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## **Experts' Meeting, 15 July 2002, Brussels**

### **Background**

Working Group Three met with a group of experts who have been involved with the implementation and monitoring of both targeted and comprehensive sanctions, including financial sanctions, arms embargoes and embargoes of goods and services.

#### **I. Sanctions and Serbia**

Experts and Working Group members discussed problems with the non-targeted (or comprehensive) sanctions that had been imposed against Yugoslavia by the international community in response to the conflict there in the 1990s. Experts noted the difficulties that the current government there is encountering in pursuing reforms.

### **The Oligarchs and Sanctions Evasion**

There is an "oligarchy" in Serbia today, consisting of roughly 200 families who were enriched during the Milosevic era, largely through corruption. These families have roughly twenty per cent of the country's national wealth, and many of their assets may be in Cyprus and Russia. The oligarchs continue to retain power and wealth, and the new government has encountered a number of obstacles in tracking down their assets and bringing them to justice. Some Serbian officials estimate that of the 200 families, the government might be able to convince 50 of them to return to legality in some way, while another 50 would strongly resist such efforts and should be "attacked" by the police and other law enforcement agencies. The fate of the remaining 100 families will depend on how effectively the government deals with the others.

Regarding measures for dealing with those who have enriched themselves under sanctions and who continue to present obstacles to reform in Serbia, the international community should consider working with the Serbian government to create a "cordon sanitaire" around the most important offenders. This would allow the government to account for, freeze and seize the fortunes that they have transferred to various foreign accounts by way of international money laundering networks and the use of complex financial vehicles.

It takes Serbian officials one to two years to track down assets that have been stolen from the government and hidden in front companies. Even when assets are found and frozen, targets may manipulate humanitarian exemptions to their advantage. The former Serbian Minister of Health was discovered with 800 million Swiss francs, which had been frozen, presumably by the Swiss government. He asked for his assets to be partially unfrozen, however, due to

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his child's illness and medical expenses. The government that had frozen the assets complied for humanitarian reasons.

### **Comprehensive and Targeted Sanctions – Problems and Circumvention**

There were many problems with the sanctions regime against the FRY. Most Serbs concluded that they were counterproductive and cruel. Specific problems include the population's perception of the sanctions regime as unjust, and the "rally round the flag" effect seen in many other sanctions episodes.

Comprehensive sanctions also led to illegal trafficking in goods and contraband items. Some Serbian officials have estimated that 60% of the Serbian economy remains "gray", or informal. The Milosevic regime supported these illegal activities and praised them as patriotic. The regime was able to direct state agencies and resources to participate in and support sanctions busting, including customs services, police, tax officials and the judiciary. These patterns of smuggling and unofficial economic activity have made it extremely difficult for the new government to collect taxes.

Slobodan Milosevic's regime started to become weak when targeted sanctions were applied against the powerful elite (the oligarchs) of the regime. These people felt the pressure of sanctions when their assets were frozen, and they could not travel to Cyprus and other states where they had stashed their assets. It is important to note that because these people were part of the governing regime (e.g. the President of Parliament), they did not initially attempt to hide their stolen assets or to open accounts under fictitious names because of their status in the government. Once these people were targeted more directly by sanctions, they used expensive lawyers in countries such as Switzerland and Luxembourg to set up front companies, some under the names of their children. They set up various bank accounts in countries such as Russia, China and Cyprus and changed the names of the account-holders to hide their identities.

### **Psychological Impact of Sanctions and the Media**

Comprehensive sanctions also reinforced the paranoia nourished by the regime's media and increased popular support for the Milosevic regime. Milosevic had told the population for years that the world was against them, and sanctions and NATO's bombing campaign confirmed this to much of the population. This interaction between state-controlled media in a target country and popular perceptions of sanctions would seem to be relevant to targeted sanctions as well.

Once sanctions were targeted against Milosevic's regime, the population's cynicism leads them to assume that his cronies (who were the subject of targeted sanctions) would simply become part of the "nomenklatura". There was a complete information blackout. Serbs did not understand why targeted sanctions were not used earlier, instead of comprehensive sanctions.

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### **Sanctions Assistance Missions (SAMs)**

Problems with SAMs and sanctions against FRY:

- Political expediency led to exceptions to keep Greece on board. Goods were initially allowed to transit through Yugoslavia, even though it was under “comprehensive” sanctions.
- Varying level of commitment from countries involved made SAMs work difficult.
- Bordering states had power to prohibit sanctioned goods from getting through to FRY but initially lacked the mandate to seize goods.
- Threats to SAMs team members created security problems.

### **Lessons learned from SAMs:**

- Prior to implementation, it is important to explain SAMs to states involved as cooperative endeavors rather than inspections regimes.
- SAMs can only work where the host country genuinely wants the mission to succeed.
- Political incentives (e.g. prospects for EU membership) helped encourage cooperation from states.
- Important for teams to be multinational.
- Longer missions worked better (e.g. six months instead of the three months or less).

### **Additional Recommendations**

International judicial proceedings that occur after sanctions are lifted or suspended to retrieve money and assets stolen during the reign of target regimes are slow and often ineffective. Additional measures are necessary. Serbs are aware that at the trial of Slobodan Milosevic in The Hague, no one is asking him where the \$30 billion Euros are that disappeared during his tenure.

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## II. Financial sanctions

A typical large European bank may have a few officers at headquarters who specifically deal with financial sanctions, and one officer at its various regional headquarters. In most cases officers that are entrusted with Anti-Money Laundering tasks are also entrusted with ensuring compliance with financial sanctions.

Information about sanctions comes to banks slowly, and compliance and sanctions officers have to look at the EU website daily for changes to EU sanctions regulations. When sanctions are issued, banks must inform their relevant employees worldwide and check their accounts against sanctions lists.

A new law in Germany requires banks to give the names of owners and the numbers of all their accounts to the German government. It is not clear if this will shift the responsibility of identifying accounts to be frozen to the German authorities

Large European banks typically implement sanctions in the following way (chronologically):

Friday	Sat/ Sun	Monday	Tues.	Weds.	Thursday	Friday	
Embargo published therefore legally binding		Start embargo Processing.  Type checklist, EDP Screening request, Internal Publication	EDP- Screening and Documentation	Same as Tuesday	Information on results; decision about preventive freeze; freezing request sent to divisions.	Central Bank reporting, including balances based on search results (Mon. or Tuesday's balances)	<b>Freeze Active</b>
<i>TRANSACTIONS ARE POSSIBLE!</i>					<i>Entering of freeze data</i>		<b>Freeze active</b>

It is important to note that until recently, these accounts did not have to be checked retroactively for suspicious movements prior to the publication of an embargo. New regulations, however, will require banks to give EU governments and the European Commission information on prior six months of bank transactions.<sup>1</sup> As for non-EU member states, Switzerland normally closely follows the EU's rules regarding financial sanctions but is not obliged to do so. Those countries that are candidate countries or associate countries of the EU often claim that they comply with EU sanctions requirements, but in many cases the requisite national legislation is not in place.

<sup>1</sup> A six-month retroactive reporting requirement was included in the EU sanctions against Zimbabwe (Regulation 310/2002) and in the new Regulation (881/2002) against Al Qaida, Taliban and Usama bin Laden. So far no bank has provided this information on this period to the European Commission.

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### Challenges for Sanctions Implementation and Background Information

- Money laundering -- There is some cross-over between systems (especially software) that banks have installed to combat money laundering, and that needed to comply with sanctions regimes. Many bank officials now share responsibility for anti-money laundering (AML) efforts and sanctions. However, in countries that are deemed “non-cooperating countries and territories” (NCCT) by the OECD’s FATF on Money Laundering, foreign banks operating in those countries generally cannot freeze the account of a person who is a target of sanctions. However, the bank may choose to close that person’s account to avoid harming the bank’s reputation.
- Correspondent Bank Accounts and Clearing Methods for Foreign Exchange Transactions may hide from the banks involved, and therefore to the government authorities, which funds are transferred to whom and for what purpose.
- Domestic legislation – A country needs to have laws that allow it to autonomously freeze funds. However, under AML requirements and counter-terrorism obligations, banks are obliged to do certain things. Most banks are afraid of a loss of reputation (so-called “reputational risk”), which provides them with incentives to comply with international norms on their own initiative.

Banking experts raised numerous concerns about implementation of financial sanctions:

- Cost (for banks) of trying to implement sanctions. For instance, banks are reluctant to do more rigorous screening for names on sanctions lists, such as setting their screening systems to match 80-90% homonymy because when information about sanctioned individuals or entities is overly general or vague, the bank’s screening procedures (i.e. screening software) retrieves too many hits. Each hit has to be frozen immediately and checked manually.
- If governmental authorities are not able to tell a bank which hits are valid and which are errors, banks are exposed to liability risks for making the wrong decisions about specific accounts.
- All payment systems are electronic, so there is little human intervention by the banks.
- Privacy concerns:
  - Banks may not transfer knowledge and information across borders, even within Europe, unless it is public information.
  - In some countries, such as Belgium, banks are not permitted to keep databases on individuals.
- Translation problems when dealing with different alphabets and languages.
- People use false names and front companies.
- Money and goods do not follow each other. For instance, arms may be sold to the former Yugoslavia from Israel but the money may be sent to Cyprus or the Vatican.
- During period when financial sanctions are discussed but not imposed targets can make necessary arrangements to move funds.

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- Many countries fail to cooperate with sanctions or claim to be cooperating but continue to make investments in sanctioned countries through foreign subsidiaries (e.g. some American businesses continue to invest in Cuba through their foreign subsidiaries despite U.S. government sanctions).
- Investigations into irregular bank activity only occur when something goes wrong or if a customer complains about a transaction not working as planned.
- It is difficult to identify the real economic beneficiary of most bank transactions.
- Highly skilled lawyers and accountants help make many transactions appear legal.
- Existing laws for AML and anti-fraud purposes, such as “know your customer rules”, require banks to know the destination of the funds they transfer, but banks believe this is impossible. Possible to know the next destination of funds they send but not the final destination.

### **Bankers' Recommendations**

- Lists of targeted entities should include full information to overcome the following problems:
  - First name/surname is not always clear (e.g. in which order should banks search names such as “Makthab Al-Khidamat/Al Kifah”?)
  - First name missing
  - Date of birth missing – if first name and date of birth are missing, it results in too many false hits.
  - Titles vs. names not always clear (e.g. Maulawi, Mullah, Mufti, Sheikh)
  - Abbreviations for groups (e.g. “HUM”) are not clear – may be alias or simply an affiliation
  - If “Al” is part of the name, should banks search the name with or without “Al”?
  - Address information – clear identification of city is difficult
  - Different language versions of some regulations lead to confusion (e.g. “Schwarzer September” and “Black September”). Are these aliases?
  - If a hit in the bank’s customer database shows additional first names that are not mentioned in the regulations, question arises regarding validity of hit.
- Better coordination of information from entities imposing sanctions (e.g. after September 11<sup>th</sup>, some banks received more than twenty different lists of names of targets whose assets should be frozen).
- “One stop shopping” for information on sanctions for companies that must implement them, such as banks.
- Local laws should be uniform, or at least more compatible (e.g. banks cannot share information about an account in Switzerland with their colleagues in France). Banks would prefer a “level playing field”.

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- Some states have excessive reporting requirements for transactions (e.g. Spain requires banks to transmit all names of those making transactions over 10,000 Euros to authorities), but there is very little, if any, investigation of the information.
- Banks can and do transmit some names to the appropriate government ministry in cases of doubt regarding whether or not two names are really for the same person. Clear procedures for doing this and rapid response from the relevant ministry are important.
- Some banks screen all new accounts for names of targeted individuals as well as people from certain countries, and from foreigners with “local” names that raise bankers’ suspicions.
- Legal (especially civil) protection when banks freeze accounts – Customers often sue banks for blocking their accounts. In Switzerland for instance, if a bank transmits a name and it turns out to be wrong, then they will be sued for violating the person’s privacy. Banks want protection from transmitting names in relation to AML or sanctions efforts because in such cases, they are fulfilling their legal obligations.
- Incentives needed to encourage banks to run additional screens.
- Allow banks to take payment for their customary fees from frozen accounts.
- Informal communications between bankers and police can be helpful.
- Exceptions to privacy laws (e.g. data protection laws) would help banks share information regarding sanctions targets.

### **General Recommendations**

Members of Working Group Three and our invited experts expressed frustration that useful advice on problems of implementation of financial sanctions was included in the Interlaken process, but the UN tends to “forget” the expert advice it receives.

Regardless of the type of sanction being used, greater public diplomacy is needed to explain sanctions to the population in targeted countries.