Central banks and sanctions: What's the deal?

Ian Bolton examines the complicated relationship between central banks across the globe and sanctions. Often central banks play a role as regulator, equally they may themselves be the subject of sanctions. Finally, they play a role in pushing forward the world of FIs and therefore find themselves at the forefront of developments like crypto-currencies which may have significant sanctions implications.

Central banks play an important role in a country's financial and commercial system. Typically, a nation's central bank manages that nation's currency and the monetary policy of the State. They also typically oversee the commercial banking system and act as a supervisor and regulator. In most developed countries, the central bank is independent of political interference, although even then there is normally some control by the executive and legislative bodies within the country. For example, in the UK the Governor of the Bank of England is appointed by the government. In other jurisdictions, despite the World Bank and International Monetary Fund supporting central bank independence, they are seen as an integral part of a government's administration.

Given all of this, it is natural to ask: What is the role of central banks in the world of sanctions?

When people think of central banks and sanctions the obvious link for most is that central banks may act as implementors and enforcers of financial sanctions, regulating the FIs that operate in their jurisdictions. However, this is not always the case, nor is this the only role that a central bank may play when it comes to sanctions. Indeed, a central bank may play no significant role at all. The other obvious link is that central banks may themselves become the target of sanctions, most recently seen in the designation by the US of the Afghanistan Central Bank and the freezing of its assets.

Therefore, there is not a one-size-fits-all response to the question of sanctions and central banks, nor how FIs should seek to manage their relationships with central banks.

The role of central banks

A central bank is an FI that is tasked with, and given control over, the production and distribution of money, such as the US Federal Reserve which prints and distributes US dollars. A central bank will also be in charge of a country's credit and interest rates. This means that it often falls to the central bank to decide on interest rate rises and cuts, such as the recent interest rate cut by Turkey's Central Bank on 23 September.[1] Additionally, central banks are typically in charge of a country's monetary policy and the regulatory framework by which banks active in its jurisdictions must operate. In some cases, such as the UK, central banks regulate through prudential regulators. In the UK this is the Prudential Regulation Authority.[2] Some of the roles prudential regulators fulfil are ensuring the solvency of FIs in its jurisdiction, and strengthening accountability of FIs.

Often central banks will work with other key regulators and government departments such as the Financial Conduct Authority ('FCA') in the UK, which was established in 2013 and tasked with supervising the conduct of FIs within the UK.[3] In this role as a regulator of the financial sector, central banks may be responsible for implementing and enforcing sanctions.

In extremis, central banks may also be a lender of last resort for FIs and the government if they are in financial difficulties. In the case of FIs, the impact on citizens would be significant.

Regulator

As seen, commercial FIs operate under the rules set out by central banks, and typically under the supervision of the prudential authority that sits within them. Specifically, central banks are likely to set not just the rules for operating within the jurisdiction, such as financial reserves, but also policies and guidance to ensure accountability and fairness of competition. In most countries commercial FIs require a banking licence to operate, which will be administered by the central bank. Both in their own right as central banks, and through their prudential authority, central banks will monitor banking operations and may take enforcement action should a situation warrant it. When it comes to combating financial crime, almost all central banks will play some role within a country's wider efforts. Exactly what this role is can vary significantly, from preparing guidance for FIs to implementing and enforcing financial crime regulations, such as sanctions.

Central banks and sanctions

When it comes to how countries implement and enforce financial sanctions, every country is unique. Given this, the involvement of central banks is often unique to the individual jurisdiction being considered. In some countries, such as the UK, the central bank plays a limited role in sanctions implementation and enforcement, although often this is due to changes in the ways financial sanctions have been implemented over the preceding years.

In the UK, when sanctions, including financial sanctions provisions, were first used as part of a wider foreign policy toolkit, whilst the policy was owned by Her Majesty's Treasury ('HMT'), the implementation and enforcement of financial sanctions was devolved to the Bank of England, who established the Financial Sanctions Unit. It was for the Bank of England to ensure that the FIs they regulated abided by sanctions and implemented the necessary asset freezes, etc. This changed on 24 October 2007, when the responsibility for administering financial sanctions in the UK transferred back to HMT.[4] From this point on, the Bank of England had little involvement in financial sanctions implementation or enforcement except through the FCA, who limit their role to an expectation that FIs have systems in place to manage financial sanctions obligations.[5]

In other countries, like Ireland and the UAE, the central bank is the relevant regulatory implementation and enforcement body for financial sanctions.

The Central Bank of Ireland is the relevant authority for all EU financial sanctions within Ireland, whether these are EU autonomous Restrictive Measures, or as a result of a UN Security Council resolution.[6] As such, the Central Bank of Ireland will issue financial sanctions updates, and require FIs and all relevant persons to supply it with information relating to suspected financial sanctions breaches. The Central Bank of

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Ireland will also issue penalties in Irish law for a breach of EU financial sanctions under the authority of the Minister for Finance. The Central Bank of Ireland will also issue guidance for FIs on their obligations under financial sanctions.

In the UAE, the Central Bank of the UAE ('CBUAE') is responsible for implementing and enforcing financial sanctions.[7] The CBUAE, as with most central banks, will often look to work with FIs to remedy potential shortcomings with regards to financial sanctions, as well as fining the firms where appropriate, such as the fine on 14 September of six exchange houses operating in the UAE,[8] or the fines of 11 banks in January 2021.[9]

Central banks can often play a role in financial sanctions implementation and enforcement without being the principle agent.

In the US, the Federal Reserve forms just one component of US financial sanctions implementation and enforcement mechanism, alongside OFAC, the Department of Justice and individual State bodies like the New York Department of Financial Services. The Federal Reserve Board ('FRB') will often act where other US agencies have identified, and potentially enforced, financial sanctions breaches by FIs. Often the FRB will take action where the sanctions breaches amount to more than one-off incidents, and instead are indicative of wider failings in conduct by the relevant FI, such as controls and policies. The FRB's $164 million fine of Standard Chartered Bank for its 'unsafe and unsound practices relating to inadequate sanctions controls' issued in April 2019[10] is a helpful example of this. In such cases, the FRB will issue fines and potentially agree a term of ongoing review into sanctions policies and controls within the FI by the FRB. The FRB, in fulfilling this responsibility, has issued significant fines against a range of US and foreign-owned banks for over a decade, including HSBC, Standard Chartered Bank, BNP Paribas, Société Générale S.A., MetLife, and Citibank. Despite this it is far more common for OFAC to level fines at FIs for financial sanctions breaches in response to specific cases.

When central banks become sanctioned

Whilst the exact role central banks play in the implementation and enforcement of sanctions may vary, all central banks can face the reality of becoming a sanctioned entity under the right circumstances. Although many central banks are autonomous institutions, and therefore not considered to be government agencies, the close links maintained by some central banks to their governments can mean they are seen as legitimate targets for sanctions. Despite this, the US, UK and EU are the only jurisdictions that have sanctioned central banks to date.

Iran: US sanctions have been in place on the Central Bank of Iran for over 20 years. Whilst they were lifted in 2016 as part of the implementation of the Iran Nuclear Deal, President Trump re-instated sanctions in September 2019, for their alleged involvement in financing attacks on Saudi oil fields, and financing both Hizballah and the Iranian Revolutionary Guard's Quds Forces. The September 2019 sanctions included provision for secondary sanctions. For FIs this has brought significant risk if any transactions they conduct with the Central Bank of Iran are deemed to be 'knowingly significant transactions'. This had an unintended consequence on the delivery of humanitarian aid to the country. In response, OFAC issued a general licence covering the involvement of the Central Bank with regards to humanitarian transactions.

Venezuela: As part of the US response to the ongoing crisis in Venezuela, on 17 April 2019, pursuant to Executive Order 13850, the Central Bank of Venezuela was designated,[11] including sanctions measures against key individuals within the Bank. Again, there were

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questions over the potential unintended consequences on humanitarian aid, although OFAC issued FAQs that made it clear such transactions were still allowed.

North Korea: The US also has sanctions on North Korea's Central Bank, first applied in September 2017. This designation listed the Central Bank as a blocked agency controlled by the North Korean government. This effectively cut off North Korea's Central Bank from any transactions involving US Dollars, and made it even more difficult for FIs to support humanitarian efforts in North Korea.

Ukraine: The US has also sanctioned the Donetsk People's Republic Central Bank, although this has had limited impact given the breakaway province's lack of international recognition outside of Russia.

Syria: The EU, UK and US all have sanctions in place on the Central Bank of Syria. For the US, the sanctions focus on discouraging investment in government-controlled areas of Syria. OFAC also has concerns that the Central Bank has links with terrorist networks across the Middle East. By designating the Central Bank, it makes it more difficult for the bank to support these organisations. For the UK and EU, the sanctions focus on the Central Bank providing funds and support to Bashar Al-Assad's regime.

Afghanistan

Finally, in mid-August, following the fall of the Afghan government and takeover of the country by the Taliban, the US sanctioned the Afghanistan Central Bank,[12] focusing on an asset freeze to prevent the Taliban from using the nearly $9.5 billion in assets.

In all six examples, whether it is a US, UK or EU listing, the impact of designating a central bank is significant. Designating a central bank effectively cuts off that market to any FI from the sanctioning jurisdiction. It also cuts off that market from trading in those currencies. In each case it is possible to see an impact on humanitarian aid and support. In many ways, designating a central bank is the nuclear option of sanctions.

Innovators in the banking world – CBDC?

Away from traditional sanctions, it is also worth noting that in the ever-increasingly complicated world of crypto-currencies there are significant roles for central banks, and this can have a sanctions dynamic. A number of central banks are considering the creation and use of central bank digital currencies ('CBDC'). Indeed, in April 2021 the Bank of England and HMT established a joint taskforce[13] to explore the use of CBDCs and encourage the growth of the FinTech sector in the UK. In adopting CBDC there are possible sanctions risks and opportunities. Crypto-currency remains an area with little regulation, and CBDCs could be one way to overcome this. In other examples, Venezuela's Central Bank worked with the Maduro government and attempted to adopt a crypto-currency, the Petro, to evade sanctions on the country. The Petro was first launched in February 2018, with limited success. In September 2021, El Salvador became the first country to adopt Bitcoin as legal tender, a move instigated by the government but criticised by the Central Bank of El Salvador. CBDCs and wider crypto-currencies represent a key convergence, therefore, between sanctions and central bank activity.

Conclusion

For FIs, how to work with central banks on sanctions depends on their specific role in a particular country. It is therefore important to ensure that FIs understand the role of the central bank in the markets they operate in.

FIs that are looking to operate in jurisdictions where the central bank has been designated must have a strong compliance programme to ensure that activity does not cause a sanctions breach. Additionally, FIs should make certain they take sufficient time to understand the compliance picture of any transactions in these jurisdictions, and document any relevant decisions. This said, it is important to also note that in almost all examples of sanctions on central banks, those using sanctions have made provision to support humanitarian assistance.

Links and notes

1 https://www.reuters.com/business/turkish-central-bank-surprises-with-rate-cut-sought-by-erdogan-2021-09-23/
2 https://www.bankofengland.co.uk/knowledgebank/what-is-the-prudential-regulation-authority-pra
3 https://www.fca.org.uk/about/the-fca
4 https://web.archive.org/web/20080529145459/http:/www.bankofengland.co.uk/publications/financialsanctions/statement071010.pdf
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