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Episode title: Financial institutions having trouble seeing through the fog of Russia sanctions

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Gregg Wirth: Hello and welcome to Thomson Reuters Institute podcast. Today we're speaking about Russian sanctions and how global financial institutions are trying to comply with them. Speaking with us is Brett Wolf and Rachel Wolcott of Thomson Reuters Regulatory Intelligence. They're both co-authors of the new white paper, *The fog of sanctions: Global banks & businesses face unprecedented challenges in applying measures against Russia*. Thank you for joining us, Brett and Rachel.

Brett Wolf: Happy to join you.

Gregg Wirth: Thank you. Looking over the paper, it describes an environment of significant challenge for global financial institutions and other entities as they try to comply with imposing sanctions on a massive scale against Russia and its leaders since its invasion of the Ukraine. What is driving the most significant of these challenges that financial institution institutions are facing?

Brett Wolf: Well, from my perspective, I would say it is the fact that there are so many bits of guidance being issued by the Treasury Department in the form of general licenses, individual licenses, FAQs, just a tremendous amount of detail. There are so many "ifs" and "ands" and "buts" that the complexity is just astounding. And as a result of that, it's requiring financial institutions to escalate various questions, you know, to the level of in many cases general counsel or perhaps even going to outside legal counsel to get answers, taking a lot of time and it's very costly. I know that many financial institutions and compliance officers would have preferred a simple blanket ban on Russia-related activity. It would have made it a lot simpler, but yeah, the general complexity is astounding, and it is like nothing we have ever seen. The notion of somehow partially disentangling yourself from a G20 economy, just on the face of it, it sounds difficult, and the details make it considerably worse. What about you, Rachel?

Rachel Wolcott: I would say the scale and speed of the sanctions, just how many there have been and how quickly they were implemented, I'd say that came as a big surprise to a lot of European and UK banks, for example. I think people weren't really prepared for the unity on this on this topic and I would also say that one of the big problems has been the kind of a lack of maturity in and amongst the different sanctions regimes, having to go into a lot of detail about whether somebody, a certain activity, certain company is in scope of sanctions or out of scope. And that has to go down to finding some very particular information about beneficial ownership and that kind of thing. You know, really knowing your client on a level where, you know, firms might not have had to go before and something that Brett and I have talked about before I mean Russian oligarchs and Russian politically exposed people are masters at using shell companies and offshoring assets to, using for a variety of purposes, you know, for their own wealth or, you know, funding various overseas activities that furthers the interests of the Russian government. So, I would say people were, firms were already behind the curve there just because the target of the sanctions are so savvy at using financial services and financial corporate structures to do their bidding. I mean, they've been doing it since the Soviet times.

Gregg Wirth: Yeah, that makes sense and you both hinted at it in the paper about a lack of clarity and cooperation among the allies as they try to oppose the kind of sanctions that would be the most impactful against Russia. Why has this kind of poor coordination among the allies developed? Brett?

Brett Wolf: Well, I mean, I'm not sure I'd call it a lack of coordination, although I can see that perspective, but to me, I see it as variations in the priorities and economic necessities of the nations involved in issuing these sanctions. You know, for instance, if we talked about Russian oil in the United States, you know, it was fairly quick to say no more imports of Russian oil. It wasn't so easy for Europe to take those kinds of steps, so these sort of differences in the way our economies are nested and combined with the Russian economy I think has probably been the primary driver of this. I think there probably, you know, is significant cooperation and significant talks between the nations involved. Which in a sense might be one of the good outcomes of all of this, is the lack of unilateralism on the part of the US and the fact it's actually communicating with allied nations while issuing its sanctions, but there are differences. There are different oligarchs that are targeted by different nations. There are different industries. And all of this absolutely lends to the incredible complexity that firms are facing. I'd assume it's probably the same on your side of the pond, Rachel?

Rachel Wolcott: I would say that just to go back to what I was saying earlier about the there, there are different levels, levels of maturity and development in in sanctions regime and I think it's widely accepted that the US OFAC regime is the most developed in the world, whereas here in the UK, for example, they really had to scramble to, including in passing new legislation, to be able to adopt or sanction people more quickly. And a good example of this is now we've got a cut and paste system essentially so, if something if the US OFAC comes out with some sanctions, a lot of times, not every single time, the UK will cut and paste those sanctions, which means they don't have to do the, you know, due diligence and check out whether or not these people are being worthy of sanctions yet. So, they've got a sunset clause on them. They can't prove that these people don't need to be sanctioned. Then after, I think it's like after 100 plus days the sanctions lapse unless they've put the supporting documentation in place. There's been staffing issues at the Foreign Colonial and Development Office, which is leads on sanctions here in the UK, so they've had to boost their team but they claim it's been tripled there, but what's actually happened is they've surged people in to get up to speed and be able to keep on top of these copy and paste sanctions, so make sure that the supporting evidence is there in time. Just one more thing on that would be there was a lot of political resistance in the, in the beginning towards sanctioning certain Russians because the, as Brett was talking about, here in the UK Russian money has played a big role in the UK property market. We have just last week gotten a overseas beneficial ownership register for things like property that we never had that before, so it was really easy for individuals to hide assets here in the UK, and something we're going to talk about later is reputation laundering. People, oligarchs and other wealthy Russian individuals, have really been able to use London as a place to basically, layering their, their assets become part of the upper echelon of society and they've done that in part by giving a lot of money to politicians. So, people didn't want to cut off that source of income.

Gregg Wirth: Yeah, that's really interesting and pretty disturbing too. A big chunk of the paper talks about what the global financial institutions and other entities themselves can do to navigate the situation. You know, and the paper talks about some strategies such everything from like de-risking the entire region to ramping up the banks' know your customer protocols. Among these, Brett, what do you think are the best options for global banks as they try to work through this all?

Brett Wolf: Well, I suppose my response would have to be that it depends on the risk appetite of the particular financial institution and the degree to which they're willing to take on sanctions risk by continuing to do business with unsanctioned parties in Russia, and that's going to vary considerably between financial institutions. You know, interestingly, some financial institutions are feeling pressure to maintain some ties and not to completely de-risk. In part because their correspondent banks need them to stay in the wire transfer payment chain at least during the wind down period for business. So, you know, in addition to what a financial institution is comfortable with, they also, you know, have other financial institutions they need to continue working with around the world. So, perhaps if you're able to de-risk and Russia business is not at all profitable for you it's sort of a no brainer, just get out. But if you do have substantial, very substantial business in Russia and it's profitable, you may want to stay in, but really make sure all your I's are dotted and T's are crossed in terms of your customer due diligence, your enhanced due diligence in order to continue doing business with parties that might be at high risk for being sanctioned, and of course, to avoid doing business with any that are already sanctioned. Do you have any thoughts, Rachel?

Rachel Wolcott: Yeah, I would agree that I don't think there's been a zero-tolerance approach to Russia risk by banks, especially probably not European and UK banks because a lot of times these will be very profitable customers for the banks. And I think it's going to be a difficult conversation between the sanctions team and the business to say you have to drop this, this customer who on paper looks perfectly, perfectly fine. I would think that one thing that banks might be on the lookout for is reputational risk. I think it would be pretty embarrassing at this point given the sentiment towards Ukraine and being very sympathetic to Ukraine that of a firm or any company would be seen to be sanctions busting unless it was a mistake. And one thing that Brett and I've covered a lot over the years or various leaks that come out there was the FinCEN leaks, there are the Panama Papers, Paradise Papers and these show that it takes a lot for a bank to disengage from a problematic client.

Gregg Wirth: I thought one of the more fascinating parts of the paper, something you've mentioned earlier, was that these reputation launderers are now working with Russian oligarchs to help obscure, like their sorts of assets and really kind of muddy the waters around, you know, making them look vulnerable to sanctions. Who are these launderers and what exactly do they do?

Rachel Wolcott: Well, I think this has been going on for a while and it's not just Russians and it's not just in the UK or in the US, but it happens all over the place. I mean, what you see kind of from a high-level is that especially in Europe if a country has a particular kind of colonial affiliation, so between France and you know various African countries where they might have been a, you know, have been a call it colonized back the entity back, you know, a couple 100 years ago, you know, each of these European countries have those colonial relationships. And then of course, the UK has this big relationship with Russia and so does Germany and Austria and Switzerland to a certain extent. So, people who have become wealthy in many of these former colonies want to come to Europe and spend their money and start a life, new life have a have a big house, so they hire PR people to publish, get them into glossy magazines, but it's those kind of things one of the things that's highlighted in the Enablers Act is lawyers for example, help and accountants helping wealthy, we're talking ultra, ultra-wealthy individuals, funnel their money in using shell companies or using the law firms accounts, that that kind of thing. And I mentioned earlier political donations, charitable donations, this is how people become accepted into this kind of high society without many questions asked, and we sort of become, you know, part of the scene and they're able to come live here or live in other places without raising a lot of

suspicion and it's some of these reputation launderers can be a little more sinister by post, you know, posting kind of disinformation on social media and that's something that's come up in sanctions is the US and the UK a little bit have done cyber sanctions, so if you're posting misinformation or disinformation online there are some really well known they call them troll farms in Saint Petersburg that do this to try to kind of influence people's ideas about, you know, who who's right and who's wrong about certain things. You know, things like COVID vaccines and all that kind of stuff. And it was something, and Brett did a piece on this a couple months ago, that the Wolfsburg Group has picked up on that how when you're doing adverse media screening, there is disinformation out there now. It's hard to you to come to a conclusion if, on the one hand you're reading in the high society magazine that so and so is such a wonderful person and somebody who's got a very similar name comes up on a sanctions list, I mean, what do you do about that? It just makes it different, difficult to know your client in that way.

Gregg Wirth: I can see that, that does sound like they are doing a somewhat successful job of muddying the waters. Finally, I just wanted to touch on something I thought was a kind of a troubling assertion that the paper made. It spoke about how many global financial services firms are finding it difficult to hire enough financial crime compliance professionals and others to meet all these added demands, demands on personnel and resources that these the Russian sanctions and new legislation have brought. What can, if you're a compliance leader in a global firm, what can you do about this situation with the, with the talent strategy?

Rachel Wolcott: Good question, right?

Brett Wolf: Yeah, I mean it's very difficult. I guess the short answer is ask the board for additional funding so you can be competitive in you're hiring because there's no doubt that the experts in this field are in very high demand and can command considerable salaries, and I'm sure that that figure that they can command it, has increased in recent months, and firms are competing to hire these top experts. But they're also leaning on consultants and outside counsel, which of course is a costly exercise. But I've been told by chief compliance officers that that training new compliance professionals and hoping they'll stay with your firm is not the approach to take because once they're getting trained, many of them are moving out the door to other firms that are offering more money. So, it's difficult right now, it's tough out there, but so firms are going to, they're going to have to find a way to, and I know some compliance professionals might chuckle at this, but find a way to get additional funding from the board. Even if it means taking in these articles of regulatory intelligence as written and pointing at a line from it and just trying to sell it to senior management or the board, but it's, yeah, it's a tough time.

Gregg Wirth: Yeah, well, certainly your paper makes that makes a good case that that the compliance teams need more, more resources. What are you saying, Rachel?

Rachel Wolcott: Well, I agree with everything that Brett is saying. It's not like people major in being anti-financial crime experts in college or university, it's something that you come to through other means. You know, a lot of people are former law enforcement and former intelligence. You know a lot, I guess a lot of people, I mean, I've never heard it, maybe you have Brett, say when I grow up, I want to be an MMRO or I want to be a financial, financial crime investigator. So, I think that's part of it like Brett touched upon, you have to rely on in-house training or what some of the professional accreditations that are out there like ACAMS that sort of thing that takes a lot of time and effort on, on the individuals part. You think you've got a job and then you've basically got to do a whole course about having to learn

about how to do your job. So, I think that that's one thing, you know, pitch it. I'd love to hear if there is like a natural talent pool for this, but you know, I've, I've never, I've never come across it. I'd also say there's like one of the things that makes it difficult is there is a bit of a misconception about how all of this works. And so, let's say a bank is going out to, you know, they put in their annual report or we're hiring, we've got 3000 AML KYC staff pioneers with crimes, working on sanctions or whatever. I mean, there'll be a core of those that are sort of the real veterans and experts that Brett has described, a lot of these people are going to be working in an offshore jurisdiction. And I wouldn't say like almost like a call center, you know, with lots of cubicles, they're going to be looking at transactions and having to decide if they're suspicious or not, if they've been flagged up. You know, this is expensive these people are trained, but they're not always trained, you know, to the level of expertise that a person working in a house might be and there is a lot of turnover. I've even heard that people who work in these offshore centers will get hired, between the time they start, they're supposed to start they've already been poached to go elsewhere, so it's very competitive and you know, they they're having to do a lot of, lot of tedious grunt work as well. And I mean, it's not like being, you know, a private investigator or anything. They've got to, you know, keep motivated and keep focused, and I think that's kind of hard.

Gregg Wirth: Oh, definitely, definitely agree. You agree, Brett?

Brett Wolf: I would agree 100%. And, you know, when all of this got started in late February, you know, I began keeping tabs talking to sources and as the months wore on, I was talking to some of the most senior sanctions compliance officers in the United States and I was hearing that, you know, I didn't take this job to work 60 hours a week. Now, I used to be a very senior treasury official and this, you know, I thought I was taking a job with work life balance and at this point it's just gotten ridiculous in terms of the hours we're having to work. So yeah, they're shorthanded, but they're also, they just it's difficult to have people with the depth of expertise that's needed in such a complex sanctions enforcement environment, you know, everyone expects that, you know, OFAC and perhaps even the Department of Justice are going to make an example of someone you know, some firm that in it, in their view, has not done what they needed to do in terms of customer due diligence or in terms of sanctions, screening and reviewing alert. Mistakes are going to be made and if those mistakes are perhaps not reflective of a systematic problem, but one-off issues, you might be OK. But if this Russia situation reveals deep weaknesses in a firms sanctions compliance program, those firms that that don't have the expertise that they need and don't have the policies procedures that they need, they could be in for a large fine and obviously the reputational damage that goes with that. And I the one thing that I couldn't possibly overstate is that it's vital for firms to document thoroughly the steps that they're taking right now to ensure sanctions compliance and to ensure that there are no gaps in their programs because those, you know, if your policies say you're doing something, you better be doing it and it's a tough time right now and firms are having to put in a lot of time and effort to get this done, I guess I close with that.

Gregg Wirth: That's amazing. It's it seems the sanctions that were supposed to have the negative impact on Russia have had collateral damage really with everybody involved as far as the government imposing them and certainly the banks and financial institutions that have to comply with them. Thank you both, Brett and Rachel for your time today.

Brett Wolf: Thank you for inviting us.

Rachel Wolcott: Thank you.

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