The wind of change at the G7 in Brussels: Upstream risk management

Aug 05 2014 Denisse V. Rudich

Change is in the air. This year's meeting of the heads of G7 nations in Brussels was an unprecedented event, with the European Union, which is a permanent observer of the G7/8, hosting the summit for the first time.

The reason behind this was the suspension of Russia's membership of the G8 and the decision of the G7 countries to withdraw their attendance from the G8 summit scheduled to be held in Sochi on June 4 and 5. It reflected the major shift in the global security and geopolitical landscape seen in recent months. Drivers of this shift include the Russian annexation of Crimea from Ukraine, which has placed renewed focus on countries in transition and capital flight; the increase in its engagement with Iran, which has historically been the target of comprehensive sanctions regimes worldwide; and poor governance structures and domestic conflict in the Middle East and Africa, which continues to be exploited by extremists and terrorist groups.

In the Brussels G7 Summit Declaration, the G7 leaders explicitly linked financial crime issues to the development agenda and security, which the leaders identified as essential to "building a lasting peace". This article will provide an overview of country-specific and regional issues addressed at the G7 summit in the context of sanctions, terrorism and terrorist financing, and asset tracing and recovery. It will further provide recommendations on how financial institutions can manage their upstream risks by taking the G7 dialogue into account and applying a risk-based approach.

High-risk and sanctioned countries

Ukraine

As the reason behind Russia's suspension from the G8, the situation in Ukraine headlined the G7 summit agenda. TheG7 leaders affirmed the decision to enforce sanctions against Russian and Ukrainian entities and individuals identified as "threatening the peace, security and stability of Ukraine". Although strong language was used in the Declaration, with the G7 stating that its members stood ready to "intensify the targeted sanctions" and impose additional restrictive measures, European leaders stressed during press briefings that there was no automated mechanism in place to trigger level three sanctions. Additional sanctions would only be put in place against Russia following consultations, if events should require it, they said.

Public sources have indicated, however, that the U.S. is working with its allies to target particular economic sectors, including Russia's energy and financial markets, for the next round of sanctions related to the Russian/Ukraine situation, to address further escalation of tensions if and when required. The G7 also called on illegal armed groups to disarm, highlighting that the current domestic environment in Ukraine could act as a breeding ground for separatist terrorist groups.

The G7 leaders also welcomed the Ukraine Forum on Asset Recovery (UFAR) held in London at the end of April. During the two-day meeting, organised by the U.S. and the UK, officials met to identify steps to find and return the estimated $3 billion in stolen assets. UFAR was intended to send the message that G7 countries "are making it harder than ever for corrupt regimes or individuals around the world to move, hide and profit from the proceeds of their crime". This supports the G7's commitment to work with "governments and other financial centres to follow up on asset recovery efforts".

Middle East and Africa

The G7 leaders identified a number of unstable regions and countries in the Middle East and Africa, many of which have sanctions regimes in place. With regard to specific countries, the G7 pledged to continue to assist the government of Afghanistan to strengthen its governance institutions, reduce corruption, combat terrorism, support economic growth and counter narcotics. The 2013 International Narcotics Control Strategy Report drafted by the U.S. government highlighted that Afghanistan produces more than 90 percent of the global opium supply. United Nations sanctions are in place and include travel bans, arms embargoes and asset freezes on designated persons, including members and supporters of the Taliban and designated terrorist group Al Qaeda. European Union sanctions are also in place, as are a series of unilateral sanctions issued

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by different countries, particularly those maintained by the Office of Foreign Assets Control (OFAC) in the U.S.

During discussions on Iran, the G7 welcomed a diplomatic resolution of the Iranian nuclear issue and efforts made by the E3+3 (China, France, Germany, Russia, the UK and the U.S.). Any progress made is welcome as it will allow sanctions to be scaled back even further. This could, in time, address the need to diversify sources of oil and gas supplies to Europe, which was identified as a priority by the G7 as part of the energy security agenda item.

The G7 leaders further called on Iran to reject all acts of terrorism. Iran is listed by the U.S. as a State Sponsor of Terrorism and is subject to one of the most comprehensive sanctions regimes with UN, regional and country-specific sanctions in place. Measures range from asset freezes on designated persons to restrictions dealing with the Iranian banking sector and restrictions on transfers of funds to and from Iranian persons, entities or bodies and/or Iranian-sourced goods (such as oil), and a U.S. dollar ban. U.S. government sources have estimated that there are more than $100 billion in restrained Iranian assets.

In Libya, the G7 indicated it would support a "free, prosperous and democratic Libya". Libya is subject to sanctions for serious human rights abuses by proscribed persons, which are subject to asset freezes.

With regard to Syria, the G7 denounced the use of chemical weapons and highlighted the need to hold extremist groups performing human rights abuses to account. European Union and U.S. sanctions against Syria consist of import and export bans (including an oil embargo) and targeted asset freezes on members of the Syrian government and those responsible for violence against civilians. Syria is listed as a State Sponsor of Terrorism by the U.S. government and the Islamic State of Islam and Syria (ISIS) and the Levant (ISIL), which forms part of the Al Qaeda network, is very active in Syria. Recent public sources have identified that ISIS/ISIL is self-financing and uses revenues from the sale of oil resources it now controls to further finance its operations.

The 2013 Global Terrorism and Insurgency Attack Index published by Jane's Terrorism and Insurgency Centre earlier this year highlighted there had been a marked increase in terrorist attacks in Arab Spring countries and lethal attacks in Sub-Saharan Africa. The G7 reiterated its "condemnation of terrorism and our commitment to cooperate in all relevant fora to prevent and respond to terrorism effectively, and in a comprehensive manner, while respecting human rights and the rule of law". Leaders further condemned the kidnapping of hundreds of girls by Boko Haram in Nigeria and pledged to support the Nigerian government to bring the perpetrators to justice and return the girls. The Financial Action Task Force's report, "Terrorist Financing in West Africa", indicated that since 2008 between $40 and 65 million had been paid in ransom to terrorist groups.

The G7 leaders further identified Somalia, Nigeria, South Sudan, the Central African Republic and the Sahel as regions "affected by the scourge of war, terrorism, organised crime, corruption, instability and poverty". Additionally, the G7 welcomed the ceasefire signed with armed groups on May 23 in Mali and the Central African Republic.

In the area of asset tracing and recovery, the G7 welcomed the Third Arab Forum on Asset Recovery (AFAR) and reaffirmed its commitment to the Deauville Partnership. The Deauville Partnership makes available technical and financial support to Arab Spring countries in transition, including Egypt, Tunisia, Morocco, Libya, Jordan and Yemen. The partnership comprises all G7 countries, the EU and regional partners and international financial institutions, and countries continue to track down funds and work with governments and financial intelligence units to return stolen assets.

Asia

The G7 discussed North Korea, condemning its continued development of nuclear and ballistic missile programmes and reiterating concerns about "systematic, widespread and gross human rights violations". North Korea is subject to UN and EU sanctions targeting its nuclear proliferation programme and there are a number of unilateral country sanctions against it. Sanctions range from asset freezes on proscribed persons, as well as an arms embargo, a U.S. dollar ban and a ban on the transfer of goods that could be used to contribute to the development of nuclear capabilities.

Applying a risk-based approach

Given the emphasis on adopting a risk-based approach, financial institutions should identify business areas that deal with customers in the regions and countries discussed by G7 leaders and/or clients who have active operations in these countries. Businesses captured by money laundering regulations should revisit country risk ratings and consider re-classifying (if relevant) these countries as high-risk so that new customers are subject to enhanced customer due diligence (including identification of source of wealth and/or source of funds as appropriate) or enhanced continuous monitoring as required (i.e., annual due diligence reviews, enhanced transaction monitoring, requiring documents to be notarised, etc.). The rationale for this risk rating is that these are either countries in transition with limited ability to enforce anti-money laundering and counter-terrorism laws, where they are in place, or subject to sanctions.

All persons and businesses, including those not captured by money laundering laws, are subject to sanctions. The sanctions regime is an absolute regime, meaning that if a person breaches sanctions regulations or statutes, it is likely that that person or body has committed a criminal offence. Given the recent $9 billion penalty and criminal conviction of BNP Paribas, which was also discussed by leaders at the summit, it is essential that businesses pay close attention to its sanctions controls. This includes ensuring sanctions screening and payment filtering is carried out on a continuing basis, that IT systems are regularly refined and tested, and that appropriate staff training is delivered so that staff are aware of their obligations.

Financial institutions should remain vigilant regarding any capital outflows from these countries and make staff aware of the requirement to report any suspicious transactions or requests to transfer funds to or from these countries, especially when a customer request does not reflect the customer's usual course of business. Financial institutions should also consider closely monitoring payments originating from and going to beneficiaries located in those jurisdictions, where sufficient information is available.

Additionally, a number or terrorist groups have been identified as operating in these regions. Financial institutions should ensure that they maintain their local and global sanctions lists up-to-date and that they are screening their payments and customers, including directors and beneficial owners, and trade finance documentation against these on a regular basis. For subsidiaries or representative offices of financial institutions headquartered in other jurisdictions, it is recommended that the list where the parent company is registered is also screened against, particularly where deals and transactions are booked within that country.

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Financial institutions should be aware that some sanctions regimes, such as the U.S. OFAC lists, have extra-territorial reach. Where true matches are made, financial institutions should submit reports to both their local financial intelligence unit and the government department responsible for issuing sanctions lists, which may be different from the financial intelligence unit.

As the international system of governance changes, it is essential that financial institutions continue to monitor world events to ensure that their systems and controls not only remain fit-for-purpose but also that they are addressing emerging threats and working with governments to provide timely and accurate data, and preventing the international financial system from being abused.

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