

Senate Committee on Banking, Housing, and Urban Affairs

Countering Russia: Further Assessing Options for Sanctions

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Chairman Crapo, Ranking Member Brown, and other distinguished members of the Senate Committee on Banking, Housing & Urban Affairs, I am honored by your invitation to testify before you today.

This is the Committee's second hearing in the past several weeks on assessing next steps and further options for U.S. sanctions on Russia. I commend your attention to this issue of growing urgency to our national security and to the collective security of the international order that the United States has led since the founding of the United Nations over 70 years ago.

I am also grateful for the substantial contribution of the expert witnesses who testified before you on this topic last month. Their prior testimony and ongoing work, together with the contributions of other dedicated experts studying this topic, continue to inform our thinking at the Financial Integrity Network and the testimony that I will deliver to you today.

The primary basis of my testimony, however, is the experience that I have gained in helping to shape and implement sanctions policy over the past fifteen years, in the U.S. Government, the international community, and in the private sector. Based on this experience and as explained in greater detail below, I believe there are important steps that Congress should take to protect our national and collective security by clarifying and strengthening sanctions on Russia, summarized as follows:

- 1) Prioritize targeted sanctions against Russian leadership engaged in illicit conduct.
Congress should target sanctions against Russian leadership engaged in illicit conduct by:
 - (i) Calling for the establishment of a Russian Counter-Illicit Financing Task Force dedicated to tracing, mapping, sanctioning, and prosecuting illicit Russian financial flows that intersect with the U.S. financial system, and for working with allied governments to similarly track, trace, and combat illicit Russian financial flows, largely as proposed in the Countering Russian Hostilities Act Bill;
 - (ii) Providing specific funding for the Russian Counter-Illicit Financing Task Force, to be managed by Treasury and the Department of Justice to ensure interagency participation and support as needed across law enforcement, intelligence, regulatory, and financial authorities;

- (iii) Codifying and consolidating existing sanctions authority to specifically target Russian leadership engaged in illicit conduct, largely as proposed in the Countering Russian Hostilities Act Bill;
- (iv) Expanding existing sanctions authority to specifically target Russian leadership engaged in illicit conduct that, with respect to any foreign state: (a) undermines democratic processes or institutions; (b) threatens the peace, security, territorial integrity or sovereignty; or (c) misappropriates state assets;
- (v) Prioritizing and expanding derivative sanctions against persons and entities owned or controlled by; acting for or on behalf of; or materially, financially, or technologically assisting Russian leadership engaged in illicit conduct, including by calling upon Treasury to lower the ownership threshold for derivative designations from 50 percent to 25 percent, consistent with Treasury's final rule on customer due diligence for U.S. financial institutions;
- (vi) Creating a Europe and Eurasia Democracy and Anti-Corruption Fund as proposed in the Countering Russian Hostilities Act, and further creating specific funding for publication of studies and research on corruption of Russian leadership.

Prioritizing targeted sanctions against illicit conduct by Russian leadership will expose, contain, disrupt, and potentially deter such conduct. Efforts that can expose corruption of Russian leadership may be particularly powerful in raising opposition to such conduct in Russia. Prioritizing derivative designations in particular will give much greater economic impact to primary designations against Russian leadership by going after the networks that support and benefit from illicit conduct engaged in by such leadership.

- 2) Call upon Treasury to consider designating under Section 311 of the USA PATRIOT Act any Russian financial institutions engaging in substantial transactions associated with any illicit conduct by Russian leadership;
- 3) Heighten controlled pressure on the Russian economy. Congress should consider building upon Treasury's sectoral sanctions program to heighten controlled economic pressure on Russia, including by:
 - (i) Calling upon Treasury to expanding designations of Russian financial institutions, defense firms, and energy companies under the sectoral sanctions program;
 - (ii) Applying new sanctions against any persons with respect to purchase, subscription to, or facilitation of the issuance of sovereign debt of Russia, as proposed in the Countering Russian Hostilities Act Bill;
 - (iii) Applying new sanctions against any persons with respect to investments in the Russian energy sector, as proposed in the Countering Russian Hostilities Act Bill;

- (iv) Considering new sanctions against any persons with respect to investments in the Russian financial or defense sectors;
 - (v) Calling upon Treasury and the intelligence community to produce a study of key Russian sectors exposed to economic sanctions and U.S. and allied countries' exposure to potential counter-sanctions by Russia; and
 - (vi) Based on such a study, considering new sectors for possible designations under the sectoral sanctions program.
- 4) Strengthen the effectiveness of U.S. sanctions in general. Congress should strengthen the operational effectiveness of U.S. sanctions by:
- (i) Providing funding for Treasury to expand its sanctions targeting, compliance, and enforcement resources and capabilities, particularly with respect to derivative designations of key node primary sanctions targets;
 - (ii) Considering requiring Treasury to issue regulations specifying sanctions program and training requirements for global financial institutions operating in the United States and for other sectors vulnerable to sanctions busting and sanctions evasion;
 - (iii) Calling upon FinCEN to issue final anti-money laundering ("AML") rules on the reporting of cross-border wire transfers and on AML program, SAR reporting, and customer due diligence ("CDD") requirements for investment advisors to heighten the transparency of the U.S. financial system in accordance with international standards;
 - (iv) Calling upon FinCEN to consider rulemaking extending AML requirements to title insurance companies and/or others involved in the sale of high-end real estate as necessary to close proven sanctions evasion and money laundering vulnerabilities in the U.S. real estate market;
 - (v) Calling upon Treasury to issue a report offering recommendations for expanding information sharing under Section 314 of the USA PATRIOT Act to enhance the effectiveness and reduce the costs associated with counter-illicit financing analysis by U.S. authorities and across the U.S. financial system.
- 5) Facilitate operational sanctions capability in allied countries. Congress should enhance foreign partner capacity in key allied countries by providing funding to Treasury to launch a Foreign Partner Training Program across sanctions administration, implementation, and enforcement.

These recommendations are based in large part upon key developments, conditions, and challenges evident in the recent evolution of sanctions policy and implementation, as discussed in greater detail below.

Background

I was extraordinarily privileged to serve our country at the United States Department of the Treasury for 11 years following the terrorist attacks of 9/11. I worked for and with an immensely talented and dedicated group of individuals from across the U.S. Government, the financial services industries, and various governments with shared interests in our collective security. This was a pivotal period in the development and institutionalization of financial and economic power as an increasingly important component of our national and global security.

With bipartisan leadership across the Congress and four Administrations, we collectively constructed, secured, and deployed an unmatched capability to exploit financial information and apply financial and economic pressure to identify and attack threats to our national security. We also secured, strengthened, and expanded enduring multilateral support for these efforts, including through global frameworks, relationships, and mechanisms that continue to protect the international financial system from a wide range of illicit activity and actors. Developing and applying a broad array of financial and economic sanctions against various threats to our collective security constituted a core component of these efforts.

For the past four years at the Financial Integrity Network, our mission has focused on assisting allied governments, the global banking sector, and critical industries in developing and implementing financial policies that advance our collective security and protect the international financial system from abuse. A key area of our work has been collaborating with clients and partners to design, implement, assess, and strengthen effective and workable sanctions policies within broader financial security risk management regimes.

Throughout my experiences in government and the private sector over the past fifteen years, U.S. sanctions policy has continued to evolve, benefitting from lessons learned over time. My recommendations above for strengthening sanctions against Russia are based on this recent history of sanctions evolution, and how this history has revealed key conditions and challenges to strengthening the effectiveness of sanctions policy in general, including with respect to sanction against Russia.

Important Developments in the Recent Evolution of Sanctions Policy

Designing, implementing, assessing, and strengthening current sanctions programs requires an understanding of the recent evolution of sanctions policy within the broader rise of financial power and economic statecraft. This evolution is marked by four inter-related and fundamental developments:

- (i) The emergence of sanctions and targeted financial measures as a core component of foreign policy, national security, and collective security strategies;

- (ii) Shifting expectations of sanctions policy as an increasingly operational, targeted, and nuanced tool designed to achieve real financial and economic impact;
- (iii) Expanded application of sanctions against a broader range of illicit conduct, and
- (iv) The increased blending and interdependence of sanctions and anti-money-laundering (“AML”) regimes.

These developments, briefly explained below, help shape the conditions and challenges that sanctions policymakers should consider in developing, assessing, and strengthening sanctions programs, including with respect to sanctions against Russia.

The emergence of sanctions as a core component of foreign policy, national security, and collective security strategies

The emergence of sanctions and targeted financial and economic measures as an essential component of foreign policy and national and collective security strategies is evident in the relatively recent and rapid expansion of sanctions programs at global, multilateral, and national levels. Since the terrorist attacks of 9/11, virtually every United Nations Security Council resolution addressing various threats to global peace and security has included heightened sanctions and other targeted financial and economic measures. This includes global responses to illicit activities ranging from terrorism to the proliferation of weapons of mass destruction, as well as global responses to rogue regimes and destabilizing elites in various countries such as Afghanistan, the Central African Republic, the Democratic Republic of the Congo, Iran, Libya, North Korea, Somalia, Sudan, South Sudan, and Yemen.

In addition to this global expansion of sanctions programs, the United States has prominently coordinated multilateral sanctions campaigns targeting collective security threats associated with the Bashar al-Assad regime in Syria and Russian aggression in the Ukraine. The United States also continues to work with the European Union and other partners in maintaining other multilateral sanctions programs against oppressive and corrupt governing regimes in countries such as Belarus and Zimbabwe, and in implementing conduct-based sanctions against designated terrorist groups and their support networks.

At a national level, the United States continues to impose broad economic sanctions against Cuba, notwithstanding the substantial relaxations introduced in the last years of the second Obama Administration. The United States has also introduced and heightened unilateral sanctions against oppressive and corrupt elements of the governing regime in Venezuela. And the United States has expanded conduct-based sanctions against threats ranging from drug trafficking and terrorism to proliferation and malicious cyber-enabled activities, as well as against transnational criminal organizations more broadly.

Similarly, other jurisdictions, most notably the European Union, have developed unilateral sanctions programs to advance foreign policy interests such as combating kleptocracy, including with respect to ongoing asset recovery efforts against the former Mubarak regime in Egypt.

This broad expansion of various types of sanctions programs underscores the increasing importance of sanctions as a core component of global, multilateral, and jurisdictional strategies to advance fundamental foreign policy interests and address various threats to national and collective security.

Shifting expectations of sanctions policy

The emergence of sanctions as a fundamental component of foreign policy and national and collective security strategies is due in part to the shifting expectations of sanctions policy. This is notwithstanding the historically consistent overarching purpose of sanctions as a means of advancing core foreign policy interests and addressing threats to national and collective security.

In general and with a few notable exceptions, expectations associated with sanctions policy have shifted in two fundamental ways. First, sanctions have evolved from primarily political “name and shame” symbolic measures to operationally meaningful tools to deter, change, disrupt, and/or contain activity that threatens core foreign policy or national or collective security interests. As operational rather than purely political or symbolic measures, sanctions are increasingly expected to create real financial and economic pressure on their intended targets.

Second, as sanctions have become more operational, they have also become more tailored and nuanced, targeting specific actors or conduct of concern while minimizing collateral damage to third parties or related interests. Policymakers increasingly craft, tailor, and adapt specific types of sanctions to address specific types of threats, maximizing the effectiveness of sanctions while minimizing collateral harm. This is evident in the rise of conduct-based sanctions and the general move away from comprehensive jurisdictional embargoes and towards regime-based sanctions, targeting specific elites responsible for the threatening behavior of concern.

Expanded application of sanctions against a broader range of illicit conduct

As sanctions have shifted towards a more operational and targeted approach, they have been applied against a wider range of illicit conduct previously addressed exclusively by criminal law enforcement, or occasionally by the use of force. Such illicit conduct includes drug trafficking, terrorism, the proliferation of weapons of mass destruction, cybercrime, and transnational organized crime more broadly.

This emergence and expansion of such conduct-based sanctions have been driven by both necessity and opportunity. Such sanctions are increasingly necessary to protect and advance core foreign policy and national and collective security interests against an expanding array of threats that have become more sophisticated and globalized in an increasingly globalized economy. And such

conduct-based sanctions provide us with an opportunity to apply our considerable financial and economic power in a manner that directly attacks these threats, in support of law enforcement, foreign policy, and other national security interests.

The emergence of conduct-based sanctions has also been critical in targeting jurisdictional sanctions programs against government elites that are responsible for a targeted country's threatening behavior. Such sanctions have increasingly targeted a sanctioned country's government officials and related individuals responsible for activities such as: (i) threatening the peace, security, territorial integrity or sovereignty of other states; (ii) misappropriating state assets; (iii) undermining democratic processes or institutions, or (iv) engaging in gross human rights abuses.

Increased blending and interdependence of sanctions and AML regimes

As sanctions have become more expansive, operational, and targeted, they have also increasingly depended upon and overlapped with AML regimes. This is particularly true with financial sanctions or economic sanctions that are primarily implemented and enforced through the financial system. At a fundamental level, the effectiveness of such sanctions depends critically on the financial transparency achieved through sound implementation of robust AML preventive measures by the banking and financial services industries. The customer and transactional due diligence conducted by financial institutions pursuant to AML regulation enables such institutions to identify and manage risks associated with sanctioned parties, activities, and jurisdictions. Without the financial transparency achieved through implementation of such AML requirements, compliance with many sanctions policies would be substantially limited or even unachievable.

In addition to this fundamental reliance of operational sanctions effectiveness on financial transparency gained through implementation of AML preventive measures, most conduct targeted by sanctions is also criminalized as predicate offenses to money laundering. This includes drug trafficking, terrorist financing, WMD proliferation (smuggling / violation of export controls), organized crime more broadly, and corruption. This overlap enables sanctions policy to benefit from the support of AML regimes across governments and the global financial system, where such conduct is targeted for as a basis for suspicious activity reporting, investigation, prosecution, and asset forfeiture.

Finally, sanctions policy may focus on targeted financial measures that may also be required or authorized by AML authorities. Depending on the particular sanctions program and scenario, sanctions may not require an asset freeze, but may prohibit certain financial relationships, investments, or transactions, akin to certain AML measures such as in applying Section 311 authorities of the USA PATRIOT Act. And as a practical matter, sanctions implementation increasingly requires AML risk management measures, such as certifications, representations, and enhanced due diligence.

This is particularly true with respect to the sectoral sanctions levied by the United States, the EU, Canada, and other countries against Russia. While such sectoral sanctions do not require asset freezing or outright prohibition of relationships or dealings with sectoral sanctioned parties, they do impose certain debt or equity financing prohibitions with respect to such designated parties, as well as other restrictions. These complex sanctions were deliberately designed to enable ongoing relationships with sanctioned parties while putting financial and economic pressure on key parts of the Russian economy. Financial institutions that must comply with these sanctions while remaining engaged in business with sectoral sanctioned entities rely upon a combination of sanctions screening and AML-like enhanced due diligence measures and controls.

These developments in the recent evolution of sanctions policy as described above can assist policymakers understand conditions and challenges that impact sanctions effectiveness.

General Conditions and Challenges for Assessing Sanctions Effectiveness

The recent evolution of sanctions policy reveals general conditions and challenges for assessing sanctions effectiveness as follows:

- First, effective sanctions policy and implementation requires clear sanctions objectives and criteria. With respect to sanctions against countries, the evolution of sanctions policies and programs, and in particular the complex combination of sanctions relevant to some countries such as Russia, has raised challenges of clarity and common understanding regarding sanctions objectives and criteria. Policymakers should ensure that objectives and criteria for specific sanctions programs are clear, and that these remain clear as underlying circumstances change. Policymakers should also ensure that sanctions objectives and criteria are well understood, including among allied countries, across affected business communities and the compliance industry, in the popular media, and within sanctioned countries – particularly when sanctions target corruption by ruling regimes. Such clarity and understanding may facilitate greater compliance with and more active support for various sanctions programs among allied countries, within affected industries, and among the general public.
- Second, as sanctions programs have become more operational and nuanced, they must be flexible to adapt to changing circumstances. Such flexibility is crucial to maintain the effectiveness of sanctions against intended targets while preserving their workability for compliance and implementation purposes. Policymakers should ensure that authority is delegated to the Treasury with sufficient discretion to manage, administer, and implement sanctions programs in a dynamic and complex environment.
- Third, the general shift away from classic jurisdictional embargoes and towards regime-based sanctions targeting illicit conduct by governing elites not only minimizes collateral damage to innocent parties, but also highlights and holds accountable specific individuals engaged in such illicit conduct. When such illicit conduct includes corruption, it may make it more difficult for sanctioned regimes to blame the United States or sanctions programs for economic problems that are likely due to the corruption and failed policies of the sanctioned regime.

Policymakers should generally favor developing such regime-based programs targeting illicit conduct over comprehensive jurisdictional sanctions. Derivative designations associated with such targeted programs can still introduce largely prohibitive jurisdictional risk in such countries for outside markets; however, the cause of intended or collateral economic pain in the sanctioned regime's country may be more visibly attributed to the illicit conduct of the regime and its control over the country's economy. This may help create internal pressure for the ruling regime to change its behavior.¹

- Fourth, the growth and complexity of operationally focused sanctions have put substantial pressure on sanctions implementation, administration, and enforcement resources, both within the government and across the private sector. As policymakers consider strengthening or expanding sanctions programs, they should ensure that appropriate government resources are available to implement these programs effectively, including for purposes of providing clear and workable guidance for the financial community and other industries whose compliance systems are critical in making sanctions operationally meaningful.
- Fifth, effective implementation of and compliance with increasingly complex sanctions programs and requirements demand specialized expertise, particularly in global finance and other industries exposed to sanctioned parties, activities and jurisdictions. Policymakers should support sanctions implementation and compliance by considering requiring training programs that specifically focus on developing such expertise in highly exposed industries.
- Sixth, the disparity between the United States and the rest of the world in sanctions administration, implementation, and enforcement – including with respect to global and multilateral sanctions programs – weakens sanctions effectiveness and heightens the burden of sanctions compliance for U.S. persons and authorities. Policymakers should prioritize not only global or multi-lateral political support for sanctions, but global and multi-lateral operational capability in sanctions administration, implementation, and enforcement. It is astonishing that 16 years after 9/11 and the adoption of United Nations Security Council Resolution 1373 requiring all countries to develop targeted sanctions against global terrorism, that only a handful of countries have invested in any meaningful sanctions administration, implementation, oversight, guidance, or enforcement. By and large, the Treasury's Office of Foreign Assets Control ("OFAC") remains a singular source of expertise, authority, and capability on sanctions administration, oversight, and enforcement, and the Treasury's broader Office of Terrorism and Financial Intelligence remains a unique institutional authority in targeting and implementing sanctions programs within a broader financial security approach and framework.

Policymakers should consider training budgets and personnel to assist foreign partners who commit to developing operational sanctions capabilities, particularly within a broader financial

¹ For similar reasons, policymakers should also consider converting existing comprehensive jurisdictional sanctions against Cuba and Sudan to regime-based programs targeting illicit conduct.

security framework. Facilitating such foreign capability may also make it easier to engender political support for using such capabilities against common threats to collective security.

- Seventh, notwithstanding the need for greater multilateral capability in sanctions administration, implementation, and enforcement, the increasing use of sanctions by authorities around the world may expose the United States and its allies to retaliatory sanctions by countries subject to U.S. and allied sanctions. This concern should limit our consideration of technical assistance to allied countries and should drive a proactive study of our exposure to retaliatory sanctions by countries currently or potentially subject to U.S. sanctions. Policymakers should consider financing such a study.
- Eighth, the increased blending and interdependence of sanctions and AML regimes underscore the importance of investing in AML regimes not only to combat money laundering and financial crime, but also to facilitate compliance and implementation of sanctions policy. Where holes in AML regulation, implementation, supervision, or enforcement prevent financial institutions from truly understanding their customers or transactions, sanctions evasion becomes an elevated and real risk. In recent years, several enforcement actions resulting in billions of dollars of fines levied against global financial institutions for breakdowns in sanctions and AML compliance underscore this reality.

To facilitate effective sanctions implementation, policymakers should ensure that sound and robust AML regimes extend across the financial system and deliver the financial transparency required to identify and manage sanctions risk.

Sanctions policymakers should also leverage AML authorities and resources to provide investigative, analytic, and prosecutorial expertise and support to combat illicit conduct targeted by both sanctions and AML regimes.

Conclusion

Over the past generation, the United States has led the global development and institutionalization of global and national frameworks to combat financial crime, exploit financial information, and leverage financial and economic power, including through the development and implementation of sanctions policy. We must continue to invest in this capability, at home and abroad, and fully utilize this capability to combat threats to our national security, including with respect to dangerous behavior by the Russian government. I am hopeful that my testimony will assist the Congress and the Administration in continuing to lead these efforts.

I am grateful for the opportunity to testify before you today, and I look forward to your questions.