, OFAC issued seven civil money penalties totaling almost \$1.7 billion and the Board issued four civil money penalties totaling \$788 million related to U.S. sanctions programs. For example, French bank BNP Paribas faced civil money penalties after apparently processing certain U.S. dollar-denominated funds transfers involving parties subject to OFAC regulations that omitted or concealed relevant information. Our objective was to assess the Board's approach to evaluating FBOs' OFAC compliance.

Background

OFAC administers and enforces U.S. economic and trade sanctions programs primarily against countries and groups of individuals, such as terrorists and narcotics traffickers, to help accomplish foreign policy and national security goals. OFAC regulations require financial institutions to comply with sanctions programs by blocking or rejecting accounts and transactions that involve any persons, entities, or countries included on OFAC's specially designated nationals and blocked persons list. OFAC is responsible for identifying sanctions violations, and the Board assesses the OFAC compliance programs of FBOs' U.S. operations. Under delegated authority from the Board, supervision employees at each of the 12 Federal Reserve Banks conduct OFAC compliance examinations of financial institutions.

Findings

The OFAC examinations we reviewed did not always include documentation to adequately explain the rationale for the examination approach or the basis for conclusions. While the *Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations* includes guidance on what to include in examination workpapers and the *Bank Secrecy Act/Anti-Money Laundering Examination Manual* includes OFAC examination procedures, there are no guidance or minimum expectations specific to how OFAC examinations should be documented. Thorough, consistent documentation would help ensure effective knowledge transfer for frequently changing examination teams, consistent supervision of banking organizations, and efficient work processes for Reserve Bank examiners.

We also found data reliability concerns in the National Examination Database regarding whether OFAC had been reviewed. These data reliability concerns may have occurred because there is no established definition of what it means to review OFAC and because Reserve Banks do not have consistent data entry procedures. In addition, the National Examination Database does not capture data that would indicate the extent of coverage of OFAC examinations.

Recommendations

Our report contains recommendations designed to strengthen the Board's supervision of OFAC compliance. In response to our draft report, the Director of the Board's Division of Supervision and Regulation concurs with these recommendations and notes that efforts are underway to address them. We will follow up to ensure that the recommendations are fully addressed.

Summary of Recommendations, OIG Report 2017-SR-B-003

Recommendation number	Page	Recommendation	Responsible office
1	13	Assess the value of issuing guidance to formalize and clarify minimum documentation requirements specific to Office of Foreign Assets Control examinations and conduct examiner training based on workpaper standards.	Division of Supervision and Regulation
2	17	<p>Assess the value of collecting Office of Foreign Assets Control examination information in the National Examination Database. If the Board determines that it needs to continue collecting the data in the National Examination Database, the Division of Supervision and Regulation should</p> <ul style="list-style-type: none">a. provide additional guidance for when to mark yes in the National Examination Database that Office of Foreign Assets Control compliance has been reviewed.b. assess whether the National Examination Database form should be modified so that users of the data can more effectively determine the frequency and extent of coverage of Office of Foreign Assets Control compliance examinations.	Division of Supervision and Regulation



OFFICE OF INSPECTOR GENERAL

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
CONSUMER FINANCIAL PROTECTION BUREAU

March 15, 2017

MEMORANDUM

TO: Michael S. Gibson
Director, Division of Supervision and Regulation
Board of Governors of the Federal Reserve System

FROM: Melissa Heist *Melisse Heist*
Associate Inspector General for Audits and Evaluations

SUBJECT: OIG Report 2017-SR-B-003: *The Board Can Improve Documentation of Office of Foreign Assets Control Examinations*

The Office of Inspector General has completed its report on the subject evaluation. We conducted this work to (1) assess the Board of Governors of the Federal Reserve System's (Board) approach to evaluating foreign banking organizations' compliance with Office of Foreign Assets Control (OFAC) regulations and (2) understand to what extent the Board adapts its approach to assessing compliance based on any lessons learned from high-profile enforcement actions. We focused our evaluation on the first objective because we determined during the course of our evaluation that the Board's primary responsibility is assessing regulated financial institutions' OFAC compliance programs rather than identifying violations.

We provided you with a draft of our report for review and comment. In your response, you outline actions that will be taken to address our recommendations. We have included your response as appendix B to our report.

We appreciate the cooperation that we received from the Division of Supervision and Regulation and from the Federal Reserve Banks of Atlanta, Boston, Chicago, Cleveland, Dallas, New York, and San Francisco. Please contact me if you would like to discuss this report or any related issues.

cc: Suzanne Williams
Maryann Hunter
Jason Gonzalez
Jack Jennings
Michael Johnson
Kevin Stiroh
Jim Nolan
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Introduction

Objectives

We initiated this evaluation of the Board of Governors of the Federal Reserve System's (Board) supervision activities for the U.S. operations of foreign banking organizations (FBOs) in response to an increase in the number and dollar amount of high-profile enforcement actions related to Office of Foreign Assets Control (OFAC) violations. From 2010 to 2014, OFAC issued seven civil money penalties related to U.S. sanctions programs totaling almost \$1.7 billion and the Board issued four civil money penalties totaling \$788 million to large FBOs under the Board's supervision.¹

Our objectives were to (1) assess the Board's approach to evaluating FBOs' OFAC compliance and (2) understand to what extent the Board adapts its approach to assessing OFAC compliance based on any lessons learned from high-profile enforcement actions. We focused our evaluation on the first objective because we determined that the Board's primary responsibility is to evaluate regulated financial institutions' compliance programs, rather than to identify OFAC violations. As a result, the Board has not modified its approach to assessing OFAC compliance in response to high-profile enforcement actions.

To accomplish our first objective, we selected a judgmental sample of Reserve Banks' OFAC examinations of FBO entities operating in the United States with over \$100 million in assets. The sample included 172 examinations from seven Reserve Banks. We reviewed electronic working papers (EWPs) associated with these examinations to assess whether they met workpaper standards based on relevant criteria, such as examination manuals.

For more information on our scope and methodology, see appendix A.

Background

Office of Foreign Assets Control

OFAC, part of the U.S. Department of the Treasury's (Treasury) Office of Terrorism and Financial Intelligence, administers and enforces U.S. economic and trade sanctions primarily against countries and groups of individuals, such as terrorists and narcotics traffickers.² For example, the Syria sanctions program, one of the most comprehensive implemented by OFAC, addressed policy concerns related to Syria's (1) pursuing weapons of mass destruction and missile programs and (2) undermining U.S. and international efforts to stabilize Iraq. The

-
1. FBOs can acquire or establish freestanding banks or bank holding companies in the United States. The Board regulates and supervises these entities as domestic institutions.
 2. More information about OFAC can be found on Treasury's website: <https://www.treasury.gov/about/organizational-structure/offices/Pages/Office-of-Foreign-Assets-Control.aspx>.

sanctions can be either comprehensive or selective, using the blocking of assets and trade restrictions to accomplish foreign policy and national security goals. OFAC requires financial institutions to block or reject accounts and transactions that involve any persons, entities, or countries included on its specially designated nationals and blocked persons list.

Institutions under the supervision of the Board must establish and maintain procedures to ensure and monitor compliance with the requirements of the Bank Secrecy Act (BSA). By contrast, there is no similar legal requirement for institutions to have an OFAC program and to establish and maintain relevant procedures in order to comply with sanctions. OFAC requirements are separate and distinct from the BSA, but both OFAC and the BSA share a common national security goal. For this reason, many financial institutions view compliance with OFAC sanctions as related to BSA compliance obligations and supervisory examination for BSA compliance as logically connected to the examination of a financial institution's compliance with OFAC sanctions. Although there is no statutory or regulatory requirement for a financial institution to maintain a written, risk-focused program for complying with OFAC requirements, the Board expects financial institutions, including FBOs, to do so as a matter of sound banking practice.

A memorandum of understanding (MOU) between OFAC and the Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision—collectively, the federal banking agencies (FBAs)—sets forth procedures and expectations for sharing information related to OFAC's administration and enforcement of economic sanctions, banking organization compliance with OFAC requirements, and particular violations of OFAC sanctions.³

Each FBA has the authority to examine the safety and soundness, financial condition, and compliance programs for the financial institutions it supervises. Under the MOU, FBAs must notify OFAC promptly of any apparent, unreported sanctions violations and of any significant deficiencies in a banking organization's policies, procedures, and processes for ensuring compliance with OFAC regulations. In turn, OFAC must notify the appropriate FBA of apparent sanctions violations by a banking organization after OFAC becomes aware of a violation.

Foreign Banking Organizations

FBOs are headquartered outside the United States but may have legal entities in the United States supervised by the Board. The scope of an FBO examination by the Board depends on the legal entity type subject to supervision. For example, branch offices, which are generally deposit-taking entities with a full range of banking activities, are subject to more robust examinations than representative offices, which serve as liaisons and marketing vehicles for the parent bank but cannot directly provide traditional banking services, such as accepting deposits or making loans.

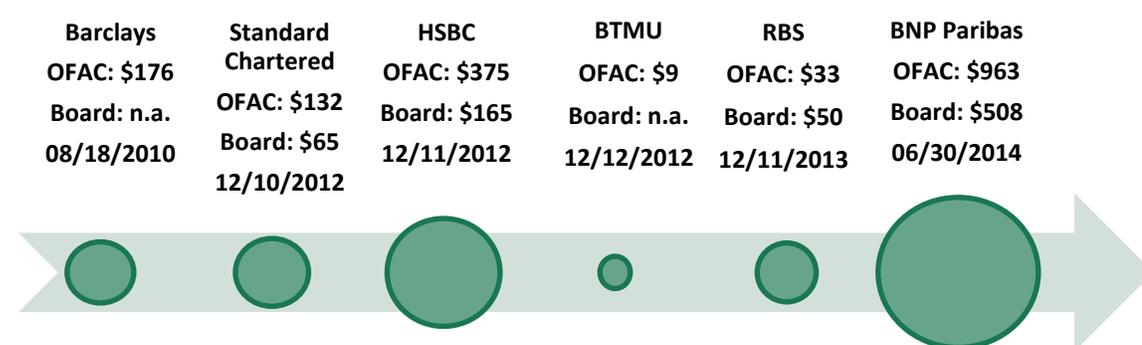
3. Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act abolished the Office of Thrift Supervision and transferred its powers and authorities to the Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency on July 21, 2011.

Recent High-Profile OFAC Violations

OFAC may impose civil money penalties when a financial institution attempts to process a transaction with persons, entities, or countries that should have been blocked or rejected. The FBAs, including the Board, can also assess informal and formal enforcement actions, such as written agreements, cease-and-desist orders, and civil money penalties.⁴ These enforcement actions often specify the corrective actions that an institution must take to ensure its OFAC compliance program becomes consistent with regulatory expectations.

Board officials noted that FBOs have devoted greater attention to OFAC compliance following the rise in the number and dollar amount of enforcement actions related to OFAC violations. Figure 1 shows OFAC and Board civil money penalties that were within our sample from 2010 through 2014.

Figure 1: OFAC and Board Civil Money Penalties, 2010–2014 (in millions)



Source: OIG analysis of public enforcement actions.

Note: For Barclays, the Board issued a cease-and-desist order but determined that no civil money penalties were necessary. For BTMU, the Board indicated that the transactions were historic and that the bank had already completed remediation by the time of the OFAC enforcement action. The penalties the Board imposed against Standard Chartered, HSBC, RBS, and BNP Paribas were collected by the Board under section 8 of the Federal Deposit Insurance Act and paid to Treasury. The penalties imposed by OFAC in these cases were deemed satisfied by the penalties assessed by the Board and other federal and state government authorities.

n.a. not applicable

Board officials also noted that the OFAC violations referenced in figure 1 generally occurred when overseas FBO affiliates concealed, removed, omitted, or obscured references to, or the interest or involvement of, sanctioned parties in U.S. dollar Society for Worldwide Interbank Financial Telecommunication (SWIFT) wire payment messages sent to U.S. financial institutions, which is sometimes referred to as wire stripping. Board officials stated that FBOs removing this information in some instances caused domestic entities, including those related to the FBOs, to unknowingly violate OFAC sanctions. In addition, the removed information made it more difficult to detect potential OFAC violations. According to Board officials, wire stripping may be less of an issue in the future, as the format for the SWIFT payment messages is being updated to

4. Section 8 of the Federal Deposit Insurance Act, as amended, 12 U.S.C. §1818, provides the Board with the authority to take enforcement actions, including those relating to deficiencies with OFAC. Civil money penalties collected by the Board are deposited into Treasury's general fund.

require the information necessary to determine whether a transaction results in an OFAC violation.

Board officials also stated that enforcement guidelines issued by OFAC in 2009, which incentivized self-disclosure of violations by an institution, changed the approach of U.S. financial institutions, including FBOs, to OFAC compliance.⁵ Under the 2009 OFAC guidelines, an institution self-disclosing OFAC violations could reduce the severity of its civil money penalties. We learned that financial institutions began to conduct more internal reviews and self-disclose possible violations to potentially limit prospective penalties. Six of the 13 OFAC enforcement actions between 2010 and 2014 involved voluntary self-disclosures. In addition, Board officials noted that some institutions are voluntarily reevaluating and reducing the risk posed by their global operations—for instance, by choosing not to do business in certain countries that may present heightened Bank Secrecy Act/Anti-Money Laundering (BSA/AML) and OFAC risks.

OFAC Compliance

OFAC is charged with identifying sanctions violations, and the FBAs, including the Board, do not have a primary role in identifying OFAC violations. Rather, Board officials noted that the Board is responsible for evaluating regulated financial institutions' compliance programs, including the policies, procedures, and processes that institutions follow to comply with OFAC laws and regulations. More specifically, the Board conducts examinations to evaluate the adequacy of an institution's internal controls for identifying suspect accounts and transactions and for reporting blocked or rejected transactions to OFAC. The Board shares its regulatory responsibility with other state and federal supervisory authorities.

The Board's BSA/AML section, within the Division of Supervision and Regulation (S&R), is responsible for overseeing the Federal Reserve System's OFAC examination activities. The BSA/AML section develops and implements BSA/AML and OFAC examination policies and procedures, including various training and education initiatives. The Reserve Banks have internal and external training activities for examiners who conduct OFAC examinations.

OFAC Examinations

Under delegated authority from the Board, examiners at each of the 12 Reserve Banks generally perform OFAC reviews as part of the BSA/AML assessments conducted during safety and soundness examinations.

5. 31 C.F.R. Part 501, Appendix A, Economic Sanctions Enforcement Guidelines, 74 Fed. Reg. 57,593 (November 9, 2009), available at https://www.treasury.gov/resource-center/sanctions/Documents/fr74_57593.pdf.

Guidance

Examiners identified two main guidance documents for conducting OFAC reviews of FBOs:

1. *Bank Secrecy Act/Anti-Money Laundering Examination Manual*. The Federal Financial Institutions Examination Council's (FFIEC) *BSA/AML Examination Manual* provides guidance to examiners for conducting BSA/AML and OFAC examinations.⁶ Although the OFAC regulations are not part of the Bank Secrecy Act, the *BSA/AML Examination Manual* includes an overview and examination procedures for examining a bank's policies, procedures, and processes for ensuring compliance with OFAC sanctions. These examination procedures include the 10-step FFIEC OFAC workprogram to "assess the bank's risk-based OFAC compliance program to evaluate whether it is appropriate for the bank's OFAC risk, taking into consideration its products, services, customers, entities, transactions, and geographic locations." The member agencies of the FFIEC, including the Board, jointly developed the OFAC workprogram with input from OFAC. The *BSA/AML Examination Manual* provides examiners with discretion for determining the specific procedures to be performed and how to document examination comments and conclusions, but in general, the examiner must ensure that all workpapers have sufficient detail to support conclusions discussed in the report of examination.
2. *Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations*. The *FBO Examination Manual*, issued and developed by S&R, provides a comprehensive overview of banking and nonbanking activities that may be conducted in a wide variety of branches, agencies, subsidiaries, and representative offices. It includes five sections dealing with particular banking activities that relate specifically to the examination and evaluation of U.S. entities of FBOs. These sections are an overview, examination objectives, examination procedures, internal control questionnaire, and audit guidelines. Specifically, the *FBO Examination Manual* provides guidance to examiners on how to prepare workpapers and what information and documentation to include.

Examination Process

OFAC examinations, like other Federal Reserve System examinations, are generally risk focused.⁷ The examination procedures performed by examiners depend on the type of examination, entity, and risk profile of the institution. Despite these variances, the Board and Reserve Banks described a consistent approach for conducting OFAC examinations that includes three main phases, as shown in figure 2.

1. Scoping and planning. This phase includes developing a scope memorandum containing information such as relevant and emerging risks at the institution, recent supervisory activities, and planned examination activities.
2. Conducting the examination. This phase involves examiners' review of the OFAC compliance program to ensure the program consists of adequate internal controls. Board

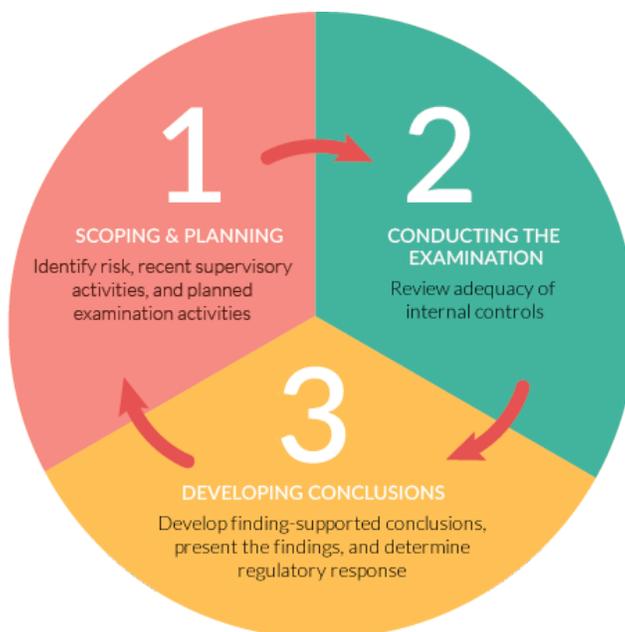
6. In addition to the Board, the FFIEC member agencies include the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau.

7. The Federal Reserve's risk-focused approach to supervision requires understanding an institution's operations, risk controls, and risk profile. Under the risk-focused approach, an examination's scope, procedures, and area of focus is determined by considering the institution's size, scope, complexity of operations (U.S. operations only for FBOs), risk undertaken, and risk management and control frameworks. Areas posing significant risk to the institution's operation are subject to greater supervisory scrutiny.

and Reserve Bank interviewees stated that they used the FFIEC OFAC workprogram to guide their examinations.

3. Developing conclusions. This phase involves assembling findings about the OFAC compliance program's adequacy, developing conclusions supported by those findings, discussing the preliminary conclusions with bank management, presenting the conclusions in the report of examination, and determining and documenting an appropriate regulatory response, if any.

Figure 2: OFAC Examination Process



Source: OIG graphic based on the *BSA/AML Examination Manual*.

The composition of an examination team frequently changes from year to year, including the team's leader, the examiner-in-charge. As a result, during the next examination cycle, a subsequent team—which may be composed of some or all new examiners—will start the scoping process again. Therefore, it is imperative that the prior examination team thoroughly and logically documents the rationale for the approach used to conduct the examination and the team's findings. When examination results are well documented, the following examination team will be able to quickly understand the rationale for the prior team's approach, use the knowledge gained during the prior examination, and design the examination scope in a manner that maximizes the usefulness of the prior examination results.

Reserve Banks use an electronic database to document sets of EWPs supporting the results of OFAC examinations. In our opinion, EWPs should generally contain documentation of the three phases of an examination described above. As noted in the *FBO Examination Manual*, sufficient documentation of the work performed during an examination is important because it demonstrates and supports the quality of the examination conducted. By sufficiently documenting the work performed, examiners facilitate an effective transfer of knowledge from one examination team to the next or from one Reserve Bank to another. Sufficient documentation also allows for an effective review by supervisors, quality assurance teams, and oversight entities.

Following an examination, Reserve Banks record the results, such as the reports sent to the institution and changes to ratings, in the National Examination Database (NED).⁸ Part of the National Information Center, NED is specifically designed to support bank supervision. The National Information Center contains information related to the supervision of institutions for which the Board has a supervisory, regulatory, or research interest, including both domestic banking organizations and FBOs operating in the United States.

8. Workpapers and other supporting documentation used to arrive at conclusions during the examination are not included in NED but are stored in a different system.

Finding 1: The Board Can Improve the Consistency of OFAC Examination Documentation Across Reserve Banks

The approach to documenting OFAC examinations is not consistent across Reserve Banks. The primary goal of workpapers is to provide a clear description of the many tasks performed during an examination, organized in a manner that facilitates review and future reference. In our review of the documentation of OFAC examinations within sets of EWPs, we found that EWPs did not always provide sufficient or effective documentation to support examination procedures, results, or conclusions. While the *FBO Examination Manual* includes general guidance on what to include in examination workpapers and Reserve Bank examiners have various guidance documents they can use to plan, scope, and conduct an examination of OFAC compliance, there are no guidance or minimum expectations specific to documenting OFAC examination results. The absence of specific OFAC examination documentation guidelines led to EWPs that did not consistently provide the rationale for examination approaches or support the conclusions. Thorough, consistent documentation would help ensure effective knowledge transfer between examination teams and Reserve Banks, especially given the potential for changes to the composition of supervisory teams.

Varying Practices Highlight Both Inadequate and Effective Documentation Methods

During our review, we found inconsistencies in the documentation included in EWPs related to (1) scoping and planning, (2) conducting the examination, and (3) developing conclusions. The approach to documenting OFAC examinations in EWPs differed among the Reserve Banks, at times resulting in insufficient documentation of scope memorandums, examination procedures, narratives to support conclusions, and supporting materials.

We also found that certain Reserve Banks and examination teams documented their approach and results thoroughly and clearly. Effective documentation is critical to providing a clear description of what happened during examinations. Well-documented descriptions of the rationale for the examiners' approach, their results, and their conclusions allow subsequent examination teams to build on the learning of prior teams. Further, conclusions in the EWP that are clearly organized and directly supported by attached or linked documentation allow examiners to quickly identify support for findings reached in the final report of examination. Therefore, we suggest that these documentation practices be shared and replicated across Reserve Banks and individual examination teams.

Scope Memorandums

The *FBO Examination Manual* states that a scope memorandum should be prepared, providing a detailed summary of the supervisory strategy for an institution and assigning specific responsibilities to examination team members. However, we did not consistently find scope memorandums included in the EWP or sufficient detail in the scope memorandum of the OFAC-related examination procedures performed.

In our review of 141 EWPs, 4 lacked a scope memorandum and did not provide a reason or justification for why one was not included. Another 51 EWPs lacked a scope memorandum but provided various justifications for why it was not included. We found that Reserve Banks inconsistently used these justifications for situations in which they would not prepare a scope memorandum. For example, one Reserve Bank does not prepare scope memorandums for representative offices due to the limited transaction activity at that type of entity, while other Reserve Banks do.

The remaining 86 EWPs included a scope memorandum, but 24 made no reference to OFAC or the specific FFIEC OFAC workprogram steps that the examination team intended to perform. The lack of a scope memorandum, or sufficient detail within the scope memorandum about OFAC-related examination work steps, made it difficult to determine which activities would be conducted during the examination.

We did, however, see instances of effective scope memorandums that clearly indicated the work to be performed and facilitated our review of the EWP.

- At one Reserve Bank, we noted that examiners included documentation of the scope of OFAC compliance examinations even for low-risk FBOs. This scope documentation explained the rationale for the examination team's low-risk assessment as the basis for its approach. As a result, we expected to see less OFAC-related documentation in the EWP supporting these examinations.
- At another Reserve Bank, we noted instances in which examiners documented in the scope memorandum reliance on prior work performed by the supervised institution's internal audit function, including specific details concerning the extent of the reliance. This approach made it clear which FFIEC OFAC workprogram steps were not being conducted during that examination, as well as a rationale for not conducting those steps.

Examination Procedures

The FFIEC *BSA/AML Examination Manual* outlines examination procedures within the FFIEC OFAC workprogram for evaluating whether an FBO's OFAC compliance program is commensurate with the FBO's risk profile, which includes its products, services, customers, entities, transactions, and geographical footprint. The manual gives examiners discretion to design an examination, stating that not all examination procedures are likely to be applicable for every banking organization.

In our review of EWPs, we found inconsistencies in how Reserve Banks used the FFIEC OFAC workprogram for documenting OFAC reviews. We also found inconsistencies in how Reserve Banks document OFAC reviews at representative offices. However, in each of the approaches outlined below, we noted various examples in which examination procedures were consistently and clearly documented in the EWP, which would facilitate a transfer of knowledge between examination teams and Reserve Banks.

Use of FFIEC OFAC Workprogram to Document OFAC Reviews

Six of the seven Reserve Banks in our sample acknowledged using the FFIEC OFAC workprogram to conduct and document an OFAC review. We reviewed 45 EWPs from these six Reserve Banks and expected to observe aspects of the FFIEC OFAC workprogram completed and included in each of these EWPs.

However, 21 of the 45 EWPs at four of the six Reserve Banks did not include an FFIEC OFAC workprogram. Of those 21 EWPs, 8 included an explanation or rationale for why the examiner did not use the FFIEC OFAC workprogram. In the remaining 13 EWPs that did not include an FFIEC OFAC workprogram or an explanation for why it was not included, the specific procedures the examination team performed and the basis for the team's conclusions regarding the institution's OFAC compliance program were not clear. In contrast, certain examination teams documented completed FFIEC OFAC workprograms that clearly indicated which OFAC procedures were conducted as part of the review.

The seventh Reserve Bank acknowledged that its examination teams used the FFIEC OFAC workprogram as a guide when developing the scope of the examination but did not use it as a template for documenting the results of OFAC examinations. As a result, we did not expect to see the FFIEC OFAC workprogram in the EWPs for examinations at this Reserve Bank.

Nevertheless, this Reserve Bank consistently organized and documented the OFAC review performed in a product memorandum in its EWPs. This consistent organization and documentation of examination activities in product memorandums made it easy to locate certain documentation.

Use of Representative Office Workprogram

All the Reserve Banks in our sample stated that they do not require the use of the FFIEC OFAC workprogram to document examinations of representative offices. Representative offices generally serve as a liaison and marketing vehicle for the parent bank, typically providing no traditional banking services and conducting few transactions. As a result, representative offices have minimal levels of OFAC risk. Because OFAC examinations are risk based, we expected to see a limited OFAC review in EWPs for examinations of representative offices.

We found that documentation of OFAC reviews of representative offices performed by all Reserve Banks in our scope was minimal, which aligned with the depth of the review performed. The organization of examination procedures performed at representative offices differed by Reserve Bank and examination team. For example, one Reserve Bank used a representative office workprogram when conducting examinations of a representative office, which include a limited set of examination procedures tailored to the minimal operations at these entities. Use of this workprogram helped to clearly document the activities performed and the rationale for the approach. The absence of this workprogram made it more difficult to determine which activities the examination team performed to assess the entities' OFAC compliance program. The use of this workprogram could be applied across Reserve Banks and examination teams to facilitate more consistent documentation of OFAC reviews at representative offices and facilitate a more efficient knowledge transfer from one examination team to the next.

Narratives to Support Conclusions

The *FBO Examination Manual* contains guidance for examiners about what to include in examination workpapers, so that those materials fulfill their intended objectives. Specifically, the manual states that workpapers should “provide written support of the examination procedures performed during the examination” and that examiners should “indicate why certain steps or procedures were eliminated or deemed unnecessary.” It also states, “[t]he clarity of workpapers should be such that an examiner or examining official unfamiliar with the work could readily understand them.”

In our review of 24 FFIEC OFAC workprograms in EWPs, we found 3 instances across two Reserve Banks in which the examiners did not document adequate written support, based on the criteria above, for various procedures performed. In these instances, we could not readily understand the work performed for the examination or the basis for the team’s conclusions.

Conversely, EWPs that included detailed narratives provided context around the rationale for procedures conducted and the conclusions reached. These narratives often indicated prior year results, findings identified during the current examination, and any significant plans for the entity that would change its risk profile for OFAC compliance. We noted that two Reserve Banks occasionally included results from the prior year’s examination in addition to the results of the current examination. In these instances, the examination teams made it easy to follow the sequential progression of a specific area reviewed.

We also observed that some examination teams did not consistently document the rationale for not performing specific examination procedures. For example, an examiner indicated that a certain procedure step was “not applicable” for that examination, but we could not readily understand the basis for that conclusion. In interviews with examination staff at two Reserve Banks, examiners explained that they often practiced “exception-based documentation,” where they documented only issues or findings rather than why certain steps were unnecessary.

However, this approach to exception-based documentation may not completely transfer knowledge from one team to the next, as the next examination team would only be aware of issues found during the previous examination but would not understand the rationale for the scope, breadth, or depth of the prior team’s work.

Supporting Materials

The *FBO Examination Manual* states that the primary goal of workpapers is to strengthen the examination process by providing a clear description of the many tasks performed during an examination. More specifically, the *FBO Examination Manual* states that material in workpapers should be organized to facilitate review and future reference. It also states that workpapers should “document the policies, practices, procedures, and internal controls of the branch” and “document the results of testing and formalize examiner’s conclusions.”

Of 95 EWPs of examinations of entities that were not representative offices, 26 EWPs did not include supporting materials attached to or linked in the FFIEC OFAC workprogram, product memorandum, or other conclusion documents. We observed different types of omissions:

- Certain examination procedures included a narrative of conclusions but did not reference or include the materials reviewed to substantiate such conclusions.
- Examiners referenced policies and procedures reviewed but did not link to or otherwise attach them, preventing us from readily substantiating the examiner’s review.
- Examiners referenced the results of testing conducted, but the testing documents were not identified or specifically linked or attached, likewise preventing us from determining what specific testing the examiner was referring to.

We also found that the organization of EWP’s differed among individual examination teams and Reserve Banks. Some Reserve Banks included supporting materials in the EWP, but we found that documents were difficult to locate, and we could not determine which documents were reviewed under certain examination procedures. For example, while the documents may have been included in the EWP, they were located in a zip file and examiners did not indicate which specific documents were reviewed to support conclusion statements made. In contrast, one Reserve Bank used footnotes to attach and link to specific supporting materials in its product memorandums, while a different Reserve Bank often inserted documents directly in its FFIEC OFAC workprogram. Both of these practices allow future examination teams to quickly determine the support for statements and conclusions drawn. In situations in which there were no document links or attachments with the conclusion statements, it was difficult to determine whether there was supporting documentation—or its location—for the conclusions and assertions made in the report of examination.

No Guidance or Minimum Expectations Specific to Documenting OFAC Examinations Are Available

The inconsistencies in documenting OFAC examinations occurred primarily because of the lack of specific guidance for documenting OFAC examinations across the Federal Reserve System. Board officials indicated that the lack of a legal requirement for institutions to have an OFAC compliance program may contribute to the inconsistent supervisory reviews. Although there is general Federal Reserve workpaper guidance, we did not observe consistent criteria or guidance that included minimum expectations for documenting the rationale for the OFAC procedures performed and the supporting materials reviewed to draw conclusions. Reserve Banks in our scope identified different workpaper documentation criteria that examiners follow when conducting examinations. The *FFIEC BSA/AML Examination Manual* provides guidance for procedures to consider when conducting an OFAC review, but it gives examiners discretion for which specific procedures to perform. This discretion is necessary, given the variety of entities that FBAs supervise and the different types of examinations that examiners perform. The *BSA/AML Examination Manual* does not include guidance on documentation requirements, and although the *FBO Examination Manual* does include guidance on what to include in workpapers, the guidance is not specific to OFAC reviews. In addition to the *BSA/AML Examination Manual* and the *FBO Examination Manual*, Reserve Bank employees indicated that they also use local Reserve Bank guidance.

Inadequate Documentation May Prevent Effective Knowledge Transfer Among Examination Teams

Effective documentation is critical to providing a clear description of (1) the rationale for the examination procedures performed given the discretion afforded to supervisory teams to select among FFIEC examination procedures in designing the approach to OFAC examinations and (2) the results of the examination. Examiner rotation requirements and employee turnover contribute to fluid supervisory teams, which also increases the importance of effective documentation to facilitate knowledge transfer. Without adequate documentation, an effective knowledge transfer may not occur from one examination team to the next or from one Reserve Bank to another, because examiners may not be able to determine what activities were conducted during the prior examination or during the examination of an entity by a different Reserve Bank. For example, we noted one instance in which examiners were unable to explain what happened on a particular examination because the previous examiner was no longer employed by that Reserve Bank. Effective documentation allows for subsequent teams— at either the same or a different Reserve Bank—to understand the thought process for the procedures performed and the results, avoiding inefficiencies.

Conclusion

By implementing guidance and training on minimum documentation requirements for OFAC examinations across the Federal Reserve System, the Board can facilitate effective knowledge transfer and ensure more consistent supervision of FBO entities' compliance with OFAC laws and regulations. Although our review found instances of insufficient OFAC examination documentation across Reserve Banks, we also identified effective documentation practices that the Board and Reserve Banks could benefit from if widely implemented or shared. By identifying thorough and easy-to-follow documentation practices—and expanding them Systemwide by providing new guidance, documentation requirements, or examiner training—the Board's coverage of OFAC compliance would improve through increased consistency, efficiency, and effectiveness.

Recommendation

We recommend that the Director of S&R

1. Assess the value of issuing guidance to formalize and clarify minimum documentation requirements specific to OFAC examinations and conduct examiner training based on workpaper standards.

Management's Response

In the response to our draft report, the Director of S&R concurs with this recommendation and explains that S&R has begun assessing the value of issuing guidance to formalize and clarify minimum documentation requirements specific to OFAC examinations. The Director also notes that S&R currently has a number of examiner training programs that include OFAC issues and

that S&R will assess how to either augment these existing training programs or develop new training programs that will address and improve examiner workpaper standards.

OIG Comment

The actions described by the Director of S&R appear to be responsive to our recommendation. We will follow up to ensure that the recommendation is fully addressed.

Finding 2: Data Reliability for OFAC Examination Information Contained in NED Can Be Improved

The Board uses NED data to create a record of the number of OFAC reviews conducted and to facilitate responding to requests for the Board's OFAC examination information, under its information-sharing MOU. However, we noted some data reliability issues, and it was difficult to determine the scope of reported examinations in the data. Specifically, NED entries for certain examinations indicated that OFAC compliance had been reviewed, but no documentation was available in the EWPs to confirm that a review occurred or to describe the procedures performed. In addition, in some cases, NED double-counted certain examinations or inaccurately indicated that examination teams reviewed OFAC compliance. The Board requires Reserve Bank examiners to document in NED whether teams reviewed OFAC compliance during BSA/AML examinations. We noted that there is no Board guidance concerning the extent of OFAC procedures performed by an examination team that would warrant indicating that OFAC had been reviewed, and Reserve Banks have different methods of recording and inputting the information related to an examination into NED. As a result, we could not reliably determine the number and scope of OFAC examinations that occurred during our review period.

OFAC Examination Data Reported in NED Was Not Always a Reliable Indicator of Whether an OFAC Review Occurred

In selecting a sample of OFAC examinations to review, we requested a list of all FBO examinations that included an OFAC examination between 2010 and 2014. S&R produced that list from a *yes/no* field in NED meant to indicate whether OFAC was reviewed.

However, the NED data was not a reliable indicator of whether an OFAC review had occurred. In our EWP review, we found that

- 21 EWPs indicated that an OFAC assessment occurred but did not contain any documentary evidence of the review.
- 6 EWPs were double-counted in NED. In these examples, documentation in the EWP confirmed a target examination related to assessing the entity's OFAC compliance program occurred; however, reviews of the subsequent annual roll-up examinations showed that although no additional examination activity was conducted, an additional OFAC review was recorded in NED.
- 2 EWPs indicated in error that an OFAC compliance examination had occurred.⁹

9. Our request for only those examinations checked *yes* for OFAC review precluded our team from determining whether any OFAC examinations in our requested sample were checked *no* inaccurately.

The Board Has Not Defined the OFAC Supervisory Activities That Warrant Indicating in NED That an OFAC Review Occurred

We understand that the Board has not defined the circumstances that warrant an affirmative response to the question of whether OFAC compliance was reviewed in NED. As a result, we observed a variety of approaches to completing this task. Reserve Bank officials gave varying explanations of when an examination team should indicate *yes* in NED. For example, we heard that one Reserve Bank indicates that an OFAC examination occurred during the annual roll-up even if no additional OFAC examination procedures had been performed. Officials at another Reserve Bank mentioned that they do not indicate that an OFAC review occurred during the annual roll-up unless additional examination work related to OFAC had been performed.

NED Does Not Capture the Scope of OFAC Examinations

The OFAC field in NED does not capture specific details about the scope of an OFAC review. For example, all EWPs of representative offices in our sample indicated that an OFAC review had occurred. However, the binary *yes/no* field in NED does not lend itself to highlighting the variability in the examination procedures performed or the scope of coverage between examinations of two different entity types. For example, an OFAC review at an FBO branch with full banking activities would look the same in NED as that of an OFAC review at an FBO agency with minimal banking activities. In addition, a review of the same entity in subsequent years may be of differing levels—for example, an in-depth, full-scope review in one year but a targeted review of the highest-risk areas the next.

Reserve Bank officials told us that they do not use this data for any internal purposes, and that they collect it solely to provide information to the Board. A senior Board official explained that the purpose for collecting the OFAC information is to create a record of the number of OFAC reviews conducted by the Federal Reserve and to generate a record of reasons why OFAC reviews were not conducted with the BSA/AML examination, if applicable. Further, the official stated that Board staff members track and review Reserve Banks' examinations relative to established mandates.¹⁰ Board officials also told us that they use NED data to facilitate responding to requests for OFAC examination information.

Conclusion

Given the data reliability concerns we identified regarding the OFAC examination data in NED, the Board should assess whether there is value in continuing to use NED to collect the information or whether to use another method. If the Board determines that continuing to collect data related to OFAC examinations in NED is valuable, enhancements to data collection are necessary to provide more accurate results and reliable data.

10. 12 U.S.C. §§ 1818(s)(2) and 1786(q) require that the appropriate FBA include a review of the BSA compliance program at each examination of an insured depository institution.

Recommendation

We recommend that the Director of S&R

2. Assess the value of collecting OFAC examination information in NED. If the Board determines that it needs to continue collecting the data in NED, S&R should
 - a. provide additional guidance for when to mark *yes* in NED that OFAC compliance has been reviewed.
 - b. assess whether the NED form should be modified so that users of the data can more effectively determine the frequency and extent of coverage of OFAC compliance examinations.

Management's Response

In the response to our draft report, the Director of S&R concurs with this recommendation. The Director explains that S&R has begun assessing the value of collecting OFAC examination information in NED. The Director notes that S&R will assess whether there is value in continuing to collect this information in NED and will provide any additional guidance to ensure that information in NED is marked as intended. The Director also states that S&R will assess whether the NED form should be modified so that users of the data can more effectively determine the frequency and extent of coverage of OFAC compliance examinations.

OIG Comment

The actions described by the Director of S&R appear to be responsive to our recommendation. We will follow up to ensure that the recommendation is fully addressed.

Appendix A

Scope and Methodology

To accomplish our objectives, we reviewed activities and controls associated with the Board’s approach to supervision of FBOs’ OFAC compliance between 2010 and 2014. Our evaluation assessed the individual Reserve Banks’ approaches to conducting supervision of OFAC compliance, including examiner training, workpaper completion, the NED database, and communication and coordination among the Reserve Banks and the Board. We also reviewed the Board’s role in OFAC compliance supervision, including communication and coordination with OFAC.

We reviewed applicable laws and regulations relevant to OFAC compliance, such as Treasury’s Economic Sanctions Enforcement Guidelines at 31 C.F.R. Part 501, Appendix A. We also reviewed the requirements outlined in a signed MOU between OFAC and the FBAs, including the Board, to help determine the roles and responsibilities of applicable federal agencies. Finally, we reviewed guidance documents, including the *FBO Examination Manual* and the *BSA/AML Examination Manual*, to understand guidance provided to Board examiners as well as examination procedures for evaluating an institution’s OFAC compliance program.

We also interviewed Board and OFAC officials to better understand how each organization approaches OFAC compliance. We reviewed written communications between the Board and OFAC to determine whether they met the MOU requirements. In addition, we examined OFAC training materials and discussed OFAC-related training with Board and Reserve Bank officials.

To evaluate the Board’s approach to supervision of OFAC compliance at financial institutions, we selected a judgmental sample of OFAC examinations of FBOs. We focused our sample on OFAC examinations of FBOs due to the rise in the number and dollar amount of recent high-profile OFAC enforcement actions. To create a sample population, we requested that the Board provide a list of OFAC examinations that occurred for all U.S. entities that had a foreign organization as the parent or top holder and were supervised by the Board between 2010 and 2014.¹¹ The Board provided a list of 954 examination events for FBOs conducted by Reserve Banks. The list of examination events included data about each FBO in the population, such as the responsible and examining Reserve Bank, examination type, entity type, total entity assets, and combined and composite regulatory ratings.

We selected a judgmental sample of 200 examination events out of the population of 954 examination events provided by the Board. We considered several attributes in selecting our sample, including total asset size, compliance rating, examining Reserve Bank, and whether the institution was subject to an enforcement action. We excluded 28 examination events that were subsequently found to be led by state regulators. Our sample resulted in a population of 172 examination events that were associated with 141 sets of EWPs.¹² The examination events

11. A Board-conducted manual review process was required to aggregate this information because NED does not possess a single “entity type” code that captures the requested data.

12. One EWP may be associated with multiple examination events for an institution.

and associated EWP in our sample occurred at 14 FBOs and were conducted by seven Reserve Banks: Atlanta, Boston, Chicago, Cleveland, Dallas, New York, and San Francisco.

Table A-1: EWPs at Reserve Banks in Our Sample

Atlanta	Boston	Chicago	Cleveland	Dallas	New York	San Francisco	TOTAL
15	9	16	1	26	56	18	141

Source: Sample selected by OIG based on examination events provided by the Board.

We reviewed EWPs in our sample for documentation of OFAC-related activities conducted during the examination. Specifically, we reviewed documentation of scope memorandums, FFIEC OFAC workprograms (if applicable), policies and procedures, and testing. We interviewed Reserve Bank officials at each of the seven Reserve Banks in our sample to understand how they conduct examinations and assess OFAC compliance. We also interviewed examination staff responsible for conducting examinations at each of the seven Reserve Banks to address specific questions from our review.

We reviewed seven enforcement actions issued during the scope of our review for the FBOs in our sample. These enforcement actions included OFAC settlements, Board-issued cease-and-desist orders and civil money penalties, and MOUs. We reviewed the Board’s and Reserve Banks’ processes for following up and closing out enforcement actions in our scope.

We conducted our fieldwork from March 2015 through August 2016. We performed our evaluation in accordance with the *Quality Standards for Inspection and Evaluation* issued in January 2012 by the Council of the Inspectors General on Integrity and Efficiency.

Appendix B

Management's Response



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF
SUPERVISION AND REGULATION

March 6, 2017

Mr. Mark Bialek
Inspector General
Board of Governors
of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington DC, 20551

Dear Mr. Bialek:

Thank you for the opportunity to comment on your draft report, *The Board Can Improve Documentation of Office of Foreign Assets Control Examinations*. We appreciate the effort that the Office of the Inspector General (OIG) has put into this report and the recommendations it has provided for improving our supervisory processes in ensuring that the U.S. operations of foreign banking organizations (FBOs) comply with the economic sanctions administered and enforced by the U.S. Department of Treasury's Office of Foreign Assets Control (OFAC).

The draft report makes two (2) recommendations designed to strengthen the Board of Governors of the Federal Reserve System's (Board's) supervision of OFAC compliance. We agree with the recommendations and have provided our responses below.

- 1. Assess the value of issuing guidance to formalize and clarify minimum documentation requirements specific to OFAC examinations and conduct examiner training based on examiner workpaper standards.*

We agree with the recommendation and recognize the importance of economic sanctions administered by OFAC in foreign policy and national security goals. Examiners currently have general examination and documentation guidance in the FBO Examination Manual and the Federal Financial Institutions Examination Council Bank Secrecy Act/Anti-Money Laundering (FFIEC BSA/AML) Examination Manual. In response to the recommendation, we have begun assessing the value of issuing guidance to formalize and clarify minimum documentation requirements specific to OFAC examinations.

Regarding examiner training, there are a number of existing examiner training programs that include OFAC issues, such as those provided by the Board's BSA/AML Section, the FFIEC or OFAC. For example, on an annual basis, the Board's BSA/AML Section hosts an in-person training conference for senior supervisory staff from across the Federal Reserve System to discuss pertinent topics such as OFAC. We will assess how to either augment these existing training programs or develop new training programs that will address and improve examiner workpaper standards.

2. *Assess the value of collecting OFAC examination information in NED. If the Board determines that it needs to continue collecting the data in NED, S&R should*
 - a. *Provide additional guidance for when to mark yes in NED that OFAC was reviewed*
 - b. *Assess whether the NED form should be modified so that users of the data can more effectively determine the frequency and extent of coverage of OFAC compliance examinations.*

We agree with the recommendation and have begun assessing the value of collecting OFAC examination information in NED. Should we determine there is value in continuing to collect this information in NED, we will provide additional guidance to ensure that information in NED is marked as intended. We will also assess whether the NED form should be modified so that users of the data can more effectively determine the frequency and extent of coverage of OFAC compliance examinations.

Thank you for the opportunity to provide comments on this report. We are committed to addressing the recommendations and contributing to effective implementation of our OFAC examination responsibilities.

Regards,



Michael S. Gibson
Director
Division of Supervision and Regulation



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