

# Facing the sanctions challenge in financial services

## A global sanctions compliance study





# Interviewees

**Lord Patten**

Former Commissioner for External Affairs  
European Union

**Roberto Hollander**

Director, Compliance and Risk Management  
Banco Bradesco

**Michael Hamar**

Former Chief Risk Officer  
National Australia Bank

**Reinhard Preusche**

Chief Compliance Officer  
Allianz

**Stephen Lock**

Head, Group Financial Crime and Security  
Old Mutual

**Guido Sollors**

Former Managing Partner  
Berenberg Bank

**Axel Kappstein**

Head of Compliance  
Berenberg Bank

**Joseph Cachey III**

Chief Compliance Officer  
Western Union

**Peter Ziverts**

Vice President, Compliance  
Western Union

**Neville Hall**

Global Head of Compliance  
Travellex

**Daren Allen**

Partner  
DLA Piper

**Guy Boyd**

Head of AML Sanctions Compliance  
ANZ

**Mohamoud H Abdalle Farah**

Chairman of Board of Directors  
Amal Express

**Augusto Restrepo**

Administrative Vice President and Legal Representative  
Bancolombia

**Mark Musi**

Chief Compliance and Ethics Officer  
Bank of New York Mellon

**Burkhard Varnholt**

Chief Investment Officer  
Bank Sarasin

**Valerie Dias**

Chief Risk and Compliance Officer  
Visa Europe



# Executive summary

Sanctions<sup>1</sup> are as much a fact of life for modern business as global markets. Financial services firms in particular are devoting increasing attention to sanctions compliance, as they navigate a shifting regulatory landscape in which guidelines are often unclear. This Economist Intelligence Unit study, sponsored by Deloitte, looks at the sanctions challenge facing the financial services industry and is based on an online survey of 388 executives and managers in the sector, as well as in-depth interviews with experts and corporate leaders. Its key findings<sup>2</sup> include:

**Increasing complexity, regulatory rigor, and the inconsistent nature of global regimes are raising the bar for sanctions compliance.** Nearly half of respondents surveyed (46%) by the Economist Intelligence Unit consider sanctions compliance a growing concern; and 63% say it has consumed more time, money, and personnel in the last three years. The biggest cause is the growing complexity of the task — cited by 71% of those in the compliance function — as firms need to check a wide variety of available information against ever-longer lists of sanctioned individuals and organizations. These checks generally use automated databases in the first instance, but all too often follow-up searching on the alerts generated through the automated tools must be conducted manually. This process is time consuming and can be expensive, especially if there are a large number of alerts requiring manual review.

Increasing global regulatory rigor in enforcing these requirements has made the task all the more pressing. Meanwhile, inconsistent regulations present notable compliance and, sometimes, legal challenges for organizations, according to interviewees for the study.

**Despite a measure of apparent confidence, financial services executives recognize that there is a lack of awareness in sanctions compliance that needs to be addressed.** Although 64% of survey respondents believe that their sanctions compliance efforts are sufficient, beneath the surface there is less confidence. Specifically, 45% of C-Suite executives worry that their industry is not sufficiently aware of the implications of sanctions compliance requirements for its business practice, against 30% who disagree.

Moreover, among non-banking financial services companies, 46% of respondents believe that they have established an effective sanctions compliance culture. In fact, only 28% have conducted a full sanctions risk assessment — the cornerstone of an effective sanctions program.

Examples of areas that need improvement across the respondent group include the following:

- Only 44% of companies have a clear, well-defined sanctions policy.
- At nearly one in four companies compliance staff receive training, at best, just once every two years.

<sup>1</sup> In order to provide greater analytical focus, this study uses a narrow definition of sanctions as “restrictions imposed on the economic activity of, or economic interaction with, specified individuals, organizations, and/or states.”

<sup>2</sup> Certain calculations in this white paper do not include “Don’t Know” responses so that a more detailed comparison can be presented.

**As the sanctions environment changes, the leading programs and strategies are also changing in a variety of areas:**

- **Culture and responsibility for sanctions compliance.** Only 56% of companies surveyed say that they have established an effective company-wide culture in this area. The growing importance of sanctions compliance makes it more necessary to create an appropriate culture, which begins with senior management setting the appropriate “tone at the top” for the issue.
- **Risk management.** Companies with well-defined sanctions programs are including risk assessments as part of best practice. Of this group, 70% were either in the process of completing or had already completed a formal sanctions risk assessment in the last two years. Regulators also now expect risk management to play a role in compliance: Office of Foreign Assets Control (OFAC) issued its Economic Sanctions Enforcement Procedures in the U.S. in January 2006 (updated in September 2008) which require that banks have programs in this field consistent with the risk they face. Risk assessments can be beneficial in allocating resources appropriately and designing effective processes. Nevertheless, risk-based approaches may be insufficient to protect against the strict legal liability involved with sanctions compliance, although a well-designed program may lead regulators to mitigate punishments for such breaches.
- **Information technology.** Information technology (IT) is essential for the intensive screening involved in sanctions compliance. The difficulties inherent in the task, and the still-developing state of the software, however, present challenges to global institutions: 44% of those surveyed believe that today’s technology does not meet current requirements without substantial manual assistance and 37% think this will still be true in three years. The overall efficiency of screening technologies — especially the large number of false positives they produce — is a particular problem. Depending on the nature of the products and services offered, technology solutions alone often uncover few real violations without substantial manual follow-up evaluation.
- **Global programs.** Companies that report that they have well-defined sanctions programs are much more likely to have programs that are consistent across the company: 73% of this group set policy at the global level, against just 41% of other survey respondents. Interviewees for this study say they find such an approach more efficient and effective. Of greater importance, global consistency is essential where violations of a particular country’s sanctions can occur anywhere in the world. Although legal restraints can sometimes make it impossible, according to the interviews leading companies are trying, as much as they can, to obey every country’s sanctions everywhere, rather than to have different programs in different countries. More than half of survey respondents based outside the U.S., for example, report using the OFAC list for sanctions screening, and more than a third of non-EU respondents use the EU lists. Still others use aggregate lists that also include the OFAC and EU names, making global homogeneity even more widespread.

# Introduction

## Who took the survey?

A total of 388 financial services executives and managers participated in the Economist Intelligence Unit's survey on sanctions, conducted in August through September 2008. 41% of respondents were board members, chief executive officers and other C-level executives; 32% of respondents were from the Asia-Pacific region, 28% from Western Europe, 24% from North America and 16% from the rest of the world. 50% of respondents' organizations had annual revenues greater than U.S. \$5 billion.

Sanctions and global markets are closely intertwined, with governments using the former to stop certain actors from exploiting the economic opportunities of globalization. Lord Patten, former External Affairs Commissioner of the EU, sees no let-up in their "epidemic use. They have become the only thing that a lot of governments feel is in their gift, beyond a strong communiqué, as a gesture of disapproval."

Academics and policy makers may argue over their effectiveness, but for global businesses, "sanctions have always been there, and always will be," says Neville Hall, Group Compliance Director for Travelex, a UK-based global payments and foreign exchange company. The only question is how best to comply. Although sanctions can affect almost any industry, financial services is a particular focus for regulators.

Getting it wrong can be costly. The potential reputational damage of association with known war criminals, terrorists, or drug dealers is considerable. Guido Sollors, until recently Managing Director at Germany's oldest private bank, Berenberg, credits the high awareness among bankers to this issue: "If you get involved in a deal with a prominent criminal, you can close up shop." Similarly, Valerie Dias, Chief Risk and Compliance Officer for Visa Europe, a Europe-wide membership organization, says that the payment systems industry takes the issue "very seriously. It is not something we can mess around with. We are constantly concerned about not just fraud but, the use of these funds to support activities like terrorism, prostitution, child pornography, or other unsavory activities."

In addition to reputational injury, the prospect of fines and forfeitures for sanctions breaches is substantial and growing, especially for those who transgress U.S. legislation where each offending transaction, no matter how small, carries a possible penalty of U.S.\$250,000. In late 2005, the Dutch bank ABN Amro agreed to a fine of U.S.\$80 million for violations of OFAC regulations committed in Dubai and India. In early 2008, the bank announced an agreement in principle with the U.S. Department of Justice to pay U.S.\$500 million to resolve all aspects of its dollar-dealing activities then under investigation.

In January 2009, Lloyds TSB agreed to a forfeiture of assets of U.S.\$350 million to cover violations of certain U.S. sanctions against Iran and Sudan. Financial services companies are taking note. Michael Hamar, recently retired chief risk officer at National Australia Bank, says the initial ABN Amro fine "got people's attention. The amount of money that Lloyd's set aside [and then paid] was riveting."

Sanctions errors are costly in myriad ways, but compliance, no matter how well intentioned the institution, is far from straightforward. The regulatory requirements globally are evolving rapidly and regulatory tolerance for violations is waning, if not gone altogether. In October 2007, the U.S. quintupled possible penalties for violations; in September 2008, OFAC released significant new enforcement guidance; and U-turn transactions were prohibited in November 2008. Meanwhile, also in September, the European Court of Justice, the EU's highest court, threw European sanctions policy into disarray by ruling in the Kadi case that the countries under its jurisdiction could not enforce United Nations (UN) sanctions lists because those on these lists had no legal avenue to appeal. (Although the Commission believes it has a viable new procedure in this matter that will satisfy the court, the case is once more before the courts.)

This Economist Intelligence Unit study, sponsored by Deloitte, reviews the growing challenges in sanctions compliance, how companies are faring in facing them and where leading practice is headed.

# The growing challenge

## The scope of the challenge

Sanctions compliance has been gaining increasing attention among financial services companies. Daren Allen, a UK-based partner in the international legal firm DLA Piper, who specializes in financial crime, notes that whereas money laundering and fraud were previously the leading focus, “In the last couple of years we’ve seen much more [focus] than ever on sanctions, and a real concern that people are going to get caught out. It has jumped right up the agenda.” Executives across the business have taken note, and those in the compliance function report the change even more clearly.

The key findings of the Economist Intelligence Unit survey include the following:

- 46% of all respondents and 58% of those in the compliance function, call sanctions a growing concern which is consuming greater resources at their firms. Only 15% and 17%, respectively, disagree.
- For 31% of those surveyed and 46% in the compliance function, sanctions compliance is among their business’ leading compliance priorities.
- 63% of survey respondents and 77% of those in the compliance function, have seen an increase in the level of time, money, and personnel devoted to supporting the sanctions program.
- The issue is also grabbing executives’ time: 63% of C-Suite respondents and more than 80% of compliance executives report an increase in senior management attention devoted to sanctions compliance.

Compliance costs are substantial and growing. Mr. Sollors says that recent changes in European sanctions regulations have “doubled or tripled the amount of work. Berenberg has seen a striking increase in personnel costs,” including a doubling in the size of the compliance department over three years. Similarly, Reinhard Preusche, Chief Compliance Officer at the Munich-based insurance group Allianz, notes that while sanctions were a small part of compliance until recently, now one-sixth of his staff are dedicated to them. Personnel are often the smaller part of the costs. The British Bankers Association (BBA) estimates that large retail banks will spend millions of pounds per year on staff time in this area, but tens of millions on systems.

The growth in the sanctions compliance challenge is widespread, but not universal across financial services: 8% of companies do not have a policy that deals with potential violations because they are so rare. Roberto Hollander, Director of AML/CFT (anti-money laundering/combating the financing of terrorism) at Brazil’s largest private bank, Banco Bradesco, says that the bank has such a policy. Nevertheless, he notes that nearly all of his company’s activity is domestic, and its clients rarely trade with affected countries. Therefore, this kind of compliance “doesn’t have a big impact on us.”

Such situations, however, are the exception. Survey figures from all geographies, as well as interviews from across the financial services sector, all point to increasing compliance challenges. Even Banco Bradesco’s minor sanctions obligations involve, says Mr. Hollander,

“more work than we had before.” More typically, National Australia Bank’s Mr. Hamar believes that “the single most important thing is to reinforce the message that just because you are a business banking manager in New Zealand, doing business with local companies exporting around the world, it doesn’t mean you can ignore the legislation.”

### Expanding lists, multiplying complexity

The main drivers of this shift appear to be interrelated: the number and complexity of sanctions; the inconsistent nature of global sanctions regimes; and increasing rigor in enforcement. 73% of survey respondents within the compliance function believe that the number and complexity of sanctions demanding compliance by their firms are increasing.

The figures for individuals and companies when, for example, they screen payments, bear this out. In September 2006, the BBA told the House of Lords that UK banks operating internationally needed to pay attention to 34 different sanctions lists when screening. Then, roughly 6,000 people and organizations were on the three largest lists — those of OFAC, the UK Department of the Treasury, and the EU. By November 2008, OFAC’s list alone had reached nearly 9,000 — including entries from the Islamic Movement of the Taliban in Afghanistan, to Drokdal Abdelmalek and his 46 different aliases or variations in name spelling.

Government regulators appear to believe that the growth in the number of people and organizations on such lists does not increase the conceptual difficulties of sanctions compliance. Government officials have said repeatedly that new sanctions on individuals in countries such as Sudan or Burma do not, per se, add to complexity because the expectations are the same when dealing with designated persons.

For companies involved in more complicated transactions, however, e.g., multinational banks, the situation appears to be otherwise. The biggest sanctions challenge, cited by 56% of survey respondents and 71% of compliance executives, is the complexity of screening all dimensions of financial transactions. Even something as basic as a payee’s name causes challenges. Inconsistent methods

of transliteration of Slavic or Arabic names, for example, make compliance more complicated than running intended recipients through a simple database. Some degree of flexibility and fuzzy logic is needed to allow for near matches, but the degree is a judgment call. To use a common example, with overly loose settings, the actor, Cuba Gooding Jr., might appear as a possible violation of U.S. Helms-Burton sanctions against Cuba.

Sorting through even obvious false positives requires time and resources and is not foolproof. In July 2008, a global retail bank twice froze the weekly pay of a UK national of Zimbabwean birth when deposited into her local London account, because she shared a surname with the sanctioned Zimbabwean President Mugabe. The Head of Compliance at a global bank says that sanctions compliance has become “more time consuming because there are an increasing number of people on the list. That really becomes challenging.” A simple Society for Worldwide Interbank Financial Telecommunication (SWIFT) payment has numerous pieces of information besides names, and companies are increasingly expected to scan all of them.

Moreover, the need to comply in a way that is not unduly disruptive to the ongoing business needs of the institution cannot be overlooked. As the Mugabe example above shows, an error can leave customers in financial difficulty. Travelex’s Mr. Hall says that, with small amounts of currency exchange, it is impossible to screen all transactions and still serve customers. “You couldn’t conduct business” if you did, he says. Joseph Cachey III, Chief Compliance Officer of the US-based money transfer company, Western Union, notes that being able to clear payments by legitimate clients efficiently is considered good customer service.

Most financial services companies may worry less about customer disruptions because all their competitors will be instituting the same sort of compliance programs. This is not always the case, however. Amal Express, a hawala brokerage, has found that even a substantial number of legitimate customers, who may not fully understand the reasons for compliance requirements, will sometimes switch to competitors willing to ignore the law [see next page].

### **Hawala and sanctions**

In recent years, the global realities of sanctions compliance have collided with a means of money transfer existing in certain Islamic countries since medieval times, referred to as hawala.

The practice is simple. A sender gives money to a local broker who then instructs an agent based near where the intended recipient resides to pay out an equivalent sum, less commission. Unlike modern wire-transfer companies, however, traditional hawala dealers didn't keep track of individual transactions. They merely maintained running tabs on the amount owed between brokers, which they settled periodically. No formal legal instruments existed or capacity to enforce debt collection: the system relied on trust.

A UN study conducted in 2002 estimated that between U.S.\$100 billion and U.S.\$300 billion flowed annually through hawala and similar systems, or about 2.5% of world trade. The potential for abuse attracted regulatory interest, especially after September 11. The problem with shutting hawala companies — regulators refer to these as Money Service Businesses (MSBs) — is that they are sometimes the only channel for sending remittances from the developed world. These remittances are economically essential in poorer states. In Somalia, for example, the rule of law and the banking system barely exist. Mohamoud Abdalle Farah, Chairman of the Board of Amal Express, one of the largest Somali hawala groups, says that without the system, his fellow citizens in the country and in refugee camps "could not have survived years of civil war."

Mr. Abdalle says that when compliance requirements began to rise, Amal understood that "in the long run, only law-abiding MSBs will survive in a regulated society." The new rules meant substantial changes. The company needed extensive support from the United Nations Development Program and the EU to negotiate, as its website says, "the maze of bewildering international regulatory requirements in the post-9/11 period."

Changing Amal's internal practices was the easy part. Mr. Abdalle explains that it now has policies, technology, standards, and training to ensure compliance from start to finish. Three bigger, interrelated problems — cost, the competitive environment and customer mistrust of change — have proved greater challenges. Mr. Abdalle says, "We haven't benefited from being compliant in pure business terms." The required technology upgrades and ongoing employee training have not come cheaply.

In this, Amal has much in common with most financial services companies. The company, however, has not been able to "increase our commission rate because of competition," thus squeezing margins very thin. If every MSB were compliant, then any one company "would not worry very much about the extra costs or losing business." Although Mr. Abdalle believes that the vast majority of his industry is law abiding, there are exceptions, which hold an advantage when operating in regions "where there is only the law of the jungle and gun point."

Adding to a legitimate MSB's problems is client mistrust, even in developed countries, of compliance requirements. For example, Britain modestly tightened its regulations in 2007. Mr. Abdalle, then head of Amal's UK operations, recalls that customers disliked providing identification and address details, and were suspicious of their intended use. Unfounded rumors spread that brokers had become government agents: "Since hawala has historically been based on trust, this gossip reduced the volume of our business," says Mr. Abdalle. Amal lost a quarter of its clients, mostly to competitors willing to conduct "underground" transactions.

Modern sanctions requirements are forcing hawala to change and brokers need to negotiate this transition. The health of the industry, along with the lives of some of the world's poorest people, depends on it.

Relatively speaking, payment information is often the most straightforward part of compliance: screening is only one control and is not even relevant to certain sanctions requirements. This does, however, illustrate why so many companies are concerned about getting their compliance programs correct given the increasing complexity of the task.

Regulators in many jurisdictions are responding by trying to clarify their program requirements. In January 2006, for example, OFAC released its Economic Sanctions Enforcement Procedures for banks, and in September 2008 it issued new Enforcement Guidelines.

### The impact of regulators

Government officials have said that such documents are designed to make things more straightforward, not to add to banks' difficulties. One official recently observed that: "the whole spectrum of sanctions programs, ranging from country, to regime, to individuals, and each having its own nuances, can be a difficult area to master." And, "we are sensitive to that." The intent, he observed, is to issue regulatory and interpretive guidance designed to add clarity to requirements: "We are continually looking to make our regulatory system more accessible and more transparent to promote compliance."

The Economist Intelligence Unit's survey results indicate that despite OFAC's intentions, banks are still struggling to comply with what they see as growing demands from regulators. Indeed, for U.S. respondents, this was tied for the leading sanctions-related challenge — cited by 44% of those based there. It was the second-biggest problem for respondents globally — cited by 41%.

This is more than simply a U.S. issue. Two-thirds of survey respondents have seen the degree of rigor displayed by regulatory authorities grow and only 2% have experienced a drop. National Australia Bank's Mr. Hamar says, "What was once one item among many has become, if you are operating in multiple locations, the focus of the highest percentage of examination by foreign regulators." DLA Piper's Mr. Allen notes that the UK's Financial Services Authority is also tightening up in this area: "The FSA is looking to make examples here, as it did with AML [anti-money-laundering]."

Increasing expectations and rigor by different regulators worldwide are causing additional problems where the requirements conflict. Guy Boyd, Global AML/Sanctions Officer at ANZ, the Australia-based banking group that operates in 30 countries, says, "the biggest thing we've noticed is the multi-jurisdictional complexity." Some 64% of survey respondents have had similar experiences, stating that the degree of difficulty of complying with global regimes has increased.

# Worries beneath the surface

Though companies surveyed expressed confidence in their sanctions compliance activities, below the surface significant concerns seem to exist about their own and colleagues' performance.

When asked specifically, 64% of respondents thought their own corporate compliance efforts were sufficient given the risks faced and 56% believed that they had established an effective culture of sanctions compliance across the company. At first glance, this may seem like a positive result, but for a field involving complex legal obligations with potentially high penalties for failure, such figures may also imply that too many companies could lack sufficient rigor.

Our interviews also suggest that such confidence as exists is not absolute. Partly, this is simply because the task is so difficult: ANZ's Mr. Boyd notes that financial services firms are trying hard but recognize that "some of the obligations are incredibly difficult to guarantee compliance with. Combined with the penalty and enforcement landscape, this has a number of industry members worried. You won't find many that are extremely confident that they won't get stuff wrong. You are always prone to human error." More broadly, though, the concern also arises from a sense that the depth of the challenge is not fully appreciated: 45% of C-Suite executives agree that the financial services industry is not sufficiently aware of the implications of sanctions compliance requirements for business practice against 30% who disagree.

Although nearly every interviewee concurs with statements by regulators that "there is an increasing awareness of [regulatory] expectations and the law when it comes to sanctions," the survey suggests that even this is not uniform throughout financial services. Banks on the whole have been doing more than other parts of the industry, in part because their central role in facilitating payments across the economy has made them of particular interest to those enforcing sanctions. Whereas 66% of bankers believe they have an effective compliance culture, for others in financial services the figure is just 46% and for insurers in particular just 37%. More striking, 41% of non-bankers believe that their industry is not sufficiently aware of the implications of sanctions compliance for its business practices, against just 28% who disagree.

The survey also reveals potential weaknesses in performance on sanctions compliance. Only 44% of respondents — and just 33% of non-bankers — have a well-defined, clear program specific to this area. Similarly, only about 50% of companies have operationalized what policies they do have. According to OFAC regulations, the absence of a program — or an inadequate one — can result in regulatory discipline, possibly even fines. Thus a substantial number of companies appear to have left themselves exposed to regulatory risk at the very least.

Another area of concern is the completeness of screening. When asked about various types of payments, on average slightly less than seven in 10 domestic transfers are screened. This figure is expected to rise only marginally in the near future, to around three-quarters. For example, 68% of respondents screen domestic inbound checks and 75% expect to do so in three years' time.

There are competing views on the value of domestic screening. For ANZ, says Mr. Boyd, it depends on the jurisdiction and type of transaction. "If all participants in the domestic clearing system are sanctions screening their customers, then screening domestic payments is superfluous."

Many U.S. banks think similarly, but Bank New York Mellon takes a more conservative view. Chief Compliance and Ethics Officer, Mark Musi says, "We screen everything. Clearly the risk is lower on the domestic side, but even there if you don't look carefully, payments could involve a foreign institution." Beyond banking, a company like Western Union, acting effectively as its own clearing system, needs to screen U.S. and all other domestic payments.

There is little debate over the importance of cross-border screening. Here the survey figures are surprising. Overall, roughly a little over seven in 10 of such international payments are screened, and for inbound checks — the example used earlier — the current figure is 72%, which is expected to grow to 82% in the next three years. These numbers are just a little greater than those for domestic payments. Banks fare noticeably better, but still screen only about 80% now and probably close to 90% in future. Companies that are not screening may, quite simply, come to the attention of terrorists, drug dealers, as well as others on sanctions lists, and eventually, therefore, of regulators.

An often unrecognized weakness in compliance is hiring the right staff and adequately training them. Some 63% of survey respondents say that those making sanctions compliance-related decisions at their companies are adequately trained; only 13% disagree. Nevertheless, a lack of such individuals is a problem for many survey respondents: 31% working in compliance departments cite this as a leading challenge in implementing sanctions programs, making it one of their biggest challenges.

This partly arises from the nature of the work. Stephen Lock, Head of Group Financial Crime and Security for UK-listed Old Mutual Group, explains that, due to inadequacies in the data provided within sanctions lists, large retail firms may have many possible hits on a daily basis. However, the vast majority will lead to nothing and the review process is tedious. He says, "You need knowledge and experience to do this effectively, but it can be mind-numbingly dull and maintaining concentration to ensure that the true hits are identified is a real challenge."

The right incentives can help retain talented people in tedious jobs, but to negotiate the complex field of sanctions they need training. Here a surprising number of companies appear to fall short. At 24% of firms surveyed, even specialist sanctions compliance staff received relevant training only once every two years at most, including 7% who received no training.

The optimal amount of training is open to debate, but regular education in this fast-changing area appears to be an important success factor says Mr. Hamar: "The key to having capable people is precisely the same in this field as any other: it requires an investment of resources, monitoring and testing."

### **Company size matters, but should it?**

For financial services companies, size is no justification for poor performance on sanctions compliance. The legal requirements are the same and no inherent reason exists for underachievement. Augusto Restrepo, Vice President Administrative at Bancolombia — to whom the compliance function reports — says, “It doesn’t matter if you are a small, medium or big bank. With good processes, technology, policies and training, you will do well.”

The Economist Intelligence Unit survey suggests, however, that larger companies — those with annual revenues of about U.S.\$10 billion — are more active than smaller ones — those with revenues below U.S.\$10 billion. For example:

- Big companies are about twice as likely to have well-defined, clear sanctions programs (64% to 31%) and to have operationalized their efforts globally (70% to 38%).
- Despite their higher volume of business, larger firms are much more comprehensive in monitoring, especially cross-border transactions of which they screen about 90%.
- Larger businesses are more likely to be frequent trainers: 82% of respondents from these companies report that training of sanctions compliance staff occurs once a year or more, compared with 64% of those surveyed from smaller competitors.
- As a result, a lack of trained staff is a serious problem for the sanctions compliance programs of only 18% of big companies compared with 28% of smaller ones. Moreover, while 70% of the former agree that their staff is adequately trained for their jobs, only 58% of the latter do.

As DLA Piper’s Mr. Allen observes: “Larger banks have invested a lot of money on compliance. A number of smaller players don’t necessarily view it as a priority.”

This divergence arises from two differences in the compliance challenges that larger and smaller firms face. First, scale elevates certain risks. The Head of Compliance at a global bank explains that for larger banks, “you have a humongous customer base, you are working in multiple jurisdictions, across multiple environments. It has its challenges.”

Being small brings risks of its own, however. Mr. Sollors explains that while such firms may find it easier to manage compliance procedures, if something does go wrong, “the consequences would be higher. If officials in the United States thought that a small bank was not compliant, it would be no problem for them to stop its clearing business there. It could not live with that for even one day.” As recent events have shown, governments will react if large banks are in trouble, but if very small ones “face a crisis, nobody would care.”

Another great advantage of larger companies is access to resources, notes the Head of Compliance at a global bank (cited above): “Because we are a large organization and realize the implications of failure, we have the means to invest to ensure that we don’t fail.”

# Movements in leading practices

In response to the changing sanctions environment, leading practices are shifting in a variety of areas, including the following:

## Establishing the right culture

Establishing the right compliance culture depends on various factors, including who takes ownership of the area. Sanctions compliance programs most frequently reside largely or entirely within the general compliance function. As one might expect, in terms of executing policy and day-to-day management, chief compliance officers (CCOs) are by far the most likely to be in charge — At 34% of organizations, CCOs are in charge of executing policy and at 38% of organizations they are in charge of day-to-day management. They more often share ultimate responsibility for managing the firms' sanctions programs, although even here CCOs are still, by a slight margin, most frequently in charge (24%), followed by the board (23%) and CEO (21%).

These figures probably give too small an impression of the CCO's dominance of the area. Survey respondents included smaller firms without a C-level compliance official. Respondents from compliance functions — and therefore from companies that have specialized compliance operations — indicate that ultimate authority resides with the CCO 44% of the time, more than the board and CEO combined (33%).

Our interviewees insist that companies must avoid putting sanctions compliance into a silo. A strong culture is as important here as in other areas of compliance. Mr. Hall explains, "I can't single-handedly be responsible for making sure every customer behaves. A culture of compliance has to be a fundamental part of operational management. It is critical." Mr. Sollors agrees: "It does not work if you have only a bright compliance department. The awareness of every single employee is crucial." Mr. Allen adds that for successful firms, it is "a theme throughout the organization, not something seen as a cost but as a function that will prevent the firm being dragged into scandal."

Ownership of the issue at the very top is essential to establishing this culture. Mr. Musi believes that a prerequisite in this area is a proper atmosphere set by the board, CEO and entire executive team: "It is their responsibility." Mr. Hall also says the tone "has to come from the top down. If it is not seen as crucial, it cannot succeed, or else will be seen as the poor relation behind revenue."

Resources as much as culture are involved. Among surveyed companies with a compliance function, those where ultimate authority for sanctions resided with the board or the CEO were noticeably more likely than those where the CCO was in charge to have devoted increased time, money, and personnel to sanctions compliance over the last three years (77% to 70%). They were also more likely to see it as a growing concern that would receive further investment (56% to 43%).

These basic truths, almost clichés, about culture and leadership are true of any type of compliance. They matter even more here than elsewhere, however, because of two particular challenges. First, sanctions compliance has risen rapidly in importance, and may simply have not been a concern to most people. Mr. Hamar notes, “At the most senior level in a majority of banks, and at the board level, there is a great focus on this issue and understanding of the enormous reputational damage that screwing up can cause. How the bank manager understands this, who knows?”

The politics of sanctions also do not help. Stephen Lock notes that “where there is no local regulatory drive, people only become engaged in the process grudgingly and it can be like swimming against the tide.” Getting the message across to those who consider sanctions to be interference by foreign governments will never be simple. The risks of non-compliance, however, make it essential to build an appropriate culture.

### **Risk management tools and sanctions compliance: A marriage of expediency?**

Another issue involving the relationship of sanctions compliance with the broader company is its link with risk management. All compliance and regulatory issues have enterprise risk implications and sanctions are no exception. Mr. Hamar, who oversaw compliance while serving as National Australia Bank’s Chief Risk Officer, believes that “effective sanctions compliance requires an integrated approach on the part of people with compliance and risk accountability.”

In addition to cooperating with the risk function, companies are showing a growing interest in using risk-based approaches in sanctions compliance, especially since OFAC’s Economic Sanctions Enforcement Procedures required that compliance programs be tailored to a bank’s risk profile.

Accordingly, those with well-defined sanctions programs are including risk assessments — an essential first step to a risk-based approach — as part of leading practice. Of this group, 70% were either completing, or had completed in the last two years, a formal sanctions risk assessment, against just 36% of those without a well-defined program.

A risk-based approach can greatly enhance effectiveness. Mr. Restrepo says that by feeding risk analysis into the design of compliance systems so as to avoid potential problems, “you do more than 50% of the work.” In fact, for a large company deciding on how to allot limited resources, some risk assessment is essential.

Although highly beneficial, indeed necessary, in practice, a risk-based sanctions program is not a guarantee of success. Every sanctions breach, no matter how small, remains a possible violation of the law. In most countries, whether the “violation” will trigger a regulatory fine, or worse, is left to the discretion of law enforcement agencies. As a lawyer, Mr. Allen “gets nervous about the language of a risk-based approach when it comes to legal obligations. If you fail to comply with a legal obligation, you are on the hook and it is up to law enforcement whether it wishes to proceed against you.” Government officials have said that, whatever the practical necessities involved in creating a compliance program that allows a company still to function as a profitable business, ultimately the law must govern. “Compliance is a legal obligation for anyone doing business globally” said one government official. Thus, while regulators may be more lenient toward those with well-structured compliance schemes, they will not look the other way should breaches occur.

Thus risk assessment, and strategies based around it, form one essential element of an effective compliance program, but they do indemnify the company from potential failure. Mr. Hall expresses the dilemma most companies face: “If you think of the practical limits on resources, I don’t think anyone can ever assert with 100% authority that no sanctioned transaction has taken place. It is working out where you draw the line. I hope that most regulators would understand this.”

### The role of technology

To address the volume of work involved in screening the vast majority of the world's payments, financial services companies are seeking to exploit the potential of information technology. In particular, they are rapidly increasing the use of IT at the detection stage, the initial screening for possible red flags, which are then investigated manually. Less than 20% of respondents work for firms that have fully automated this process, but over 50% expect to have done so in three years time. Similarly, companies with largely manual processes look set to drop from 37% to 17% over the same period.

Leading companies, however, see IT as a necessity, but in no way a complete solution. The issues correspond to those related to risk management. Mr. Boyd says, "Without technology, you wouldn't have a hope of complying. You couldn't possibly review all of these payments manually." IT also brings the advantage of consistent treatment of payments. Mr. Musi says, "If you start with good automated processes, there is less subjective thinking."

Unfortunately technology, however essential, can introduce a host of difficulties as well. First, the available software does not meet the needs of many of the responding companies: 44% of respondents do not believe it meets current requirements without the help of substantial manual processes and 37% expect that it will not do so in three years — an improvement, but not an ideal result. Moreover, where technology is effective, it is often only after substantial work.

Mr. Restrepo's comments are typical: "The new technology we are acquiring is not ready to confront the new risks in compliance matters. We have to work with our providers to modify it. Technology providers are a little behind." Banks have it easier than the rest of the sector: Mr. Cachey of Western Union explains that most sanctions and AML software is built for them. "Typically, we end up building our own stuff." Adds Mr. Hall: "Anyone with a good system would have cornered the market."

The biggest problem for software is the inherent difficulty of the screening process. Companies need an algorithm that compares individuals or entities associated with a payment to a variety of lists with varying qualities and

levels of data, all while incorporating a degree of fuzziness to allow for spelling mistakes and variations. The result is a vast number of false positives. In one payment stream Travelex had about 60,000 hits, of which only one was potentially real.

These high numbers bring costs. Dr. Preusche notes that, to satisfy regulators, decisions on all hits must be documented. Even if each takes 15 minutes to deal with, the resources expended become significant.

The obvious solution — to make the software algorithm less vague — holds perils when any breach creates a legal liability. Mr. Musi says, "You can move trillions of dollars, but if you slip up, you don't get kudos for the 99.999% of transactions you did appropriately."

Finally, after initial screening, technology can be less effective in spotting real problems than human intelligence and experience. Mr. Hall says that at Travelex, "we get more real reports to regulators arising from staff making personal reports than from systems."

The reason may be the nature of the task itself. Mr. Cachey notes that since the OFAC list is readily available, sanctioned individuals are unlikely to be caught out and use their actual names: "Public lists are not an effective way to catch bad guys." Mr. Sollors adds, "The systems which Berenberg has are fine, but the most important thing is the quality of the people. If there really were to be a terrorist financing issue, it would be from a 'John Smith' from London or a 'Hans Muller' from Berlin. Because of the sophistication on the terrorist side, employee awareness cannot be high enough."

Thus, while technological screening is imperative, it is only one part of a comprehensive program. A well-trained team of sanctions specialists is also a must if the program is to function equal to the risks. Technological solutions are improving, but in Mr. Hall's words, it is best not "to put all your eggs in the basket of automated systems." Sanctions compliance programs with a substantial manual component remain critical for monitoring for behaviors which will not be caught by sanctions technology alone, especially when criminal organizations use front

companies, complex structures, intermediaries, and fake names.

### The shift to a global approach

Elements of sanctions compliance, from setting strategy to overseeing lists, can be run at a global, regional, or local level. The Economist Intelligence Unit survey indicates that, although overall strategy tends to be set on a group basis, companies are currently just as likely to do much of the rest nationally or regionally. The difference between those businesses with well-defined sanctions programs and those without, however, is stark, and suggests that those working hardest on the issue are going global [see chart]. Even after taking into account the size of companies and the number of countries in which they are present, the pattern is similar.

Interviewees indicate that this is a recent development. For example, Mr. Lock explains that Old Mutual is working toward a common database, training, and programs, but in a pragmatic way. Where local operations have effective, inexpensive programs, “it seems stupid to insist on change, but it is important to ensure consistency of approach.” Dr. Preusche also speaks of a shift in the past two to three years toward more centralization, especially for higher-risk areas, even though Allianz is a traditionally decentralized company.

Global approaches can be more efficient and effective. Mr. Boyd says that a central sanctions unit makes ensuring adequate resources, staffing, and expertise easier, and Mr. Lock points to the benefits of data hubbing to assist in the implementation of sanctions monitoring programs. Mr. Allen also notes the pitfalls of local variations: “It is very difficult to put in a policy that takes account of different jurisdictional approaches, and difficult for people on the front line to implement.”

The most important reason for the shift to global programs, however, is that the issue is now far too important not to have central oversight. Looking across the industry, Mr. Allen says, “If you are dealing in US dollars, or have a US presence, there tends to be a single policy. I haven’t seen one that differentiates [by country].” Dr. Preusche says that for Allianz’s operations in high-risk countries, “Everything has to be approved centrally. We

have a legal counsel who can check and understand our tools, but regular compliance staff could not do that sort of analysis.” Even in a decentralized company like Western Union, where local agents often help run compliance programs, sanctions “is pretty much centralized at HQ,” says Pete Ziverts, the company’s Vice President for Compliance. “We don’t even engage with agents on this type of thing because of strict liability.”

The survey figures show the extraterritorial reach of sanctions. For respondents based outside of the US, 53% of companies explicitly use the OFAC list in sanctions compliance, and a further 24% employ some form of aggregate list that might include OFAC names. For those based outside the EU, 36% use the EU list explicitly and a further 31% employ some form of aggregate.

Ironically, governments seem as yet unaware of their own power. The potential influence of business activity beyond one’s jurisdiction does not affect policy makers “very much at all,” says Lord Patten. “What goes through people’s minds more is that, if we impose sanctions, other people will pick up business opportunities that we will miss.” The percentage of financial services companies at least looking for such opportunities seems to be diminishing.

**Elements of sanctions compliance handled at global level**

	<b>Companies with a well-defined sanctions program (%)</b>	<b>Other companies (%)</b>
<b>Setting sanctions compliance policy</b>	73	41
<b>Developing and overseeing procedures</b>	54	29
<b>Testing for compliance with policies and procedures</b>	35	26
<b>Maintaining relevant lists and registers</b>	48	27
<b>Deploying sanctions-related software</b>	45	23
<b>Developing staff training programs</b>	45	23
<b>Engaging in board and C-Suite level communication</b>	53	27



# Conclusion

Financial services companies face a growing challenge in complying with sanctions regimes. Failure in this area has already cost major banks hundreds of millions of dollars, and regulators are pressing ahead with new powers and initiatives.

The sector as a whole has an inconsistent sanctions compliance record. Many companies do not even have a formal program in this area and, as noted above, there are issues with the extent to which screening takes place and the degree of employee training. Perhaps the biggest red flag is that only just over half say they have established the culture of compliance necessary to fulfill the legal requirements involved in the field.

As the difficulties in the area grow, and the price of failure mounts, some leading companies are taking steps the whole industry should consider following:

- The growing importance of sanctions rules highlights an urgent need to create an appropriate culture of compliance. Corporate leaders should emphasize this issue, especially with employees who may previously have felt that the rules did not apply to them. The task may be more difficult in countries where people resent the political goals of some country-specific sanctions regimes.
- It is essential to allocate resources necessary to implement and maintain a sanctions compliance program that meets regulatory expectations.
- Companies need to design well-thought-out systems that minimize their exposure; to document why they took the decisions they did; to monitor their implementation; to run them rigorously; and to review the changing risks regularly. At the very least, this will reduce the number of likely sanctions breaches and, if any should occur, increase the chances of leniency from regulators.
- Technology is an essential, but imperfect shield against non-compliance. Companies may have to consider working with sanctions specialists in order to reach a required standard rather than simply relying on off-the-shelf solutions that often times cannot keep up with the changing or new requirements.
- Companies that are most active in the field are turning to unified, global, and risk-based programs of sanctions compliance. There are no guarantees that failures won't occur. However, the more comprehensive, efficient and understandable the program - still permitting an appropriate level over the risks of non-compliance - the better.

Ultimately, sanctions represent a significant regulatory risk that cannot be eliminated, but with attention to the details and robust implementation of comprehensive sanctions programs, the risks can be mitigated substantially. In a global market, financial services companies will have to learn to live with this uncomfortable fact of life.



# Contacts

**Michael Zeldin**

Global AML Practice Leader  
Deloitte Financial Advisory Services LLP  
+1 202 378 5025  
mzeldin@deloitte.com

**Alison Clew**

Principal  
Deloitte Financial Advisory Services LLP  
+1 617 437 3059  
aclew@deloitte.com

**Graham Dillon**

Partner  
Deloitte Australia  
+61 02 9322 5111  
gdillon@deloitte.com

**Mark Tantam**

Partner  
Deloitte UK  
+44 20 7303 2146  
mtantam@deloitte.co.uk







This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte, its affiliates and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

Copyright © 2009 Deloitte Development LLC. All rights reserved.  
Member of Deloitte Touche Tohmatsu