

Working Group Paper #9

Measures to Increase

The Effectiveness of Sanctions

The International Working Group on Russian Sanctions

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<https://fsi.stanford.edu/working-group-sanctions>

I. Introduction

The International Working Group on Russian Sanctions¹ aims to provide expertise and experience to governments and companies around the world by assisting with the formulation of sanctions proposals that will increase the cost to Russia of invading Ukraine and support democratic Ukraine in the defence of its territorial integrity. This is our ninth working paper, which provides new analysis on weaknesses in the current sanctions regime and proposes measures to improve compliance. Further information on our proposals and additional analysis can be found on our website.²

This paper makes proposals to improve the effectiveness of sanctions in achieving their objective – constraining Russia’s ability to finance and prosecute its war in Ukraine – by highlighting attempts to get around sanctions and proposing measures to counter such attempts and secure a high level of compliance with sanctions.

We appreciate the results achieved so far by the sanctions coalition in implementing and enforcing sanctions. Our aim is to make constructive proposals which build on these achievements to improve the effectiveness of sanctions further.

The context is that sanctions on Russia are having a major impact, with most Western companies pulling out of Russia, half of Russia’s international reserves frozen, and the impending loss of Russia’s core European markets for oil and gas, combined with a price cap on oil, severely impacting Russia’s export earnings. Yet sanctions will take time to have their full effect. For much of this year, the catastrophic impact of sanctions on the Russian economy has been mitigated by high oil and gas prices and revenues. Looking ahead for current sanction policy, we expect the Russia economy to be in a fragile state by the middle of next year, as sanctions curb technology imports, where Russia has a critical dependency, and curb export earnings and Russia’s ability to finance its budget and war.

However, achieving this outcome where sanctions heavily constrain Russian action is dependent upon securing broad compliance with sanctions. If Russia can find ways to get around sanctions, then the impact will be reduced, prolonging the conflict. In addition, law-abiding companies and countries which follow the sanctions will be adversely impacted relative to sanction-breakers. This is unfair and would risk undermining the credibility and effectiveness of – and support for – sanctions.

¹ All members of this working group participate in their private capacities, but we have consulted with numerous government officials, particularly with the Government of Ukraine.

² Our aim was not to produce a consensus document, but instead to provide a menu of possible additional measures to be considered by governments, multilateral institutions, and private actors. The implications of every sanction have not been thoroughly analyzed, and not everyone agrees with every specific sanction or action proposed.

In this paper, we focus on key sectors – military, finance and energy. We start by highlighting some of the many ways in which Russia has been trying to get around sanctions in each sector. We then make proposals on how to counter attempts to circumvent sanctions and reinforce sanction compliance. In particular, we propose a twin-track approach of targeted actions to counter attempts to circumvent sanctions, while working towards a more systematic approach to sanctions.

Immediate Enforcement Actions. First, we propose targeted actions to counter attempts to get around sanctions. The focus is on improved and more aggressive enforcement, although other measures also help, e.g., more consistent and comprehensive sanctions, especially on military enterprises, and improved formulation of sanctions to eliminate loopholes.

Sanctions System. Second, we propose putting in place an improved system, underpinned by better information and better sharing of information, to support enforcement of sanctions, including a unified sanctions list, an offender list, a watch list of high-risk companies and individuals, a traffic light system for assessing country compliance with the sanctions regime, compilation of data on Russian trade, and improved sharing of data among allies.

Finally, if Russia continues to use force to revise international borders, as it is doing in Ukraine, we recommend that the advanced economies evolve from imposing piecemeal sanctions to a more systemic approach to managing and regulating economic relations with Russia to contain and restrain it – a Cold War 2.0 approach. This would involve implementing a special trading regime with Russia, with the objective of minimizing trade, and blocking Russian access to Western technology, markets and finance, pending a move to a peaceful Russian foreign policy. Technically, this might require all Western companies trading with Russia to have a special license and meet additional regulatory and reporting requirements. To increase pressure for a change in Russian policy, we propose as a first step that Ukraine’s partners make clear to Russia that systematic containment and isolation would be the eventual consequence of continued aggression in foreign policy.

To support the sanctions regime, we propose that the sanctioning governments establish structured dialogue between business and government on Russian sanctions and trade to ensure feedback and support good policy and effective implementation. To help define the new relationship, we also suggest that leading research centers be commissioned to research and analyze current trade with Russia, for instance in the military-defense sector, in the energy sector, in the financial sector, and on the structure and ownership of oligarch assets, and the options for future regulation.

II. Sanction Effectiveness: Military

Attempts to Evade Sanctions

Analysis of weapons used by the Russian army in Ukraine reveals extensive use of technological components manufactured in the United States, the Netherlands, Germany, Switzerland, Japan, China and Taiwan. We assess that the Russian military-industrial complex is not able to replace foreign high-tech components in Russian armaments in the near term. Recent cases show that, following introduction of a full-scale sanction regime against Russia, Russian defense companies are using various strategies to evade sanctions and ensure the flow of technological components needed for its military industry.

These include:

- i) Using third-country intermediaries. Many imported dual-use products such as electronic components – used in multiple military applications, including rocket systems, planes, helicopters, and drones – have been supplied to enterprises of the Russian military-industrial complex via companies in third countries that buy them from Western suppliers and then deliver them to Russia. Russian defense manufacturers set up intermediary companies in non-Russian jurisdictions to procure the necessary technological components for their weapons.
- ii) Leveraging established relationships. Over many decades, Russian defense concerns have developed partnerships with many defense enterprises in allied countries, as well as in jurisdictions over which Russia has leverage, such as Belarus, Central Asian countries and Armenia. For example, the Chirchik Aviation Repair Plant in Uzbekistan has a long-standing relationship with ODK-Klimov, the Russian producer of gas turbine engines for Russian military aircraft, which is part of the state-owned Rostec corporation. Similarly, the Kazakhstan-based TOO Zenit-K is known to have well-established cooperation with Russian military enterprises.
- iii) Building new relationships. It appears that the supply shortages experienced by Russian forces in Ukraine have forced Russia to turn to less technologically advanced countries, notably Iran, for supplies and equipment. In particular, Iranian-origin drones have recently been used extensively by Russia against civilians and civilian infrastructure in Ukraine. This is in violation of three international agreements: a) a U.N. Security Council ban on the transfer of drones capable of flying 300 kilometers or more; b) UN Resolution 2231, which maintains certain restrictions on Iranian missiles and related technologies until

October 2023, including on the export and purchase of advanced military systems such as Unmanned Aerial Vehicles, and c) sanctions on Qods Aviation, which manufactures some of the drones and is on the U.N. sanctions blacklist and subject to an asset freeze by all countries. In this regard, we welcome the action taken by the U.S. Department of the Treasury to target actors involved in production and transfer of Iranian UAVs to Russia for use in Ukraine.

- iv) Importing individual components. Rather than importing a final product, which may be more visible and subject to sanctions, Russia often imports the components, which are less visible and often not subject to sanction, to obtain the technology it needs, since it has the industrial culture and specialists to assemble final products out of these components. This applies to dual-use goods as well as goods with Western technology that are critical to the broader Russian economy, such as chips, medical equipment, and nuclear and machine-building equipment. In this context, we would pick out two critically important areas where enhanced scrutiny of trade with Russia, and better enforcement of sanctions, could materially impair the capacity of the Russian military-industrial complex:

Suppliers of critical components: In the past, Russia's military-industrial complex has been dependent on imports of key components such as electronics, circuits, boards and air purifiers from the following companies: Mesit ASD S.R.O (Czech Republic), VKG Oil (Estonia), Nautech Electronics or SBIS Technology (Russia), Amkor Technologies (USA supplies products through the Philippine division), TaT Technologies (Israel), Shenzhen Baoshi Technologies Co Ltd (PRC), Schaeffler Aerospace GmbH&Co.Kg (Germany), Esp Safety Pvt Ltd (India), Ningbo Jiangbei Xinye Metal Works Co (PRC), Qingdao Evergreen Machinery Co Ltd (PRC), Binzhou Zili Precision Metal Technology Co Ltd (PRC), Wudi Runxin Stainless Steel Products (PRC), Risbridger (Great Britain), Aeroforge (USA), TOO Zenit-K (Kazakhstan).

Russia's military-industrial complex has also been dependent on foreign suppliers of components for production and maintenance equipment, including metalworking machines, and measuring and test equipment. Companies who have supplied these components to Russian military-industrial enterprises in the past include: SCHUNK GmbH&Co. KG (Germany), Walter AG (Germany), TRUMPF GmbH&Co. KG (Germany), Kemmler GmbH (Germany). These companies have worked through a network of Russian distributors as well as through local subsidiaries.

Supplier of bearings: In addition, Russia has been dependent upon the import of bearings. Here, foreign manufacturers who in the past cooperated with Russia

include: SKF (Sweden), INA (Germany), FAG (Germany), HTH (Japan), KOYO (Japan), Timken (USA), NSK (Japan), ASAHI (Japan), CRAFT (Lithuania), MPZ (Belarus).

- v) Contract extensions. In some cases, sanctions imposed after the Crimean annexation – e.g., for the provision of military components by the French firm Thales – were evaded through the simple expedient of agreeing an extension to an existing contract, which was exempt from the sanction, since it was concluded before the sanction came into force. Contract extensions then allowed counterparties to extend the term of an agreement concluded before the imposition of sanctions against Russia. In practice, this particular loophole appears to have now been closed by the EU authorities³.

Targeted action to improve effectiveness of sanctions

Enforcement. To interfere with the supply of foreign parts and components used by Russian companies to manufacture key military products – such as the warheads on Iskander systems which have killed hundreds of Ukrainians – we propose that the sanctioning authorities in each country ask every company in their country that is responsible for the supply of these components to explain their processes for authorising supply of components, and to impose a cost – a sanction or fine, depending on the severity of the transgression – on companies that have not put in place robust arrangements to prevent supply to the Russian military and have thereby recklessly failed in their duty to introduce reasonable safeguards to ensure compliance with sanctions. These process requirements – evidence of a robust process to prevent supply to the Russian military – can also be applied to any financial intermediary involved in financing transactions of the supplier.

Tighter sanctions. Under the umbrella of the Russian state defense corporations, notably Rostec and Roscosmos, there are many separate legal entities, including trading companies, military factories, civil-military factories, and some entities with private sector participation, including trading companies, which have been partners with military companies for decades. As a result, many military manufacturers, suppliers and their trading partners – all typically with their own bank accounts and legal personality, i.e., ability to sign contracts on their own account – are still not sanctioned, providing numerous loopholes in the sanctions regime.

³ EU guidance on sanctions against Russia clarify that extension of contract (whether tacit or explicit) on or after 2 March 2022 constitutes a new contract and falls under sanctions. Further, the EU guidance explains that framework contracts, annexes, and ancillary contracts that specify essential contract elements and were signed on or after 2 March 2022, are considered as new contracts.

https://finance.ec.europa.eu/system/files/2022-08/faqs-sanctions-russia-execution-contracts-claims_en_0.pdf

We propose a three-step approach to this challenge:

First, introduction of sectoral sanctions on all trade in military products with Russia, covering a) Russian producers of military-industrial products; b) trading and commercial companies involved in importing technological components for the Russian defense industry; and c) intermediary companies between Western producers and the Russian defense industry.

Second, sanctioning all the individual legal entities in the Russian military-industrial complex and their trading partners separately, including imposing secondary sanctions on Western companies and individuals who facilitate this trade. For instance, we believe that Table 1 shows some key Russian defense enterprises which have not yet been sanctioned.

Third, reaching out with a strong message to warn key enterprises and countries which represent a risk for sanction compliance – such as those listed above – about the importance the sanctioning governments place on compliance with sanctions. Ideally, this message would be reinforced by some accompanying high-profile enforcement actions on delinquent Western companies who have continued to supply the Russian military since Russia’s invasion of Ukraine.

Table 1. Important Russian Defense Enterprises Not Yet Subject to Sanctions

| Name of Defence Enterprise | Function of Enterprise |
|--|--|
| Zavod "Sokol" LLC, CJSC "Saratovsky Aviation Plant" | Repair of R-27 aviation guided missiles |
| JSC "Izumrud" | Installation and adjustment of ship's artillery fire control system |
| "RT-Komplekt" LLC | Supply of component products for Russian aviation, instrument-making, and shipbuilding industries |
| JSC "NVP "Topaz" | Production of hardware and software for control of land- and ship-based aircraft |
| "Baltic Engineering Technologies" LLC | Production of electric tugs to ensure storage, operation, preparation for delivery on a carrier of ballistic missiles for submarines |
| JSC "Order of the Red Banner of Labor All-Russian Research Institute of Radio Equipment" | Maintenance of communication equipment, radio technical support of flights and Air Force air control system (ACS) |
| JSC "Association of EVT" | Maintenance of communication equipment, radio technical support of flights and Air Force air control system (ACS) |
| JSC "Zvezda Scientific and Production Enterprise" named after academician G. I. Severin" | Supply of UPAZ-1 – a means of refuelling long-range aircraft in the air |
| PJSC "ODK - Ufa Motor-Building Production Association | Producer of Russian gas turbine engines |
| "Lipetsk Mechanical Factory", LLC | Manufacturer of transporting units for S-300, S-330BM and S-300VM "Antey-2500" air defence missile systems |

We have also identified some critical dependencies in the Russian defense industry, which could be targeted:

- i) The supply of niobium, which in the form of ferroniobium – niobium alloyed with iron - is used in the production of hulls, structures of armored vehicles, ships, missiles, and elements in jet engines. Russian companies source supply through the Brazilian office of CBBM (Companhia Brasileira de Metalurgia), which provides 85% of global ferroniobium supply. CBBM could be a target for secondary sanctions unless they cease supply to Russia, while the Russian companies engaged in supply of ferroniobium could also be targeted: JSC "Sudomeh Supply", JSC "Uralskaya Stal", PJSC "Novolipetsky Metalurgichesky Kombinat", CJSC "Sudmeh Supply".
- ii) The dependence of JSC "Ryazan Metal-Ceramic Devices Plant" – Russia's only supplier of sealed magnetically controlled contacts, and part of the "Roselektronika" holding of the "Rostech" corporation – on technical components, including magnetic contacts, relays and switches which have been provided in the past by "Proximity Instrumentation Controls GmbH" (Germany); temperature sensors from "Anakysis Ltd" (Greece) and automation equipment from "Comeco Inc." (Bulgaria).
- iii) Foreign suppliers to the enterprises of the "Roselektronika" holding. In the past, these have included LLC "Kntant-Astana" (Kazakhstan), PJP Tech Co., Ltd (South Korea), Photic Nova Technique inc. (South Korea), POSSIBLE, INC (Japan), Quindago Sources Optics (PRC), Walz Elektronik (Germany), Alta Industries Srl (Italy), JSC "Planar" (Belarus), JSC "Integral" (Belarus), JSC "Peleng" (Belarus), Jema France (France), Valvo Bauelemente GmbH (Germany), Secret Guardian LTD (Israel), CJSC "Professionalnie setevye sistemy" (Belarus), JSC "KB Display" (Belarus), LLC "Itelsys Bel" (Belarus), JSC "NIIEVM" (Belarus), LLC "Global Photon" (Russia).

In addition, we note a need for continued focus on implementing sanctions – essentially by restricting Russian access to hardware and software – which will degrade Russia's physical and cyber operations in the space domain, including degrading the ability of the Russian Federation to carry out Direct Ascent Anti-Satellite Weapons Testing (DA-ASAT) or other offensive kinetic anti-satellite attacks, including via threatening on-orbit rendezvous proximity operations, as well as jamming and cyber-attacks on commercial and military space assets.

Further, we propose that any time period for phasing in of sanctions be as short as possible, that the sanctions explicitly rule out any exemption for contract extensions, and that the sanctions levy fines on any Western companies which agree to such contract extensions.

III. Sanction Effectiveness: Finance

Attempts to Evade Sanctions

Concealing the beneficiary. Sanctioned individuals are likely to try to find ways to keep and manage their assets in the advanced economies, where they are secure from arbitrary seizure, and to preserve the lifestyle of their families. One strategy is to add additional intermediaries between the sanctioned individuals and the financial institutions in the developed countries to conceal the ultimate beneficiaries of the funds. A second strategy is to take advantage of the complex legal structures through which oligarchs control their assets – generally to protect their assets and minimize their taxes – to implement additional measures to evade sanctions. A third strategy is to move funds to jurisdictions that are friendly to Russia and/or do not have high standards of disclosure, allowing them to conceal data on the ultimate beneficiary. Potentially higher-risk jurisdictions include countries over whom Russia has leverage or offshore centers with low standards of disclosure. All these strategies are likely to be developed and proposed by a number of consultancy firms, wealth and asset management companies, and niche law firms which seek to provide services to sanctioned individuals and help conceal the identity of the ultimate beneficiary through shell companies, nominee owners, complex structures and other techniques.

Transferring assets to an unsanctioned related party. In several cases, about-to-be-sanctioned individuals have moved their assets to a proxy just as sanctions were imposed. In several cases, oligarchs have transferred their assets overnight to relatives or close friends, e.g., the Russian oligarch Melnichenko transferred ownership of the Swiss company EuroChem to his wife the day before the EU imposed sanctions on him. Similarly, the Russian oligarch Usmanov, who is now sanctioned in all G7 jurisdictions, transferred considerable assets to one of his sisters, Saodat Narzieva, an obstetrician from Tashkent, Uzbekistan. In another example, VTB Bank (now fully sanctioned) used to own 50% plus one share of The Post Bank but sold two shares of The Post Bank just after the invasion. Now, VTB Bank owns less than 50% of the shares of The Post Bank, which helps The Post Bank to get around OFAC's 50% ownership rule which imposes sanctions on companies owned 50% or more by sanctioned parties.

Payment systems. After the invasion, the key payment card providers Visa and Mastercard left the Russian Federation, the key contactless payments apps – ApplePay and GooglePay – ceased to be supported in Russia, Western Union left Russia, and sanctioned Russian banks have been cut off from transactions with the global financial system, including with the SWIFT system.

In response, Russia has promoted the Russian-made payment system Mir and the Chinese Union Pay card systems to provide an alternative for international payments. For instance, the Central Bank of Russia signed an agreement with the National Bank of Turkey on payments,

opening the prospect of clearing cross border payments in local currency, and multiple Turkish banks started to accept Mir cards. However, after an intervention by the US Treasury, Turkish banks have now reportedly stopped accepting Mir cards.

Many Russians have obtained a Visa or Mastercard they can use internationally in Armenia, Azerbaijan, Georgia, Kazakhstan, Uzbekistan and Tajikistan. Generally, they had to apply for the local equivalent of a national identification code/insurance number and use this code/number to obtain a card. Now, various Russian tourist companies offer trips to these countries, and help in obtaining a temporary residence permit (for example, in a hotel), to facilitate an application by a Russian citizen for a national identification code. The term for consideration of the application, depending on the country of submission, is from two to ten days, as advertised by representatives of the "card tours" – a fact indicative of established cooperation with local government agencies.

The Central Bank of Russia (CBR) launched SBPay (СБПэй), an application Russians can use for contactless payments directly from a bank account without using a bank card. It does not work with large banks like Gazprombank and Sberbank, but partners with about thirty second-tier banks like Metkombank, Kuznetsbiznesbank, Morskoy Bank, etc. By July 1 all Russian banks were obliged to start accepting payments through the SBPay System. In addition to SBPay, there is Huawei Pay, a payment app developed together with the Chinese payment system Union Pay, which works with banks including Zenit, Gazprombank, Rosselkhozbank, Primsotsbank, Primorye, Kredit Ural Bank, Bank Sankt-Peterburg and Sovkombank.

On a national level, Russia has worked on developing alternatives to SWIFT. One example was the Hello Pay payment system, which was intended to focus on cross border transactions in partnership with the Russian Transkapitalbank. In April 2022, the U.S. Department of the Treasury imposed sanctions on Transkapitalbank, which explicitly offered banks in Central Asia assistance in circumventing sanctions. Hello Pay was to service those transactions, but its launch was delayed due to the sanctions. In the short term, second-tier Russian banks not subject to sanctions may become more active in offering correspondent services and offering payment systems, including cross border payments, that will be available to Russian users.

In addition, Russians can make cross border transactions using the Russian system KoronaPay, which is not subject to sanctions. For making currency transfers, the payment system uses several correspondent banks, including those in the United States. KoronaPay has an unsanctioned subsidiary in Europe, Koronapay Europe Limited, which can carry out transactions from Russia to the European Union.

Finally, while crypto transfers are in principle traceable, in practice crypto transactions are not yet regulated in terms of anti-money laundering or counter-terrorist financing, so sanctioned Russian persons and entities may have more options to evade sanctions by using crypto, where, unlike banks, platforms and exchanges generally do not have a robust know-your-customer process to verify identity. In this context, U.S. authorities have made a helpful start. The mission of Task Force KleptoCapture – the interagency law enforcement body dedicated to enforcing sanctions imposed in response to Russia's aggression against Ukraine – specifically includes "targeting efforts to use cryptocurrency to evade U.S. sanctions, launder proceeds of foreign corruption, or evade US responses to Russian military aggression."⁴ Building on this, U.S. authorities have already identified an extensive list of Russian nationals and entities attempting sanctions evasion using crypto⁵ and brought several cases for attempted sanctions evasion using crypto.^{6 7}

Targeted action to improve effectiveness of sanctions

Tighter sanctions

Sanction the parts as well as the whole. In cases where both the oligarch and the holding company are subject to sanction, we would advocate a similar approach to that proposed for the military-industrial complex: in addition to the holding company, sanction all the component legal entities within the group of companies to eliminate any unsanctioned subsidiaries which may be used as loopholes for sanction evasion.

Nominee beneficiary. We propose that sanctions that are applied to the ultimate owner and controller of the assets should be also applied to any nominee who has been given formal title to the assets as part of a sanction evasion strategy.

Professional advisors. We think that rogue professional advisors who are facilitating sanction evasion should be a primary target for secondary sanctions, and they should be vulnerable to prosecution under the anti-money-laundering regulations, as facilitators of money-laundering mechanisms. We would also expect a professional ban for at least a period of some years in case of a serious breach of sanctions.

⁴ The United States Department of Justice Press Release <https://www.justice.gov/opa/pr/attorney-general-merrick-b-garland-announces-launch-task-force-kleptocapture>

⁵ <https://home.treasury.gov/news/press-releases/jy0731>
<https://home.treasury.gov/news/press-releases/jy0954>

⁶ U.S. issues charges in first criminal cryptocurrency sanctions case. The Washington Post <https://www.washingtonpost.com/dc-md-va/2022/05/16/first-us-criminal-cryptocurrency-sanctions/>

⁷ Press release of Attorney's Office Eastern District of New York <https://www.justice.gov/usao-edny/pr/five-russian-nationals-and-two-oil-traders-charged-global-sanctions-evasion-and-money>

Payment system. We see two different ways in which the sanctions regime on payments can be reinforced.

The first, focusing on the current scope of sanctions, is to tighten enforcement of the current sanctions, including taking action to prevent an expansion in the Mir and Union Pay networks, as recently done by the U.S. Treasury in Turkey; putting pressure on Visa and Mastercard to prevent unwarranted issuance of cards to Russian citizens in other countries on the basis of fake documentation as residents, e.g., requiring applicants to provide some additional proof of residency in addition to a national code or insurance number, such as a pay cheque or a utility bill; and to act swiftly, as done by the U.S. Treasury in the case of Transkapitalbank, to sanction banks offering services to evade sanctions.

The second approach, recognizing that the situation is dynamic and that some of the strategies for evading the impact of sanctions may be currently legally permitted, would be to expand the scope of sanctions.

Options for further actions here – with more ideas in our paper on financial sanctions – include:

Sanction further Russian banks, to prevent migration of international transfers and business to unsanctioned banks. Here, we would recommend sanctioning Gazprombank with a tightly defined exemption for energy-related payments, although we note that such an exemption will shortly be largely redundant as the European oil embargo takes effect and Russian gas flows to Europe fall to negligible levels. We would also recommend extending full sanctions to the remainder of Russia's top 30 banks which are unsanctioned, or unsanctioned by most of Ukraine's partners, such as Bank Saint Petersburg, Bank DOM RF, Bank ZENIT, Uralsib, Russian Agricultural Bank and The Post Bank.

Sanction the KoronaPay subsidiary in Europe, Koronpay Europe Limited, which has enabled it to continue facilitating crossborder transfers.

Sanction the CFT group of companies, which includes the Golden Crown payment system. The CFT company organizes the exchange of documents between users of the Bank of Russia's Financial Message Transfer System (FTS) and ensures receipt and sending of SWIFT format documents via secure communication channels of the Central Bank, so sanctioning this company would hit the internal Russian system of bank transfers.

Cryptocurrency. Cryptocurrencies were often designed to be anonymous and are widely used for money-laundering and tax evasion. They provide an obvious loophole for sanctioned persons. Over time, the solution will be to impose on crypto platforms/exchanges the normal

Know Your Customer (KYC) rules which banks must follow to crack down on money-laundering and tax evasion. However, given the time required to implement these changes, we propose a total ban on transactions with cryptocurrency exchanges located in Russia or Belarus, or controlled by residents of Russia or Belarus, and a penalty charge of perhaps 20% to be paid to an account to support the reconstruction of Ukraine on any crypto transfers that use wallets registered to citizens of Russia or Belarus.

Enhanced supervision for higher-risk jurisdictions

High-risk jurisdictions. We would favor collaboration by the sanctioning authorities to identify a list of higher-risk jurisdictions, perhaps by assessing jurisdictions on a traffic light system as low, medium or high risk for sanctions evasion. Once this assessment is in place, then any transactions involving an institution from a higher-risk jurisdiction would trigger an enhanced level of scrutiny, e.g., an extended KYC procedure, from Western banks in the main money markets and their Western suppliers. This would give the Western banks and companies the time to conduct an in-depth KYC screening – and would also incentivize compliance with sanctions, as the enhanced scrutiny would slow down all the affected institutions’ transactions, impacting their non-Russian clientele.

IV. Sanction Effectiveness: Energy & Trade

Attempts to Evade Sanctions

Mixing oil to conceal country of origin. In this scheme, oil of Russian origin is blended with oil of another country until the non-Russian component exceeds a threshold level at which point that oil is no longer classified as Russian oil.

Turning off the tracker and transferring ship-to-ship to conceal country of origin. Another strategy is to use a “dark vessel”, where a Russian-flagged ship with Russian oil disables the Automatic Identification System (AIS) system to avoid being tracked, and while off the radar transfers its oil ship-to-ship to a non-Russian flagged ship. This ship under a non-Russian flag then sells this oil as its own, from its own country or from its supplier, rather than as Russian oil. This type of scheme has been used to traffic Venezuelan oil, and the reported increase in the percentage of Russian tankers who go off AIS suggests it is being actively used by Russia.

We believe there is a high risk that Russia will seek to circumvent maritime trade sanctions, given Russian assistance to other sanctioned regimes. Notably, Russia supported sanctions evasion by North Korea by engaging in various deceptive shipping practices. For instance, the UNSC Panel of Experts on sanctions relating to North Korea detected

transshipment of North Korean coal to Russian territory before shipping to China in 2017.⁸ As indicated by the Panel, Russia failed to respond to requests for clarifications. In addition, Russia may also exploit the open registry system whereby a vessel can sail on the high seas under a foreign flag, irrespective of the nationality of its owners and operators to conceal the origin of its cargo.

Shadow fleet. It has also been alleged Russia is building up a “shadow fleet” of tankers to evade current and forthcoming oil sanctions.⁹ In fact, we note reports¹⁰ that the tanker fleet of Volga Shipping company, owned by Mr. Lisin – a leading Russian oligarch who has so far only been sanctioned by Australia – has been involved in shipping oil or oil products from Russian ports to a transshipment point 20 nautical miles off Constanța port (Romania).

New intermediaries/trading arrangements. Sanctions may be evaded by means of establishing or buying out companies, including financial institutions in countries where Russia has leverage. These companies may then purchase sanctioned goods from Western companies and deliver them to Russia. For instance, the Qatari bank CQR Bank belonged to VTB Bank before the war, and then in May was bought out by the offshore group Amathus Investment Fund SPC without any apparent change in the composition of the Board. This highlights the risk that CQR Bank will be used to finance trade which attempts to circumvent sanctions.

New trading routes. Similarly, Russia may seek to establish new logistics routes to mitigate the impact of sanctions. For instance, the transport company FESCO is opening a new route to Vladivostock, with export-import operations between Russia and China (Vladivostok-Tianjin), paying for container transportation in Chinese yuan. One source alleges that, after the arrival of Russian products and raw materials in China, the country of origin of the goods can be changed, allowing Russian goods to be presented as Chinese and evade sanctions.

It is also reported that Russia is working with Iran to launch the alternative transport route known as the International North-South Transport Corridor to connect the Persian Gulf and Indian ports with Russia and allow Russia to avoid sea transport through the Turkish straits and European waters. For the route to function, a railroad connection between Iran and Azerbaijan needs to be completed. However, for the moment, this construction is blocked due to U.S.

⁸ S/2021/211 Final report of the Panel of Experts submitted pursuant to resolution 2515 (2020), para.73.
<https://undocs.org/Home/Mobile?FinalSymbol=S%2F2021%2F211&Language=E&DeviceType=Desktop&LangRequested=False>

⁹ Russian Oil Logistics in Chaos Ahead of Looming Sanctions, by Serene Cheong, Bloomberg, October 23, 2022
<https://www.bloomberg.com/news/articles/2022-10-23/russian-oil-logistics-in-chaos-with-weeks-until-sanctions-bite>

¹⁰ <https://www.radiosvoboda.org/a/news-skhemy-tankery-rf/32023011.html>

sanctions against Iran, and further development depends on progress on restoring the nuclear deal with Iran¹¹.

Parallel imports. These imports involve importing products without the permission of the intellectual property owner. Reportedly, this has made it possible to establish a supply of iPhone mobile phones and other similar products from Hong Kong to Macau, then by plane to Uzbekistan, from which the goods are delivered to Russia. There is reportedly a similar parallel import scheme for importing Coca-Cola drinks from Kyrgyzstan.

Targeted action to improve effectiveness of sanctions

Enhanced system for supervision of trade.

Risk-based approach to sanctions compliance. We propose a risk-based approach to sanctions compliance that includes enhanced measures whenever there is a risk of dealing with Russia. We propose enhanced supply chain due diligence on Russia-related trade activity in order to detect and counter sanctions-evading techniques, such as falsification of documents, consolidation of goods, concealing of end-users, complex ownership or management of the counterparty, ship-to-ship transfers, and using third countries for transshipping purposes.

Supply chain due diligence. Exporters and entities across the global supply chain should conduct due diligence on trade with Russia to ensure that recipients and counterparties to a transaction are not sending or receiving sanctioned goods or dealing with sanctioned parties. We propose implementing controls that allow for verification of country of origin, ultimate destination, end-users, and recipients of goods. Where applicable, they should request copies of export licenses and complete, accurate shipping documentation, including bills of lading or airway bills that identify the origin and destination of cargo. All entities that participate in supply chains with Russia-related concerns should be encouraged to review the details of the underlying shipping voyage, including the vessel, commodity, origin, destination, and all parties to the transaction. As a part of supply chain due diligence, all parties should review the relevant documents to the transaction to demonstrate that the underlying goods were delivered to the proper destinations listed in the documentation and not diverted in an illicit or sanctions-evading scheme.

Known transactional alerts. We suggest the following transactional alerts may be especially relevant in dealing with Russia-related sanctions evasion:

¹¹ Iran and Russia Seek New Sanctions Evasion Corridor by Emil Avdaliani, September 22, 2022, <https://cepa.org/article/iran-and-russia-seek-new-sanctions-evasion-corridor/>

- Business transactions involving a change in shipments or payments that were previously scheduled to go to Russia or Belarus, or a company located in Russia or Belarus, but that are now going to a different country/company;
- Last-minute changes to business transactions associated with parties located in Russia or Belarus;
- Trade involving freight-forwarding firms that are also listed as the product's final end customer, especially items going to traditional Russian transshipment hubs;
- Abnormal shipping routes for a product and destination; and
- Business transactions involving payments being made from entities located in third-party countries not otherwise involved with the transactions and known to be a potential transshipment point for exports to Russia and Belarus.

Transshipment. Transshipping is a significant sanctions evasion method, and it is expected to be widely used by Russian sanctions evaders. In determining which jurisdictions could pose increased transshipment risks, we recommend taking into consideration the following factors including whether the jurisdiction: (1) is geographically contiguous with Russia; (2) is neutral or politically sympathetic to Russia; (3) has strong economic ties with Russia; (4) is listed on leading advisories such as, for example, FinCEN and the U.S. Department of Commerce's Bureau of Industry Join Alert from June 28, 2022.¹²

Commodities of special concern. Due diligence should be enhanced for trade in goods which are particularly likely to be targets of sanction evasion. This applies in particular to dual-use goods, i.e., goods that can be used for both civil and military purposes, which include but are not limited to: aircraft parts and avionics equipment, antennas, cameras, GPS systems, internal measurement units, test equipment, integrated circuits, marine equipment, semiconductors, sonar systems, underwater communications, underwater equipment, and vacuum pumps. These so-called "commodities of special concern" should be subject to robust export controls to identify the end-users. We also propose that export of these categories of goods to Russia and Belarus should be prohibited.

Maritime and shipping industry related sanctions. We support the proposal to cap the price of Russian crude oil and petroleum products announced by G7 countries in September 2022.¹³ According to the plan, the provision of services supporting maritime transportation of Russian oil and related products will be permitted only where such products are sold at or below the price cap. This price cap has not yet been established and will be set by the coalition of countries implementing the policy. However, to support this plan, we propose requiring oil traders and companies to verify whether their crude is Russian in origin. Helpfully, oil has a clear chemical signature, linking a shipment to its source, so certification can be verified by

¹² FinCEN and Bis Joint Alert

¹³ Microsoft Word - G7 FM Statement September 2022 FINAL.docx (bundesfinanzministerium.de)

testing. To enforce the regime, any shipment declared not to be of Russian origin, which testing then discovers to be of Russian origin, could be subject to seizure. Further, crude shipments which do not provide assays and participate in the system of verification would be treated as Russian oil and would have to be sold in conformity with the price cap below market prices and could not be supplied to Western markets.

To tackle potential circumvention when oil and LNG tankers switch off their AIS systems and perform a ship-to-ship transfer, governments could further require any vessel delivering to an allied port (a) not to have any missing AIS data, and (b) to carry sensor equipment to detect and monitor any transfer behaviour while at sea. This enforcement regime could be further strengthened by a provision to only allow lading at ports that maintain open monitoring infrastructure and full provenance, and that do not allow Russia-origin vessels or vessels with missing AIS data to trade. Further, governments could use the shipping network inference data to aid the tracking of Russian ships attempting to launder their oil, which would also help identification of ports and jurisdictions that are enabling the illicit transfers.

We would also propose compilation of an offender list (“blacklist”) of oil transporters, traders, financier, insurers and technical shipping service providers that have assisted Russia in evading the oil embargo, and a watch list of oil transporters, traders, financiers, insurers and technical shipping service providers - especially those with the capability to facilitate high-risk ship-to-ship sanctions evading hydrocarbon trade on the high-seas - are suspected of having assisted Russia in evading the oil embargo and are subject to enhanced scrutiny (“greylist”). These lists need to be administered and continuously updated.

We propose a watch list of companies and countries deemed to be at particular risk of facilitating sanctions evasion, with enhanced scrutiny of any purchases of Western technology which might be destined for Russia, and of any sales of goods which might be Russian in origin and subject to sanctions but presented as goods from another country. We also recommend vigorous defence of IP rights to combat parallel imports.

We recommend strengthening the open registry system to prevent it being abused to conceal the Russian origin or destination of cargos by introducing sanction compliance checks into routine port inspections and boosting the due diligence capabilities of open registries¹⁴. Open registries may need some additional support to perform this function effectively.

We recommend considering the Pacific Security Maritime Exchange (PSME) as an example of multilateral collaboration in sanctions enforcement. The information-sharing system was specifically established to prevent sanctions evasion by North Korea and includes Australia,

¹⁴ Christopher J. Watterson, Stephen Osborne, Samuel Grant, *Open Registries as an Enabler Of Maritime Sanctions Evasion*. Marine Policy 119 (2020), p.

Canada, France, Germany, Japan, New Zealand, the Republic of Korea, the UK and the U.S. PSME proved to be effective in identifying smuggling ships and disrupting black market networks¹⁵.

V. Improving Sanction Effectiveness

The effectiveness of sanctions depends upon effectively countering attempts to get around sanctions and securing a high level of compliance with sanctions.

To combat attempts to get around sanctions, we propose two directions for action: immediate enforcement action, combined with a strengthened sanctions system posing a credible threat of discovery, and future enforcement action.

Immediate enforcement. Here, we would urge high-profile action on examples of sanctions evasion, and in particular active use of additional measures on sanction evaders and secondary sanctions on facilitators of sanction evasion, as illustrated by recent U.S. action against Transkapitalbank, against Turkish banks using the Mir card and against the Russian oligarch Deripaska. In particular, we would urge enforcement action on all involved in supply of components to the Russian defense industry, to ensure that Western companies have robust arrangements in place to avoid supply of components to a sanctioned entity, and a requirement on oil companies and traders to certify that there is no Russian oil in a cargo to be able to sell into Western markets.

Improved system for sanctions enforcement and regulating trade with Russia. Over time, the effectiveness of the sanctions regime will crucially depend on the quality of information on sanctions. We urge the sanctioning authorities to work closely together to generate this information, which should in turn support greater coordination and alignment. This could include:

A unified sanctions list, showing in one place all Russian entities and individuals which have been sanctioned, what the sanction is, and which members of the coalition supporting Ukraine have imposed it;

An offender list of all companies against whom enforcement action has been initiated and the outcome of that enforcement action;

¹⁵ <https://www.state.gov/dipnote-u-s-department-of-state-official-blog/nations-collaborate-to-prevent-north-korea-from-evading-un-sanctions/>

A risk list or watch list of companies believed to be involved in sanctions evasion, and of individuals involved in such trade, which will be subject to enhanced clearance and approval procedures;

A traffic light system to assess compliance by countries which may be involved in trade with Russia, with a “red” traffic light designation triggering enhanced clearance and approval procedures for trade.

Russian trade data – now that Russia has eased to publish trade data, compile substitute Russian trade data from bilateral sources, showing the evolution of Russian imports and exports, particularly for key items, such as oil and gas.

Sharing information on Russian sanction evasion schemes, including such techniques as changing customs classification codes, issuing fake documentation and certificates, and other measures to conceal the intended origin or destination of the goods.

In addition, there are a couple of institutional options to put cooperation on a more robust and formal basis, which we believe have merit.

Expert Panel. Establish an institution to monitor and report on compliance with sanctions on Russia across various jurisdictions. Such a body could be modelled on the UNSC Panel of Experts on sanctions relating to North Korea (“*The Panel of Experts* – see Annex 1”).

Treaty. Agree an international treaty among Ukraine’s partners to strengthen cooperation, including criminalizing violation of sanctions on Russia, and providing the legal basis for international cooperation in detecting and freezing sanctioned assets.

However, institutional changes can be contentious and take time. Near term, we see the key to improved enforcement as cooperation on the tasks listed above, which should provide high-quality data and information to support enforcement and improve compliance.

We also propose a structured dialogue between business and government on sanctions – and the regulation of trade with Russia – to ensure feedback and support good policy and effective implementation. Finally, we propose that governments commission research and analysis on key sectors in trade with Russia – for instance, the military-defense sector, the energy sector, the financial sector and oligarch asset holdings – and proposals on how to regulate and manage economic interaction in the future with a revisionist aggressive Russia.

Note: The inclusion of affiliations is for identification purposes only and does not represent an endorsement of shared views with the co-signer.

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Annex 1: Panel of Experts - An Option for Improving Sanction Effectiveness

The Status and Mandate of the UNSC Panel of Experts

The Panel of Experts was established in 2009 by a Security Council Resolution and is composed of experts in customs and trade control, financial forensics, arms control, maritime transport, etc.

UNSC sanctions enforcement mechanism has a two-level structure:

- Committee of the Security Council consisting of all the members of the Council, established by Resolution 1718 (2006), and
- Panel of Experts, established by Resolution 1874 (2009), which we would characterize as a working body of the UNSC Committee.

It is the Committee that has the authority to seek from member states information regarding the actions taken to effectively enforce sanctions, to act in response to alleged violations, to designate sanctioned individuals and entities, and to propose measures to strengthen the effectiveness of sanctions¹⁶.

The Panel of Experts is entrusted with the following tasks¹⁷:

- Assist the Committee in carrying out its mandate;
- Gather, examine and analyze information from States, relevant UN bodies and other interested parties regarding the implementation of the sanctions regime, in particular incidents of non-compliance;
- Make recommendations to the Security Council, or the Committee or member states on measures to improve sanctions enforcement (examples include recommendations to designate certain entities, vessels and individuals involved in sanctions evasion); and
- Provide periodical reports with its findings and recommendations to the Committee.

Over the years, the Panel exposed various sanctions evasion techniques in its reports. These include Russia's assistance to North Korea in circumventing financial sanctions by opening accounts in Russian banks for designated North Korean nationals¹⁸ and executing

¹⁶ Resolution 1718 (2006) Adopted by the Security Council at its 5551st meeting, on 14 October 2006, para. 12. <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N06/572/07/PDF/N0657207.pdf?OpenElement>

¹⁷ Resolution 1874 (2009) Adopted by the Security Council at its 6141st meeting, on 12 June 2009, pra. 26. <https://documents-dds-ny.un.org/doc/UNDOC/GEN/N09/368/49/PDF/N0936849.pdf?OpenElement>

¹⁸ S/2021/211 Final report of the Panel of Experts submitted pursuant to resolution 2515 (2020), para. 140. <https://undocs.org/Home/Mobile?FinalSymbol=S%2F2021%2F211&Language=E&DeviceType=Desktop&LangRequested=False>

payments to North Korean front companies through Russian banks¹⁹, illicit import of dual-use technology, refined petroleum and other sanctioned commodities and goods, export of coal in excess of established limits, etc.

Principal Parameters of Proposed Institution

Clearly, the Panel's ability to perform its functions largely depends on access to information and states' willingness to collaborate. Even though the Panel operates under the auspices of the UN Security Council, it periodically reports that certain states fail to provide information or avoid giving meaningful responses to the Panel's requests. However, the Panel still manages to produce comprehensive and grounded reports, which shed light on complicit states' questionable practices.

Therefore, we believe that the viability of such an institution is contingent upon multilateral support from the sanctioning nations and their partners. Theoretically, establishment of such an institution could be initiated by the UN General Assembly, which might help to gain support of the member states.

We suggest that the proposed institution would have the following mandate:

- Gather, examine, and analyze statistical data and other information obtained from the states and other sources to identify incidents of sanctions evasion by the Russian Federation.
- Liaise with competent national authorities and international organizations (such as FATF) regarding practical coordinated steps to preclude sanctions evasion by the Russian Federation and to take punitive measures against complicit entities;
- Serve as an informational hub for national authorities, banks, business entities, and other actors who may require clarifications regarding the sanctions regime;
- Develop and publish recommendations to standardize due process mechanisms;
- Develop and publish recommendations to eliminate legislative loopholes, especially in jurisdictions with weak financial monitoring and oversight; and
- Promote transparency in international sanctions efforts by publishing its findings and recommendations.

¹⁹ S/2021/211 Final report of the Panel of Experts submitted pursuant to resolution 2515 (2020), para.140.
<https://undocs.org/Home/Mobile?FinalSymbol=S%2F2021%2F211&Language=E&DeviceType=Desktop&LangRequested=False>