



**ACCUITY**

# How to manage the risks of sanctions in trade finance

As regulators shift their focus to the financial institutions that finance sanctions-busting trade, **Heather Lee**, Director of Risk and Compliance Strategy at Accuity, discusses how institutions involved in trade finance can better understand the who, where and what of the trades they are financing.



**F**ines and legal action against companies that have breached international sanctions – such as the Chinese telecoms and smartphone manufacturer ZTE, which paid out US\$900mn for violating US sanctions against Iran and North Korea, or the US\$2mn fine handed out to Exxon for breaching sanctions against Russia – regularly hit the headlines. But a series of cases in recent months has signalled a significant change in the approach of regulators: institutions that finance sanctions-busting trades are now also in the firing line.

In June, the US announced criminal charges and economic sanctions against a regional Chinese bank, Dandong Hongxiang Industrial Development, accusing it of money laundering and financially supporting North Korea's

nuclear weapons programme. A month later, regulators in Latvia fined two lenders, Norvik Bank and Rietumu Banka, more than US\$3mn as part of an ongoing investigation into attempts to bypass international sanctions against North Korea. So far, five Latvian institutions have been fined for, among other things, failing to carry out sufficient due diligence and gather sufficient information about transactions. Norvik Bank said in a statement that it would review its client portfolio and invest to make sure its compliance met all regulatory and best practice requirements.

These are high-profile examples of financial institutions falling foul of international sanctions, but they serve as a clear warning to the sector that regulators are willing to chase those who finance sanctions-busting trades, even unwittingly,

as well as those that carry them out.

Sanctions risks have exacerbated the already complex area of trade finance. The increased focus on compliance by regulators across the world, particularly when it comes to proliferation finance and the financing of terrorism, has added to the pressure on banks to step up their internal processes for vetting trade finance documentation. As a result, the cost of compliance is rising, at a time when margins are tight.

Trade finance has traditionally relied on manual processes but the need to meet the highest levels of compliance in an operationally efficient way has encouraged rapid automation. Automating screening processes is now a high priority for banks – at a recent seminar we held on sanctions risks in trade finance transactions, for example, 72% of those taking part said

they already had a trade-based money laundering solution in place.

Our concern, though, is that the approach of many institutions isn't sophisticated enough to manage the increased risk associated with trade finance. Screening SWIFT messages has often been seen as sufficient, but there are many reasons why this is no longer enough.

In order to fully understand the risk profile of a trade, you need to know a lot more than the details of the customer requesting the finance and any counterparties. You need to know as much as possible about the goods that are being traded (and what they could be used for), their destination, method of transport and route. This includes screening for goods that could be also used for military purposes, nuclear proliferation or terrorism and, because vessels as well as countries can be the subject of sanctions, checking for all vessels associated with sanctioned countries.

The complexity of trades and the risks involved mean that any screening solution needs to be comprehensive, adaptable, and based on high quality data that's regularly updated. So what does best practice look like?

Best practice should, as a minimum, cover these three essential elements:

- Screening for dual-use and military goods
- Screening continuously over the trade life cycle
- Screening data points across all documentation and not just SWIFT messages.

### Screening for dual-use goods

Many firms are good at screening the 'who' and 'where' of a trade but less effective at screening the goods themselves – mainly because that's often seen as the job of Customs. Screening for dual-use goods – such as acetone peroxide, which could be used in nail polish remover or in improvised explosive devices – is a particularly challenging task. Detail and context are important; some innocent goods are weaponised when manufactured to a certain tolerance. The quantity, destination, vessel and companies involved in the trade will all be relevant.

A growing number of banks routinely screen for dual-use goods – 63%, if the audience of our recent webinar is any indication. But a closer examination of the screening techniques used throws up some worrying points. Some, for example, say they rely on the expertise of their staff

to spot high-risk goods – which might be effective, but certainly isn't auditable if the authorities begin asking questions.

Most banks that have a screening programme use some form of dual-use goods detection, checking the goods either against the European Union Dual-Use List and military list, or against their own internal list of high risk goods, or through a CTRL+F search. There are two main problems with this approach.



Heather Lee, Accuity

**“Our concern is that the approach of many institutions isn't sophisticated enough to manage the increased risk associated with trade finance.”**

Heather Lee, Accuity

The first is that this type of search inevitably throws up a lot of false positive results that take time and resources to work through – raising the risk that innocent goods will be held up or rejected and the reputation of the bank damaged.

The second is that the language of trade and the language of sanctions are very different. There are, for example, many synonyms for bromobenzyl cyanide, otherwise known as tear gas, including its chemical formula (C<sub>8</sub>H<sub>6</sub>BrN) and CAS number (5798-79-8). A screening tool will need to be comprehensive, covering all known synonyms and acronyms, and customisable to minimise false positive results.

The good news is that dual-use screening tools have developed rapidly in a short space of time. At Accuity we first integrated the EU Dual-Use List into our screening tool in 2012 when a large multinational cargo company asked for our help. Over time, we've adapted and improved the screening tool to address the many challenges of the process; our latest version, for example, uses natural

language and 'fuzzy logic' to capture the varying descriptions of dual-use goods.

### Continuous screening

A typical trade – if there is such a thing – is a long and complex journey, in terms of both geography and time. Screening SWIFT messages essentially gives you a single snapshot at one point along that route. That's not enough. Sanctions are constantly changing – you might be protected at the beginning of a trade but exposed to risk by the time it is completed – and every stage of the trade, particularly during transit, presents different risks.

Best practice screening takes into account the fluid nature of trade and sanctions, making sure that information is comprehensive (covering goods, vessels, locations, companies, banks and counterparties) and constantly updated. And good screening is proactive, rather than reactive.

That's why our clients are increasingly interested in knowing not just what is aboard a vessel, but exactly where a ship is at every point in its journey. If it sails near a risky port, they want to know without delay. Tracking tools are becoming increasingly sophisticated for this reason, allowing banks to actively monitor every journey and receive an alert if a vessel strays outside its expected route or if it turns off its tracking software.

### Document screening

Screening SWIFT messages provides basic information on the goods and counterparties, but there is a wealth of other data available, as well as the technology to mine it.

It's now possible for all documentation to be screened, from the original letter of credit through to remittance stage, and the data stored to create a detailed audit trail. So why not use it? Screening all documentation associated with a trade gives you a comprehensive and up-to-date picture, including any changes that have been made since the original letter of credit was prepared, to the planned stopping off points for vessels. When it comes to trade finance, information is power.

Managing the risks associated with sanctions and trade finance is, essentially, a detective game. The clues are out there – you just need to be sure that you don't miss them.

To find out more about how to manage sanctions risk in trade finance visit: <https://accuity.com/what-we-do/trade-compliance-screening/>