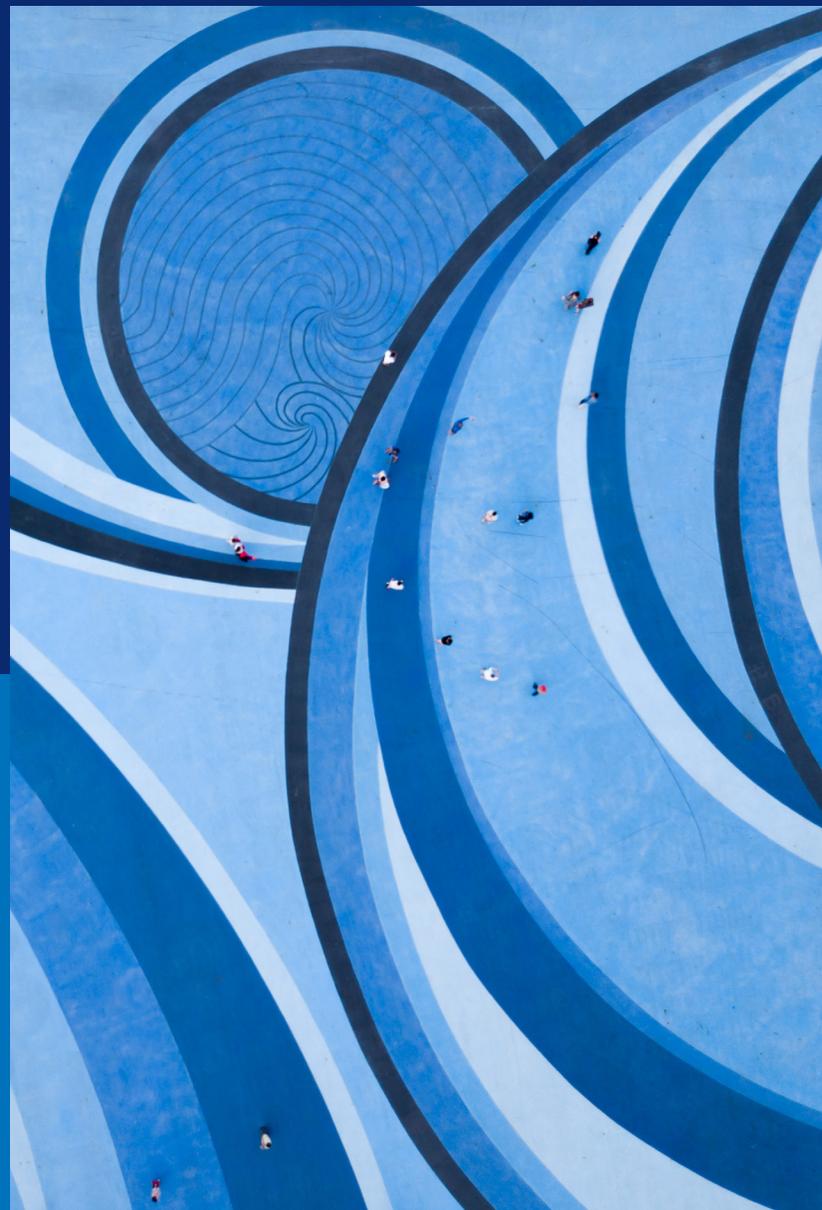


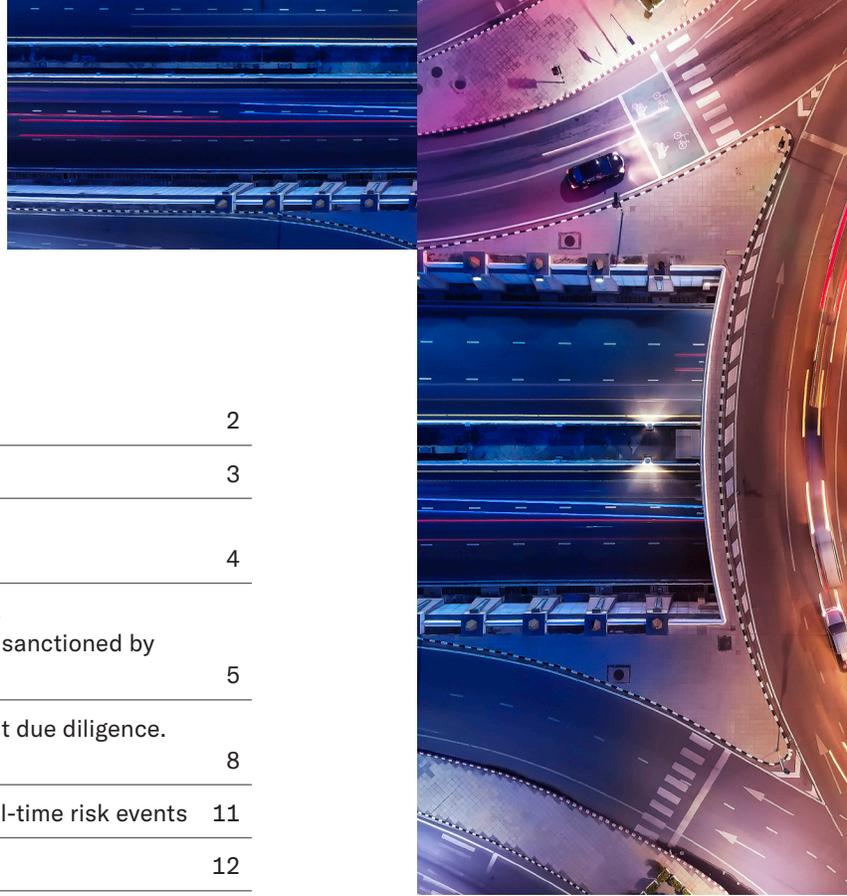
A new frontier in sanctions awareness and compliance

In collaboration with:

U.S. Department of State's Office
of Cooperative Threat Reduction

CRDFGLOBAL





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Executive summary

After new economic sanctions were levied in the months following Russia's invasion of Ukraine, global financial institutions needed clarity on the processes and policies they had in place. Recognizing the importance of fostering dialogue and boosting awareness of critical sanctions enforcement, the U.S. Department of State and CRDF Global implemented a series of conferences worldwide, with Moody's providing its financial crime experts, data, and solutions to conduct the workshops.

Each workshop covered global sanctions frameworks, compliance, and risk management strategies, and at least one case study of evasion techniques. In this paper we share three of those case studies, as well as the sanctions compliance program guidance attendees have found most helpful. The use cases are based on real life examples, but all names of individuals and entities shown in the case studies below are fictitious.

The collaboration among Moody's, the U.S. State Department's Office of Cooperative Threat Reduction (CTR), and CRDF Global exemplifies a successful public-private collaboration aimed at increasing awareness and enhancing the effectiveness of economic sanctions.

Current state of affairs

International communities are taking a multilateral approach to economic sanctions against Russia following its invasion of Ukraine in February 2022. The measures, including extensive financial restrictions, were immediately imposed, and have continued to evolve and strengthen. According to the Department of Justice, this sanctions campaign aims to weaken and disrupt Russia’s ability to wage war while stabilizing the global economy¹.

At publication, the United States and its allies have successfully blocked or frozen more than \$58 billion in financial accounts and economic resources owned by sanctioned Russians², and about \$300 billion of Russia’s Central Bank assets³. The U.S. Department of the Treasury’s Office of Foreign Assets Control (OFAC) announced stricter measures and expanded sanctions authorities at the 2023 G7 Summit in Hiroshima.

In response to tougher sanctions implementation efforts by allies, high-ranking political representatives, military, paramilitary persons, and entities operating in key sectors in Russia and Belarus are employing increasingly sophisticated sanctions evasion techniques.

Assets are being concealed in a complex labyrinth of trusts, tax havens, shell companies, and other means aimed at circumventing sanctions, according to analysis provided by financial crime industry practice leads to Moody’s.

The number of entities and individuals on various sanctions lists has grown rapidly, with parties sanctioned by extension growing on an even larger scale.

It is crucial for governments and institutions to have a comprehensive understanding of the legal framework, implementation mechanisms, and risk-based approaches to ensure the effectiveness of sanctions in a new era of evasion. This requires continuous dialogue and cooperation between government agencies, financial institutions, and other key stakeholders involved in the design and enforcement of sanctions.

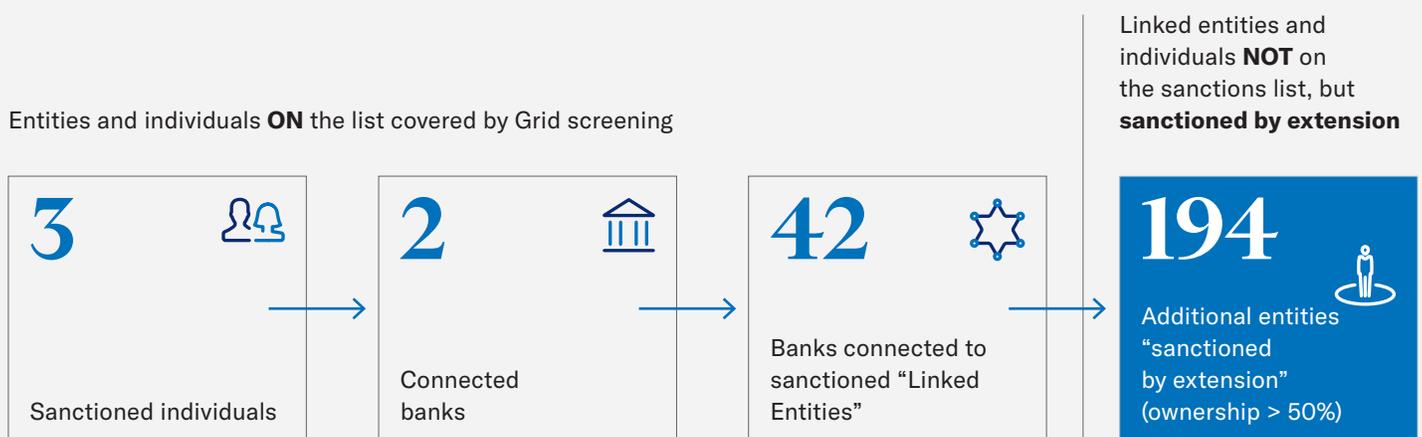


FIGURE 1: Going beyond sanctions lists to uncover entities and individuals sanctioned by extension⁴

¹ Source: <https://www.justice.gov/usao-edny/pr/five-russian-nationals-including-suspected-fsb-officer-and-two-us-nationals-charged>

² Source: <https://home.treasury.gov/news/press-releases/jy1329>

³ Source: https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_22_4232

⁴ Data is derived from Moody’s Grid screening tool as of February 2023.

Improving sanctions implementation

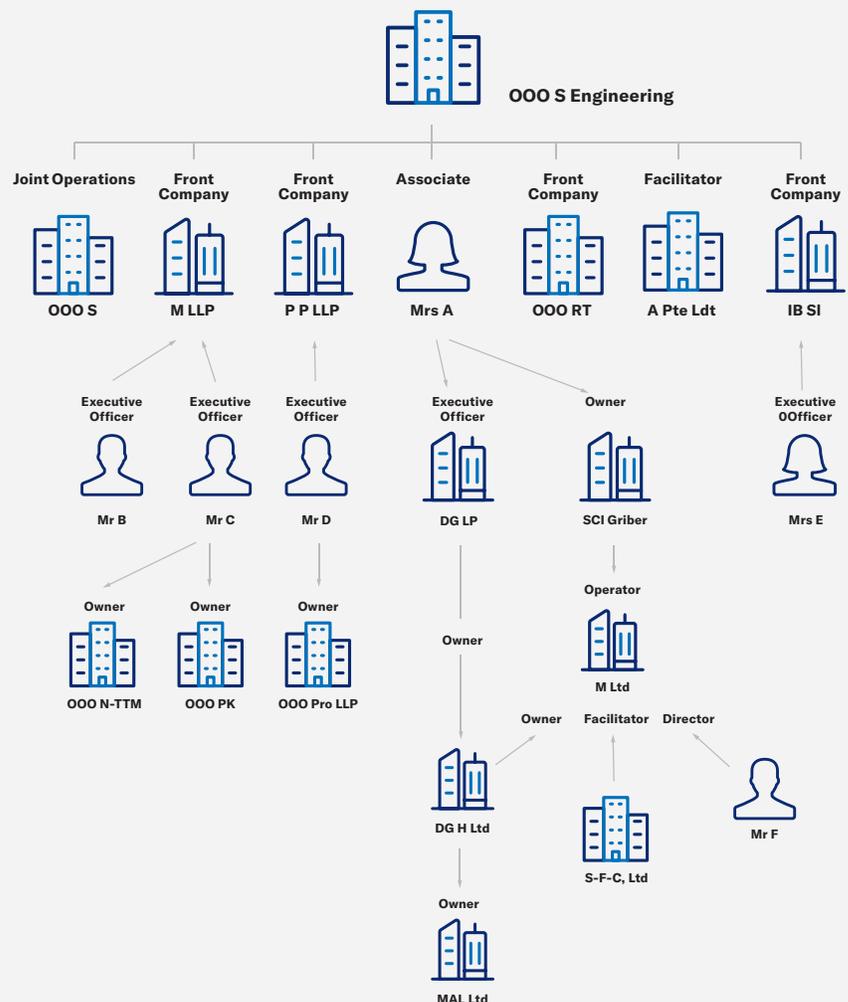
CASE STUDY 1: UNRAVELING A COMPLICATED PROCUREMENT NETWORK

When OFAC announced its crackdown on sanctions evasion networks and Russian technology companies⁵, it revealed a trend in sanctions evasion that arose as early as 2014 to 2016, following the sanctions imposed in response to Russia's annexation of Crimea⁶. Multiple sanctioned individuals created overly complex corporate structures to achieve ultimate control and influence over the entity, even if the ownership structure, as well as direct and indirect shareholdings, did not reflect a shareholder ownership of 50% or more. These informal or hidden formal coalitions were complicated to dissect and detect.

In the case study below, published by the U.S. Department of the Treasury, an engineering company with a global footprint engaged in proliferation activities by means of a procurement network for acquiring military applicable technology. According to a press release distributed by the U.S. Attorney's Office, Eastern District of New York, the engineering company managed an extensive network of shell corporations and bank accounts worldwide, with the intent to conceal the true recipients of U.S.-sourced equipment⁷.

FIGURE 2:

The U.S. Department of the Treasury's depiction of an engineering company with global footprint procurement network⁸



⁵ Source: <https://home.treasury.gov/news/press-releases/jy0692>

⁶ Source: <https://www.consilium.europa.eu/en/meetings/european-council/2014/03/20-21/>

⁷ Source: <https://www.justice.gov/usao-edny/pr/five-russian-nationals-including-suspected-fsb-officer-and-two-us-nationals-charged>

⁸ Source: This graphic was recreated from <https://home.treasury.gov/news/press-releases/jy0692>. This is a real use case.

Evolving methods to capture the dynamic nature of sanctions

CASE STUDY 2: IDENTIFYING SHELL COMPANY OPERATIONS THROUGH A SANCTIONED BY EXTENSION ENTITY

With the increasing complexity and sophistication of sanctions evasion techniques, direct screening of entities against OFAC's Specially Designated Nationals and Blocked Persons list (SDN list) is no longer adequate. There are instances where sanctioned entities take advantage of loopholes to use legal persons as a vehicle to evade detection.

For financial institutions to mitigate the potential risks posed by the abuse of using legal persons, it is vital that their compliance teams discover potential shell companies within their client portfolio, as well as conduct due diligence on all counterparties in transactions.



X3X SINGAPORE PTE. LTD.

 Bukit House, Singapore, Singapore
X3X12345

SANCTION RISK SUMMARY

- X3X Singapore Pte. Ltd. does not appear to be directly sanctioned.
- X3X Singapore Pte. Ltd. is not directly sanctioned but appears to have sanctions risk exposure due to ownership and should be reviewed.
- X3X Singapore Pte. Ltd. has sanction risk exposure due to the entity's leadership and should be reviewed.
- X3X Singapore Pte. Ltd. has 1 sanctioned shareholders of 12 shareholders and should be reviewed.

DIRECT SANCTIONS

NF

Not found

Direct sanctions were not found for this entity.

SANCTION BY EXTENTION

S

Sanctioned

%100.00

OFAC SSI

%100.00

UK

FIGURE 3:

Sanction risk summary of the spa and wellness company⁹

⁹Data is derived from Moody's Sanctions360 solution.

Moody's used its database to unravel entity and ownership information for this Singapore-based company, and identified a possible shell company operation based on these common indicators:

- **Questionable shareholder voting power:** The company operates a spa and wellness business registered in Singapore, but a look at the shareholders in Figure 4 shows there are multiple overseas owners with significant voting power, including two government agencies. This is a common red flag for a financial institution to further investigate the company's operations.
- **Entity ownership:** Using data to unwrap the levels of ownership (Figure 5), we see the entity is ultimately owned by sanctioned parties in Russia, which may indicate they are concealing ownership to circumvent sanctions.
- **Address of incorporation:** A further perusal of this company's information reveals the same address of incorporation is used by more than 100 other entities, all rolling up to the same ultimate beneficial owner, which is indicative of shell company risk.

An entity with a similar ownership structure, company information, and other shell company risk indicators could easily bypass a financial institution's risk alerts if the institution does not have in-depth knowledge of its client profiles. Besides opening financial institutions to greater regulatory scrutiny, these banks may also be fined for inadequate risk and detection controls in the event of success sanctions evasion or money laundering.

For compliance teams to understand the larger interconnected network in which these sanctioned entities operate, they need to synthesize global datapoints that reflect the dynamic, real-time developments in these networks.

Over the course of the Russia/Ukraine conflict, sanctions evolved from an initial emphasis on Russian and Belarusian entities to entities in other jurisdictions that have current or previous trade and economic activity with Russia, such as Switzerland, Cyprus, United Arab Emirates, Singapore, Hong Kong, the Cayman Islands, and Italy. Financial institutions can calibrate their risk-based approaches on sanctions compliance based on the location of these entities.



Drawing upon our decades of experience operating internationally and our deep commitment to mitigating sanctions evasion, this programming provides tailored and effective compliance training solutions all over the world. As part of our broader vision for a more secure world, we take pride in strengthening institutions by connecting individuals, and empowering them with knowledge and due diligence resources to use in their professional capacity.

Tina Dolph
CRDF Global President and
Chief Operating Officer

Entity name	Voting power	Country	Direct sanctions
X3X SINGAPORE PTE. LTD.		Singapore	APAC
S Oil Company	100.00%	Russian Federation	OFAC SSI UK
R Invest	20.28%	Russian Federation	NONE FOUND
T Oil Invest	23.38%	Qatar	NONE FOUND
Q Investment Authority	23.38%	Qatar	NONE FOUND
Z Limited Liability Company	100.00%	Russian Federation	NONE FOUND
Government of R	76.51%	Russian Federation	NONE FOUND
Government of Q	23.38%	Qatar	NONE FOUND
Federal Agency of R	66.45%	Russian Federation	NONE FOUND
R Investment authority	23.47%	United Kingdom	NONE FOUND

FIGURE 4:

Government of R has a 76.51% voting power in the spa and wellness company¹⁰

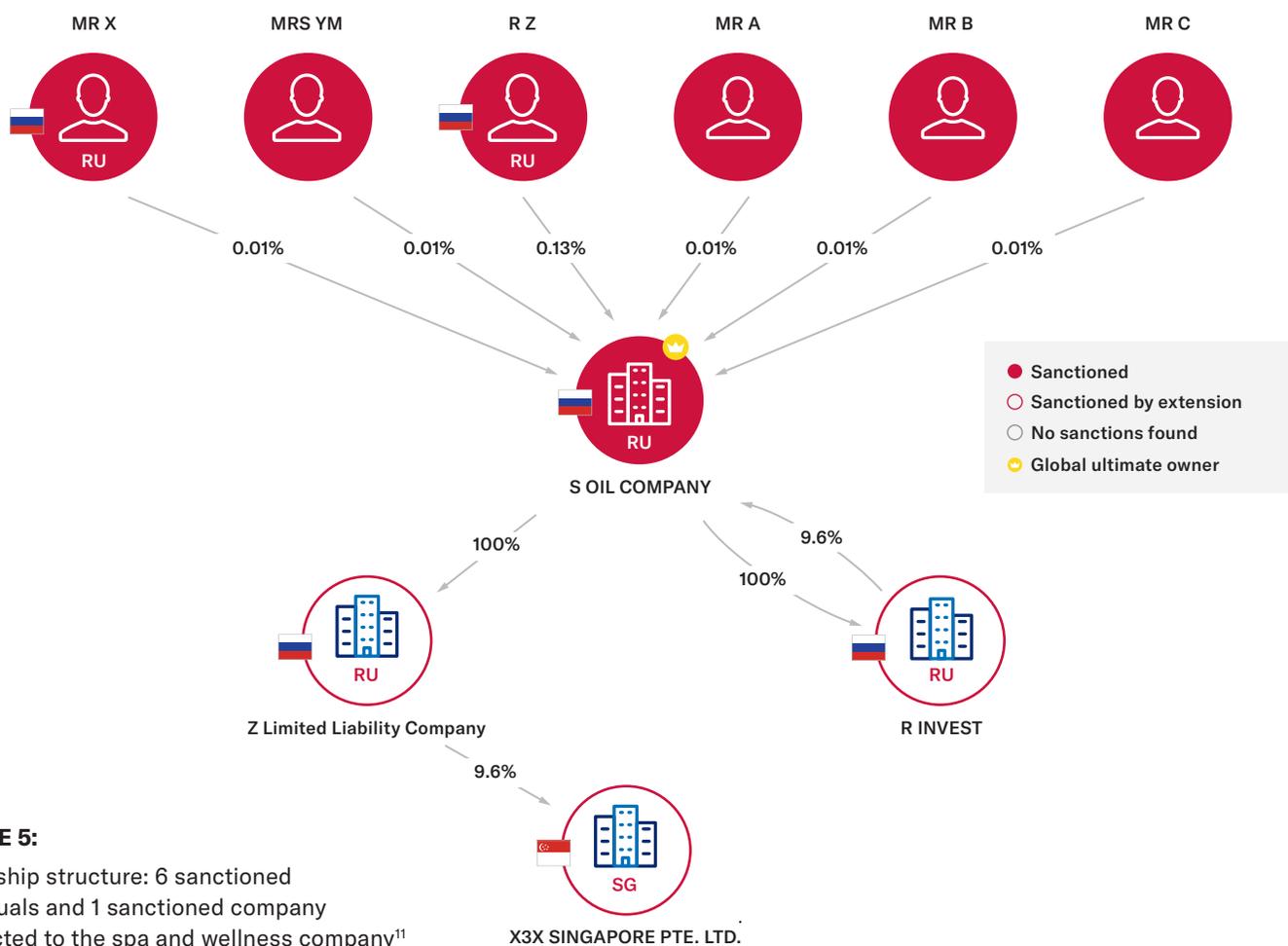


FIGURE 5:

Ownership structure: 6 sanctioned individuals and 1 sanctioned company connected to the spa and wellness company¹¹

¹⁰ Data is derived from Moody's Sanctions360 solution.

¹¹ Data is derived from Moody's Sanctions360 solution.

Continuous tracking of sanctions risk exposure through robust due diligence

CASE STUDY 3: UNCOVERING CONTROL AND HIDDEN INFLUENCE EXTENSION ENTITY

There are three questions when it comes to ownership:

- 1 Who controls the entity
- 2 How they control the entity
- 3 Where their customers are located

The case study highlighted in this section focuses on economic sanctions intended to freeze the assets of individuals associated with the Russian regime.

Figure 6 reflects the sanction risk summary of a European company in the manufacturing and logistics industry. There are no sanctions exposures flagged for the entity and its shareholders.

Figure 7 shows the ownership structure taken right after the invasion of Ukraine. The ownership tree reflects four family members at the top, with a combined ownership of 49.2% – just under the threshold set by OFAC's 50 Percent Rule¹².



LIA STEEL INDUSTRIAL

 R. KALANTOS, 100 KAUNO M., Lithuania
X3X123456

SANCTION RISK SUMMARY

- LIA Steel Industrial does not appear to be directly sanctioned.
- LIA Steel Industrial is not directly sanctioned and no other sanctions exposure was currently detected.
- LIA Steel Industrial does not have any sanctioned entities in its leadership.
- LIA Steel Industrial does not have any sanctioned shareholders found among 12 shareholders.

DIRECT SANCTIONS

NF

Not found

Direct sanctions were not found for this entity.

SANCTION BY EXTENTION

NF

Not found

Sanction by extension were not found for this entity.

FIGURE 6:
Sanction risk summary of the engineering company¹³

¹² Source: <https://ofac.treasury.gov/faqs/401>

¹³ Data is derived from Moody's Sanctions360 solution.

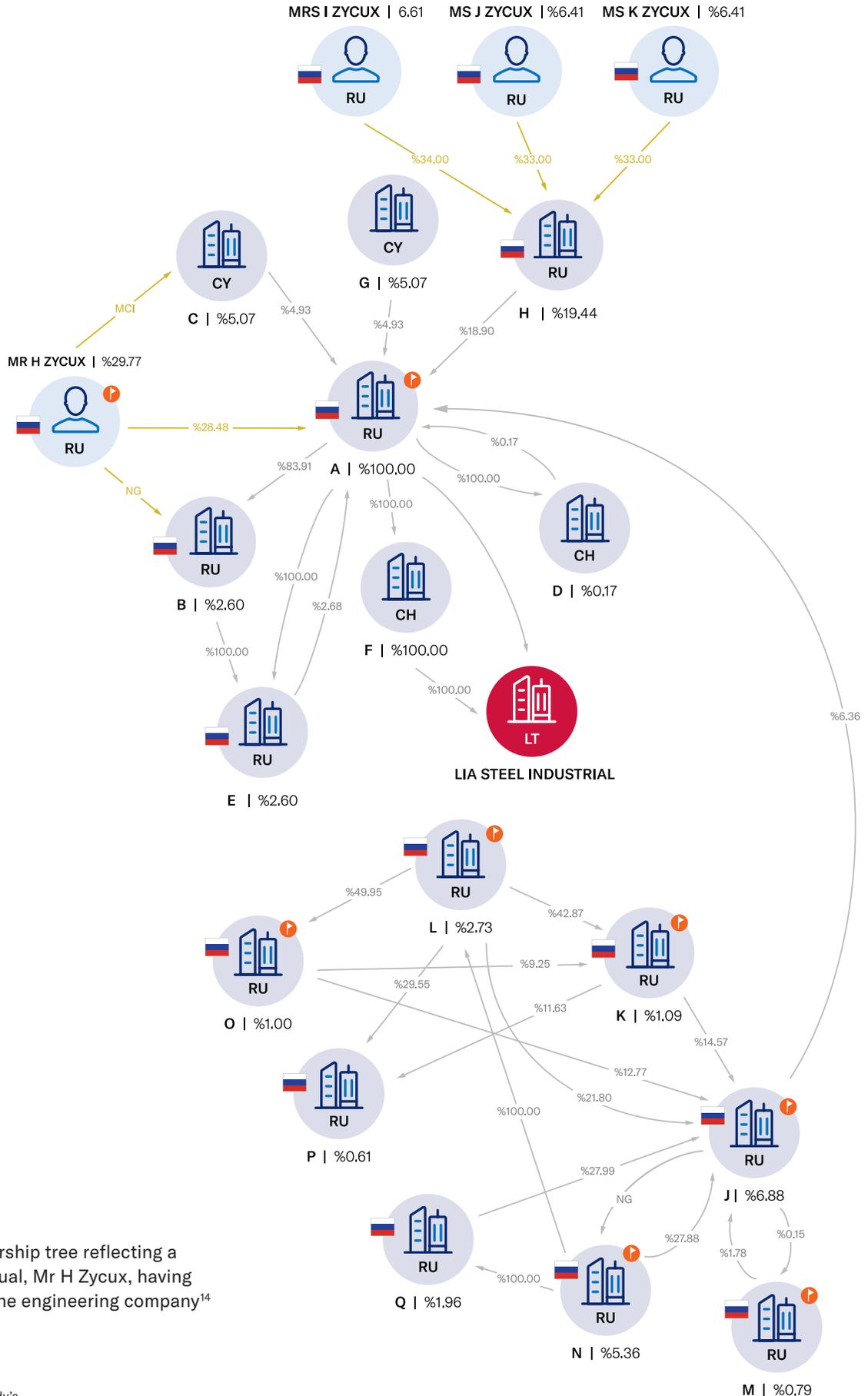


FIGURE 7:
Pre-invasion ownership tree reflecting a sanctioned individual, Mr H Zycux, having 29.77% shares at the engineering company¹⁴

¹⁴Data is derived from Moody's.

One might conclude that the largest shareholder in the family, Mr H Zycux, who owns 29.77%, has no control over the company. However, Figure 8 shows Mr H Zycux is associated with an OFAC designated entity, and the power score calculated measures his influence at 98.60%.

The risks associated with this company are also highlighted by the following indicators:

- Mr H Zycux is the board chairman of the sanctioned company in question (Figure 9).
- There is circular ownership with another company doing business in the embargoed oblasts of Donetsk and Luhansk.
- The company was also connected to a sanctioned joint-stock company connected to the Russian government. After the invasion, there was a reshuffle, and ties with the Russian government were severed due to the appearance of a new Russian shareholder, Ms VG (Figure 10). However, red flags still warrant careful due diligence.

For compliance teams to understand the larger interconnected network in which these sanctioned entities operate, they need to synthesize global datapoints that reflect the dynamic, real-time developments in these networks.

Entity name	Voting power	Country	Direct sanctions
LIA STEEL INDUSTRIAL		 Lithuania	
JCO CH Yutuku	1.26%	 Russian Federation	NONE FOUND
Mrs I Zycux	1.33%		NONE FOUND
Mr H Zycux	98.60%	 Russian Federation	NONE FOUND
LIA International	100.00%	 Switzerland	NONE FOUND
ABC Company	1.47%	 Cyprus	NONE FOUND
V holdings	1.30%	 Cyprus	NONE FOUND
MECHEL MINING AO	1.26%	 Russian Federation	NONE FOUND
LIA Mining	100.00%	 Russian Federation	NONE FOUND
S1234567	1.47%		NONE FOUND

FIGURE 8:

Mr H Zycux has a voting power of 98.6% at the engineering company¹⁵

¹⁵ Data is derived from Moody's Sanctions360 solution.

PERPETUAL KNOW YOUR CUSTOMER (PKYC) CHECKS TRIGGERED BY REAL-TIME RISK EVENTS

In a more recent snapshot of the same company, shown below in Figure 10, we see Mr H Zycux now has a larger ownership stake of 36.15%. The ownership structure is also more simplified, as one family member (Ms K Zycux, Figure 7) has been removed as owner, removing the apparent connection to the Russian government – this could potentially have been done to avoid sanctions detection.

However, one of the new beneficial owners in the third layer is a Russian national. Given this constitutes a material change in the risk profile of the business relationship, it would be prudent for a financial institution to conduct event-triggered screening as part of perpetual KYC efforts.

Mr H Zycux

Chairman of the Board of Directors (since 27/2009)



H ZYCUX

Chairman of the Board of Directors

WLT_Watch List / SAN Sanction, Date: 26/03/2022

This entity appears on the United States Treasury Department's Office of Foreign Assets Control (OFAC) Non-SDN List. Appears on the Sectoral Sanctions Identifications, RUSSIA-E014024 Lists, Approval Date: 04/07/2022

US Treasury Dept. OFAC Consolidated Non-SDN Sanctions List

FIGURE 9:

Mr H Zycux is on the sectoral sanctioned list from the United States Treasury Department's Office (OFAC) Non-SDN list¹⁶

¹⁶ Source: This graphic was recreated from US Treasury Department's Office of Foreign Assets Control Non-SDN list. This is a real use case.



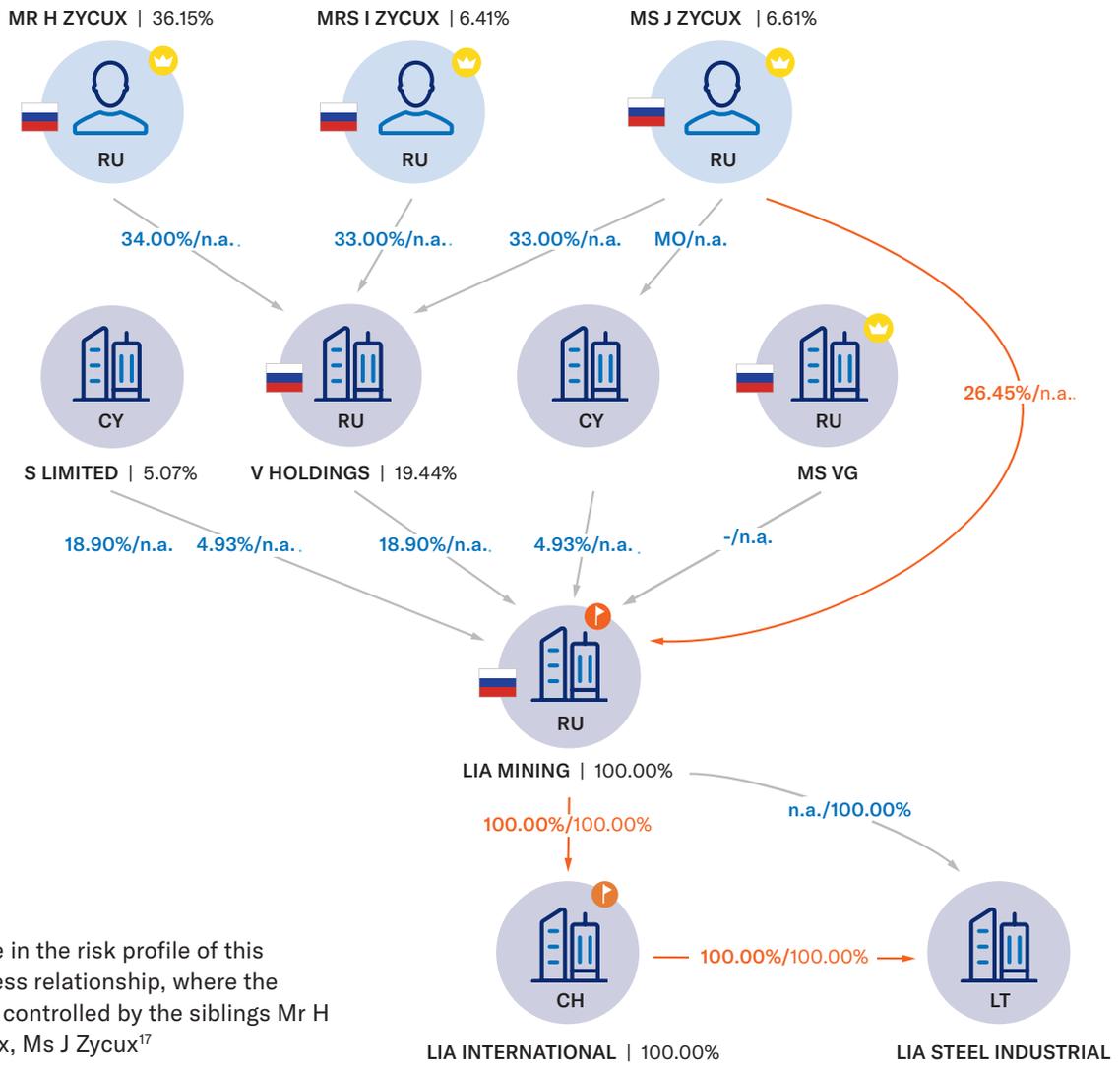


FIGURE 10:

A material change in the risk profile of this company's business relationship, where the ownership is now controlled by the siblings Mr H Zycux, Mrs I Zycux, Ms J Zycux¹⁷

¹⁷Data is derived from Moody's.

Compliance course of action

GOING BEYOND THE LIST

The linear screening method of matching names against the official sanctions lists is insufficient. It exposes organizations to significant risks as it does not take into account entities owned and/or controlled by sanctioned persons.

Today's sanctions climate has engendered creative sanctions evasion techniques that leverage shell companies, use of opaque jurisdictions, and false divestment to family members and close associates to obfuscate ownership and control.

In order to identify entities that are considered sanctioned by extension, extensive due diligence is required to protect organizations from sanctions risks.

Providing your organization access to comprehensive data and intuitive investigative tools are crucial to ensuring that sanctions risks are effectively and efficiently identified.

ESTABLISHING ROBUST INTERNAL CONTROLS

To mitigate the risks posed by growing sanctions evasion techniques, it is important to ensure staff are adequately trained and have access to the right data and tools. Guidance should be provided around sanctions evasion trends and challenges, such as, but not limited to, the following:

- Establishment of complex networks of organizations to obfuscate ownership by a designated entity.
- Usage of shell companies – risk indicators include unusual financial statements, registered address and/or directors utilized by an unusually high number of companies, location in opaque jurisdictions, conflicting corporate purpose, lack of web presence.
- De facto control by a designated individual despite limited ownership. This may be done through false divestment of ownership shares to family members and close associates, holding directorship or other leadership positions, or having significant voting power through the establishment of voting coalitions.

Continuous monitoring of an organization's customers, suppliers, and other relevant counterparties such as owners, directors, and shareholders are imperative. However, due to the volume and breadth of due diligence that must be conducted, more sophisticated organizations have utilized curated datasets, intuitive investigation tools, and artificial intelligence to help them effectively detect sanctions evasion risks.

FOSTERING A GLOBAL APPROACH TO SANCTIONS COMPLIANCE

The collaboration among Moody's, the U.S. State Department's Office of Cooperative Threat Reduction (CTR), and CRDF Global exemplifies a successful public-private collaboration aimed at increasing awareness and enhancing the effectiveness of economic sanctions.

These workshops aim to enhance the understanding of the legal and regulatory framework governing the application of economic sanctions, including relevant US and international laws, local regulations, and guidelines. Secondly, we aim to provide practical guidance on the implementation of sanctions, including best practices for compliance and risk management, as well as strategies for identifying and addressing potential sanctions evasion.

The program acknowledges that access to the right datasets and understanding exposure to complex corporate structures can be challenging. By combining risk-relevant sanctions data with ownership and control information, financial institutions can ensure compliance with applicable regulations.

Finally, the program aims to facilitate the exchange of information and experiences between government officials, financial institutions, and other stakeholders involved in the design, implementation, and enforcement of sanctions.

The workshops took place in 2022 and 2023 in Asia-Pacific, Britain, Europe, and the British Virgin Islands.

ABOUT CRDF GLOBAL

CRDF Global is an independent nonprofit organization that provides international training and capacity building programming to advance safety, security, and sustainability. With offices around the world, the company promotes international research integrity and knowledge security, data and IP protection, and cyber and information security globally. CRDF Global collaborates with government agencies, academia, and the private sector to strengthen connectivity among experts and tailor the application of international best practices that allow for transparent scientific discovery and applications of research and technology.

<https://www.crdfglobal.org/>

ABOUT U.S. DEPARTMENT OF STATE, OFFICE OF COOPERATIVE THREAT REDUCTION

The Office of Cooperative Threat Reduction (CTR) is funded by the nonproliferation, anti-terrorism, demining and related programs (NADR) account, and manages the Global Threat Reduction program. CTR efforts include disrupting the funding, transport, and acquisition of WMD material, technology, and expertise by proliferator states such as China, DPRK, Iran, Russia, and Syria, as well as preventing WMD attacks by ISIS and other terrorist actors.

<https://www.state.gov/bureaus-offices/under-secretary-for-arms-control-and-international-security-affairs/bureau-of-international-security-and-nonproliferation/office-of-cooperative-threat-reduction/>

ABOUT MOODY'S

Moody's is transforming compliance and third-party risk management. Integrating award-winning data, workflow automation, and AI-driven solutions, we are creating a world where risk is understood so decisions can be made with confidence.

With innovative technology and industry expertise, Moody's automates perpetual monitoring of counterparty risk across global networks in near real-time. We work with customers to shape their know your customer (KYC), anti-financial crime, risk, and compliance programs around their risk appetite, operational needs, and strategic goals.

Moody's is helping customers build a picture of risk across 197 countries, and 211 jurisdictions, screening against our database of +23 million risk profiles, +550 million entities, and +51,000 sanctioned entities.

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