

Priorities of financial institutions around the globe and the key challenges facing the sector in 2021



Ian Bolton looks at the various challenges financial institutions around the globe are facing, how these challenges vary at different FIs and across different regions, and where there are commonalities.

I would like to begin by thanking all those heads of sanctions and sanctions compliance officers from a wide range of FIs who took the time to speak to me or provide contributions in preparation of this article. Whether on the record or off, your input was greatly appreciated, and without your valuable insights and contributions I would not have been able to produce this piece. Due to the number of sanctions compliance officers who spoke off the record I have decided to remove all names for consistency. I hope it will prove useful in giving a flavour of concerns across different jurisdictions and for different FIs.

Overview

In my discussions with sanctions staff at FIs, it was universally clear that 2020-2021 has been exceptionally busy, increasingly challenging, and complex time in the world of sanctions compliance. Whilst this will not be surprising to many readers, it is how FIs have responded to these challenges which has varied. For some FIs with well-established sanctions compliance programmes, it was the sanctions regimes themselves that caused the most significant challenges, such as the increasing sanctions on China. For others it was the interplay of international sanctions obligations with domestic law, such as in Latin America, where the rights of individuals to have bank accounts often trumps international sanctions policies. A further group of FIs, where sanctions compliance programmes are less well established, including in several African countries like Zambia and Kenya, the focus has been on developing

compliance frameworks and policies, whilst explaining the changing risk dynamic to customers.

Many FIs are undergoing substantial overhauls in their sanctions compliance team frameworks, screening programmes, and technology. In some instances, these decisions are to help decrease costs, whilst retaining a high-level of performance. In others, it is about further enhancing what already exists. In certain FIs across either emerging areas, such as cryptocurrencies, or in emerging markets, where sanctions concerns are stimulating change, like in Chile and Ghana, sanctions compliance teams and policies are being created and customers educated.

It is also clear that a period of political change is something that FIs are having to be mindful of. In the United States, we have the change of administration from Trump to Biden, and whilst sanctions remain a key tool for the US, exactly how they will be employed is changing. In Europe, we have had Brexit and the EU is coming to terms with this change and the resulting dynamic shift in some areas of EU policy, including on sanctions, where the UK had been traditionally very vocal. For the UK, the positives of the newfound ability to respond to issues quickly with autonomous sanctions is tempered by the lack of the weight of 28 Member States adopting the same measures. China and Russia are both increasing their own uses of autonomous sanctions, with China's blocking statute adding further complications. Sanctions at the

United Nations level broadly remain blocked to progress with a divided Security Council.

Even when looking on a more micro level regarding financial regulations, there have been changes in how they seek to implement and enforce sanctions regulations, such as with the new head of Office of Financial Sanctions Implementation ('OFSI') in the UK, and reviews by the Financial Action Task Force ('FATF') on their standards regarding cryptocurrencies and, separately, proliferation finance. It cannot be stressed enough how important it is for FIs to understand where regulators approach issues from and what their expectations are. Equally, it is important for regulators to understand the positions of the FIs, as the Global Head of Sanctions at Scotiabank, said, 'the work of FIs is where the sanctions rubber hits the road, and sanctions would likely not work without the implementation of the banks.'

Sanctions compliance programmes

Whilst for many FIs sanctions compliance programmes are now well established in 2021, for example HSBC first implemented a global sanctions policy in 2014, FIs are continuing to develop and build their programmes to meet the ever-changing risks they face.

Across most of Canada, the EU, US and UK, FIs are now well versed in sanctions compliance, with some exceptions, such as the Nordics. Within FIs in these jurisdictions the efforts around sanctions compliance programmes is increasingly focused on both efficiency and improving the ability of staff to accurately identify and then mitigate the risk. FIs here are seeing this as making sure

sanctions compliance is part of their business as usual, as a sanctions compliance officer at BNP Paribas explained. In this environment a key element is investing in new technologies to meet the challenges.

Looking at the Nordic region in a bit more detail, it is clear that there have been a number of sanctions and anti-money laundering ('AML') issues in the last couple of years, especially regarding activity in the Baltic countries, and Nordic FIs are undergoing a remediation process at the moment. In the view of a sanctions compliance officer at Danske Bank, the remediation is made up of:

- building controls to a greater level of maturity;
- recruiting the right staff and providing the right training;
- making sure that customer due diligence ('CDD') is at the heart of business activity; and
- managing domestic and international sanctions law in a more sophisticated manner.

In much of Africa and Latin America, the focus is on standing up sanctions compliance programmes, which to date have not necessarily been a priority in these markets, where sanctions are used less frequently domestically. According to a sanctions compliance officer at a bank in Argentina, much of the financial crime compliance focus until now has been around AML and anti-bribery and corruption, sanctions have had limited focus. However, in a number of markets this is changing, according to sanctions compliance officers at FIs in Ghana, Nigeria, Kenya and Chile, significant investment has recently been poured into their sanctions compliance teams and programmes. Although this brings new challenges in terms of educating customers to these types of risks and concerns.



SCREENING OF SECURITIES IS FRAUGHT WITH COMPLICATIONS, SUCH AS LACK OF DATA, AND FOR GLOBAL OPERATIONS DISPARATE AND DISCONNECTED SYSTEMS.

In several countries in the Middle East and the Association of Southeast Asian Nation ('ASEAN'), sanctions compliance teams have been established for a number of years and programmes are in some instances very mature, such as Singapore and the United Arab Emirates ('UAE'). Nevertheless, investment has been increased, in part due to the growing complexities of the sanctions environment both internationally and domestically. A sanctions compliance officer at a bank in the UAE pointed to the enforcement case involving the Turkish HalkBank in the US, and action by the UAE Central Bank regarding a number of banks in the UAE, as showing the need for FIs to remain alert to sanctions risk. In the Philippines and Malaysia, as just two examples from ASEAN, there has been progress in the last year regarding domestic legislation over export controls and other sanctions measures, including asset freezing. Whilst these are not in force yet, banks in the region are looking to build their sanctions compliance teams in anticipation of growing complexity.

Technology

The growing abilities of technology to decrease the sanctions compliance burden, and help eliminate some of the noise and complexities, is meaning a lot of FIs across

2020-2021 are investing heavily in this area. For some FIs, it is about 'partnerships with sanctions-tools providers' as one sanctions compliance officer at a Kenyan bank explained. For others, it is about seizing the opportunities presented by the latest developments in machine learning, also referred to as artificial intelligence ('AI'). Integrating third-generation screening tools is in some cases a slow process, in part, as one sanctions compliance officer at a European FI made clear, because 'if the machine gets it wrong you are still at fault'. However, it is fair to say that for some major FIs, such as HSBC and Citibank, AI screening is being fully adopted and mainstreamed. This is because, as a sanctions compliance officer from BNP Paribas highlighted, AI screening has the ability to eliminate false positives, allowing sanctions staff to focus on the more complex cases and real sanctions risk.

However, as a sanctions compliance officer at a leading Canadian bank highlighted 'screening of securities is fraught with complications, such as lack of data, and for global operations disparate and disconnected systems'. This view and concern was echoed by sanctions compliance officers at ICBC and a number of UK international banks. According to all, the reality is that in this area the importance of trained sanctions compliance staff cannot be underestimated.

Several FIs are focusing on refining their CDD tools and, as a sanctions compliance officer at a German bank made clear, it is vital that, with an increase in CDD information, FIs have the right tools to handle this information, ensuring it is seen by the right people whilst protecting data. Being able to manage this information in an appropriate manner that allows for risk mitigation was something that was also highlighted by a sanctions compliance officer at a leading bank in Pakistan. Finally, investment in case



management tools is a focus for several FIs, with sanctions compliance officers at BNP Paribas and other European banks highlighting this as an area of focus, to increase staff efficiency and their ability to identify regulatory risk.

Trade and maritime measures

Trade sanctions and maritime compliance are becoming an increasing focus for a significant number of FIs. On trade this means increasingly looking to develop the skills, training and understanding of staff to interrogate dual-use goods lists and understand export control regimes. However, it is a complicated area and often FIs do not have enough information available to them to be able to make determinations regarding goods, even where they do have staff with the right skills. When looking at trade measures a sanctions compliance officer at a leading German bank highlighted that having the right staff is vital to being able to carry out work on proliferation finance, to be able to understand the trade flows and potential usages of the goods. However, the officer also made clear that sanctions staff at banks are not specialists in goods, and therefore it can often be unreasonable to expect banks to understand the risks posed by some goods. There is a strong belief among many FIs

that more assistance from governments and multilaterals, such as the UN and EU, is needed regarding the role of FIs in implementing trade sanctions.

On maritime compliance and ensuring vessels being used by customers of FIs to transport their goods are not being used to evade sanctions, FIs have increased both their own understanding of what is required, and how best to mitigate the risk. FIs are increasingly turning to third-party compliance consultancies to understand the ownership structures around vessels, and also to be able to track vessel movements and activities. There is a concern that asking FIs to do this can have a detrimental impact, however, on an FI's ability to carry out financial sanctions compliance, given banks do not have limitless resources they can utilise on compliance. FIs did welcome the guidance that both the US's Office of Foreign Asset Control ('OFAC') and the UK's OFSI published in 2020 on sanctions compliance in the maritime domain.

Cryptocurrencies, blockchain and ransomware

Significant numbers of FIs are increasingly focusing on the technological developments of cryptocurrencies and blockchain, as well as the issues surrounding ransomware



THE POTENTIAL USE OF SECONDARY SANCTIONS, BY THE US REMAINS A KEY FOCUS FOR MANY FIS.

attacks. Ransomware attacks are providing FIS significant pause for concern, in most cases this is not because of attacks on the banks themselves but rather on their customers. Working with customers who have been the victim of ransomware attacks, and trying to establish what, if any sanctions risk there may be in paying a potential ransom, is proving difficult according to a sanctions compliance officer at a major US bank. It has been further complicated by regulatory notices from OFAC and the Financial Crimes Enforcement Network ('FinCEN') in 2021, which have placed significant responsibility and onus on banks when facilitating their customers paying a ransom in this way.

Cryptocurrencies are increasingly part of the mainstream financial system. However, many FIS remain wary around cryptocurrencies and exchanges. As a sanctions compliance officer at a Canadian bank stated, 'cryptocurrencies and exchanges are here to stay and therefore traditional FIS will have to respond'. Despite this assessment, several FIS are reluctant to engage, for example ICBC are currently not processing cryptocurrency payments, nor looking to onboard cryptocurrency exchanges.

According to a sanctions compliance officer at ICBC, they are very interested in the potential use of blockchain and how it may provide greater visibility and security around

trade transactions. Blockchain is already being utilised in the trade of particular minerals, such as cobalt. However, for blockchain to really be useful it is important the information is shared with the right people and at the right time, i.e., before the trade is already in motion. This was something few other FIS mentioned, however, it is something that has been increasingly discussed by manufacturers/suppliers and logistics companies as potential ways to mitigate some sanctions risks.

Secondary sanctions and conflict of law

The Global Head of Sanctions at Scotiabank highlighted the growing conflict of international and domestic laws around sanctions as an area of considerable focus for them. This was echoed by many other FIS. To many FIS, it seems the complications of having to abide by domestic banking laws and prudential regulations is often in conflict with abiding by sanctions regulations, both domestically and internationally, especially where for example there is a US nexus.

A particular issue that was highlighted by several US and Canadian sanctions compliance officers revolved around the need to abide by domestic laws across Latin America to provide bank accounts, versus the concern of having potential customers who are designated for sanctions on their books. Amongst European and British FIS there is an increasing feeling of being caught between EU/UK legislation and US legislation on sanctions, and risks around over compliance. Several sanctions compliance officers at European banks, including in Ireland, France, and Germany, said they are keeping a close eye on how the UK's autonomous sanctions regime develops, and whether there will be any extraterritorial risks/concerns for them.

The potential use of secondary sanctions, by the US remains a key focus for many FIS. FIS have been watching the Biden administration carefully for any

clue as to the role secondary sanctions will play for them. To date the indications regarding Russian and Chinese sanctions look positive suggesting, that secondary sanctions may not be a key tool for the Biden administration. Concerns regarding secondary sanctions seem to be particularly high amongst European, Indian, and ASEAN FIS. One sanctions compliance officer from India, for example, highlighted the concerns around India's purchase of Russian anti-aircraft batteries, due to be completed by the end of 2021, as a key test of the Biden administration's position on secondary sanctions.

Sanctions regimes

The number one issue for almost all FIS, and everyone I spoke to for this article, was the ongoing use of sanctions by the US, UK, EU, Canada and Australia, on China and China's countersanctions. International multijurisdictional FIS, that have significant exposure in the Far East, especially in China, are particularly caught in the middle of the growing sanctions by both sides. They face having to make decisions between potentially key markets, as well as involvement in international trade. Often FIS are having to develop local sanctions policies covering Hong Kong, Macau, and China that differ from their global sanctions policies, such as in the case of HSBC and Standard Chartered Bank.

In Canada, there is a very heavy focus on the human rights abuses in China but in common with many other FIS, a sanctions compliance officer from a leading Canadian bank highlighted the confusion caused by the US Executive Order 13959, and the sense that the Biden administration is unlikely to 'back down in terms of the geopolitical tensions between Washington and Beijing'.

For India, the sanctions on China come at a time of increased tensions between India and China as well. However, Chinese investment

and businesses in India are significant and this has a sobering effect. An Indian sanctions compliance officer pointed to the dominance of Huawei in the Indian market as just one example of the complicated picture for Indian FIS when dealing with China.

The Global Head of Sanctions at Scotiabank highlighted, for FIS it is not just trade between China and Western countries where the impact of these sanctions is being felt, but also in areas of the world where China has invested heavily, both in companies and infrastructure, through programmes like the 'Belt and Road Initiative'. This is true across Latin America, ASEAN, and Africa and, as one sanctions compliance officer at a leading South African bank made clear, it is impacting their ability to raise capital for these projects.

The developing Chinese sanctions regimes, blocking statute and China's aggressive resistance to the West's sanctions regarding Xinjiang, are all causing considerable concern amongst Western FIS. This is especially true of EU banks given the recent rise in rhetoric between the EU and China.

On Russia, FIS are breathing a slight sigh of relief that the recent US sanctions on sovereign debt was restricted to the primary market as this has a more limited impact. However, the sanctions activity around Nord Stream 2 is certainly proving an area of concern for several European banks. A sanctions compliance officer at Danske Bank made it clear that they view this US Executive Order as mapping out the US position, although the key will be around how it is enforced. A number of FIS in the US and Canada believe the US sanctions on Russia are only likely to increase as there is bi-partisan support for this in Congress. Within the EU and UK, sanctions compliance officers highlighted the increasing use of sanctions relating to human rights abuses in Russia, as well as cyber and chemical attacks, as areas to

watch, and that their FIs were focusing on mitigating Russian exposure.

For FIs in ASEAN, Europe, Australia, Canada, the US, and UK the ongoing coup and turmoil in Myanmar is a particular focus. A lot of the focus is on the raw materials and minerals coming out of Myanmar, and on ensuring that assets belonging to the military leaders are identified and correctly frozen. For Nordic banks a number of their customers have exposure in Myanmar, especially in the textile trade, and mitigating this risk is becoming a priority. As a sanctions compliance officer at Danske Bank made clear 'it is not just about mitigating sanctions risks but also about ethical business practices'. Additionally, some of the concerns here are related to Chinese investment and the involvement of Chinese companies to prop up the military regime.

FIs across the world are watching developments with Iran closely, as talks continue between the P5+1 (the five permanent UN Security Council members and Germany) and Iran regarding the US re-joining the Joint Comprehensive Plan of Action ('JCPOA'), also known as the Iran nuclear deal, and whether Iran will return to full compliance. The assessment of several sanctions' compliance officers from the US, British, Canadian, and European FIs is that a deal may be likely, but the reality is that many FIs will retain limited risk appetite for engaging with Iran. There are many wider financial crime concerns with regards to operating in Iran, and for many FIs this, and the possibility of sanctions snapback/other countries pulling out of the deal, make investing in and supporting business in Iran a risk that cannot be easily mitigated. For FIs in the Middle East, this is of less concern, however dependent on where the FI is based there may be domestic concerns that prevent re-engagement should the US re-join the deal. According to one sanctions

compliance officer at a major UAE bank, even if the US re-joins the JCPOA, they are unlikely to re-engage in business with Iran given the regional dynamic and the UAE's own concerns over Iran's behaviour.

Other sanctions regimes and concerns

Of the other sanctions regimes, FIs seem to be largely focused on Venezuela and Cuba. For several European and British banks, there is a focus on the US sanctions regime on Cuba, where there is a hope that the Biden administration may look to ease some of the measures that were re-introduced by the Trump administration. The focus tends to be on inward investment into Cuba, and holidays by European nationals. With regards to Venezuela, there is concern around the methods Venezuela has employed to evade sanctions, with even Indian FIs paying attention to this and looking to mitigate risk. There is also a watching brief regarding what the Biden administration's much vaunted sanctions review will conclude regarding the unintended consequences of US sanctions on Venezuela. A few FIs named Turkey as a country they are concerned may end up being sanctioned given current developments, and there is a watching brief around the human rights abuses and increasing lack of democracy. However, the position of Turkey as a NATO member and close to the EU throws up significant questions as to the likelihood of sanctions.

Human rights sanctions regimes, such as the Magnitsky-style regimes across the US, UK, EU and Canada, are becoming increasingly important for FIs for a number of reasons. These global programmes are not constrained to any specific country, and this causes significant complications when trying to horizon scan for sanctions risks and mitigate by exiting relationships. Their global nature also means that businesses and FIs in countries where there are not sanctions

must be increasingly vigilant. As one sanctions compliance officer at a South African bank stated, the designation of the Guptas by the UK government, whilst predictable, has meant South African FIs are having to review their customer base, especially when they may have British operations. Equally, the use of the programmes seems to be increasing in frequency, and often bringing countermeasures by countries like Russia and China when their nationals are designated.

Conclusion

It was clear from discussions across the different FIs and sanctions compliance officers that a broad number of sanctions issues stand out for all, and across most jurisdictions. However, it was also clear that why these issues mattered often varied region to region, and there were both subtle and significant differences on priorities away from these issues. The clearest priority is the relationship between China and the US, and how sanctions are used. There is a particular focus on Hong Kong and the implications for its financial centre. As a sanctions officer based in Hong Kong at one of the leading international banks made clear, 'large multinational FIs are having to rethink how they apply global sanctions policies, and in some circumstances adopt local sanctions policies to cover Hong Kong and China'. This is despite OFAC once again, on 18 May 2021, not listing any FIs as having significant dealings with those designated in Hong Kong under US sanctions measures.

The use of sanctions on Russia by several countries, including the US, UK and EU Member States, is another key area. There remains a lot of concern around the direction of talks with Iran on the US re-entering the JCPOA, and what the Iranian elections in June may mean, and ultimately whether any of this will encourage greater business with Iran, especially for FIs. It was clear that Myanmar is the biggest growing concern with regards



COMPLIANCE IS NOT JUST ABOUT MITIGATING SANCTIONS RISKS BUT ALSO ABOUT ETHICAL BUSINESS PRACTICES.

to sanctions implementation over the last 12 months, especially given the degree of state ownership and affiliation with key businesses. Beyond this, the growth of human rights sanctions and their use by the US, UK, EU, and Canada is something most sanctions compliance officers are watching keenly, and shows that country specific sanctions policies will not cover all circumstances. These thematic regimes, including the UK's recent anti-corruption regime represent a real challenge for FIs. As a sanctions compliance officer in a leading British bank made clear, thematic regimes make the opportunities for horizon scanning for possible new designations and measures that much more difficult. Venezuela remains an area of concern not just for FIs working across Latin America, but also given Venezuela's interest in cryptocurrencies and successes in sanctions evasion, elsewhere across the globe.

An interesting trend that emerged from the discussions with various FIs and sanctions compliance officers was that the DPRK is not a major concern for most. It rarely came up, and when it did it was largely through the prism of ransomware. In many ways I did not find this that surprising, and in my own assessment this is likely due to two factors. Firstly, the restrictions on the DPRK, as set out under UN Security Council Resolutions (and

enhanced by several countries including the US, EU, and UK) are amongst the toughest of any sanctions regime currently in use, and could be said to be comprehensive in nature. Secondly, the last time UN sanctions on the DPRK were tightened is in 2017, and throughout much of the Trump administration there at least appeared to be less tension with the DPRK (although not at the start), who refrained from significant testing of nuclear capabilities or ballistic missiles. This has meant from an FI perspective the sanctions have remained relatively stable and predictable to implement, and by and large, except for humanitarian aid, the DPRK is a jurisdiction few, if any, FIs will interact with.

Away from specific sanctions regimes causing concern, or being prioritised by FIs, heavy investment in adopting and refining sanctions compliance policies, and the technology these are reliant on, such as screening is a focus. Third generation screening solutions

are being utilised increasingly by FIs. Machine learning is allowing them to refine the three levels of defence in sanctions compliance. The increasing integration and understanding of non-financial sanctions within FIs is also a welcome improvement, with banks like ICBC, HSBC, and BNP Paribas now incorporating export control screening into their systems. The increased focus within FIs on the maritime sector, and how international trade flows, is also notable. Across all of this, FIs are increasingly working with compliance-related companies and organisations, such as Polestar, Windward, Kharon and Chainalysis, to better mitigate their risks. It is also important to note that FIs remain committed to offering sanctions-specific training to their staff, with the likes of the Association of Certified Anti-Money Laundering Specialists ('ACAMS') and the International Compliance Association ('ICA') proving ever more popular, and new partnerships being established

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such as that between the ICA and UK Finance.

Whilst the FIs are monitoring developments in the sanctions world closely, adapting to changes as necessary, and continuing to spend significantly on sanctions compliance, including the latest technologies, it is unlikely there will not be further significant fines by regulators, such as OFAC and OFSI, on FIs. The work of FIs may seem on the surface to those from outside the industry as straightforward and clear, but the truth is this

is far from the case. The very nature of the work FIs do, the support to international trade they provide, and the lack of information they often have when completing work, such as processing payments, means it is almost inevitable FIs will make mistakes. The reality is that operating in such 'interesting times', often across multiple jurisdictions, and dealing with complex, sometimes vague, and frequently conflicting legislation, means those mistakes may often lead to sanctions breaches and fines despite FIs best efforts. ✓

