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Comments in response to Call for Submission: UCM-Study on the notion, characteristics, legal status and targets of unilateral sanctions

Much has been written about the effects and legality of unilateral coercive measures (UCMs). There are certainly questions of legality when a state imposes sanctions for the purpose of achieving regime change, which constitutes aggression under longstanding international law and the United Nations Charter. There are certainly human rights issues when sanctions imposed by a state cause extensive or indiscriminate impact on a country's economy, affecting health, education, or food security. It is also quite important to note that while UCMs, on their face, may only implicate the markets or other economic participation of the sanctioning country, certainly it is the case that some sanctions that are ostensibly unilateral in fact may be greatly magnified by the political or economic influence of the sanctioner. This often occurs, for example, in the case of the United States, which holds weighted voting on the boards on international financial institutions, including the WorldBank and the IMF; and whose currency is used in international oil transactions, and is the global reserve currency. Much has also been written (with good reason) about extraterritoriality, where, for example, the sanctioning state seeks to claim jurisdiction over foreign nationals, and then imposes obligations or prohibitions regarding their economic or financial interactions with a sanctioned government or entity.

But I would like to comment on what might be called the shifting of agency: where the sanctioner creates conditions that, in effect, force private actors to sever their ties with the sanctioned entity; then in the face of extensive economic disruption, the sanctioner disclaims responsibility for these acts and from their consequences.

This can be seen particularly when two conditions are in play at the same time: first, the sanctions are vague or burdensome; and second, the penalties are severe. In these circumstances, banks or other companies then—consistently and predictably—engage in a risk assessment in which they then determine that it is preferable to reduce their services, or withdraw from a market altogether, rather than risk draconian penalties. These two conditions can be found most frequently in regard to US sanctions. Although there are a number of countries that impose unilateral coercive measures, the US is the most extreme, and its measures are the most far reaching. In the case of US sanctions, the Treasury Department's Office of Foreign Assets Control (OFAC) has imposed harsh penalties on banks, shipping companies, tech companies, and others. In several cases, these penalties have been on the order of half a billion dollars. In the case of BNP Paribas in 2014, the US penalties totalled some $9 billion, and included a partial suspension of access to the US Federal Reserve system. Exclusion from the US financial system is viewed as the "death penalty" for Western banks engaged in facilitating US dollar transactions.

At the same time, US regulations are not entirely clear regarding exactly what private actors must do to comply. There are lists of persons and entities that are blacklisted, and private actors that have a business presence in the US are subject to penalties if they transact business with Specially Designated Nations (SDNs) and other listed entities. But it is not enough to check their customer list against the blacklist. Banks also must "know their customer" (Know Your Customer, KYC) in ways that extend beyond the usual identifying information; and in some cases they must also "know their customer's customer" (KYCC) as well. There is not an explicit template to be followed.   Rather, banks and other businesses are expected to develop individualized methods of inquiry to ascertain whether a customer (or a customer's customer) may have ties to a sanctioned entity, even when these ties are quite attenuated. This creates a considerable burden for a bank, shipping company, or manufacturer, well beyond what is ordinarily required for business transactions. And even then, if it turns out that the manufacturer sold goods that eventually and indirectly ended up in a sanctioned country, the manufacturer still may face harsh penalties.

These sorts of measures serve to maximize OFAC's discretion, while also ensuring that private actors face a degree of uncertainty that cannot be eliminated. It is not entirely clear exactly what is required for compliance, so to avoid the risk of severe penalties—of a sort that would bankrupt the company, or cripple it in some other fashion—private actors will often either over-comply, or will withdraw altogether from a market they view as inherently risky. Where this triggers humanitarian consequences, sanctioners such as US Treasury Department officials may then insist it is not their doing; it is the bank or the insurer or manufacturer that chose not to do business, beyond the parameters of the sanctions.   But in fact, the sanctioner is creating the conditions that make it commercially impossible for private actors to do otherwise. Simply imposing sanctions can trigger a change in the overall assessment of the "country risk," and that alone may drive banks or other companies to withdraw. But sanctions implicate other regulatory frameworks as well: banks are required to have extensive measures relating to anti-money laundering (AML) and counter terrorism financing (CTF), in part to ensure that those who are sanctioned are not able to access banking services. All of this imposes considerable costs, and risks, on banks, which then determine that it is more cost effective simply to withdraw altogether from a market that is considered insecure.

The humanitarian consequences of this “de-risking” are considerable, disrupting the pipelines for legal transactions such as family remittances. And as unilateral sanctions (either on their own or in combination with anti-money laundering and other regulatory frameworks) pressure banks to reduce or terminate their services, this also impacts the work of humanitarian aid organizations.

> [T]he broader phenomenon of “de-risking” by the private sector, and in particular by financial institutions, has created challenges for the humanitarian sector. Banks and other private sector actors de-risk because of the perception that servicing humanitarian actors in contexts where sanctions regimes are in place comes with a high risk of sanctions violations and exposes them to fines and potential reputational damage. This leads them to restrict, or even refuse to provide, services, which directly affects the ability of humanitarian organizations to operate. Furthermore, significant de-risking by banks is increasingly driving humanitarian actors to work through informal payment channels or to use cash. This not only creates security risks for humanitarian actors, it also makes the money harder to trace and increases the risk of extortion and misuse or diversion of funds to finance terrorism, undermining one of the central aims of sanctions measures.[1]

One of the most significant contexts in which de-risking occurs is the termination of correspondent bank relations (CBRs). Domestic banks rely upon relationships with correspondent banks to facilitate cross-border fund transfers and other critical financial services. The trend we have seen in the last decade is that sanctions have increasingly driven major Western banks to terminate their CBRs. It is not that the sanctions explicitly require banks to terminate these relations. Rather, the sanctions create conditions of such risk that it is the only commercially feasible option. The results are often immediate and far-reaching. For example, in December 2018, the US imposed additional sanctions on Nicaragua. These did not prohibit all banking transactions; but they increased the country’s risk profile. Within weeks, Wells Fargo

[1] Alice Debarre, “Making Sanctions Smarter: Safeguarding Humanitarian Action,” International Peace Institute, December 2019, p. 3

and Bank of America announced that they were terminating their correspondent relations with several of Nicaragua's major banks, and withdrew from the country.[2]

The termination of CBRs can be devastating, particularly for countries in the Global South. For example, Somalia is heavily dependent on remittances sent from Somalis living abroad. An incident a few years ago illustrates how fragile this lifeline is, and how easily it can be disrupted. In 2015, Merchants Bank of California was the primary correspondent bank for remittances sent from the US to Somalia, handling about 80% of all of those remittances, amounting to some $200 million annually. Merchants Bank closed down its fund transfers to Somalia, out of concern that the bank would face severe penalties in the event that any of those funds were to find their way to Al-Shabab, an organization on the US sanctions blacklist. The impact was described by a US Congressman as "catastrophic," saying "There is no doubt that a decline in remittances will exacerbate the humanitarian crisis and erode the gains Somalia has made in recent years."[3]

These are not isolated occurrences. In the last decade, terminations of CBRs have been increasing. In 2014, a survey by the British Banking Association of 11 international clearing houses found that, in the prior three years, "many thousands of correspondent relationships were closed."[4] In 2015, three quarters of the large correspondent banks responding to a World Bank survey reported that they had reduced their CBRs.[5] A publication of the World Bank's International Finance Corporation noted that Africa was especially hard hit.

> In Sub-Saharan Africa this trend is greatly pronounced: The percentage of banks with a negative outlook increased from 0 percent to 27 percent. According to a 2016 survey by

[2] "US Bank Pulling-Out of Nicaragua," *Confidencial*, December 12, 2018.

[3] "US bank to axe Somalia transfers over al-Shabab fears," BBC, February 6, 2015.

[4] "De-Risking by Banks in Emerging Markets—Effects and Responses for Trade," *EMCompass*, Note 24, International Finance Corporation, November 2016, p. 2.

[5] Ibid**.**

> the International Chamber of Commerce, 35 percent of respondents reported experiencing termination of correspondent banking lines.[6]

A study from 2020 found that the trend has continued unabated. Over the past decade, cross-border correspondent bank relationships have declined by about one fifth.[7] While this is not due to unilateral sanctions alone, the loss of CBRs is, certainly at least in part, a response to sanctions and the "high-profile actions and penalties across the banking industry."[8] In a study on the reasons for terminating CBRs, about 90% of the large correspondent banks surveyed included "imposition of international sanctions on jurisdiction of respondent" as one of these reasons.[9]

An IMF report noted that the use of unilateral sanctions has increased, notably by the US and the EU, and concluded that "[c]omplying with an expanding sanctions regime may also be leading banks to reconsider or terminate CBRs."[10] But while there are several jurisdictions that employ unilateral sanctions, it seems that US sanctions have been responsible for the greatest pressure on the banking community: "the major enforcement actions on customer due diligence-related breaches… are heavily concentrated in the United States and relate to U.S. sanctions."[11] An IMF report notes that

> most large fines for misconduct related to customer due diligence issues have been levied for breach of the U.S. sanctions framework. A survey of the largest penalties for customer due diligence-related breaches reveals that out of 24 fines of more than US$ 100 million, all but one originate in the United States.[12]

The loss of CBRs, in turn, impacts the overall level of financial inclusion. The IMF has warned that "if not contained, the aggregate decline of correspondent banking threatens to result

[6] Ibid.

[7] Tara Rice, Goetz von Peter, and Codruta Boar, "On the Global Retreat of Correspondent Banks," *BIS Quarterly Review*, March 2020, p. 1.

[8] Ibid., p. 42.

[9] Michaela Erbenova, et al., "The Withdrawal of Correspondent Banking Relationships: A Case for Policy Action," International Monetary Fund, SDN/16/06, June 2016, p. 20.

[10] Ibid., p. 22.

[11] Ibid., p. 24.

[12] Ibid.

in negative effects on financial inclusion, stability, growth and development goals.[13] Others have noted that "It is becoming increasingly clear that this trend is at odds with global goals for financial inclusion and that the withdrawal of services is forcing some customers to make payments using less regulated channels."[14]

Financial inclusion entails access to formal, regulated financial services, such as wire transfers within and outside the country for remittances and trade, access to credit in a safe and legal manner, and payment processing through a financial institution rather than as cash transactions.

> Of all of the components of a financial system, banks are the driving force. They are the actual mechanisms that transmit money to individuals and businesses that need it to operate and grow; they provide formal channels to store and invest wealth; and they are integral to monetary policy initiatives. They are essential to basic economic function, stability, and growth. Banks also work across borders to provide clients with access to foreign exchange and foreign markets and, in many cases, goods produced outside of their country. Thus, banks are critical to linking emerging markets to the global economy.[15]

The loss of CBRs affects financial inclusion in many ways. For one thing, even when a country is able to find replacement CBRs, the costs may be exorbitant. For example, between 2013 and 2016, international banks terminated almost half of the 75 CBRs in Liberia. Every Liberian bank lost at least one CBR, and one bank lost almost 80% of its CBRs. One bank found a replacement CBR, but the processing fee was $150 per check. Thus, the cost of that service made it effectively unavailable in a wide range of situations.[16]

In Africa, financial exclusion has long been a serious problem, sustaining poverty and impeding social and economic development. As of 2013, only 23% of adults in Africa had an

[13] "De-Risking by Banks in Emerging Markets—Effects and Responses for Trade," *EMCompass*, Note 24, International Finance Corporation, November 2016, p. 2.
[14] "De-Risking and Financial Inclusion," *ACAMS Today*, vol. 16, no. 2 (https://www.acamstoday.org/issue-16-2/)
[15] "De-Risking by Banks in Emerging Markets," p. 1.
[16] Michaela Erbenova, et al., p. 15.

account at a formal financial institution. In the Democratic Republic of Congo and Central African Republic, more than 95% of adults do not have an account at a formal financial institution.[17] Financial inclusion has implications for, among other things, access to remittances from family members abroad. Globally, only about 14% of account holders use their account to receive remittances, but in Africa an estimated 41% of those with bank accounts use them for remittances. And within Africa, the use of accounts for this purpose is particularly common in fragile states: 66% of account holders report using their account to receive remittances in Somalia, 55% in Zimbabwe, and 45% in Sierra Leone.[18] So to the extent that the termination of CBRs results in the closure or unavailability of bank accounts within the African region, it seems that this will particularly impact those living in fragile states. In addition, those living in rural areas, the poor, women, less educated adults, young and older adults particularly face challenges in financial inclusion.[19]

> Among all firms, the financing constraint is more acute among the micro and small firms and also among the informal businesses. Similarly, women-owned enterprises often face higher barriers to access the right type of finance that is necessary for growth….Notably, when finance for [small and medium enterprises] in Africa is available, it is often expensive and short term.[20]

Conclusion

[17] Asli Demirgüç-Kunt and Leora Klapper, “Financial Inclusion in Africa: A Snapshot,” in *Financial Inclusion in Africa*, eds. Thouraya Triki and Issa Faye, African Development Bank, 2013, p. 44.
[18] Ibid., p. 47.
[19] Ibid., p. 55.
[20] Peer Stein, Nina Bilandzic and Martin Hommes, “Fostering Financing for Africa’s Small and Medium Enterprises,” in *Financial Inclusion in Africa*, eds. Thouraya Triki and Issa Faye, African Development Bank, 2013, p. 67.

Unilateral coercive measures have long been considered problematic in a variety of ways. Extraterritorial measures have been criticized for being counter to international commercial law. Unilateral measures imposed for the purpose of achieving regime change in the target country arguably constitute aggression, in violation of longstanding international law and the United Nations Charter. Unilateral measures are both legally and morally problematic insofar as they create or worsen food insecurity, population displacement, the breakdown of infrastructure, and the availability of health care and education. But I would suggest that we also need to look at the ways that UCMs interfere more broadly in social and economic development in the Global South, and contribute to the worsening of the already profound inequalities between North and South. It is not just that sanctions damage the countries or the individuals they are ostensibly aiming to punish or contain. The problem is that, at least in the case of US sanctions, they are designed in such a way as to compel entire global industries to go much farther than the actual terms of the regulations. While I have focused on the financial sector in these comments, the same patterns also hold in regard to shipping, insurance, technology, and energy. The vagueness and uncertainty of the compliance expectations, combined with the extreme severity of the penalties, ensures that private actors in a broad range of global industries will have little choice but to engage in a risk assessment that compels them to drastically reduce their services, or to withdraw altogether, not only from entire countries, but from entire regions. Alternatively, they may continue to service those regions, but attaching much higher costs, which in turn are passed on to governments, businesses, and individuals in the most impoverished parts of the globe. The role of UCMs in this process is attenuated and complex. But they are deeply intertwined with the worsening inequality and impoverishment of the Global South; and for that reason, we need to understand them thoroughly.