sanctions.

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We explore the key issues you need to know about and navigate to become both sanctions and AML compliant

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Sanctions & Anti-Money Laundering: Who are you really dealing with?

Although Sanctions Monitoring and Anti-Money Laundering (AML) often share common national security goals, their implementation and compliance efforts have distinct and separate requirements. However, both these issues place a solid burden on you to know who it is you are really trading or transacting with.

Failure to be compliant can have very significant implications for your organisation, and in some cases even officers of the organisation in their personal capabilities. Let us not lose sight that some sanctions can even have criminal consequences.

While criminally derived assets are subject to forfeiture and seizure under the many money laundering regulations, sanctions programs have historically emphasised freezing rather than seizing assets to achieve foreign policy goals. Typically, frozen funds are kept until sanctions restrictions are lifted whereas seized assets are rarely returned.

In addition to assets being frozen or seized, there are normally considerable fines levied on organisations or individuals that are involved in breaking sanctions or money laundering laws, whether wittingly or otherwise.

Sanctions are typically used to apply political pressure on hostile governments or regimes, such as those measures currently applied to Syria, Iran and North Korea. These assets are sometimes not just frozen but used to create "pools" of assets to;

- satisfy the interests of injured claimants and creditors against parties under sanctions; and
- aid the recovery of that country once sanctions are lifted, e.g. Libyan assets controlled by the toppled Gaddafi government were preserved during the recent civil war. Various sanctions levied against the Central Bank of Libya, and its subsidiary the Libyan Foreign bank, were lifted by the UN on December 2011. £26 billion was returned to the new government to assist it rebuild the country.

The blocking of funds or assets contrasts with the seizing or forfeiture that typically takes place under AML. A very recent seizing of funds happened when Costa Rican domiciled digital currency operator, Liberty Reserve, had its assets seized by United States Federal prosecutors in May 2013. US prosecutors charged and indicted the company itself, as well as founder Arthur Budovsky and six other employees, with money laundering and operating an unlicensed financial transaction company. Liberty Reserve is alleged to have laundered more than $6 billion in criminal proceeds. The court order issued was wide-ranging in its scope as it set out to seize the "financial products and services" of Budovsky and the other individuals in their personal capacities, including any associated accounts that they were deemed to control via directorships or other indirect ownership.

Yet the issues raised by sanctions monitoring and AML are not restricted just to companies operating in the financial services sector. Corporates of all sizes are affected more and more by the regulations either by being fined, having their products blocked during shipment or payments for goods being held within the international financial banking system. Typically because they do not historically have the more robust systems and procedures in place that correspondent banks use, the first time affected corporates become aware of the problem is when they get a letter or legal notice from a governing body asking them for information on a transfer of funds that has been frozen and reported by a bank.

Implementing sanctions monitoring and AML systems and procedures successfully can be costly and difficult. Tackling the complex international patchwork of regulatory and legal requirements, while continuing to serve clients locally can be challenging. There is the potential for significant reputational damage and

potentially large fines if adequate controls do not exist or work properly.

Sanctions and AML compliance is difficult and ever changing.

It could be said that staying sanctions compliant is like trying to "catch fire". It poses a threat and you could get burnt, it's ever changing and fuelled by various elements and once you catch it, what do you do to manage it properly?

Sanctions are normally applied by the international community for one or more of the following reasons:

- To encourage a change in the behaviour of a target country or regime.
- To apply pressure on a target country or regime to comply with set objectives.
- An enforcement tool to strengthen diplomatic efforts when international peace and security has been threatened.

To prevent and suppress the financing of terrorists and terrorist acts.

Financial sanctions are typically one element of a package of measures used to achieve one or more of these outcomes. These sorts of measures can vary from the comprehensive, such as prohibiting the transfer of funds to a sanctioned country (e.g. Syria, Iran and North Korea fall into this category on many sanctions lists) and/or freezing the assets of a government, named corporate entities or residents of the target country, or to targeted asset freezes on specific corporate entities or individuals (e.g. Russia).

Because each sanction programme is based upon a unique set of foreign policy imperatives, no two programmes are exactly alike. However, in developing any sanctions compliance response, the overriding objective organisations should look to meet is that they can provide sufficient information and tools to enable key staff to recognise suspect transactions and then allow a final and robust review by the ultimate sanctions compliance decision-maker.

While there are many sanctions lists that are relevant within national jurisdictions (e.g. US, UK, Canada and Australia), there are a few global and regional lists that require compliance on a wider basis. For instance, the UN Sanctions list is the primary global list due to the fact that all of 191 member states are meant to comply with the UN charter.

The bulk of the entities flagged on each list are often the same because each country generally incorporates the UN list within their own list. However, differences sometimes occur due to the timing of the country or region's legal framework. The main other source of difference is based upon political factors. For example, the UK and EU has now dropped most of the restrictions against Myanmar, but the US has not, it still has many entries on the OFAC SDN list.

The Myanmar example does raise some interesting questions. For instance, it is possible that although a UK firm is free to trade and transact directly into the Myanmar market, and is not in violation of any UK or EU sanctions laws, this UK firm may then be flagged on the US OFAC SDN list if it is dealing with an individual or an entity more than 49% owned by that individual. This could result in the seizure of the UK firm's US assets or result in any US subsidiary bank working in any third country, blocking any payments to or from the UK firm

The United States Office for Foreign Asset Control (OFAC) list is the most comprehensive due to the economic and political importance of the United States. Often non-US entities will screen against the OFAC list as well as any list that is a legal requirement due to their locality

Economic sanctions remain one of the biggest compliance challenges worldwide. Quite simply, there are just so many transactions every day, internationally, with so many parties, that it is very hard for most individuals, organisations

and even financial institutions to always stay abreast of those parties who are sanctioned. Most regulatory organisations often rely on financial service institutions to be the front line against violations because of their position in the financial clearing role they often play in the supply chain. Often smaller financial organisations, corporates and individuals only find out that they are in breach of a sanction once the authorities come to them following "suspicious activity" that has been highlighted by a financial institution in the payment chain.

Putting the basics in place for sanctions compliance.

Financial services organisations should establish and maintain an effective written sanctions compliance programme commensurate with their sanctions risk profile (based on a matrix of products, services, customers, suppliers and geographic)

However, that is easier said than done. There is a lot to do. An effective sanctions compliance program should include internal controls for identifying suspect suppliers, clients and transactions and reporting to the appropriate authority, whether conducted manually, through interdiction software, or a combination of both.

For screening purposes, the organisation should clearly define its criteria for comparing names provided on the appropriate sanctions list with the names in the organisation's files or on transactions and for identifying transactions involving sanctioned countries. The organisation should also address how it will determine whether an initial sanctions hit is a valid match or a false hit.

Checks should be carried out against the sanctions lists as soon as enough relevant information is available to minimise the risk of entering into a prohibited transaction. These checks should also be carried out on a frequent basis to ensure that someone the organisation is dealing with in the past hasn't now been added to a list.

Any sanctions compliance program should also include policies, procedures, and processes for timely updating of the lists of blocked countries, entities, and individuals and disseminating such information throughout the organisation operations. This would include ensuring that any manual updates of interdiction software are completed in a timely manner.

Any sanctions monitoring compliance programme must contend with a set of diverse and very fast moving parts, which add to the cost and difficult factor:

- 100 + different jurisdictions and legal regulations
- 40,000 + Names and Aliases on the lists (20,000+ on OFAC alone)
- 4 Billion + Fuzzy matching combinations
- 1 day – A list somewhere is getting updated every day
- $4 Billion + fines in last 12 months in US alone
- Typical common inadequacies within organisations when dealing with Sanctions
- Believe that individuals and entities on the list were all based overseas.
- Think that they are somehow exempt from the financial sanctions regime if they processed only low value transactions – there is no minimum limit.
- Believe screening is not necessary as they did not hold client money
- Unaware that transporting goods on a sanctioned ship or aircraft is prohibited.
- Failure to understand the difference between financial sanctions targets and politically exposed persons (PEPs). Most PEPs are not the subject of financial sanctions (although they may be)
- Believe customer due diligence checks for anti-money laundering (AML) purposes were the same as screening against the HMT list.

- Failure to screen against a list at the time of client take-on, screening only retrospectively, thus providing a service before screening had taken place.
- Failure to rescreen clients and transactions when a new list is produced.
- Unaware that they are responsible for the ultimate destination of goods when using distributors and third parties.

Whatever type of business you are involved in; if someone in the transaction chain is on a sanctions list, you are potentially committing an offense.

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