

Note

Sanctions That Sting: Private Sector Solutions to the Paper Tiger Problem

Marguerite Colson & Eric Van Nostrand†

Whether used to draw Iran into nuclear talks or condemn apartheid in South Africa, economic sanctions have assumed an increasingly important role in our national security strategy. For one thing, their effectiveness has grown markedly, thanks to today's global financial interdependence. Moreover, in light of this country's war-weariness, sanctions provide an alternative to the use of force. Given these two trends, the outsized role of economic sanctions in our national security strategy is not surprising. What may surprise, however, is the fact that sanctions remain under-enforced. This Note offers four innovative solutions to that problem. Taken together our proposals demand greater cooperation on the part of the private actors subject to sanctions as well as the government branches that levy and enforce them. Along the way, our solutions raise compelling questions about what role—if any—private citizens ought to play in the traditionally public domain of national security. In the end, we don't claim to have struck upon any fail-safe solutions to the problem of under-enforcement. Rather, we hope to direct the conversation toward a sanctions system that is both more economically efficient and more effective at achieving our foreign policy objectives.

Introduction.....	562
I. Origins of the Sanctions Regime and a Brief Survey of Its Use as a Foreign Policy Tool.....	565
A. Statutory Authorization and Application	565
B. A Diplomatic Dead End?	569
C. Shortfalls of the Current Regime	570
1. Budget Constraints.....	570
2. Diplomatic Concerns	571
3. Non-governmental Cooperation.....	572
II. Solutions.....	572
A. Qui Tam Suits.....	572
1. The Rise and Fall (and Rise) of Qui Tam	572

2. From Contracts to Sanctions: Mapping the FCA onto Sanctions Laws	574
B. <i>Bounties</i>	577
1. Investigative Clearinghouses	578
2. Financial Institutions.....	578
C. <i>Third-Party Ratings Systems</i>	581
1. The Incentive Structures of Private-Sector Rating Agencies... 581	
2. A Third-Party Rating Agency System for Sanctions Compliance.....	582
D. <i>Enforcement Risk-Pooling Through “Sanctions Insurance”</i>	585
1. Punish Sanctions Targets, not Domestic Actors	586
2. Liability Insurance	587
Conclusion	589

Introduction

Apply this economic, peaceful, silent, deadly remedy and there will be no need for force.

- Woodrow Wilson

Many of today’s most urgent and challenging foreign policy problems lie at the nexus of national security and economics. In recent years, the media provided nearly constant coverage of the American-led effort to isolate Iran financially in the hope of thwarting its nuclear program. And, as the crisis in Ukraine reached a fever pitch following the downing of a commercial airliner in July 2014, Washington called on Europe to impose tougher sanctions against Russia. That counterterrorism policymakers are relying increasingly on economic tools—and specifically sanctions—as an alternative to the use of force is perhaps unsurprising, given today’s global financial interdependence and Americans’ reluctance to pledge more troops to the war on terror.

The sanctions enforcement regime is a prominent tool in the U.S. foreign policy arsenal, but it is also defective. With national security threats erupting in Iran, Syria, North Korea, and Eastern Europe, Congress often responds with new rounds of sanctions, prompting the Treasury Department to add fresh names to the swelling rolls of sanctioned entities. But robust sanctions regimes require robust enforcement networks that “keep[] pace with legislation and diplomatic developments.”¹ Instead, the current enforcement networks are led

† Marguerite Colson: Yale Law School, J.D. 2015. Eric Van Nostrand: Yale Law School, J.D. 2015. Mr. Van Nostrand currently works as an economist at the White House Council of Economic Advisers (CEA). This work was composed before he assumed that role and the CEA disclaims responsibility for any of the views expressed herein. These views do not necessarily represent the views of the CEA or the United States. The authors sincerely thank Jon Michaels and Paul Gewirtz for their innovative and generous suggestions.

by executive agencies whose efforts are hampered by resource constraints and information deficits—debilities that sanctioned entities have recognized and exploited.

Harnessing economic incentives to serve American foreign policy aims, this Note offers four new proposals to improve the enforcement regime for international financial sanctions. Together, these solutions suggest novel ways to achieve greater buy-in from private actors subject to regulation and from coordinating government branches, working toward a fully enforced sanctions regime. The first two solutions enlist private actors to assist the government in uncovering and prosecuting sanctions violations. We recommend that Congress introduce *qui tam* provisions into the statutory sanctions regime and rely to a greater extent on bounties for identifying violations of sanctions and other counterterrorism regulations. The latter two proposals are more radical re-imaginings of the enforcement regime. Here, we recommend the institution of private ratings agencies for sanctions compliance, as well as a new liability insurance schema for unintentional sanctions violations.

A common thread in all four proposals—and one that we believe offers a comparative advantage over the current enforcement approach—is the mobilization of the private sector. For a government incapable of sifting through staggering volumes of daily financial transactions and pressured by budget restrictions, employing the private sector taps into a unique repository of valuable data in a cost-efficient way.² To that end, our solutions call for corporations and individuals to bear a good portion of front-end enforcement costs.

Apart from the benefits of cost-conservation, partnering with the private sector has been recognized as a vital, yet lacking, ingredient in effective sanctions enforcement. As Patrick Fitzgerald writes:

The importance of enlisting non-governmental parties in the war on terrorism . . . is now more clear than ever but the devil is in the details. If these programs are not properly implemented, the government's objectives may be undermined or frustrated. Similarly, the burdens imposed on those who seek to comply in good faith with the government's policies may be unnecessarily increased if the regulatory controls are not properly crafted and administered.³

1. Ramsey B. Jurdi, *Iran Sanctions Enforcement Not Keeping Pace with Rhetoric*, CHADBOURNE & PARK LLP (Apr. 2013), http://www.chadbourne.com/files/Publication/1d463291-a830-4cda-900b-8ac1e4e5eaf0/Presentation/PublicationAttachment/973e17dd-d8d4-4d63-bc77-91a51c069072/IranSanctionsEnforcement_Apr13.pdf; see also Peter L. Fitzgerald, *Managing "Smart Sanctions" Against Terrorism Wisely*, 36 NEW ENG. L. REV. 957, 957 (2002) ("[T]here is a significant difference between simply serving political goals by announcing sanctions, and promulgating controls that are actually effective in combating terrorism.").

2. Jon D. Michaels, *All the President's Spies: Private-Public Intelligence Partnerships in the War on Terror*, 96 CALIF. L. REV. 901, 902 (2008).

3. Fitzgerald, *supra* note 1, at 960. Fitzgerald also observes that resource constraints "constitute one of the most significant institutional impediments to more effective sanctions." *Id.* at 962.

Our Note tackles the devilish details. We offer solutions that incentivize the private sector to enforce sanctions and report wrongdoing, while also providing protection to good-faith actors. Taken together, our proposals realign the regulated community and the regulators as allies rather than adversaries in an effort to overcome what has been described as one of the greatest obstacles to effective sanctions enforcement.⁴

Also important, our proposals aim to amplify the legislature's voice in the national security conversation, calling for statutory solutions to the under-enforcement of sanctions. In creating a greater role for Congress, we speak to the growing concern over the unchecked power of the post-9/11 presidency.⁵ As our proposals would be implemented by statute, they would provide a legislative imprimatur to the informal practice of public-private collaboration in intelligence gathering that has, until recently, flown largely under the radar.⁶ By enshrining in statute the role that private actors are already encouraged to play in uncovering sanctions violations, policymakers may enhance—or at the very least clarify—the privacy protections guaranteed to Americans in their financial transactions. Indeed, scholars have noted that the simple requirement of outlining and justifying an intelligence program before Congress or the courts tends to lead to solutions that are more thorough and less susceptible to executive overreach and ad hoc decisionmaking.⁷ Finally, enlisting Congress may help streamline the sanctions regime by creating a coordinated and complementary approach to counterterrorism with reduced risk of conflicting legislative and executive policies.

Ultimately, it is our hope that by recruiting the regulated community and calling for enhanced inter-branch oversight, a robust and accountable enforcement effort will support the American sanctions regime. Currently, under-enforcement and selective enforcement of sanctions diminish government legitimacy both at home and abroad, threatening to “discredit our normative and legal pleas for other nations and peoples to respect the rule of law.”⁸ In fact, Senators Chuck Schumer and John Kyl raised this very concern in a letter sent to Secretary of State Hillary Clinton. Lamenting the Obama Administration's lack of resolve in going after Chinese companies violating the Iranian sanctions, the senators wrote:

4. *Id.* at 964.

5. *See, e.g.*, BRUCE ACKERMAN, *THE DECLINE AND FALL OF THE AMERICAN REPUBLIC* (2010); ERIC A. POSNER & ADRIAN VERMEULE, *THE EXECUTIVE UNBOUND: AFTER THE MADISONIAN REPUBLIC* (2010).

6. Michaels, *supra* note 2, at 904 (describing “handshake” agreements between executive and private actors).

7. *Id.* at 933.

8. *Id.* at 932; *see also* Suzanne Maloney, *Why “Iran Style” Sanctions Worked Against Tehran (And Why They Might Not Succeed with Moscow)*, BROOKINGS, Mar. 21, 2014, <http://www.brookings.edu/blogs/markaz/posts/2014/03/21-iran-sanctions-russia-crimea-nuclear> (underscoring the importance of “international cooperation in fashioning an effective sanctions regime”).

The Administration, by continuing to ignore blatant violations of our sanctions laws by Chinese companies, has undermined our sanctions regime in Iran. It has sent the message to our friends and allies—many of which have taken difficult steps to reduce their economic ties with Iran—that others will be let off the hook.⁹

The rest of this Note proceeds as follows. We consider in Part I the origins of the modern sanctions regime. With reference to several decades of sanctions programs, we recount the implementation of sanctions as a tool of foreign policy. We then identify the particular problems with current sanctions enforcement, specifically focusing on the costs of unprosecuted violations and the reasons for under-enforcement. Part II offers an in-depth look at the four proposed improvements to the sanctions regime. None of our four solutions is perfect, and we do not suggest that a flawless enforcement regime is realizable. Rather, as we make clear in our Conclusion, our aim is to start a conversation toward developing a sanctions system that is more economically efficient and more effective at achieving our foreign policy objectives.

I. Origins of the Sanctions Regime and a Brief Survey of Its Use as a Foreign Policy Tool

A. Statutory Authorization and Application

While the use of economic sanctions as an instrument of foreign policy dates back to the War of 1812, the current sanctions regime is largely an outgrowth of the 1977 International Emergency Economic Powers Act (IEEPA).¹⁰ Intended to regulate executive emergency powers during peacetime, IEEPA authorizes the President to declare the existence of “an unusual and extraordinary threat . . . to the national security, foreign policy, or economy of the United States,” and to regulate financial transactions with foreign entities pursuant to that threat.¹¹ The Act grants the President power to “investigate, regulate, or prohibit” any transactions in foreign exchange, any payments or

9. Letter from Senators John Kyl & Chuck Schumer to Sec’y of State Hillary Clinton (Sept. 28, 2010), http://www.legistorm.com/stormfeed/view_rss/368446/member/85.html.

10. Pub. L. No. 95-223, 91 Stat. 1626 (1977) (codified as amended at 50 U.S.C. § 1701-1706 (2012)).

11. Pub. L. No. 95-223, § 202, 91 Stat. 1626 (1977) (codified as amended at 50 U.S.C. § 1701 (2012)). Concerned by executive overuse of the authority to declare national emergencies, Congress passed IEEPA to regulate the President’s ability to exercise that power during peacetime. See Jarred O. Taylor, III, *Information Wants to be Free (of Sanctions): Why the President Cannot Prohibit Foreign Access to Social Media Under U.S. Export Regulations*, 54 WM. & MARY L. REV. 297, 306 (2012). To that end, the President must also declare a national emergency under the National Emergencies Act (NEA) in order to declare a state of emergency under IEEPA. 50 U.S.C. § 1621 (2006). In turn, the NEA imposes a further requirement: the President must specify the provisions of law upon which she bases a declaration of emergency. In addition, she must publish in the Federal Register and transmit to Congress a declaration announcing the continuation of any state of emergency lasting beyond one year.

credit transfers that involve American banking institutions, and the import and export of currency or securities.¹² Alternatively, the President may block or “freeze” the assets or bank accounts of any foreign entity held in the United States¹³ Finally, penal provisions of IEEPA mandated civil penalties up to \$10,000. Criminal penalties included fines not exceeding \$50,000, a ten-year prison term, or both, for willful violations of the Act.¹⁴ Subsequent amendments to IEEPA have augmented those penalties, increasing civil fines to \$250,000 or twice the illegal transaction amount. Willful violators of the Act may face up to \$1,000,000 in criminal fines, a twenty-year prison sentence, or both.¹⁵

With each declaration of national emergency, the President has delegated his authority under IEEPA to the Treasury Department, which in turn has tasked the Office of Foreign Asset Control (“OFAC”) with promulgating and updating sanctions prohibiting Americans from engaging in financial transactions with named counterparties.¹⁶ Notwithstanding today’s focus on Iran, OFAC has levied sanctions against dozens of foreign nations, entities, and individuals found to present “unusual and extraordinary” threats.¹⁷ For example, in October 1985, President Reagan issued an executive order announcing a national emergency with respect to the government of South Africa, where it was determined that “the policy and practice of apartheid [were] repugnant to the morals and political values of democratic and free societies” and presented a threat to American interests.¹⁸ Pursuant to President Reagan’s order, OFAC promulgated sanctions to prohibit U.S. financial institutions from loaning money to the South African government or any entities under its control. Likewise, in 1986 President Reagan responded to the Libyan-backed terrorist attacks in Rome and Vienna with an executive order declaring a state of national emergency against Libya, prompting OFAC to administer the Libyan Sanctions Regulations.¹⁹ Other countries targeted by

12. Pub. L. No. 95-223, § 203, 91 Stat. 1626 (1977) (codified as amended at 50 U.S.C. § 1702(a) (2012)). Following the attacks of September 11, 2001, the Patriot Act amended IEEPA, granting the president still greater power to confiscate property of foreign entities presenting terrorist threats to the United States. Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA Patriot) Act, Pub. L. No. 107-56, 115 Stat. 277 (2001) (codified as amended at 50 U.S.C. § 1702 (2006)).

13. Pub. L. No. 95-223, § 203, 91 Stat. 1626 (1977) (codified as amended at 50 U.S.C. § 1702 (2012)).

14. Pub. L. No. 95-223, § 206, 91 Stat. 1626 (1977) (codified as amended at 50 U.S.C. § 1705 (2012)).

15. 50 U.S.C. § 1705 (2012).

16. Taylor, *supra* note 11, at 306-07.

17. Individuals and entities sanctioned by OFAC are known collectively as “Specially Designated Nationals” (SDNs). OFAC maintains an updated list of SDNs that is separate from its various regulations outlining country-specific prohibitions on trade. *Specially Designated Nationals and Blocked Persons List*, OFFICE OF FOREIGN ASSETS CONTROL (Apr. 16, 2015), <http://www.treasury.gov/ofac/downloads/t11sdn.pdf>.

18. Exec. Order No. 12532, 50 Fed. Reg. 36861 (Sept. 9, 1985).

19. Exec. Order No. 12543, 51 Fed. Reg. 875 (Jan. 7, 1986). The Libyan Sanctions Regulations are codified at 31 C.F.R. pt. 550. In the years since 1986, U.S. presidents maintained a state

OFAC sanctions since 1977 include Angola,²⁰ Myanmar,²¹ Iraq and Kuwait,²² Nicaragua,²³ Panama,²⁴ and Sudan.²⁵

Apart from Cuba,²⁶ Iran has been subject to perhaps the most comprehensive U.S. sanctions regime, a program that continues to dominate foreign policy conversations.²⁷ In 1979, President Jimmy Carter responded to the revolution in Iran and the American hostage crisis unfolding there with Executive Order 12170, blocking all “property and interests in property of the Government of Iran, its instrumentalities and other controlled entities and the Central Bank of Iran.”²⁸ In the 1980s, the United States imposed additional sanctions against Iran, designed to stop what Washington believed to be Iran’s support of terrorism and, more broadly, to check its power in the Middle East.²⁹ And, following the October 1983 bombing of the U.S. Marine barracks in Beirut, Lebanon, Secretary of State George Schultz declared Iran a state sponsor of terrorism, a designation that triggered a wide range of sanctions, including a ban on exports and sales of weapons, increased oversight on export of dual-use goods, and restrictions on economic assistance.³⁰ In 1987, President Reagan, citing Iran’s support for international terrorism and “aggressive actions against non-belligerent shipping” in the Persian Gulf, issued Executive Order 12613, which imposed an import embargo on goods of Iranian origin.³¹ Upon President Reagan’s declaration of an embargo, OFAC

of emergency against Libya and imposed stronger sanctions that further restricted trade and travel pursuant to the Iran and Libya Sanctions Act of 1996. The declaration of emergency was lifted nearly twenty years later, in 2004, by President George W. Bush. *See* Exec. Order No. 13357, 69 Fed. Reg. 56665 (Sept. 20, 2004).

20. Exec. Order No. 12865, 58 Fed. Reg. 51005 (Sept. 26, 1993).

21. Exec. Order No. 13047, 62 Fed. Reg. 28301 (May 20, 1997).

22. Exec. Order No. 12722, 55 Fed. Reg. 31803 (Aug. 3, 1990).

23. Exec. Order No. 12513, 50 Fed. Reg. 18629 (May 1, 1985).

24. Exec. Order No. 12635, 53 Fed. Reg. 12134 (Apr. 8, 1988).

25. Exec. Order No. 13067, 62 Fed. Reg. 59989 (Nov. 3, 1997).

26. A complex statutory schema apart from IEEPA governed restrictions on trade with

Cuba.

27. *See, e.g.*, John Hudson, *Democratic Support for Iran Sanctions Shrinks*, FOREIGN POLICY, Jan. 28, 2015, <http://foreignpolicy.com/2015/01/28/democratic-support-for-iran-sanctions-shrinks/>; Deb Riechmann, *Obama Could Ease Many Iranian Sanctions Without Congress*, WASH. POST, Apr. 16, 2015, http://www.washingtonpost.com/politics/federal-government/obama-could-ease-many-iranian-sanctions-without-congress/2015/04/16/90625446-e470-11e4-ae0f-f8c46aa8c3a4_story.html.

28. Exec. Order No. 12170, 44 Fed. Reg. 59989 (Nov. 14, 1979). President Carter’s order resulted in the freezing of close to \$12 billion in Iranian assets. Patrick Clawson, *Iran*, in ECONOMIC SANCTIONS AND AMERICAN DIPLOMACY 85, 85 (Richard Haas ed., 1998).

29. KENNETH KATZMAN, CONG. RESEARCH SERV., RS20871, IRAN SANCTIONS I (2013).

30. Office of the Coordinator for Counterterrorism, *Chapter 3: State Sponsors of Terrorism*, U.S. DEP’T STATE (July 31, 2012), <http://www.state.gov/j/ct/rls/crt/2011/195547.htm>.

31. Exec. Order No. 12613, 3 C.F.R. 256 (1987). Rather than IEEPA, President Reagan cited the International Security and Development Act of 1985 as the statutory authority for the embargo.

promulgated the Iranian Transaction Regulations (ITR), which constitute the most up-to-date prohibitions on U.S. trade with Iran.³²

The 1990s witnessed a shift in sanctions objectives, turning from targeting terrorism outright to preventing Iran from acquiring nuclear weapons. In March 1995, as a result of Iran's alleged pursuit of weapons of mass destruction, President Clinton declared a new state of emergency and issued Executive Order 12957, outlawing American involvement in Iran's petroleum industry.³³ Two months later, Clinton announced Executive Order 12959, which further tightened existing sanctions.³⁴ In August 1997, Clinton signed Executive Order 13059, banning virtually all trade and investment activities with Iran by U.S. persons or institutions, wherever their location.³⁵

Matching the executive effort over the past three decades, Congress has augmented IEEPA with a host of new laws that strike at specific sectors of the Iranian economy and, in some instances, apply extraterritorially. In 1996, Congress passed the Iran Sanctions Act authorizing sanctions against foreign firms investing in or trading with Iran's energy sector or weapons programs.³⁶ Congress next turned its attention to deterring non-U.S. financial institutions from transacting on behalf of Iranian banks.³⁷ In 2010, it passed the Comprehensive Iran Sanctions, Accountability, and Divestment Act (CISADA), authorizing the Treasury to prohibit or restrict foreign banks from maintaining U.S. dollar correspondent accounts³⁸ or payable-through accounts for other non-U.S. financial institutions engaging in potentially sanctioned activities. CISADA curtails sharply foreign banks' ability to conduct any U.S. dollar transactions on behalf of Iranian or Iranian-linked banks. To implement the financial provisions of CISADA, OFAC promulgated the Iranian Financial Sanctions Regulations (IFSR).³⁹ Financial institutions found to violate the regulations are subject to the same penalties as those imposed by IEEPA, and they also are at risk of losing access to the U.S. financial system. Most recently, the National Defense Authorization Acts enacted in 2012 and 2013 have authorized additional sanctions on foreign financial institutions that facilitate a "significant financial transaction" with sanctioned Iranian banks.⁴⁰

32. 31 C.F.R. pt. 560 (2012).

33. Exec. Order No. 12957, 3 C.F.R. 332 (1995). Every March since 1995, U.S. Presidents have affirmed that a state of emergency continues to exist with respect to Iran. KATZMAN, *supra* note 29, at 21.

34. Exec. Order No. 12959, 3 C.F.R. 356 (1995).

35. Exec. Order No. 13059, 3 C.F.R. 217 (1997).

36. The legislation was originally titled the Iran and Libya Sanctions Act of 1996. Pub. L. No. 104-72, 110 Stat. 1541 (1996).

37. As already mentioned, by this time, U.S. persons had been banned from virtually all trade with Iran-linked entities. *See supra* notes 28-30 and accompanying text.

38. Pub. L. No. 111-195, 123 Stat. 1312 (2010).

39. 31 C.F.R. pt. 561 (2014).

40. National Defense Authorization Act for Fiscal Year 2013, Pub. L. No. 112-239 § 1245, 126 Stat. 1978 (2013); National Defense Authorization Act for Fiscal Year 2012, Pub. L. No. 112-81 § 1245, 125 Stat. 1647 (2012).

B. A Diplomatic Dead End?

As the country's reliance on economic warfare grows stronger still, it is worth stepping back briefly to consider whether sanctions—even when fully enforced—are a viable tool of diplomacy. While the focus of this Note is not on *whether* sanctions are an optimal foreign policy strategy, we recognize that our proposals would amount to little more than an academic exercise if sanctions were a diplomatic dead end. Fortunately, recent experience has made clear that targeted sanctions,⁴¹ particularly when combined with a credible threat of military action, provide a worthwhile tool to achieve American foreign policy aims.

To be sure, naysayers have long questioned the efficacy of economic sanctions as an alternative to force. In 1997, Robert Pape argued, “there is little valid social science support for claims that economic sanctions can achieve major foreign policy goals.”⁴² Especially in the lead-up to the invasion of Iraq in 2003, proponents of a traditional military invasion pointed to the futility of sanctions and their unintended effects on innocent civilians. Referring to the debates over the 2003 invasion, one popular magazine observed that “[i]n some circles—mainly but not exclusively on the right—it became an item of faith that the targets of the sanctions invariably find a way to get around them, ignore them, or force their unfortunate citizens to bear the burden of them.”⁴³ And finally, familiar skepticism about sanctions was voiced as the United States and its allies ramped up sanctions against Iran. As one defense analyst warned in 2012, “the history of sanctions shows they not only typically fail to achieve their economic objectives but also rarely achieve their political goals, such as getting a country to abandon its nuclear program or causing a regime to fall.”⁴⁴

Recent breakthroughs in negotiations with Iran, however, have quieted some critics as economic prohibitions have proven to be an effective and comparatively safe means of pursuing American diplomatic goals.⁴⁵ Indeed, few would question that the promise of relief from crippling U.S. sanctions succeeded in bringing Iranian President Hassan Rouhani to the nuclear

41. As the name suggests, targeted or “smart” sanctions are levied against individuals, entities, and organizations. In other words, they are designed to avoid inflicting financial harm or humanitarian crises on civilian populations. *See, e.g.,* Joy Gordon, *Smart Sanctions Revisited*, 25 *ETHICS & INT’L AFF.* 315, 315 (2011).

42. Robert A. Pape, *Why Economic Sanctions Do Not Work*, 22 *INT’L SECURITY* 90, 106 (1997).

43. John Cassidy, *Iran Nuke Deal: Do Economic Sanctions Work After All?* *NEW YORKER* (Nov. 25, 2013), <http://www.newyorker.com/news/john-cassidy/iran-nuke-deal-do-economic-sanctions-work-after-all>.

44. Ivan Eland, *Iran Sanctions Won’t Work*, *WASH. TIMES* (Jan. 17, 2012), <http://www.washingtontimes.com/news/2012/jan/17/iran-sanctions-wont-work>.

45. *See, e.g.,* Maloney, *supra* note 8 (labeling Iran the “exemplar for successful sanctions”).

negotiating table.⁴⁶ According to one policy analyst, “the critics have it wrong. The U.S.-led sanctions regime against the Islamic Republic, along with deft U.S. handling of the Arab uprisings, has put Iran’s leaders into a corner.”⁴⁷ Already by 2012, U.S. sanctions had reduced Iran’s oil exports by as much as 40%.⁴⁸ At the same time, Iranian citizens witnessing the rapid depreciation of their currency and concomitant rise in prices expressed dissatisfaction with the country’s leaders.⁴⁹

Still, detractors and skeptics remain.⁵⁰ To them, our response is this: whatever the wisdom of sanctions, they will continue to play an outsized role in America’s diplomatic strategy. As a result, policymakers have a basic interest in ensuring that sanctions are enforced robustly and efficiently.

C. Shortfalls of the Current Regime

1. Budget Constraints

It is widely acknowledged in the press, in policy circles, and in the academy that sanctions—particularly against Iran—are under-enforced. As Ramsey Jurdi, a sanctions lawyer at Chadbourne & Parke LLP, wrote in 2013, “[a] critical look at the US record of enforcement of sanctions against Iran reveals that prosecutions and penalties are not keeping pace with legislation and diplomatic developments.”⁵¹ The problem is chiefly one of resource constraints, as OFAC appears “hampered by a lack of resources to investigate and prosecute sanctions violators.”⁵²

46. See, e.g., Uri Berliner, *Crippled by Sanctions, Iran’s Economy Key in Nuclear Deal*, NPR (Nov. 25, 2013), <http://www.npr.org/2013/11/25/247077050/crippled-by-sanctions-irans-economy-key-in-nuclear-deal>; Cassidy, *supra* note 43.

47. Alireza Nader, *Smart Sanctions*, FOREIGN POLICY, Sept. 25, 2012, <http://foreignpolicy.com/2012/09/25/smart-sanctions/>.

48. *Id.*

49. *Id.*

50. In particular, experts doubted that recent sanctions levied against Russia would cause Vladimir Putin to change course. See, e.g., Clifford G. Gaddy and Barry W. Ickes, *Can Sanctions Stop Putin?* BROOKINGS (June 3, 2014), <http://www.brookings.edu/research/articles/2014/06/03-can-sanctions-stop-putin-gaddy-ickes> (“Sanctions thus lead to greater control by Putin over the economy. They weaken the relatively independent and modern part of Russia’s economy. They also reinforce Putin’s political power. They rally the public around Putin. . . . [O]ur current approach of dealing with Russia by sanctions and isolation will not only fail to accomplish its immediate goal of stopping Putin in Ukraine, but it will also be counterproductive to the more important, long-term objective of Russia’s evolution as a normal, modern, globally integrated country.”).

51. Ramsey B. Jurdi, *Iran Sanctions Enforcement Not Keeping Pace With Rhetoric*, CHADBOURNE & PARKE LLP (Apr. 2013), http://www.chadbourne.com/files/Publication/1d463291-a830-4cda-900b-8ac1e4e5eaf0/Presentation/PublicationAttachment/973e17dd-d8d4-4d63-bc77-91a51c069072/IranSanctionsEnforcement_Apr13.pdf. See generally Peter L. Fitzgerald, *Managing “Smart Sanctions” Against Terrorism Wisely*, 36 NEW ENG. L. REV. 957 (2002).

52. Jurdi, *supra* note 51, at 1.

Senior Treasury officials have been lamenting OFAC's financial resource constraints for years.⁵³ Each year, OFAC receives several hundred leads, but opens only about one hundred investigations, which result in around twenty enforcement actions on average.⁵⁴ Jurdi calls these numbers "surprisingly low given the broad reach of sanctions and the political importance of the Iran issue."⁵⁵ Indeed, a review of recent OFAC enforcement actions notes a concentration in actions against large financial institutions and small trade-related violations.⁵⁶ Both categories of enforcement rely heavily on voluntary disclosures as opposed to affirmative investigation by OFAC. Accordingly, much of OFAC's latest success is driven by its receipt of prepackaged enforcement actions rather than by complex cases initiated by the agency. And the situation has worsened through the most recently completed fiscal year. In fiscal year 2014, the continued effects of budget sequestration will likely result in another eight percent cut to OFAC's budget.⁵⁷

2. Diplomatic Concerns

Constrained resources are not just financial. Diplomatic equities also must be weighed. Even as Congress passes new sanctions every three to four months on average,⁵⁸ the State Department employs a diplomatic calculus that may call for certain sanctions to be enforced halfheartedly or not at all. According to Jurdi, "the State Department remains reluctant to step on diplomatic toes, particularly those of China and India, through use of extraterritorial laws. . . . [Much recent sanctions] legislation has been either symbolic or used sparsely."⁵⁹ In other words, it's not just the money. Executive agencies' diplomatic goals may conflict with congressional mandates and often make sanctions enforcement more difficult. As noted above, Senators Schumer and Kyl sent a letter upbraiding the State Department for blatantly under-enforcing the Iranian sanctions against Chinese corporations. Whether dictated by limited financial resources, diplomatic considerations, or both, under-enforcement or

53. See, e.g., TREASURY DEPARTMENT 2012 BUDGET REQUEST, C-SPAN (Apr. 5, 2011), <http://www.c-span.org/video/?298848-1/treasury-department-2012-budget-request>.

54. Jurdi, *supra* note 51, at 1. While emphasizing that OFAC "appears hampered by a lack of resources to investigate and prosecute [sanctions] violators," Jurdi does not expressly attribute OFAC's low enforcement numbers to its resource constraints. It may be the case that OFAC declines to follow some leads simply because they are unpromising.

55. *Id.*

56. *Id.* See also *OFAC Recent Actions*, U.S. DEP'T OF THE TREASURY (Feb. 17, 2015), <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/OFAC-Recent-Actions.aspx>.

57. See *FY 2014 Program Summary by Budget Activity*, U.S. DEP'T OF THE TREASURY, <http://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/6.%20DO%20BIB%20FINAL%20508%20ok.pdf> (last visited Feb. 22, 2015).

58. Jurdi, *supra* note 51, at 1.

59. *Id.*

selective enforcement of sanctions threatens interbranch comity, which may diminish the credibility of the American sanctions regime at home and abroad.

3. Non-governmental Cooperation

Finally, voluntary cooperation by regulated communities is critical to effective enforcement of OFAC's sanctions program. After all, corporations and private citizens are the actors at risk of engaging in banned financial transactions and are therefore best able to implement safeguards and proactively report violations. Fitzgerald goes so far as to argue that "voluntary implementation and compliance with [OFAC] rules" is more crucial to successful enforcement of sanctions than the agency enforcement actions themselves.⁶⁰ Yet for years, OFAC and the non-governmental actors it regulates have been at odds, driven in part by a sentiment in the private sector that current regulations take little account of the needs of businesses.⁶¹ In response, the regulated community has balked at proactively assisting OFAC to achieve its enforcement goals.

Having considered the major problems riddling the sanctions enforcement regime, we turn next to our solutions. Our proposals offer novel approaches to address resource constraints, inter-branch dynamics, and, most importantly, the relationship between regulators and the private sector.

II. Solutions

A. *Qui Tam* Suits

1. The Rise and Fall (and Rise) of *Qui Tam*

With its origins in Roman criminal law, *qui tam* derives its name from an abbreviation of the Latin phrase meaning "one who pursues the action on behalf of the king as well as himself."⁶² In broad terms, a *qui tam* provision confers authority on individual citizens, labeled relators, to sue private parties on behalf of the government. While *qui tam* provisions have historically contemplated a variety of rewards, inherent in them is the principle that the private citizen who initiated the suit is entitled to a portion of the judgment upon successful prosecution.

A paradigmatic example of an American *qui tam* statute, the False Claims Act (FCA),⁶³ was enacted in 1863 to stem the pervasive frauds committed by

60. Fitzgerald, *supra* note 1, at 964.

61. *Id.*

62. In full, the Latin phrase reads *qui tam pro domino rege quam pro se ipso in hac parte sequitur*. See 2 WILLIAM BLACKSTONE, COMMENTARIES *161. Roman law permitted private citizens successful in their suits to share in the recovery of a defendant's property. Richard A. Bales, *A Constitutional Defense of Qui Tam*, 2001 WIS. L. REV. 381, 385 (2001).

63. Ch. 67, 12 Stat. 696 (Mar. 2, 1863) (codified at 31 U.S.C. §§ 3729-3733 (2012)).

Civil War defense contractors against the Union Army.⁶⁴ As the number of wartime claims mounted, so too did suspicions that government prosecutors were complicit in many of the schemes defrauding the government. In response, Congress turned to a dual-enforcement mechanism whereby private actors would supplement public prosecutors feared to be systematically under-enforcing the statute.⁶⁵ To incentivize private actors, the original FCA authorized double damages and awarded relators of successful suits half of any damages and penalties paid in judgment. At the same time, the government retained considerable enforcement power, as it was authorized by the statute to assume control of the prosecution at any time for any reason.⁶⁶

Following the Civil War, *qui tam* actions declined, due in part to changes enacted to the FCA in 1943 that shrank the potential damage award to 10% of the judgment amount. The 1980s, however, witnessed the reemergence of *qui tam* suits amid public outcry over reports of rising procurement fraud and false claims.⁶⁷ Congress passed the False Claims Amendments Act of 1986, which increased the financial incentives for relators and ratcheted up penalties imposed on defendants.⁶⁸ The law authorized relators to receive reasonable expenses and attorneys' fees.⁶⁹ Defendants, on the other hand, faced treble damages.⁷⁰ Finally, the Act created a whistleblower provision to protect employee-informants.⁷¹

Most relevant for purposes of this Note, the 1986 legislation considerably restricted the government's ability to assume control of a *qui tam* suit.⁷² The executive branch now has a sixty-day window from the time a relator files suit to investigate the claim and decide whether to take over the prosecution. If the Department of Justice ("DOJ") intervenes during that window, then it has broad discretion over the case. The government may dismiss the suit, enter a settlement, or limit the role of the relator in the prosecution.⁷³ Yet even if the government intervenes, the relator is entitled to receive between 15% and 25% of any proceeds of the suit.⁷⁴ On the other hand, if DOJ declines to assume responsibility for the prosecution, its capacity to control the suit is curtailed: it may only enter the case upon a showing of good cause.⁷⁵ Moreover, DOJ's

64. *United States v. Bornstein*, 423 U.S. 303, 309 (1976).

65. *See Bales, supra* note 62, at 388-89; Evan Caminker, Comment, *The Constitutionality of Qui Tam Actions*, 99 *YALE L.J.* 341, 351 (1989). In no way do we mean to suggest that current prosecutors are associated with the perpetrators of fraud on the government.

66. *Bales, supra* note 62, at 389.

67. *Id.* at 389-90.

68. False Claims Amendments Act of 1986, Pub. L. No. 99-562, 100 Stat. 3153 (1986).

69. False Claims Amendments Act of 1986, § 3, 31 U.S.C. § 3730(d) (2012).

70. False Claims Amendments Act of 1986, § 2, 31 U.S.C. § 3729(a)(1)(G) (2012).

71. False Claims Amendments Act of 1986, § 4, 31 U.S.C. § 3730(h) (2012).

72. Of course, DOJ remains free to bring suit if it learns of a violation independently.

73. False Claims Amendments Act of 1986, § 3, 31 U.S.C. § 3730(c)(2) (2012).

74. False Claims Amendments Act of 1986, § 3, 31 U.S.C. § 3730(d)(2) (2012).

75. False Claims Amendments Act of 1986, § 3, 31 U.S.C. § 3730(c)(3) (2012).

participation cannot restrict the “status and rights” of the relator, a constraint that has generated uncertainty about whether the government may dismiss a suit when it intervenes after the statutory window.⁷⁶

The FCA’s qui tam provision has been extolled widely as a vital tool in combating government fraud and achieving other policy aims.⁷⁷ Since the 1986 amendments to the FCA, over five thousand qui tam suits have been filed, recouping over \$17 billion from fraudulent contractors on behalf of the government.⁷⁸

2. From Contracts to Sanctions: Mapping the FCA onto Sanctions Laws

Several of the justifications offered to support the qui tam provision in the FCA apply with at least as much force to a statutory sanctions regime buttressed by private enforcement. First, in its discussion of the 1986 amendments, the Senate insisted that fraud by defense contractors presented a threat not only to the public fisc, but to national security as well.⁷⁹ If national security is credited as a legitimate aim of qui tam suits in the contracting context, the case for private enforcement would seem to apply all the more strongly to the sanctions regime.

Second, qui tam suits have proven particularly useful in rooting out fraudulent medical assistance claims submitted to the government, a trend attributable in part to traits of the medical industry also shared by the financial services industries. The government relies heavily on private relators in the medical field because DOJ’s capacity to investigate is limited by statutes protecting, among other things, patient privacy.⁸⁰ For sanctions violations perpetrated by international companies, international privacy laws may similarly limit DOJ’s reach. Another parallel between medical claims and sanctions violations is the sheer number of transactions at issue. While DOJ may have the resources to review government contracts, it is ill equipped to scrutinize the flood of medical claims submitted under the Medicare and Medicaid programs.⁸¹ Likewise, the Attorney General cannot police every U.S.

76. Bales concedes that at least one interpretation would hold the government to be prohibited entirely from terminating a suit in this circumstance. He notes, however, that most courts have suggested in dicta that the government could move to dismiss the suit notwithstanding its late arrival to the prosecution. Bales, *supra* note 62, at 429.

77. See e.g., PAUL R. VERKUIL, *OUTSOURCING SOVEREIGNTY: WHY PRIVATIZATION OF GOVERNMENT FUNCTIONS THREATENS DEMOCRACY AND WHAT WE CAN DO ABOUT IT* 178 (2007) (noting the reduction in agency costs); Sean Hamer, *Lincoln’s Law: Constitutional and Policy Issues Posed by Qui Tam Provisions of the False Claims Act*, 6 KAN. J. L. & PUB. POL’Y 89, 101-02 (1997) (claiming that the benefits to society of qui tam suits outweigh any potential constitutional uncertainties).

78. VERKUIL, *supra* note 77, at 178.

79. S. Rep. No. 99-345; see also Caminker, *supra* note 65, at 349 (“Financial concerns aside, false claims practices may generate other diffuse injuries, including threats to national security.”).

80. Christina Orsini Broderick, Note, *Qui Tam Provisions and the Public Interest: An Empirical Analysis*, 107 COLUM. L. REV. 949, 983 (2007).

81. *Id.* at 984.

dollar transaction that may run afoul of sanctions. Finally, physicians, like citizens engaging in private financial transactions, exercise a great degree of autonomy,⁸² suggesting that only those close to a perpetrator may be able to detect wrongdoing. Unlike government prosecutors stationed in Washington and responsible for monitoring millions of transactions originating miles away, employees and competitors of mafeasant companies have easier access to on-the-ground evidence of wrongdoing.

The third, and perhaps most compelling, justification for introducing a qui tam provision to sanctions enforcement relates to timing. Timing concerns are of utmost importance in enforcing sanctions: even a few weeks of undetected violations could mean that significant sums of money are funneled to terroristic regimes. And yet, it may take months, if not years, for prosecutors to detect a pattern of prohibited transactions, let alone to build a case against sanctions violators. Federal enforcement actions are largely reactive, built from voluntary disclosures regarding high-value transactions.⁸³ Furthermore, even if prosecutors were to launch an affirmative investigation, they experience significant delays as target companies respond to subpoenas, or worse, seek to evade them.

With a few small but significant alterations, a sanctions regime incorporating private enforcement could emulate the FCA model. First, IEEPA would have to be amended to contain a qui tam provision permitting actions to be brought by private persons in addition to the executive branch. To screen against frivolous lawsuits, Congress might consider imposing a minimum transaction amount upon which a suit can be based. Then again, requiring relators to bear at least the initial costs of litigation probably serves as an adequate safeguard against frivolous suits. Second, as our sanctions regime implicates national security and diplomatic concerns to a far greater degree than does government contract fraud, restrictions on the government's ability to control relator-initiated prosecutions necessarily must be scaled back. Invoking the state secrets doctrine and national security concerns, the Attorney General should have no trouble meeting the "good cause" requirement to enter a suit past the sixty-day statutory window. Still, to be practicable, a looser good-cause standard must also be coupled with the government's ability to constrain "the status and rights" of the private litigant, even if the DOJ intervenes past the statutory window. Finally, as with the FCA, private suits brought under IEEPA would require a showing that the defendant acted at least with the knowledge of his or her illicit activity.⁸⁴ To treat sanctions violations as strict liability offenses would not only invite a barrage of private suits, each of which the

82. *Id.*

83. *See* Part I.c.i, *supra*.

84. 31 U.S.C. § 3729(a) (2012) (imposing liability on only those persons who knowingly or intentionally file false claims against the government). As mentioned above, IEEPA's criminal penalties apply only to those people who knowingly violate the law. 50 U.S.C. § 1705(c) (2012).

government would be obligated to investigate, but also deprive defendants of any number of the good-faith defenses that the government considers when deciding *ex ante* whether to prosecute a sanctions violator.

A brief hypothetical may help to illustrate how *qui tam* actions against sanctions violators might work. Suppose a compliance officer at the American arm of a major international ship brokerage house realizes that her employer has knowingly conducted several transactions with a shell company operated by Iran's national shipping line. She has reported the wrongdoing to her superiors to no avail. Armed with records of several incriminating wire transfers as well as emails making clear her superiors' complicity in the illicit transactions, the compliance officer initiates a lawsuit, which, if successful, would entitle her to up to 30% of the judgment awarded to the government as well as reimbursement for reasonable attorneys' fees. Should the government intervene and assume primary responsibility for the suit, the relator would still be entitled to receive between 15% and 25% of any proceeds.⁸⁵

The most natural objection to a *qui tam* provision in IEEPA focuses on national security: namely, sanctions are meant to be a tool of foreign policy entrusted exclusively to the President. To this argument we offer two counterclaims. First, as discussed above, should any national security concerns surface past the statutory window during which the DOJ may take control of the investigation automatically, the hurdles for the government to reenter the case would necessarily be lower than those presented in the FCA context. Invocation of the state secrets privilege or the President's Article II powers to conduct foreign policy would constitute the "good cause" requisite for resumption of government control. Second, the Supreme Court has already upheld statutory schemes in which Congress subordinates national security concerns and circumscribes executive control to promote its interest in vigorous and timely prosecutions.⁸⁶

Accompanying the national security concerns unique to private enforcement of sanctions are concerns generic to all *qui tam* suits. For instance, some argue that since private suits appeal to individuals' greed and self-aggrandizement, relators driven by dollar signs are unable to take into account broader government interests.⁸⁷ Other detractors insist that private suits saddle companies with high litigation costs that would be better spent conducting

85. One could construct a similar hypothetical substituting a business competitor or customer for the dissatisfied employee. For a breakdown of relator "types" bringing suit under the FCA, see David Freeman Engstrom, *Harnessing the Private Attorney General: Evidence from Qui Tam Litigation*, 112 COLUM. L. REV. 1244, 1296 tbl.3 (2012).

86. In *United States ex rel. Marcus v. Hess*, the Court upheld the *qui tam* provision of the False Claims Act, rejecting the Attorney General's pleas that private suits would damage the war effort. 317 U.S. 537, 547 (1943). Similarly, in *Morrison v. Olson*, the Court overrode national security and foreign policy concerns to approve an enforcement scheme charging a court-appointed prosecutor, insulated from presidential control, with investigating high-ranking executive officials. 487 U.S. 654, 654-68 (1988). For a thorough discussion of the Court's consideration of competing interests, see Caminker, *supra* note 65, at 366.

87. Broderick, *supra* note 80, at 961-62 (listing common critiques of *qui tam* suits).

internal investigations.⁸⁸ Still others criticize qui tam suits for their capacity to function as a tool of retribution among business competitors.⁸⁹ In response to the last criticism, we note that qui tam suits harness economic incentives that already exist among business competitors, and for this reason may be understood to be as much a feature as a bug. Moreover, if the enforcement mechanism is well devised, only those enterprises running afoul of sanctions need be concerned.

Proponents of qui tam suits in the contracting context have defended the merits of private enforcement against these and other criticisms.⁹⁰ As such, we will not rehash their arguments. Rather, we offer next a solution that engages the private sector without dramatically increasing private citizens' control over sanctions enforcement.

B. Bounties

If the risks incurred by a public-private prosecution scheme ultimately prove too great, the government need not wholly abandon the notion of enlisting private actors to strengthen sanctions enforcement. Rather than confer a right of action, IEEPA and other sanctions laws can simply be amended to create a bounty system for private informers.

Like qui tam suits, bounty provisions have a long history in federal statutes, covering conduct ranging from bribery and conflicts-of-interest⁹¹ to the recovery of undersea treasure.⁹² Apart from their utility as a supplemental enforcement tool and a catalyst for innovation, bounty provisions also serve a cost-cutting function, a particularly attractive prospect in the current cash-strapped climate. Indeed, President Obama stressed the potential for cost savings in a March 2010 memorandum urging agencies to increase their use of challenges and prizes to promote national goals.⁹³ Further, unlike with qui tam actions, bounties enable the government to retain total control over its enforcement agenda: the government is free to announce larger prizes for information about violations of high priority sanctions, while attaching no bounties to less urgent sanctions. To add more color to this picture, next we outline two hypothetical bounty regimes.

88. *Id.*

89. Engstrom, *supra* note 75, at 1277-78. Among other common critiques of qui tam suits, Engstrom lists dominance of the plaintiffs' bar by former DOJ prosecutors. *Id.* at 1285.

90. Broderick, *supra* note 80, at 962-63.

91. Bales, *supra* note 62, at 387 n.37 (collecting statutes that contain bounties).

92. Bales, *supra* note 62, at 388 n.40 (same).

93. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, OMB MEMORANDUM NO. 10-11, GUIDANCE ON THE USE OF CHALLENGES AND PRIZES TO PROMOTE OPEN GOVERNMENT (2010), http://www.whitehouse.gov/sites/default/files/omb/assets/memoranda_2010/m10-11.pdf. We thank Professor Jon Michaels for directing us to this source. See Jon D. Michaels, *Privatization's Progeny*, 101 GEO. L.J. 1023, 1058 (2013) (listing government-sponsored prizes as a type of "[g]overnment-by-bounty initiative[']").

1. Investigative Clearinghouses

Borrowing from Jon Michaels' case study of social-impact bonds,⁹⁴ we offer a rough sketch of how enforcement-by-bounty can bolster the current sanctions regime. On a basic level, social-impact bonds involve the government enlisting "bond organizations," which are responsible for designating and funding other private organizations to accomplish various social-service initiatives. While the bond organizations absorb all up-front and operational costs, upon reaching certain benchmarks, they are reimbursed by the government and rewarded with additional bonuses.⁹⁵ Applying this blueprint to sanctions enforcement, the government can recoup many of the same cost-cutting and innovation-inducing benefits by giving bond organizations responsibility for locating and incentivizing private actors to gather information about real-time sanctions violations. Major U.S. corporate investigation firms could fill the role of bond organizations, paying the up-front costs of recruiting private actors with whom they already have relationships. In turn, these private actors—ranging from U.S. grain traders, to German banks, to British insurance underwriters—would collect routine fees for supplying to the investigative firms intelligence about suspicious transactions or sanctioned counterparties seeking to initiate business with them. Serving as information clearinghouses, the bond organizations would then be responsible for compiling, analyzing, and reporting suspicious activity to the government. Upon meeting certain benchmarks, such as names added to the OFAC list or transaction-dollars saved, the government would repay the clearinghouses their initial investment plus a bounty pegged to the dollar amount of illegal transactions reported.

If substantial bonuses fail to ensure participation among investigative firms, the government may turn to other incentives.⁹⁶ Namely, the government can promise participating investigation firms priority review for lucrative government contracts in other areas of investigation. As the cost of losing priority review increases, non-participating firms will face the choice of either joining the government's sanctions-investigation program or paying what Michaels describes as a "tax" equal to "the cost of purchasing a priority-review voucher on the open market."⁹⁷

2. Financial Institutions

Financial institutions represent the most valuable repository of information about suspicious financial transactions. They not only clear hundreds of millions' worth of U.S. dollars each day, but also retain detailed

94. Michaels, *supra* note 93, at 1052.

95. *Id.* at 1052-53.

96. *Id.* at 1077. Michaels discusses coercive bounties to spur development of treatments for diseases afflicting third-world countries.

97. *Id.* at 1079.

financial and personal information about accountholders.⁹⁸ Since banks and their employees may not be disposed to initiate qui tam suits as relators,⁹⁹ financial institutions present especially attractive candidates for bounties. At the same time, their participation may be rather difficult to ensure given the norms of confidentiality and discretion that have long governed the banking industry, particularly in non-U.S. markets.

Despite, or perhaps because of, their persistent commitment to ensuring clients' privacy, banks are subject to reporting requirements under the Bank Secrecy Act (BSA).¹⁰⁰ Briefly, the BSA obliges financial institutions to keep records of cash purchases, report any cash transactions exceeding \$10,000, and file suspicious activity reports (SARs) alerting the government to possible tax evasion, money laundering, or otherwise criminal behavior, including sanctions evasion or terrorist financing.¹⁰¹ In 2001, the PATRIOT Act strengthened several money-laundering controls, increasing banks' obligations to monitor and report foreign correspondent banks and private accounts.¹⁰² Failure to file SARs can expose banks to civil penalties up to the transaction amount, with fines increasing if failure to file is found to be a willful.¹⁰³

Currently, the BSA reporting scheme contemplates both a negative and positive bounty for financial institutions. Focusing on the former, banks whose SARs are sufficiently comprehensive and judiciously filed are unlikely to be the target of a government investigation and civil fines (for BSA violations), which recently have reached upwards of \$450 million.¹⁰⁴ If avoidance of these fines represents significant savings (i.e., a negative bounty), it is puzzling why banks continue to violate BSA reporting requirements. Though we can only speculate about the complex risk calculus that banks assess when designing

98. Before opening accounts for new clients, banks conduct rigorous background investigations, performing Know Your Customer (KYC) and Anti-Money Laundering (AML) checks. See, e.g., *Know Your Customer & Anti Money Laundering – Customer Awareness*, CREDIT SUISSE GROUP AG (last visited July 23, 2014), https://www.credit-suisse.com/in/investment_banking/doc/important_info/aml_kyc_guidelines.pdf; *Account Opening and KYC*, STANDARD CHARTERED (last visited July 23, 2014), <https://www.sc.com/in/important-information/kyc.html>.

99. Given the near-daily news coverage of major financial institutions involved in litigation surrounding the 2008 financial crisis, it would be unsurprising if banks informally discouraged employees from embroiling themselves or the banks in any voluntary lawsuits.

100. 31 U.S.C. §§ 5311-5332 (2012).

101. *FinCEN's Mandate from Congress*, U.S. TREASURY DEP'T. http://www.fincen.gov/statutes_regs/bsa/ (last visited June 6, 2014); see also Matthew R. Hall, Note, *An Emerging Duty to Report Criminal Conduct: Banks, Money Laundering and the Suspicious Activity Report*, 643 KY. L.J. 651-53 (1995).

102. Pub. L. No. 107-56, 115 Stat. 277, §§ 312-314 (2001).

103. 31 U.S.C. § 5321 (2012).

104. In January 2014, J.P. Morgan paid a \$461 million fine for failing to report suspicious activity connected to Bernard Madoff's Ponzi scheme. *JPMorgan Admits Violation of the Bank Secrecy Act for Failed Madoff Oversight; Fined \$461 Million by FinCEN*, FINCEN (Jan. 7, 2014), http://www.fincen.gov/news_room/nr/html/20140107.html. In December 2012, the DOJ levied a \$500 million civil penalty against HSBC Bank for facilitating sanctioned transactions. HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement, JUSTICE DEP'T. (Dec. 11, 2012), <http://www.justice.gov/opa/pr/2012/December/12-crm-1478.html>.

procedural safeguards to monitor suspicious financial transactions, it seems safe to assume that too often they conclude that the benefits of retaining lucrative, if not totally aboveboard, clients outweigh the slim possibility of paying a civil fine years down the road. The same can certainly be said for small businesses for which the low risk of prosecution does not overcome the considerable costs of implementing safeguards to catch one-off transactions.¹⁰⁵ To remedy this imbalance, Congress should consider increasing the negative bounty awarded to compliant banks by raising the amount and frequency of penalties levied against bad actors.

Any increase in investigations and settlements demands a concomitant increase in resources, but the government can conserve costs by deploying private actors to report BSA violations and by rewarding them for original information that leads to a criminal fine or civil penalty (i.e. increase the positive bounty). Federal regulations already authorize the Treasury Secretary to reward informants the lesser of \$150,000 or 25% of the fine or penalty.¹⁰⁶ Yet, this provision has received scant attention, and there is little reason to believe that either the government or private citizens are taking advantage of it.¹⁰⁷ Perhaps it remains unknown to most bank employees¹⁰⁸ or its offer of reward is too insignificant to outweigh the costs, such as the effort of reporting the violation, the risk of job loss, or reputational harm.¹⁰⁹ Whatever the reason, the government can reinvigorate the bounty provision with minimal effort. First, Congress can increase the reward amount to offset the risks, both reputational and financial, of reporting. Second, it can encourage reporting with a modest outreach campaign that highlights the protections offered to whistleblowers¹¹⁰ and underscores the close connection between sanctions-violating transactions and terrorist acts.

Apart from enforcement costs, critics of our bounty regime might stress national security concerns similar to those raised by *qui tam* suits, as well as the hurdles to enlisting banks' participation. Like our *qui tam* solutions, our bounty solutions introduce private citizens into the traditionally public domains of foreign diplomacy and national security. However, unlike *qui tam* provisions,

105. Fitzgerald, *supra* note 1, at 980.

106. 31 C.F.R. § 1010.930 (authorizing the Treasury Secretary to reward any "individual who provides original information which leads to a recovery of a criminal fine, civil penalty, or forfeiture, which exceeds \$50,000, for a violation of [the BSA]").

107. A Westlaw search reveals only two citing references.

108. *Cf.* Fitzgerald, *supra* note 1, at 978 (discussing the minimal attention given to OFAC's enforcement activity).

109. The BSA contains whistleblower protections preventing discrimination against or dismissal of any employee who provides information to the Treasury about violations of the BSA. 31 U.S.C. § 5328 (2012). However, the shortcomings of federal whistleblower protections are well documented. *See, e.g.,* Richard E. Moberly, *Unfulfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 WM. & MARY L. REV. 65, 67 (2007); Robert J. McCarthy, *Blowing in the Wind: Answers for Federal Whistleblowers* 3 WM. & MARY POL'Y REV. 184, 186-88 (2012).

110. 31 U.S.C. § 5328 (2012).

which enable private citizens to initiate litigation potentially at odds with DOJ interests, the private bounty scheme reserves for the government the exclusive power of prosecution and compensation.

As to the question of whether financial institutions would participate in a bounty scheme, we acknowledge the obvious difficulties in asking banks to engage in prophylactic enforcement efforts. For one thing, these banks may be headquartered in countries hostile to U.S. sanctions. As a result, they may prove reluctant to antagonizing lucrative clients and correspondent banks in suspect countries, even at the expense of disrepute in America.¹¹¹ While we predict that these obstacles can be overcome, we concede that success depends in large measure on sizable increases in both the negative and positive bounties available.

C. Third-Party Ratings Systems

The final two solutions we consider are “free-market” enforcement mechanisms that would provide economic incentives for private enterprise to participate in sanctions enforcement. Such solutions, while substantively restricting free trade as any sanctions enforcement mechanism would, nonetheless could appear more politically palatable to interest groups predisposed to support trade liberalization because of their reliance on the private sector.

The first idea borrows a page from our domestic financial regulatory system, which relies heavily on third-party for-profit ratings agencies. Here, we consider the possibility of Congress chartering for-profit entities that rate the sanctions compliance of various financial institutions.

1. The Incentive Structures of Private-Sector Rating Agencies

First, we discuss the economics of modern credit rating agencies so that we can apply the model to sanctions enforcement. Despite their well-documented failings during the financial crisis, credit rating agencies remain an integral pillar of modern financial markets. The model is simple enough: efficient markets require perfect information, but information has costs.¹¹² Not every investor can scrutinize the detailed financial statements for every stock or bond that they might consider. In order to make smart decisions, investors pay for concise information about the creditworthiness and financial position of firms in which they invest. In the United States, an entire industry focuses on

111. Cf. Michaels, *supra* note 2, at 917 (noting backlash from global financial institutions toward U.S. intelligence-gathering efforts).

112. John Kiff et al., *Are Ratings Agencies Powerful? An Investigation into the Impact and Accuracy of Sovereign Ratings* (IMF Working Paper No. 12/23, 2012), http://www.economy.gov.ae/Arabic/DocLib/IMF%20Working%20Paper_CRAs_2012.pdf.

rating the creditworthiness of various firms.¹¹³ A few rating agencies—Standard & Poor’s, Moody’s, and Fitch—have earned enough credibility in the markets that investors are likely to invest in only those securities that these agencies have rated. In order to attract investors, the issuers of such securities are willing to pay the agencies to rate them. The agencies profit, while the market benefits from streamlined information.¹¹⁴

Besides their information benefits, rating agencies also provide the markets with monitoring benefits. Ratings are not fixed; they are revised periodically as a stock or bond’s credit characteristics evolve. Accordingly, the prospect of improving its rating encourages a firm to improve its own creditworthiness.¹¹⁵ Those two benefits of rating agencies—information and monitoring—will be useful when applying the agencies’ model to sanctions enforcement.

Of course, this very business model has been blamed as one of the root causes of the 2008 financial crisis.¹¹⁶ The chief criticism has been that since issuers themselves generally pay for the ratings, the agencies are incentivized to issue favorable ratings. Furthermore, critics assert that there was never any market mechanism to hold the agencies accountable for inaccurate ratings.¹¹⁷ Indeed, the lack of any public or private mechanism to ensure that higher-rated borrowers were actually less risky than lower-rated borrowers has generated the criticism that ratings agencies “ended up compromising the quality of their activities in order to facilitate the selling of services, and snatch or defend market shares.”¹¹⁸ We agree that both criticisms are valid and so evaluate them in the system for sanctions enforcement proposed below.

2. A Third-Party Rating Agency System for Sanctions Compliance

The same two problems that plague credit rating agencies also undermine sanctions compliance: a lack of information and a lack of monitoring. Financial market participants face the threat of “sanctions risk,” the risk of dealing with a firm that violates sanctions. Because financial institutions are highly sensitive

113. *Id.*

114. Alexander B. Mattheis, *Empirical Research on Corporate Credit Ratings: A Literature Review*, SFB 649 Discussion Paper 2013-003 (2013), <http://sfb649.wiwi.hu-berlin.de/papers/pdf/SFB649DP2013-003.pdf>.

115. See, e.g., Christina E. Banner & Christian Hirsch, *The Economic Function of Credit Rating Agencies: What Does the Watchlist Tell Us?* (2009), <http://www.frankfurt-school.de/clicnetclm/fileDownload.do?goid=000000228495AB4> (cataloguing a broad array of criticisms of credit ratings agencies and their role in the global financial crisis, including those cited here).

116. See, e.g., Elliott Blair Smith, *Bringing Down Wall Street as Rating Agencies Let Loose Subprime Scourge*, BLOOMBERG (Sept. 24, 2008), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ah839IWTL9s>.

117. *Id.*

118. Mauro Bussani, *Credit Rating Agencies’ Accountability: Short Notes on a Global Issue* (Aug. 27, 2011) at *1, available at <http://ssrn.com/abstract=1515285> (Working Paper). An earlier version of this paper was published at 10 GLOBAL JURIST 1 (2010).

to the risk that their counterparties may violate sanctions,¹¹⁹ institutions will prefer compliant counterparties.

As detailed in Part II above, the magnitude of sanctions risk is poorly understood because government enforcement agencies are under-resourced and ill-equipped to handle the massive volume of alleged sanctions violations.¹²⁰ Those same resource constraints also preclude the government from effectively encouraging compliance through readily available and accessible public communication.

If private sector firms were to dedicate themselves to performing audits of financial institutions, both of these problems could be addressed, at least partially. As with credit rating agencies, “sanctions compliance rating agencies” (hereinafter SCRA) could dedicate their resources to auditing the compliance procedures of financial institutions. If the SCRA had sufficient credibility in the markets, counterparties would prefer to deal with SCRA-rated firms because such dealings would involve less (or at least better understood) sanctions risk. Accordingly, financial institutions would be willing to pay to be rated. This arrangement would transfer the costs of information and monitoring to the financial institutions being monitored and would more efficiently distribute risk. Meanwhile, banks themselves would pay for the costs that risky behavior creates.

The benefits of this system, though, are not just economic. This system would strengthen American foreign policy not only by making sanctions effective, but also by aligning the enforcement tools with the private-sector-driven economic values so dear to American interests abroad. American interests in global trade negotiations and global financial regulatory negotiations will be strengthened if the United States can show its partners that its foreign policy is aligned with its economic values. In the absence of a private-sector enforcement mechanism, the presence of stringent sanctions regimes administered solely by the state is in some political tension with the appearance of the United States’ private-sector driven economy. The use of private ratings agencies is one form of “free market foreign policy” whereby the United States can achieve its broader foreign policy goals through effective sanctions enforcement driven by the private sector.

The difficult practical question is how such a system could get off the ground and build credibility. If the SCRA are not credible, banks will have minimal incentive to pay for a rating. A bank would prefer not to open its financial information and pay to be rated unless it faces the risk of some economic loss for not doing so. In the world of credit rating agencies, the agencies’ established market credibility provides incentive for issuers to allow

119. *OFAC Compliance in the Securities and Investment Sector*, 13 J. INVESTMENT COMPLIANCE 21, 21 (2012), http://www.treasury.gov/resource-center/sanctions/Documents/Emerald_OFAC_Article.pdf (“[R]obust communication of a firm’s OFAC obligations to its clients, affiliates, or counterparties to a transaction can mitigate OFAC risk.”).

120. See Jurdi, *supra* note 51, at 1.

themselves to be rated: the market will suspect that an unrated issuer or instrument is not creditworthy. We need to create a similar presumption for SCRAS.

Accordingly, we recommend that the government charter SCRAS, at least initially. Under such a system, financial regulators could promulgate a rule requiring that counterparties deal with SCRA-rated firms for transactions of a certain size or character. In fact, the government already requires that certain financial transactions be handled only by firms with active credit ratings in particular narrow circumstances.¹²¹ Such a state-chartered system could function as a substitute for the “credibility” that credit rating agencies have already earned.

Of course, such public sector involvement might negate one of the chief benefits of private-sector sanctions enforcement: alleviating the government’s financial burden. While this is an empirical question that the analysis of such a rule should undertake, public sector involvement under this proposal is of a materially different kind than that required by active enforcement. The public sector here has an expressive function: it confers the credibility of the state on the SCRA. Such expression has administrative costs, but because the rated firms would largely fund the agencies, the substantial costs of sanctions enforcement will have been effectively shifted to the regulated private sector, promoting cost internalization. This might not be free for the state, but it shifts the primary cost burden onto those at risk of violating sanctions.

Others might observe that the Dodd-Frank Act removes references to credit ratings agencies from a number of federal regulations,¹²² which militates against public approval or disapproval of a private ratings schema. Indeed, we believe that our proposal would also function best as a purely private endeavor; the difficulty we address with this public mechanism is the *novelty* of the SCRA market. The major national credit ratings agencies are—despite recent criticism—well-established and well-recognized. We invoke a small measure of public assistance here in order to support the nascent SCRA industry, and would hope that it might withdraw should the market become more established.

Would our SCRA model run any of the same risks that plagued rating agencies during the financial crisis? Rating agencies were blamed as contributors to the financial crisis for two primary reasons: first, the agencies’ incentives were misaligned since the companies they were rating paid them.¹²³ Second, there was no mechanism other than the free market for ensuring the

121. *Overview of SEC Regulations Surrounding Nationally Recognized Statistical Rating Organizations*, SEC. & EXCH. COMM’N, <http://www.sec.gov/rules/concept/34-34616.pdf>.

122. *See, e.g.*, Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934, Exchange Act Release No. 71194, 79 Fed. Reg. 1522 (Jan. 8, 2014).

123. *See* Maurice R. Greenberg, *Yes, but Eliminate Their Conflicts and Have Them Report to the SEC*, in *Do the Credit Rating Agencies Deserve to Exist?*, INT’L ECON. (Fall 2008), http://www.international-economy.com/TIE_F08_CreditRatingSymp.pdf.

ratings were accurate, and the free market failed to do so.¹²⁴ At first glance, similar problems might occur here: who will monitor the monitors? And if banks are paying, won't the SCRA be biased to give positive ratings?

Public sector involvement can help address those criticisms. The government can structure the market so that SCRA have an incentive to compete for *accuracy*, not for the favor of the firms they are rating. This could be accomplished in a number of ways. The federal government could pay bonuses to SCRA whose ratings prove especially accurate (as measured by giving high ratings to firms with no compliance issues and low ratings to firms that violate sanctions). Public support, in this case, would be limited to providing the financial incentive to perform well according to some objectively constrained criteria, such as—for example—never awarding the top rating to a firm penalized for a sanctions violation. The public sector would not be making any enforcement decisions in providing this bonus, so such a schema would not undermine the private character of SCRA behavior. It would only better align that private behavior with public values.

Alternatively, the government could impose negative penalties on agencies that do the opposite. Such ideas would shift the incentive structure for firms in favor of accuracy. Firms would still have an incentive to evade sanctions to the extent that the rewards of dealing with sanctioned parties exceed the cost of punishment times the probability of detection. But private rating agencies will have incentives to effectively establish accurate ratings in a way that government law enforcement agents, whose compensation does not depend upon effectiveness, does not.

To be sure, this model has other risks. First Amendment concerns make the regulation of such agencies difficult because regulating the content of their ratings could be considered a limit on the agencies' freedom of expression.¹²⁵ And while state chartering could impair the credibility on which current rating agencies rely, we lack empirical evidence to establish that this is true in practice.¹²⁶ Overall, however, this idea merits further study because of its foreign policy and economic benefits.

D. Enforcement Risk-Pooling Through "Sanctions Insurance"

Our fourth solution involves the chartering of private insurance companies empowered to pool risk and sell insurance for unintentional, non-criminal sanctions violations. Because most international regimes impose strict liability on violators without regard to any *scienter* standard, the complexity of the

124. See Haral MalmGren, *Yes, but Increased Oversight Is Essential, in Do the Credit Rating Agencies Deserve to Exist?*, *supra* note 123.

125. See generally Caleb Deats, Note, *Talk That Isn't Cheap: Does the First Amendment Protect Credit Rating Agencies' Faulty Methodologies from Regulation*, 110 COLUM. L. REV. 1818 (2010).

126. Kiff, *supra* note 90.

regulations and the opacity of ownership of many international financial institutions have given rise to several instances where firms have been held liable for unknowingly violating sanctions.¹²⁷ For example, one could be held liable for dealing with an international financial institution with a complex ownership structure and performing insufficient research to discover that the beneficial owner was an Iranian national; or accidentally paying life insurance benefits to a next-of-kin, without knowledge that the next of kin was a Cuban national.¹²⁸ Any firm risks violating sanctions unknowingly, even those with the best intentions. This creates a new risk for financial institutions, imposed on the market by sanctions regimes. Our proposed solution seeks to pool this “sanctions risk” across the industry. This solution is the most speculative of the four proposed here, and it requires the most radical shift away from the conventional understanding of sanctions enforcement. But it is also the solution, we believe, that bears the greatest upside for the domestic and foreign goals of sanctions implementation. Before we delve into the mechanics of how our risk-pooling regime might function practically, we consider the specific foreign policy goals best served by risk pooling.

1. Punish Sanctions Targets, not Domestic Actors

First, substantive discussions of sanctions enforcement often lose sight of the fact that sanctions do not exist to punish domestic financial firms. Sanctions exist to punish nations that the American government has deemed to be inappropriate trading partners. The idea is to make Iran’s economy suffer so that Iran curtails its nuclear program, not to squeeze J.P. Morgan’s bottom line. Whatever banks may think to the contrary,¹²⁹ the United States only punishes the banks insofar as their non-compliance weakens the government’s punishment of foreign nations. The primary goal remains the infliction of economic cost on other nations. The compliance costs that domestic financial firms face as a result of sanctions regimes are collateral damage. They are not a goal of U.S. foreign policy.¹³⁰ International banks, for example, scrambled to comply with the sanctions against Russia announced in the summer of 2014 as Moscow’s aggressive behavior in Ukraine persisted. While the first-order goal

127. For a catalogue of recent examples of unintentional sanctions violations, see Vincent J. Vitkowski & Stephen G. Huggard, *The Insurance Industry and OFAC Economic Sanctions*, EDWARDS ANGELL PALMER & DODGE (2011).

128. *Id.*

129. For a discussion of the current climate of hostility between regulators and the regulated community, see Part I.C.iii, *supra*.

130. Admittedly, since the 2008 financial crisis, there have been domestic political benefits to regulations that impose costs, or appear to impose costs, on Wall Street financial entities. See generally JONATHAN MACEY, *THE DEATH OF CORPORATE REPUTATION: HOW INTEGRITY HAS BEEN DESTROYED ON WALL STREET* (2013). Indeed, the fact that the domestic costs of sanctions have been focused on financial institutions has likely provided much of the political cover for the imposition of post-crisis financial sanctions on Iran, Russia, and others. However, as described at length in Part I, *supra*, such punishment was never a material goal of the imposition of sanctions for U.S. foreign policy.

of these sanctions is to inflict economic pain on Russia for deterrence and punishment, the existing policy prescription is placing immediate short-term costs on banks. Economic sanctions, in other words, always face inwards too.

Second, the problem is not limited to the fact that domestic banks are facing economic compliance costs for problems they did not create. The fact that sanctions are under-enforced—and that banks may be able to profitably evade them in certain circumstances—undermines the true foreign policy goals of economic sanctions. Rational actors in Tehran and Moscow can observe that threatened sanctions are not always executed. Under-enforcement fails to punish non-compliant banks, but worse, it signals to foreign sanction targets that sanctions are not economically relevant.¹³¹

2. Liability Insurance

Accordingly, we need a solution that (1) increases enforcement but (2) refocuses on the punishment of foreign sanctions targets rather than the punishment of domestic banks. We recommend shifting from a sanctions enforcement system that assigns fault and liability to domestic financial institutions toward a system of collective responsibility for the cost of unintentional sanctions violations. In other words, we seek a transition from a criminal-style enforcement regime that assigns liability according to fault toward a system that assigns liability to the aggregate.

Pooled insurance is one such scheme. Our recommended system would operate much like modern liability insurance for motorists. All parties at risk of a violation would pay into a common fund. When the government identifies a violation, the fund would pay, not the violator. The insurance scheme would shift our way of thinking about unintentional violations toward an “accidents happen” model. We would not assign societal shame or specific punishment on any particular violator, but on the aggregate through a common fund. This is the general approach to assigning negligence liability frequently advocated by Guido Calabresi in his seminal 1970 work, *The Costs of Accidents*.¹³² For instances where assigning liability to the entire pool minimizes aggregate costs, insurance funds can be more efficient than specialized criminal-style deterrence schemes.

As with the modern liability insurance model, it is critical that fund payments be limited to unintentional sanctions violations. Otherwise, the insurance scheme could have the perverse effect of encouraging violations because it removes the threat of punishments. Absent such a limitation, the

131. Of course, in some circumstances the American diplomatic goals might necessitate conveying the impression that sanctions are becoming less important. In such a circumstance, the benefits of the systems we propose here are less impactful, along with any mechanism that sought to increase the effectiveness of sanctions enforcement.

132. See generally GUIDO CALABRESI, *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* (1970).

scheme would incentivize active fraud to a degree that would offend criminal law theorists. Bentham and Kant agree on this much: insuring away criminal liability fails to provide for optimal deterrence and would eliminate any notion of rights-based culpability.

Furthermore, the fund should not provide unlimited insurance for violations. Some incentive not to recklessly violate the parameters of the sanctions regime, or, in more familiar terms, to remain a “safe driver,” must be maintained. The insurance cannot incentivize carelessness or intentional wrongdoing, or it will fail to appropriately enforce the sanctions regime. Accordingly, only some fixed amount of liability for unintentional sanctions should be an insurable interest. The insurable interest should be large enough to cover the size of typical unintentional sanctions violations frequently observed in the market while small enough to keep offending companies on the hook for larger transgressions. One initial estimate might place this at roughly half the largest sanctions violation liabilities, at roughly \$100 million. Each participating bank would insure its first \$100 million of cumulative sanctions liability, but any further liability would not be insurable. Alternatively—and extending the analogy to automobile insurance—the concept of “deductibles,” by which insured firms would be liable for initial violations but not beyond some limit, can also be helpful here. One drawback of a deductible-based system, however, is that once the insured party has paid the deductible in full, there is no further marginal deterrence. Both options, however, share the same underlying deterrence-based logic, seeking to pool most risk while internalizing some residual risk with the insured.

Of course, even a liability cap of the sort contemplated would still be subject to some moral hazard: a firm that has never committed a sanctions violation would still know that it has \$100 million of “consequence-free” transgression ahead of it, to continue the example above. However, we posit that this cost—a less-than-optimal incentive for small violations—is likely to be worth the benefits. Moreover, the liability cap could be sized dynamically in response to the size of the insured firm, in order to avoid gross mismatches between firm size and liability cap. As discussed more thoroughly in Part I, sanctions regimes are designed to inflict economic pain on sanctioned countries, not on the private business sector of the nation that applies the sanctions. That implies that the largest transactions are the most important, and the rational designer of a sanctions regime should accept some reduced deterrence of small violations in favor of more effective deterrence of large violations. And of course, while banks would face less of a disincentive to violate sanctions, they would face no incentive to conceal them, improving the enforcement regime.

This insurance program supports the notion that banks that commit unintentional sanctions violations are not at fault in any sort of a criminal sense. In the event such a violation were uncovered, a bank would file a claim against the insurance pool to pay its civil liability. As long as it is below the fixed

insurable limit, the pool would cover the expense. Of course, a further issue for exploration here is the incentive the schema would provide to firms who have committed *intentional* sanctions violations to cast those violations as unintentional. An insurance schema might guard against this risk by establishing bright-line standards for the sorts of clearly intentional violations not intended to be insurable—such as activity from which the violating firm benefited materially and abnormally. Truly “unintentional” violations are unlikely to drive such windfalls.

The insurance schema would serve the twin foreign policy goals of sanctions reform, improving enforcement and concentrating costs on sanctions enforcement, more efficiently than the current system. First, under-enforcement would become less of a problem, as banks would have no incentive to avoid *ex post* detection for unintentional violations below the insurable interest threshold. Banks themselves would become enforcement mechanisms. Furthermore, the cost-spreading benefits of generalized liability insurance would allow the collective financial industry to handle the costs with less economic damage than if the costs were concentrated. Thus, the bulk of sanctions’ economic impact would be focused not on domestic banks, but on the foreign targets.

Conclusion

Without robust enforcement, the American sanctions regime is a paper tiger. Yet even as this danger looms in full view, sanctions continue to be under-enforced and selectively enforced. Government agents charged with investigating and prosecuting violations of sanctions meet roadblocks at every turn, whether in the form of budget constraints or antagonism from regulated communities. Recognizing the current obstacles to enforcement, as well as the likelihood that American reliance on sanctions will continue to grow, we set out to design four solutions that maximize sanctions enforcement and enhance their economic efficiency. Specifically, we proposed introducing *qui tam* provisions into our statutory sanctions regime, strengthening government bounty programs, chartering sanctions compliance ratings agencies, and finally, shifting to a liability insurance paradigm for sanctions costs.

Taken together, our solutions aim to solve the most significant problems currently plaguing enforcement efforts. First, and most importantly, our proposals enable the government to partner with the private sector to an unprecedented degree, by implementing enforcement tactics that are commercially viable and attuned to the demands of business. Aligning the regulated community and the regulators as allies rather than adversaries, our solutions enable the government to tap into the private sector’s vast and vital repository of information. Relatedly, utilizing the resources of the private sector brings huge cost savings and helps alleviate the budget pressures partially responsible for today’s under-enforcement. Finally, our solutions

assign an important role to Congress, thereby helping to reduce interbranch dissension about enforcement priorities and adding a measure of oversight to the executive branch.

The four proposals we presented here vary in their scope, their costs, and their benefits. The largest divide is between our first two proposals, *qui tam* provisions and bounties, and our other two proposals, a private sanctions compliance ratings system and liability insurance for unintentional sanctions violations. The first two proposals can be understood as incremental reforms to the existing system, while the last two reflect a radical reimagining of the current enforcement strategy that assigns a central role to the private sector. All, however, recalibrate economic incentives to better execute foreign policy goals. At the same time, they are all high risk. Each of the solutions places considerable trust in market mechanisms to price sanctions risk and align incentives in the proper manner. Yet, as many in the national security field critical of pure economic analysis have duly observed, the free market does not always work. Whether such a central role is appropriate for the private sector is a deep democratic question that we do not address here. Among our four solutions, private rating agencies and liability insurance remain aspirational goals that will require considerable empirical study before implementation. *Qui tam* provisions and bounties are more conservative proposals that policymakers could execute without radical changes to the system.

Each of these solutions is subject to political constraints. The private sector does not like to be regulated, and the imposition of a new enforcement regime will provoke resistance among those who stand to lose from it. But the scope of our reforms is such that the weight of political constraint is mitigated: we do not propose new policies, merely new techniques of enforcement. The only way that private-sector actors stand to lose is through an end to under-enforcement. However, the claim that sanctions should remain under-enforced is a difficult position to take. Moreover, “self-regulation” has historically proved preferable to more onerous traditional regulatory regimes.¹³³

These are not “slam dunk” solutions. There are unanswered questions and the development of the details of any new enforcement regime will require empirical analysis that extends beyond the scope of legal scholarship. But we believe the balance of cost and benefit here demonstrates that further study would be fruitful, especially as geopolitical developments draw sanctions back into the limelight.

133. For example, the Financial Industry Regulatory Authority (FINRA) oversees the broker-dealer industry. Empirical data suggest that investors have traditionally found FINRA’s decision-making processes, such as those in the context of arbitration, sufficiently fair that they perceived no need to seek out traditional public-sector fora. See Barbara Black, *Is Securities Arbitration Fair to Investors?*, 25 PACE L. REV. 1, 3 (2004).