

Financial crimes observer



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Sanctions: Real impact or fake news?

While the last several months have seen a number of headline-grabbing statements by President Trump on sanctions, the reality is that actual changes to policies have been – and will likely continue to be – less impactful than his statements would indicate.¹

Despite the President's threats to impose tougher sanctions on Iran and Cuba as well as withdraw from the Iran nuclear deal, the results have proven to be little more than noise. With respect to Russia, the Trump Administration has done even less. Even though the White House faced a Congress-imposed deadline last month to impose additional sanctions on entities that conduct business with the Russian military, it declined to follow through. Instead, Treasury Secretary Stephen Mnuchin announced that he will impose additional sanctions on Russian entities in the next few months, but it remains to be seen whether such actions will be substantive or symbolic.

The one area where change has been substantive is the expansion of North Korean “secondary sanctions” that force non-US entities to decide whether to conduct business with sanctioned parties or the US. The Administration has imposed such sanctions on several international businesses and financial institutions, and has warned that there will be more to come.

Regardless of the rhetoric, inaction, and action (or perhaps because of all three), the uncertainty surrounding the landscape has caused a slowdown of investment in areas that could potentially face future sanctions.

This **Financial crimes observer** provides our perspective on recent developments in the sanctions landscape and what financial institutions should do to ensure that they are not indirectly involved in any prohibited transactions.

The sanctions landscape

North Korea

Throughout 2017, continued weapons testing by North Korea prompted the UN to adopt a series of resolutions imposing sanctions against certain individuals and sectors of the North Korean economy.² These sanctions prohibit a wide-ranging list of transactions, including a ban on conducting business with North Korean officials and state entities affiliated with its weapons program as well as capping oil and energy transactions.

The Trump Administration, however, has publicly expressed dissatisfaction with certain countries – particularly China and Russia – for their lack of effort to comply with these sanctions. In response, the White House issued an Executive Order (EO) in September authorizing the Treasury Department to impose secondary sanctions, thereby cutting off foreign entities or individuals that transact with North Korea from the US financial system. Treasury has subsequently imposed these sanctions on a number of foreign entities, including several Singaporean and Russian businesses, a regional Chinese bank, and a Latvian bank.

Last week, the Administration continued this string of enforcement by sanctioning over 50 entities involved with shipping and facilitating illicit trade with North Korea, including entities registered in China, Taiwan, Hong Kong, Singapore, and Panama. Notably, despite the Administration's warnings, no Russian entities were targeted. Simultaneously with issuing the new sanctions, the Administration released an advisory with very specific risk mitigation suggestions regarding shipping, signaling that it will expect more robust controls in this area going forward.

These actions are yet another reminder to global banks that continuing business as usual with North Korea is a very high risk strategy. Not only does it subject banks to reputational damage, but it also can also mean losing access to foreign debt and capital markets. Accordingly, financial institutions would be wise to implement tighter know-your-customer (KYC) controls in addition to identifying high risk entities. Further, US banks that have correspondent accounts with banks in, or do business with, higher sanctions risk countries such as China should apply enhanced due diligence measures to ensure no indirect involvement with any prohibited North Korean transactions.

Russia

In August, facing veto-proof majorities in both the House and the Senate, President Trump signed the Countering America's Adversaries Through Sanctions Act (CAATSA) into law.³ The law imposes additional sanctions on Russia (and also Iran and North Korea), and notably requires that Congress review and approve any Presidential decision to lift certain existing Russia related sanctions.⁴

The portion of CAATSA specifically dealing with Russia is designated the Countering Russian Influence in Europe and Eurasia Act of 2017 (CRIIEEA). One CRIIEEA requirement includes "designating"⁵ certain individuals involved with certain sectors of the Russian economy, but it remains to be seen how aggressive the Administration will be in doing so. For example, the Administration last month declined to adhere to a CRIIEEA requirement to designate parties that conduct business with Russia's intelligence or defense sectors, stating that the threat of sanctions have been acting as a deterrent. The Administration also released a report (which CRIIEEA required it to publish) warning against sanctioning Russian government bonds because doing so would have a harmful impact on US investors and the global economy.

The Administration did recently "fulfill" one CRIIEEA requirement by publishing a list of Russian political figures and oligarchs, however, instead of indicating whether anybody on the list is allegedly involved in corruption, it simply contained every Russian individual with a net worth over \$1 billion.

Other parts of the sanctions package have similarly had little impact. For example, while CRIIEEA tightens financing restrictions for the Russian energy sector, the reality is that this sector has already adapted to previous energy sanctions by focusing on alternative sources of financing (e.g., the Russian government, Russian banks, Asian banks). Additionally, while the law expands sectoral sanctions to include Russian energy export pipelines, it leaves enforcement discretion up to the Administration and no action has been taken as of yet.⁶

Despite all of this, Treasury Secretary Stephen Mnuchin indicated that additional sanctions will be issued within the next few months, and members of Congress have called for imposing additional sanctions on Russia. While it is unclear whether any new sanctions will arise, the mere possibility has caused a number of Russian individuals to act as if they may be designated. The threat has also caused one privately owned bank in Russia to recently announce that it is halting business with the Russian defense sector.

This uncertainty – coupled with the continuous addition and removal of sanctioned parties from sanctioned countries across the board – also means that financial institutions need to stay alert to avoid inadvertently conducting business with sanctioned parties. Accordingly, they should have systems in place to ensure that their screening data is continuously updated and can be verified on demand.

Iran

Last month, the White House granted a waiver of sanctions imposed on Iran to continue the Iran nuclear deal.⁷ However, it simultaneously warned that it would not grant the next waiver, which is due on May 12, unless weapons inspectors are granted immediate access to

Iranian nuclear sites and limitations on Iran's nuclear program are indefinitely extended.

The parties⁸ to the Iran nuclear deal have signaled their unwillingness to renegotiate, but unilaterally withdrawing from the agreement is easier said than done. US banks have long been prohibited from transacting with Iran, and foreign banks have long been prohibited from dealing with Iran through US banks – so any impactful Iran sanctions policy changes would require international cooperation.

Given these challenges, we expect the Administration to find other paths to impose additional sanctions on Iran – such as by designating individuals involved with weapons testing or human rights abuses. However, because much of the Iranian government is already covered by existing sanctions, any of these unilateral actions would be largely symbolic.

We also expect the Administration to ramp up its efforts in enforcing existing sanctions, including by renewing its focus on preventing sanctions circumvention by Iranian businesses.⁹ Last week, the Administration alleged that a sanctioned Iranian airline purchased US-made engines and parts through Turkish shell companies. This allegation came as the Administration is considering whether to grant licenses to allow the sale of up to \$40 billion of US-made airplanes and parts to Iranian airlines – a decision which could be impacted by the allegations.

The Administration also alleged that up to \$50 billion in sanctioned Iranian oil and gas funds have been made available to Iran through escrow accounts at various international banks, including two of South Korea's largest banks. In the past several years, the US has scrutinized European banks for (often inadvertently) facilitating Iranian access to sanctioned funds, but after multiple enforcement actions resulting in over \$16 billion in fines, these banks have enhanced their transaction monitoring programs to largely prevent sanctions circumvention from taking place. We are now seeing the US turn its focus to Asian banks – in addition to the Korean banks, we have seen several Chinese, Taiwanese, and Singaporean banks cited for compliance lapses.

The uncertainty around future sanctions and enforcement has complicated entry into the Iranian market and slowed further investment. Those that do choose to conduct business with Iran should seek to enter into shorter term agreements with Iranian entities or include escape provisions in long term agreements.¹⁰

Cuba

In November, the Administration announced amendments to the Cuba sanctions policy, which are largely the result of President Trump's commitment to reverse the Obama Administration's actions with respect to Cuba.¹¹ However, the changes to date have been relatively benign.

Specifically, the amendments prohibit financial transactions with over 175 entities – over 80 of which are hotels that are connected to the Cuban government. However, the amendments also simplify existing embargo requirements which allow for the export of all low-technology consumer goods if the intended recipient is in the Cuban private sector. Importantly, parties that have already entered into contractual arrangements prior to the issuance of the amendments will be permitted to proceed with the transactions. This is significant as the substantial investments made in Cuba thus far will not need to be unwound.

Again, while the Administration's talk has been tough with respect to Cuba, changes to the sanctions policy are more accurately described as adjustments to channel economic activity away from the Cuban military and government while maintaining authorized travel to Cuba and supporting its private sector.

Although there have been few substantial changes to the Cuba sanctions policy, financial institutions should be updating their policies to ensure that they are not participating in impermissible transactions. Many financial institutions have reported an increase in blocked transactions due to misunderstandings regarding the permissibility of certain activities. For example, payments processors have mistakenly believed that facilitating a wide spectrum of payments for Cuban goods is now permitted, but the Administration has only authorized payments for a narrow list of independent Cuban entrepreneur-produced goods.

Endnotes

1. Last year, we predicted that the Trump Administration would not take steps to substantially alter the sanctions landscape. See PwC's *Financial crimes observer, Sanctions: Will the Trump administration stay the course?* (February 2017).
2. The UN sanctions are the latest in a series of recent steps taken against North Korea. For additional information, see PwC's *Financial crimes observer, Sanctions: Recent action on North Korea* (July 2016).
3. For additional information on CAATSA, see PwC's *Financial crimes observer, Sanctions: All bark, less bite* (July 2017).
4. For additional information on existing Russia sanctions, see the *Financial crimes observer* cited in note 1.
5. Individuals that are "designated" are added to the Specially Designated Nationals list and prohibited from conducting business with US entities.
6. There are three energy export pipelines under construction –Nord Stream 2, TurkStream, and Power of Siberia – and all are being constructed in conjunction with non-US entities (EU, Turkish, and Chinese companies respectively).
7. For additional details regarding the Iran nuclear deal and related compliance considerations, see PwC's *Financial crimes observer, Iran sanctions and beyond: Avoiding the rising fines* (February 2016) and the *Financial crimes observer* cited in note 3.
8. The parties to the Iran nuclear deal are Iran, the European Union (EU), Germany, and the five permanent members of the United Nations Security Council (the United States, the United Kingdom, France, Russia, and China).
9. Sanctions circumvention refers to disguising the involvement of a sanctioned customer in a transaction. For additional information, see PwC's *Financial crimes observer, Sanctions: Circumvention methods under scrutiny* (November 2016).
10. For additional information regarding existing Iran sanctions, including which parties conduct business with Iran, see the *Financial crimes observer* cited in note 7.
11. For additional information on the previous Administration's easing of sanctions on Cuba, see PwC's *Financial crimes observer, Sanctions: Cuba restrictions falling* (April 2016).

Additional information

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