Institute for Financial Integrity

EXPERT INSIGHT

Discovering an Emerging Pattern Sanctions and AML Are Converging



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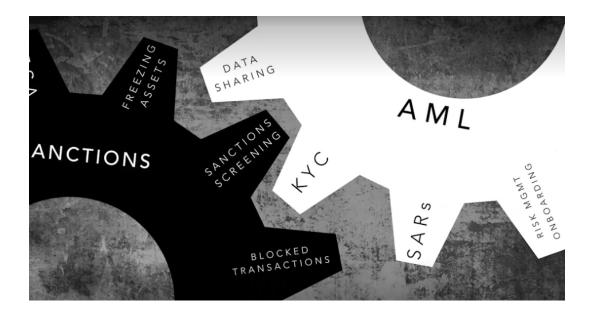
Discovering an Emerging Pattern Sanctions and AML Are Converging

Sanctions and anti-money laundering (AML) regimes, once seen as separate, have been converging. Before, these disciplines involved different data, processes, cultures, and personnel. Now, they are part of an interconnected financial integrity risk management and compliance ecosystem.

- Sanctions regimes, which have traditionally been defined by absolutes such as published lists to be screened, frozen assets, trade restrictions, and strict liability for those who do not comply, are now designed differently, moving into the realm of anti-money laundering and risk management.
- The AML system, which was born from law enforcement based on principles of transparency, accountability, and traceability, now encompasses national and financial security issues.

This convergence has real world consequences for sanctions compliance and financial crime risk management professionals. Financial institutions that understand this new landscape will be better situated to manage their real and regulatory risks. A senior US Treasury official speaking at an antimoney laundering conference in late 2023 <u>discussed</u> this convergence and its implications for financial institutions:

- "The two areas of highest priority for my office—sanctions to advance the foreign policy goals of the U.S., and the strengthening of the U.S.'s own AML/CFT regime—are deeply linked ... the continued siloing of AML/CFT and sanctions departments at some financial institutions can lead to financial institutions unwittingly, or inadvertently, processing payments involving designated entities."
 - -- Elizabeth Rosenberg, U.S. Treasury Assistant Secretary for Terrorist Financing and Financial Crimes





European and American academics have recently begun <u>writing</u> about these new dynamics and designing <u>specialized programs</u> on financial integrity covering both AML/CFT and targeted sanctions.

- "With sanctions becoming an increasingly important tool in ostracizing autocratic regimes from western markets, the need for effective enforcement of AML policies is increasing. The global AML regime will be the backbone in detecting evasion of sanctions."
 - -- Giancarlo Spagnolo and Theo Nyreröd, Stockholm School of Economics Policy Brief
- "To be truly effective, professionals must be knowledgeable about the law and policy of each of these measures (AML, CFT, and sanctions). [Our] program is carefully designed to accomplish exactly that goal."
 - -- Arizona State University, Thunderbird School of Global Management, Master of Leadership and Management with a Specialization in Financial Integrity (MLM-FI)

The convergence of sanctions and AML has been in motion for the past decade or so, but the international response to Russia's invasion of Ukraine has significantly accelerated this development. Treasury's lead AML agency—the Financial Crimes Enforcement Network (FinCEN)—highlighted to financial institutions in 2022 red flags to identify potential Russian sanctions evasion activity and reminded them to file suspicious activity reports under the Bank Secrecy Act (BSA). Treasury's lead sanctions agency—the Office of Foreign Assets Control (OFAC)—also stressed to financial institutions in 2023 the importance of implementing customer due diligence (CDD) procedures and other AML controls to mitigate sanctions risk.

- "This alert provides select red flags to assist in identifying potential sanctions evasion activity and reminds Fls of their BSA reporting obligations, including with respect to convertible virtual currency ... It is critical that all Fls identify and quickly report suspicious activity associated with potential sanctions evasion, and conduct appropriate risk-based CDD or, where required, EDD ... FinCEN also strongly encourages all Fls to make full use of their ability to share information consistent with 314(b) of the USA PATRIOT Act, and consider how the use of innovative tools and solutions may assist in identifying hidden Russian and Belarusian assets."
 - -- FinCEN Alert on March 7, 2022: FinCEN Advises Increased Vigilance for Potential Russian Sanctions Evasion Attempts
- "Financial institutions must implement baseline customer due diligence (CDD) procedures
 and other anti-money laundering controls to mitigate sanctions risk, including to identify and
 minimize their exposure to activity involving Russia's military-industrial base and those that
 support it. Best practices for a risk-based sanctions compliance program include incorporating
 information and typologies from relevant FinCEN and OFAC alerts and advisories into
 automated and manual AML controls."
 - -- **OFAC Sanctions Advisory:** Guidance for Foreign Financial Institutions on OFAC Sanctions Authorities Targeting Support to Russia's Military-Industrial Base, December 22, 2023



Areas of Sanctions & AML Convergence

The convergence of sanctions and AML regimes has been multifaceted and can be broken down into four main areas: targeting of common conduct, reliance on common preconditions, evolution of common compliance program pillars, and emergence of common red flags.

Common Targets - AML Predicate Offenses and Sanctions Programs Convergence

Sanctions and AML measures both serve as tools to combat illicit conduct. As sanctions programs and AML/CFT regimes have expanded significantly in recent years, there has been increasing overlap in the specific conduct targeted by both. Threats to national and collective security targeted by sanctions regimes have converged, in many ways, with serious organized crime targeted by AML/CFT regimes.

The chart below describes six criminal activities that are considered money laundering predicate crimes and targeted by AML/CFT regimes are also types of conduct targeted by sanctions regimes. Moreover, sanctions evasion may be a predicate offence for money laundering as it involves either a specified unlawful activity in some jurisdictions or may involve criminal activity such as fraud that is a predicate offense to money laundering.

AML Predicate Offenses	UN Sanctions	US Sanctions	EU Sanctions	UK Sanctions
Terrorism	✓	✓	✓	✓
WMD Proliferation	✓	\checkmark	✓	✓
Corruption		\checkmark	✓	\checkmark
Human Rights Violations		✓	✓	✓
Organized Crime		✓		
Narcotics Trafficking		✓		

Common Preconditions

For sanctions programs and AML measures to be effective, certain preconditions must be present, most notably financial transparency which is achieved through implementation of AML preventive measures, and information sharing and cooperation within and across institutions, economies, pubic and private sector, and across jurisdictional borders.

Financial Transparency

Protecting the international financial system from criminal abuse by identifying and closing systemic vulnerabilities through heightened transparency measures has long been an overarching objective of the AML regime. At the same time, effective implementation of sanctions policies also requires a transparent and accountable international financial system to enable the identification of sanctioned activities and interests of sanctioned individuals and entities. Achieving such financial transparency and accountability requires effective jurisdictional and institutional implementation of preventive measures—backed by sound supervision and enforcement—as called for by AML/CFT regimes.

The AML preventive measures most applicable to transparency are customer and beneficial
ownership identification and verification, company formation disclosure requirements, the
Travel Rule requiring certain information to be included with cross-border transactions, and
record-keeping requirements. Under global standards, these measures apply not just to financial
institutions but also to so called "designated non-financial businesses and professions" (DNFBPs),
including trust and company service providers, lawyers and accountants, dealers in precious
metals and stones, real estate agents, and casinos.



Information Sharing and Cooperation

Information sharing and other forms of cooperation are critical factors for effective and impactful outcomes in implementing sanctions and combating financial crimes. Cooperation in both areas comes in many forms and often supports multiple outcomes, including AML and sanctions-related investigations, analysis, indictments, assets freezing and seizing, and civil and criminal penalties. One suspicious activity report filed by a financial institution or DNFBP may contain important lead information for multiple domestic and foreign agencies working collaboratively to disrupt terrorist support networks, human rights abusers, or sanctions evaders facilitating the proliferation of weapons of mass destruction, to name just a few examples.

- According to FATF, "effectively sharing information concerning possible cases of abuse of the
 financial system with relevant authorities is one of the cornerstones of an effective AML/CFT
 system." FATF has published reports on consolidated standards on information sharing which
 are set out in 25 of 40 of its recommendations and impact 7 immediate outcomes of the FATF
 Methodology for assessing effectiveness; information sharing among competent domestic
 authorities; private sector information sharing; data protection, technology and private
 sector information sharing; AML/CFT and public-private sector partnership; and recovering
 international proceeds of crime through interagency networks.
- Sanctions-related interagency and international cooperation has reached a new high in response to Russia's military invasion of Ukraine, including the establishment of new task forces and coalitions. The US Department of Justice in 2022 established Task Force KleptoCapture, staffed with prosecutors, agents, and analysts from seven agencies to enforce Russia sanctions and export controls. Multilaterally, the 27 members of the European Union, the members of the G7 (Canada, France, Germany, Italy, Japan, the UK, and the United States), and Australia established the Price Cap Coalition to place a price cap on Russia origin crude oil and petroleum products to restrict the revenue Russia receives to fund its war in Ukraine.



Common Compliance Program Pillars

The chart below demonstrates that the essential elements of a sanctions compliance program and an AML program, as articulated by global standard-setters, are largely the same. Given the significant overlap, integrating these programs can lead to a more efficient program and overall stronger risk management for institutions.

Sanctions Compliance Program Pillars	AML Program Pillars	
Governance and Management Commitment	Governance and Management Commitment	
Risk Assessment	Risk Assessment	
Customer Due Diligence / Know Your Customer	Customer Due Diligence / Know Your Customer	
Internal Controls Aimed at identifying, assessing, and managing sanctions-related risks	Internal Controls • Aimed at identifying, assessing, and managing money laundering and other financial crime-related risks	
Independent Testing and Auditing	Independent Testing and Auditing	
Training	Training	

Consistent with global standards, financial institutions are required under the Bank Secrecy Act (BSA) and similar laws in non-US jurisdictions, and associated AML regulations and guidance, to establish and maintain an AML compliance program that includes the pillars shown above. The US Treasury's Office of Foreign Assets Control (OFAC) in 2019 published guidance strongly encouraging organizations subject to US jurisdiction, as well as foreign entities that conduct business in or with the United States, US persons, or using US-origin goods or services, to employ a risk-based approach to compliance with US sanctions. Although it notably stopped short of mandating a sanctions compliance program, it described in detail the pillars shown above and made clear that lack of an effective compliance program is the root cause for sanctions violations and a factor in pursuing enforcement actions.

Common Red Flags

FSince Russia's invasion of Ukraine in February 2022, the Treasury and Commerce Departments have repeatedly highlighted how Russia seeks to evade sanctions and export controls in support of its war effort, such as using third-party intermediaries and transshipment points to circumvent restrictions. These alerts have provided examples of red flags that can signal when and how third parties and intermediaries may be engaged in efforts to evade sanctions or export controls. Many of these red flags are the same or similar to longstanding AML-related red flags, demonstrating that AML controls and investigations can be helpful in detecting sanctions evasion and uncovering assets and transactions of designated individuals and entities. Below are ten such red flags.



Use of corporate vehicles (i.e. legal entities, such as shell companies, and legal arrangements) to obscure (i) ownership, (ii) source of funds, or (iii) countries involved, particularly sanctioned jurisdictions.



Use of third parties to shield the identity of sanctioned persons and/or PEPs seeking to hide the origin or ownership of funds, for example, to hide the purchase or sale of real estate.



Accounts in jurisdictions or with financial institutions that are experiencing a sudden rise in value being transferred to their respective areas or institutions, without a clear economic or business rationale.



Use of shell companies to conduct international wire transfers, often involving financial institutions in jurisdictions distinct from company registration.



Ownership of commercial real estate (CRE) through legal entities in multiple jurisdictions without a clear business purpose.



Transactions involving public officials and funds moving to and from countries with which the public officials do not appear to have ties.



Transactions involving public officials related to high-value assets, such as real estate or other luxury goods, that are not commensurate with the reported source of wealth for the public official or that fall outside that individual's normal pattern of activity or lifestyle.



Documents corroborating transactions involving government contracts (e.g., invoices) that include charges at substantially higher prices than market rates or that include overly simple documentation or lack traditional details (e.g., valuations for good and services).



Jurisdictions previously associated with Russian financial flows that are identified as having a notable recent increase in new company formations.



Transactions involving entities with little or no web presence (such as a website or a domain-based email account) or the online presence suggests business activity inconsistent with the stated line of business.

Conclusion

Ultimately, sanctions and AML regimes together define financial integrity and security. All those concerned with protecting the financial system from illicit use and advancing collective security interests through financial pressure campaigns must understand this overlap.

Financial institutions that understand this new landscape will be better situated to manage their real and regulatory risks. And well-trained financial integrity professionals who recognize this convergence of sanctions and AML will be better positioned to advance their careers, the interests of their enterprises, and the broader financial integrity mission.