Conference Report

Euro SIFMANet: European Sanctions and Illicit Finance Monitoring and Analysis Network
Madrid Report

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The Centre for Financial Crime and Security Studies at RUSI convened a roundtable in Madrid in late May 2023, to discuss the state of the implementation of sanctions in Spain. The event is part of the series of in-country engagements through the European Sanctions and Illicit Finance Monitoring and Analysis Network (Euro SIFMANet). The roundtable, held under the Chatham House Rule, gathered Spanish representatives from major financial institutions and relevant authorities including the Spanish Financial Intelligence Unit (FIU), Ministry of Finance and Ministry of Defence. This report summarises the main findings of the discussion related to Spain’s experience of sanctions on Russia since February 2022.

Sanctions Implementation in Spain

The roundtable opened with a description of Spain’s progress on implementing sanctions at a national level. Participants started by pointing to the positive assessment of Spain’s anti-money laundering and countering the financing of terrorism (AML/CFT) regime by the Financial Action Task Force (FATF) in 2014. The FATF rated highly both Spain’s AML/CFT controls and the understanding of the private sector in enforcing them. Participants argued that a robust AML/CFT regime can facilitate more effective implementation of sanctions, given the importance of transaction and client monitoring systems of financial institutions for monitoring sanctions breaches and ensuring sanctions compliance of their clients.

Participants did acknowledge that the FATF highlighted some deficiencies regarding Spain’s capabilities to implement financial sanctions. These weaknesses were related to significant delays in transposing new designated entities into national sanctions lists, the lack of clear channels or procedures for directly receiving foreign requests to take freezing actions, and not having proposed or made any designations. The FATF found these deficiencies to persist in its follow-up assessment in 2019. With this in mind, one representative from the public sector agreed that Spain does not have a framework that is as well-developed to implement financial sanctions as it could have, notably for identifying where a designated individual has control over an entity and for establishing ultimate beneficial ownership of companies.

2. Ibid.
Within this framework, responsibilities for sanctions implementation are distributed among various national competent authorities. Notwithstanding their varying individual responsibilities, public authorities at the roundtable acknowledged that they all also rely on the private sector to provide information on the ownership and control of entities by designated individuals. Furthermore, Spain has not adopted a leadership role among member states in the negotiation of sanctions against Russia and has proposed only a few designations, usually in conjunction with other countries. Since February 2022, in contrast to other EU member states, Spain has not passed any new legislation to facilitate the implementation of sanctions at the national level, except for an amendment to allow the freezing of unregistered assets. Some participants felt this absence leaves gaps that need addressing.

Despite these shortcomings, discussants pointed to several factors that contribute to Spain’s compliance with sanctions. First, a representative from the Spanish FIU emphasised that Spain has a good track record in implementing financial sanctions, mainly due to the experience with sanctions imposed against Iran since 2010. Second, in contrast to many other European banks, Spanish financial institutions have a record free of major scandals or fines for breaching sanctions, which participants attributed, in part, to their limited exposure to the Middle East compared with other international banks, but also to strong internal policies. Third, Spain has voluntarily chosen to comply with both EU and US sanctions for a number of years. In this regard, representatives from financial institutions at the roundtable added that while they noted Ukraine’s domestic sanctions list, to avoid overcompliance and de-risking, they restricted their sanctions actions to those entities designated by the US and the EU – all of which are also on Ukraine’s list.

Russia’s full-scale invasion of Ukraine has significantly impacted financial institutions. While many required sanctions controls are already in place, the cross-border ownership structure of large Spanish banks has required them to maintain wide-ranging oversight. Representatives from these institutions explained that they have reinforced their sanctions compliance programmes, and some have developed tools to facilitate the implementation of sanctions. An example of this is an internal website that provides staff with updates on regulatory guidance and relevant articles on sanctions.

The Spanish private sector demonstrates great understanding and commitment to effectively implement sanctions. However, there was a consensus among participants regarding the unique challenges posed by the sanctions regime.

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against Russia, in contrast to those the EU has previously implemented, which will be discussed in the next section.

Challenges in Spain

Having addressed the context of Spain’s capacity to implement sanctions, the discussion turned to the challenges the public and private sectors face when implementing the sanctions regime against Russia.

As identified by participants, a particular challenge posed by the sanctions regime against Russia is the complexity of trade sanctions. A significant aspect of this challenge is the division between financial and commercial flows. While the latter relies on Customs for enforcement, financial institutions also play an important role as they contribute by sharing intelligence on the involved actors, jurisdictions and other relevant elements such as payments related to restricted goods.

The impact of the Russian invasion has further complicated the task of enforcing sanctions, escalating from dealing with a limited number of cases to thousands of hits and increased exposure. This has heightened the risk of unintended supply chain disruption, for example in relation to food supplies. To mitigate this risk, participants welcomed the introduction of ‘firewalls’. The European Commission recently issued guidelines regarding firewalls\(^5\) that allow entities trading in agricultural and food products controlled by a designated individual to continue operating under supervision while their assets are frozen. This facilitates sanctions implementation and reduces the risk of business closures and the subsequent consequences to supply chains, business viability and staff employment.

Lack of harmonisation and alignment among member states was also identified as an issue. For example, if a bank in one member state identifies an entity connected to a sanctioned individual, a different interpretation in another member state could allow transactions to be structured to take advantage of this difference in interpretation. In such instances, participants observed that the private sector often unfairly bears the blame and may become subject to litigation. The lack of centralised mapping of entities owned or controlled by sanctioned individuals at the EU level was noted as a particular shortcoming. Currently, the private sector in each jurisdiction undertakes this mapping

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endeavour, and authorities rely on it, but there was a consensus on the need for centralisation within the EU.

One result of this divergence and lack of common criteria is that some member states have individually introduced their own sanctions lists.\textsuperscript{6} A representative from the public sector added that the lack of harmonisation in sanctioning entities also reflects commercial competition among member states. To this end, implementing sanctions in a harmonised manner would be instrumental to effectively enforce sanctions and participants recommended that the existing voluntary nature of the European Commission’s guidance and the lack of enforcement by many member states need to be addressed.

Central to this issue is the complexity of the ‘control’ criteria and determining ownership. Participants noted that the US Treasury’s Office of Foreign Assets Control follows an easier and more straightforward system in this regard, as it does not have the EU’s concept of control and relies on simple percentage rules and provides clear guidance. On the other hand, the EU frequently changes its criteria on this term and has modified its FAQs, making it challenging to implement the criteria in a consistent manner. For this reason, participants agreed that some of the sanctions and guidance put forth by the European Commission should be revisited to assess the usefulness and impact. On a similar note, representatives from the banking sector pointed to the €100,000 limit on deposits as a measure worth reconsidering, as it can be easily evaded and overcomplicates payment processes.

These challenges give rise to major concerns for representatives from both public and private sectors, namely overcompliance and de-risking. The aim of the sanctions regime is not to refuse all transactions related to Russia beyond what is mandated, but to limit the financing and resourcing of the war through targeting specific sectors and individuals. Participants have experienced a substantial increase in their sanctions workload, and many banks lack the resources to monitor all Russia-related transactions, leading them to opt for broad actions such as ending their Russia-related activities and thus overcomplying with sanctions. Financial institutions are concerned about false hits and the difficulty in achieving a high level of efficiency, often resulting in a failure to focus on the real designated individuals.

In sum, participants argued that to achieve greater effectiveness, governments need to work harder to support the implementation work of the private sector, which led to the following concluding recommendations.

Recommendations

Spain’s stakeholders in charge of implementation of sanctions voiced confidence in their understanding and experience. While Spain has not been a vocal player in the field of sanctions, the country will take over the Presidency of the Council of the EU in July 2023, placing a spotlight on the country’s sanctions capabilities and leadership. In their commitment to achieve an effective sanctions regime and overcome the identified challenges, participants put forth a series of recommendations that could inform the Presidency’s upcoming agenda.

1. **Centralised mapping of entities under the ownership or control of designated individuals, with EU-wide guidance and harmonisation.** The mapping efforts are currently the responsibility of the private sector and there is a need for an EU-level approach to list the entities under the control of designated individuals and a comprehensive European-wide guidance that ensures the information reaches the key operators implementing sanctions across the EU and is implemented in a uniform manner.

2. **Promote the introduction of ‘firewalls’.** Allowing a company to operate under supervision despite being controlled by a sanctioned individual would make sanctions more sustainable. This approach would prevent the complete devaluation of a company’s assets, which is not beneficial for either the state or the owner. An added benefit would be the shifting of responsibility from banks to the company itself to adhere to agreed controls. Currently, banks are obliged to request licences on behalf of the company. The introduction of general licences and firewalls would facilitate more agile sanctions that do not harm sectors such as fertilisers and food supplies.

3. **Criminalisation of sanctions violations.** While trade sanctions evasion can be considered contraband, financial sanctions evasion has not yet been criminalised in Spain and the European directive mandating it has not yet entered into force. Given that many countries lack the capacity to conduct investigations into sanctions breaches with the same tools as with criminal offences, criminalising sanctions evasion has become a necessary and overdue step.

4. **Strengthen the information-sharing loop.** The private sector is a key provider of financial intelligence but continues to lack sufficient feedback on the usefulness and outcomes of the information reported to the authorities. Guidance is being provided but enhancing this feedback loop would help prevent evasion.

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5. **Clarity on the extraterritoriality of sanctions.** Although the EU holds that there will be no extraterritorial application of sanctions, indications in FAQs and upcoming packages suggest otherwise. This creates uncertainty as to the exact application of the mandate.

6. **Sanctions should not be viewed separately from anti-money laundering efforts.** Even if the ultimate beneficial ownership of an entity by a sanctioned individual is only 25%, there may still be concerns about working with such entities. The focus should be on beneficial ownership transparency, and adequate resources should be allocated to mitigate the challenges the private sector faces in obtaining this information.

7. **Reassess the sanctions imposed.** The effectiveness and utility of certain sanctions have not been thoroughly assessed and should be revisited. The complications brought by the lack of clarity regarding the control criteria and rules such as the restriction on deposits over €100,000 were a recurring theme at the roundtable. In consequence, many businesses seek to achieve compliance through de-risking and overcompliance.

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