Navigating the complex sanctions landscape: letting AI take the strain

CONPEND

Contents

Foreword

Trade finance forms a key part of many banks' offerings, but in recent years, the rise of regulatory requirements has become a major concern. Banks perform rigorous checks on trade documentation, from letters of credit to bills of lading, to ensure they meet high compliance standards, with massive resources dedicated to manually processing what is estimated to be 28.5 billion paper documents each year[1].

Following the Russian invasion of Ukraine, governments around the world have acted quickly and decisively to condemn these actions. Severe financial penalties and comprehensive trade sanctions have been implemented to exclude Russia from international markets. This has resulted in increased workloads, pressure and complexities for financial institutions (FIs) – the custodians of global trade finance – as they scrambled to update and execute compliance procedures. This report is an opportunity to share our insights into the sanctions environment, how it is impacting FIs, and how they are tackling ensuing challenges.

Conpend's core mission is to empower banks and other FIs involved in trade finance to increase their productivity and efficiency. Our approach is ultimately a highly practical one: whereby the current barriers and concerns facing our clients – and the industry at large – are not only fully accounted for but integral to the solutions offered. The focus is on using artificial intelligence (AI) and machine learning (ML) to streamline and automate the highly manual process of document checking. Conpend offers a highly tailored process to support FIs on their digitalisation journey. By fully understanding our clients' needs – a credit to our roots in consulting – we can advise and implement flexible, practical solutions in partnership with our clients.

Of course, the benefits of automation extend beyond their application to sanctions. In a previous whitepaper, we made the case for automation to streamline paper-based document checking processes and its benefits for more effective data management.

We hope you find this whitepaper a useful overview of the sanctions challenges facing the trade finance industry – and the potential of AI to solve them. If you would like to know how you can benefit, or organize a demonstration, please visit our website www.conpend.com for more information, or find us on LinkedIn: https://nl.linkedin.com/company/conpend.

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1.0 Executive summary

Like a domino effect, the ongoing conflict in Ukraine has reverberated around the world – not least in trade. Amid disruption to international trade flows and supply chains, the underlying system of trade finance processes have to navigate and contend with a complex, fast-moving sanctions landscape, including an initial rapid rollout of varying international restrictions imposed against Russia.

It is the responsibility of banks to uphold these financial restrictions, maintaining a secure, trusted global trade ecosystem through rigorous, detailed, up-to-date compliance checks. Indeed, if they fail to do so, the buck lies with them, and authorities will hold banks liable and impose strict penalties for enabling transactions that violate the new rules.

Even before the war in Ukraine, sanctions monitoring was a highly specialised and time-consuming task. The intensified sanctions environment has elevated this to a whole new level:

- The restrictions against Russian and Belarus make up the largest sanctions programme ever established.
- Sanctions lack uniformity between jurisdictions, and there has been little implementation guidance.
- Illegal activity, such as fraud and money laundering, are on the rise as sanctioned entities attempt to undermine restrictions.

In response to the high-risk, high-stakes environment, many FIs have chosen one of two paths:

- Overcompliance – enforcing sanctions to the fullest possible extent.
- De-risking from the sector to reduce their exposure.

Both seek to avoid the reputational and financial consequences of non-compliance. Neither, however, is a practical or ideal solution.

But there is another way to tackle sanctions. Banks can optimise their compliance checks by shifting the burden of reviewing transactions onto technology – specifically, AI. By performing automated checks and leveraging rich data sources to build informed risk profiles, AI can transform compliance processes, improving accuracy and processing times – with banks safe in the knowledge that AI is doing its job. Furthermore, technology can handle the increased volume of processes to comply with the full breadth of new sanctions. A digital solution can also offer a high degree of customisation, allowing banks to respond and update their processes, reliably keeping up with evolving sanctions.

This paper puts forward the case for digital solutions to take on the sanctions strain, using AI and analytics to detect criminal activity. It outlines the current sanctions environment and the impact on banks and the trade finance industry at large. It also reflects our first-hand insights, including the rise of know your vessel (KYV) checks, and how technology is equipped to deal with evolving, increasingly complex compliance requirements.

2.0 The state of sanctions: where are we now

The sanctions against Russia resulting from the conflict in Ukraine have been far broader and more rapidly applied than many expected. In fact, within 48 hours of the Russian military invasion, the EU published its first major package of sanctions against Russia. Other countries and further restrictions quickly followed, as global allies reacted decisively to sever financial and trade ties.

Broadly, international sanctions target Russian financial institutions (FIs), businesses, state-owned enterprises, as well as wealthy individuals, while also limiting goods, services and finance in the country. Sanctions include the removal of key Russian banks from SWIFT, resulting in payment delays made to Russia for oil and gas, for example. The following measures have also been announced:

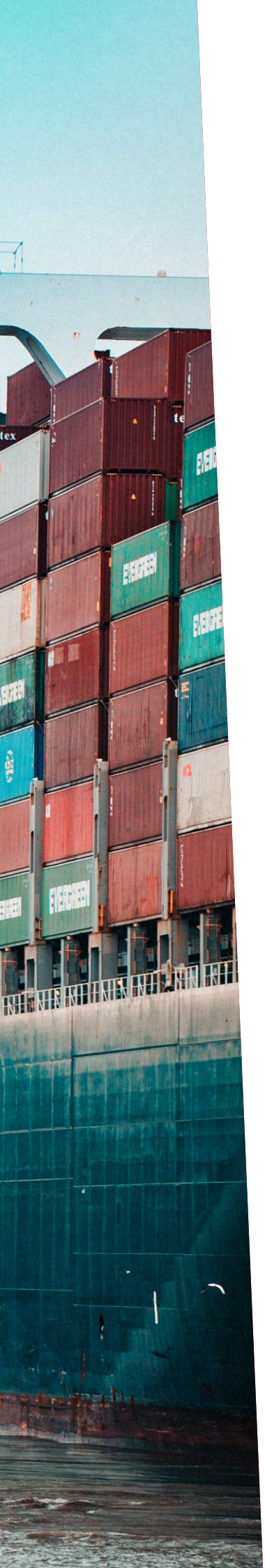
- A ban on all oil and gas imports from Russia by the US
- The EU has halted Russian coal imports and plans to ban all imports of oil via sea routes by the end of 2022
- The phase out of Russian oil imports by the UK by the end of 2022
- Germany has frozen plans for the opening of a major gas pipeline from Russia
- Many international companies[2] have suspended trading in Russia or withdrawn altogether.

The sanctions imposed are regarded as some of the most complex ever enforced by the West. And while the pace and frequency of new sanctions being introduced may have slowed, banks cannot rest on their laurels. The ongoing developments in the conflict mean that changes continue to take place unpredictably. In September, for instance, the EU, US and UK all proposed new sanctions packages. Discussions also continue to progress regarding secondary sanctions, which could see, for example, sanctions imposed against Chinese firms selling into Russia.

> "The speed and frequency of [sanctions] developments...has resulted in an operational nightmare for banks."

2.1 The role of banks: navigating the sanctions landscape

With 80-90% of cross-border trade reliant on trade finance, any international sanctions imposition impacts the trade finance industry more than any other single industry. As FIs are responsible for the flow of money and documentation that facilitate trade, the onus lies with them to catch and mitigate any sanction breaches. Thereby, sanctions create a particular regulatory risk for banks and other financiers across the globe.



This, of course, has been exacerbated by the swift roll-out of the Russian – and Belarussian – sanctions, not least because of their breadth and complexity, but also because of the limited implementation guidance in many parts of the world, and the constant vigilance required as a barrage of restrictions were introduced. Indeed, the speed and frequency of developments, with a sanctions list that grew daily at the start of the conflict[3] has resulted in an operational nightmare for banks, making it difficult to track and administer sanctions. And with Russia a top 10 global economy (prior to the war in Ukraine) its heavy involvement in global trade has made sanction developments particularly impactful from a trade finance perspective and makes monitoring for breaches all the more time consuming. Moreover, sanctions don't necessarily correspond across different countries and regulators, creating an incredibly challenging and involved environment for FIs to operate in. Indeed, the term "sanctions" is generally a container concept for a multitude of rules and regulations, presenting many deviations per region, country or even per company. For instance, the Russian sanctions proclaimed by the international community had a global nature but were by no means imposed by all countries and companies. The lack of uniformity between the specific regimes of the US, UK and EU are posing particular challenges for banks.

2.2 Illegal activity creating a high-risk, high-stakes environment for banks

Furthermore, in this environment, sanctioned entities – both individuals and businesses – may turn to other illegal activity in order to access financial markets and avoid restrictions, with sanctions busting – the deliberate disregard of sanctions – increasing the likelihood of fraud, money laundering and other financial crime. There is evidence, for instance, of the emergence of so-called "reputation launderers", who are working with Russian oligarchs to help them elude sanctions.

As a result, the pressure on FIs to catch any breaches has been heightened all the more. Banks need to be wary of an array of potential tactics to undermine sanctions, such as falsified bills of lading and certificates of origin; front companies concealing a beneficiary; ship-to-ship (STS) transfers; laundering of international maritime organisation (IMO) numbers (making an old vessel appear new); and the manipulation of automatic identification system (AIS) transponders, which are used to show a ship's location. Reports have emerged of Russian vessels turning off these devices. The behaviour recently hit headlines as a tactic to disguise the onloading of stolen Ukrainian grain from sanctioned Crimean ports, for example. Experts have also warned that some sanctioned entities may turn to the illicit gold trade to move funds across borders.

3.0 Feeling the strain: the impact on banks and trade finance

Sanctions monitoring is of course by no means a new phenomenon. It is a complex, time consuming task at the best of times. But the situation with Russia and Belarus has served to highlight how complicated and pressurised sanctions can be to the extreme. Compliance teams, which have grown in recent years as regulators tightened scrutiny of sanctions and anti-money laundering, are working furiously to keep tabs on and interpret new rules and guidance issued by governments.

Given the use of intermediaries for trade, as well as the multijurisdictional complexity of supply chains, it can be difficult to detect sanctions infringements, and related illegal activity at a bank level. Nonetheless, authorities will hold the banks liable. And the sanctions, as always, are likely to be rigorously applied, resulting in both large fines and a high level of societal condemnation for transgressors, even the case of unknowing (undetected) infringements. For example, for "wilful" violation of the rules, the US Department of Justice can pursue criminal penalties of up to US$1 million per violation; individuals can face 20 years' imprisonment[4]. Therefore, the stakes for banks are high.

Indeed, sanctions have already had consequences for FIs with strong links to Russia: Amsterdam Trade Bank (ATB), a subsidiary of Russian Alfa Bank, declared bankruptcy in April because US and UK sanctions made it impossible for the bank to make payments, despite ATB itself not facing sanctions.

3.1 De-risking

With the impacts on the trade finance industry far beyond those predicted, many FIs – and companies – have reacted with caution, sparking overcompliance and de-risking among many banks. This may impact cross-border payments and trade finance far beyond what governments had intended.

Beyond meeting the legal requirements, banks are increasingly "self-sanctioning", with the expectations for further controls, and public support for Ukraine pushing many to take a stronger stance than legally required. For example, some sanctions came with exceptions in order to allow countries to continue paying for energy from Russia. Yet, it is challenging to find a European or US bank that hasn't been excessively cautious in facilitating even permissible trade.

According to trade finance industry figures, reputational damage is a mounting concern for banks, and some FIs have chosen to cut ties with Russian companies to avoid reputational damage, despite not facing sanctions in their own countries. This includes some Chinese state banks, and lenders in India and the Middle East, for example. Some multinational companies are also voluntarily avoiding Russian-origin goods.

As they attempt to navigate the already complex area of trade finance, banks have had to adapt and step up their internal processes for vetting trade finance documentation, with de-risking actively reshaping compliance programmes. Besides the volatile environment, there are several drivers of this excessive de-risking approach to compliance – not least the inevitable consequences of the unpredictability that accompanies a regulatory regime in transition, including the perceived risk of dealing with a particular type of client (be that from a legal, reputational or financial perspective), or the costs of maintaining a robust compliance programme at a time when margins are tight.

Another complication is the fact that finding experienced compliance professionals to support increased demands is becoming increasingly challenging for many FIs[5]. It is therefore no coincidence that the necessity for a reliable solution is growing. After all, the financial and reputational damage for a company can be devastating and should be avoided at all costs.

4.0 The alternative to de-risking?
Technology taking the sanctions strain

With banks having to re-evaluate and adjust their business models as part of their protection strategies, for many, de-risking seems unavoidable. But there is an alternative at hand.

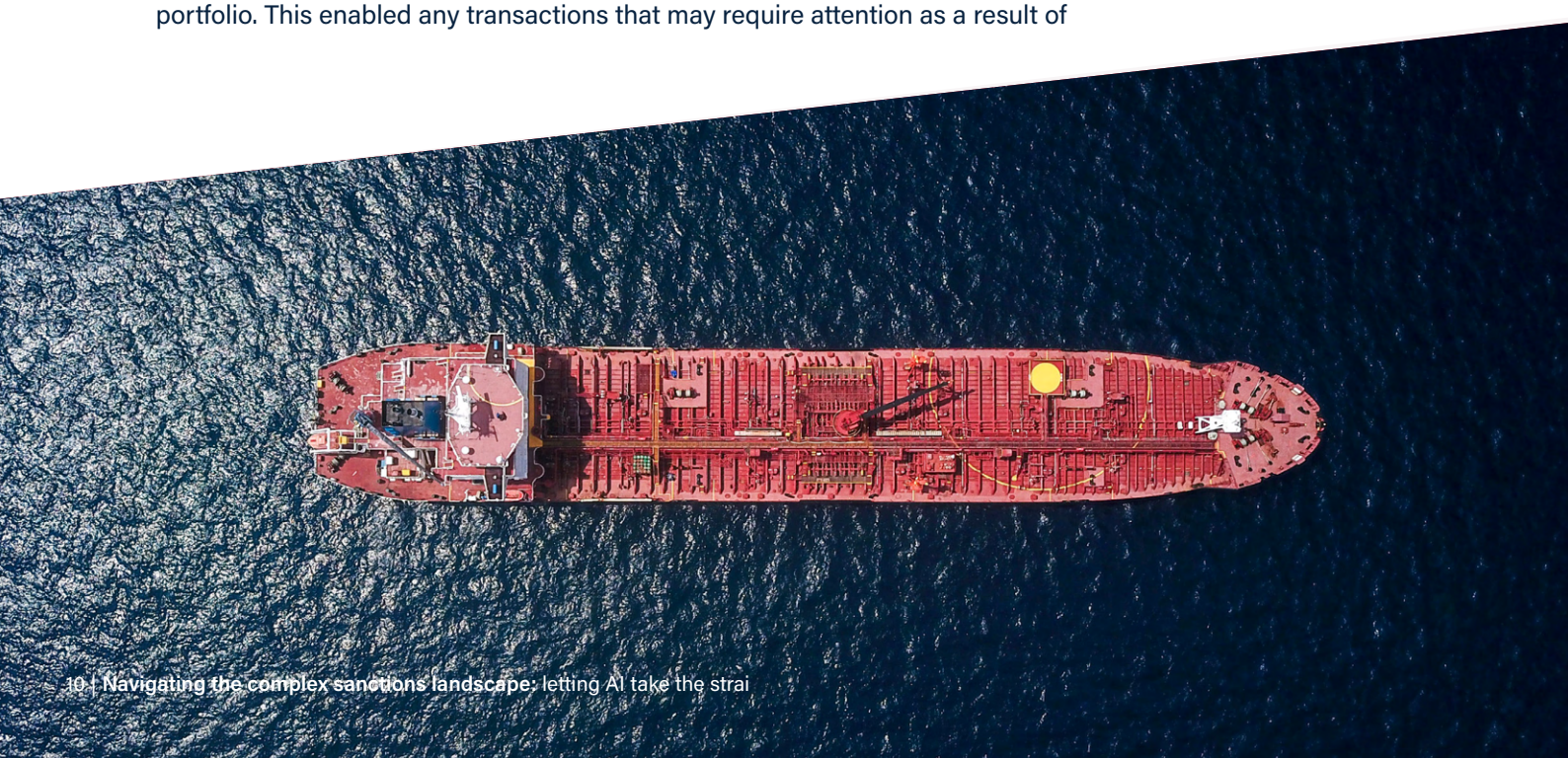
Historically, the paper-based nature of trade finance has served to drive a reliance on manual processes when it comes to compliance checks. But the growing need to meet the highest level of compliance in an operationally efficient way has seen banks increasingly seeking ways in which to make sanctions checks – and indeed, all forms of trade finance documentary checks – more efficient, cost effective and less onerous. Certainly, the complexities of global trade and the risks involved require screening processes that are thorough, robust, flexible and centred upon quality, up-to-date data.

Discarding manual processes and opting for comprehensive and adaptable digital solutions that use artificial intelligence (AI) and analytics to detect criminal activity could make a radical difference. By designating monitoring and checking to technology, the process is not only made simpler, far faster and more reliable, but banks can also free up resources and be relieved of the heavy, complex compliance burden.

4.1 Flexibility for fast-moving developments

As opposed to manually monitoring and implementing sanctions updates, AI software capabilities are able to perform this task automatically, thereby ensuring that the automated checks are aligned with the latest sanction requirements.

When the Russia sanction reforms began flooding in at the end of February, Conpend's datahub, a function of its Trade AI solution, provided the unique ability to supply all relevant updated watchlists overnight. In addition, within 48 hours of Russia's invasion, clients were provided with a specially developed script allowing them to perform keyword searches on their entire Trade AI portfolio. This enabled any transactions that may require attention as a result of



the changes to be quickly and easily identified. For example, clients were alerted to transactions linked to Russian ports, goods, entities and/or vessels. Notably, the software also assisted clients by adding new rules to their screening and evaluation processes. Such high level of customisation for specific sanction related issues is one of the key components of the Trade AI application.

4.2 Know your vessel?

In order to fully understand the risk profile of a trade, banks need to know as much as possible about the goods that are being traded and what they could be used for, including their destination, method of transport and route. This includes screening for goods that could potentially also be used for military purposes, nuclear proliferation or terrorism. And, with 90% of global trade involving the transport of goods by sea[6], checking for vessels associated with sanctioned countries is an important part of the process.

Changing a vessel's physical appearance and falsifying its documentation are tactics that are being adopted, with increasingly intelligent practices emerging as criminals attempt to evade detection. While "going dark" used to involve simply switching off a ship's AIS (see section 2.2), new deceptive shipping practices (DSPs) often focus more on a ship's identity than its location, which can be harder to detect. These new techniques include zombie vessels, identity theft, identity laundering, dual AIS transmission and GPS spoofing (broadcasting fake GPS signals). Zombie vessels, for example, are ships that have been retired and sent to ship breaking yards, only to reappear and become active again some time later. Banks therefore need to be particularly mindful of these increasingly sophisticated forms of maritime fraud.

> "Determining which vessels banks are or aren't allowed to finance is adding complexities to already demanding workloads."

"Knowing your vessel" (KYV) has become particularly critical in light of the developments with Russian sanctions. Of the roughly 44,000 tankers and cargo ships operational globally in the last two years, around 2,000 are Russian-owned or Russian-flagged. And once sanctions were put in place, many vessels, realising that the Russian (or Russia-related) flag would prevent them from docking, changed their flags overnight as they sought to evade the restrictions. Flag hopping on a vessel can take place on a frequent basis, as criminals adopt false flags and different "flags of convenience" in order to carry out illegal activity in various parts of the world.

Such practices pose issues not only for shipowners, but also for their commercial partners who might accidentally transport a sanctioned cargo, with vessels being declined access to ports or banking services as a result. Indeed, being linked to a sanction breaking activity can have consequences for many.

Determining which vessels banks are or aren't allowed to finance is therefore adding challenges and complexities to already demanding workloads for compliance teams, not least when emerging techniques to break sanctions are becoming more prevalent. Indeed, banks are not only being required to be alert to evolving sanctions, they must also ensure they are up to speed with – and equipped to detect – evolving sanction breaching methods.

A comprehensive system, such as Conpend's Trade AI, can help to address such issues. Technology can easily detect anomalies such as strange sailing patterns. For instance, a 300-meter tanker making U-turns in a narrow sea passage, or a tanker that was 275 meters long last week, appearing to be only 225 meters the following week; the historic data of vessels, including their past journeys and routes (if they have been in the South China Sea, for instance, which is notorious for illegal transshipments); where they docked; and the beneficial owners of the shipping company. For instance, the software can identify if a vessel that happens to be flying a Panamanian flag today, for instance, was in fact carrying a Russian flag prior to that.

Given that banks process hundreds of transactions per day, and that historical vessel checks may need to go back six months or more, keeping on top of these sanctions to this degree is all but impossible without AI. As a manual exercise, it would mean ploughing through files, collecting all the vessel names, then logging on to a data provider to check each vessel one-by-one-by-one-by-one. AI can thereby play an extremely sophisticated and valuable role in alerting banks to suspected illegal activity.

5.0 Data and the added value of AI

Data is king

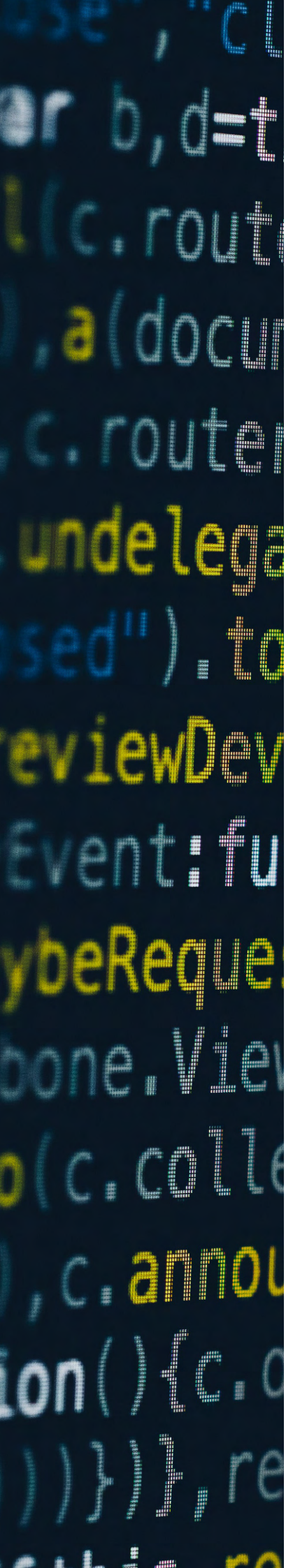
Implementing advanced AI compliance solutions and automation capabilities opens the door to a plethora of rich, interpretable data that can be used to gain deeper insights to help further enhance compliance processes.

For instance, if an individual on a sanctions list is detected in a document, technology capabilities can now enable far more layered investigations to take place. By running that name against the data available, it is possible to find additional useful information, such as the companies that individual is linked to. AI is also being used to detect missing or incomplete data captured during onboarding more broadly, thereby ensuring there is an effective, streamlined verification process in place that encompasses the breadth of know your customer (KYC) requirements.

Such solutions can also calculate and maintain customer risk scores based on defined metrics that are updated as a customer's information or circumstances change. This helps to ensure that banks know at any given moment, the risk that each customer poses to them – and in turn, their correspondent partners. Trade AI, for instance, can create profiles of banks' customers and their transactions, from which it can provide an analytical view of activity and trends at any given time, including efficiently detecting patterns and anomalies. For example, by analysing all the unit prices for a particular type of goods that the customer handles, the software can determine an average unit price. If there is a deviation of more than 10% on that price in any new transaction, the app can raise a red flag, thereby alerting FIs to unusual activity.

Indeed, it is important to note that digital solutions don't make decisions or take action based on their findings. They simply perform extensive checks quickly and effectively and raise alerts where needed. How these alerts are then interpreted, handled and ultimately classified, will always be the responsibility of the staff member performing the evaluation.

Furthermore, automating trade finance compliance checks also ensures that data is captured at the right time. Transactions where there is a deferred payment are a prime example. In such cases, sanction checks can be carried out and the transaction found to be in order, but the vessel might still be enroute, with the payment itself only due in 30, 60 or 90 days. A lot can happen during that time, after the checks have taken place. With AI, however, the sanction checks can automatically be carried out on a daily basis to ensure compliance, with any breaches or alerts displayed on the dashboard with a red flag. Such repetitive, daily monitoring processes are of course far more involved and time consuming – and far less practical – to undertake manually, making AI an invaluable tool in carrying out the most demanding and monotonous of compliance tasks thoroughly and reliably.



6.0 Conclusion

As the Russian invasion of the Ukraine continues, many banks and other trade finance participants still scramble to understand and adhere to the thousands of Russia-targeted economic sanctions and export controls that are being imposed. The disruption caused and the sheer volume of resources that are being dedicated to compliance efforts are serving to reemphasise the impracticality of manual checks. As a result, a new era in compliance processes may be emerging.

Banks are increasingly exploring alternative options to ensure a practical, robust, comprehensive sanctions checking process is in place – particularly given the hefty fines and possible criminal charges that stand to be imposed for breaches, as governments step up enforcement of the restrictions over the coming months.

AI-based automation is playing an increasingly critical, prominent role in helping banks and businesses manage their risks and improve efficiencies. Such tools give banks a far more detailed and substantial set of risk alerts, including the geopolitical implications that now have such far-reaching consequences, providing better scenario and contingency planning abilities. Undoubtedly, FIs that had already invested in such capabilities were more prepared and far better positioned to handle the recent avalanche of sanctions.

For trade finance and global trade, the past few years have been characterised by enormous turmoil, with unexpected events such as COVID-19, and now the sanctions stemming from the war in Ukraine. In such a fast-evolving and unpredictable environment, the trade finance industry will continue to face ample challenges. However, digitisation and automation can help with the understanding and the flexibility to deal with fast-moving developments, freeing up FIs to deal with more value-added tasks, including providing effective support to clients, as they themselves navigate the complex, unpredictable trade landscape.

About Conpend

By automating document checking using AI and machine learning, Conpend's clients can streamline paper-based processes – providing operational efficiency as well as increasing competitiveness by freeing resources for more meaningful reallocation.

Conpend's TRADE AI app checks against International Chamber of Commerce (ICC) rules and undertakes compliance checking against the Bankers Association for Finance and Trade (BAFT) anti-money laundering (AML) guidelines and regulatory sanctions screening, including Office for Foreign Assets Control (OFAC). Conpend strives to be part of our clients' journey every step of the way – offering them the latest innovative solutions that will change their business for the better.

Visit conpend.com to find out more.

[1] https://www.txfnews.com/articles/7382/one-step-beyond-new-uk-trade-digitisation-legislation-on-track

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