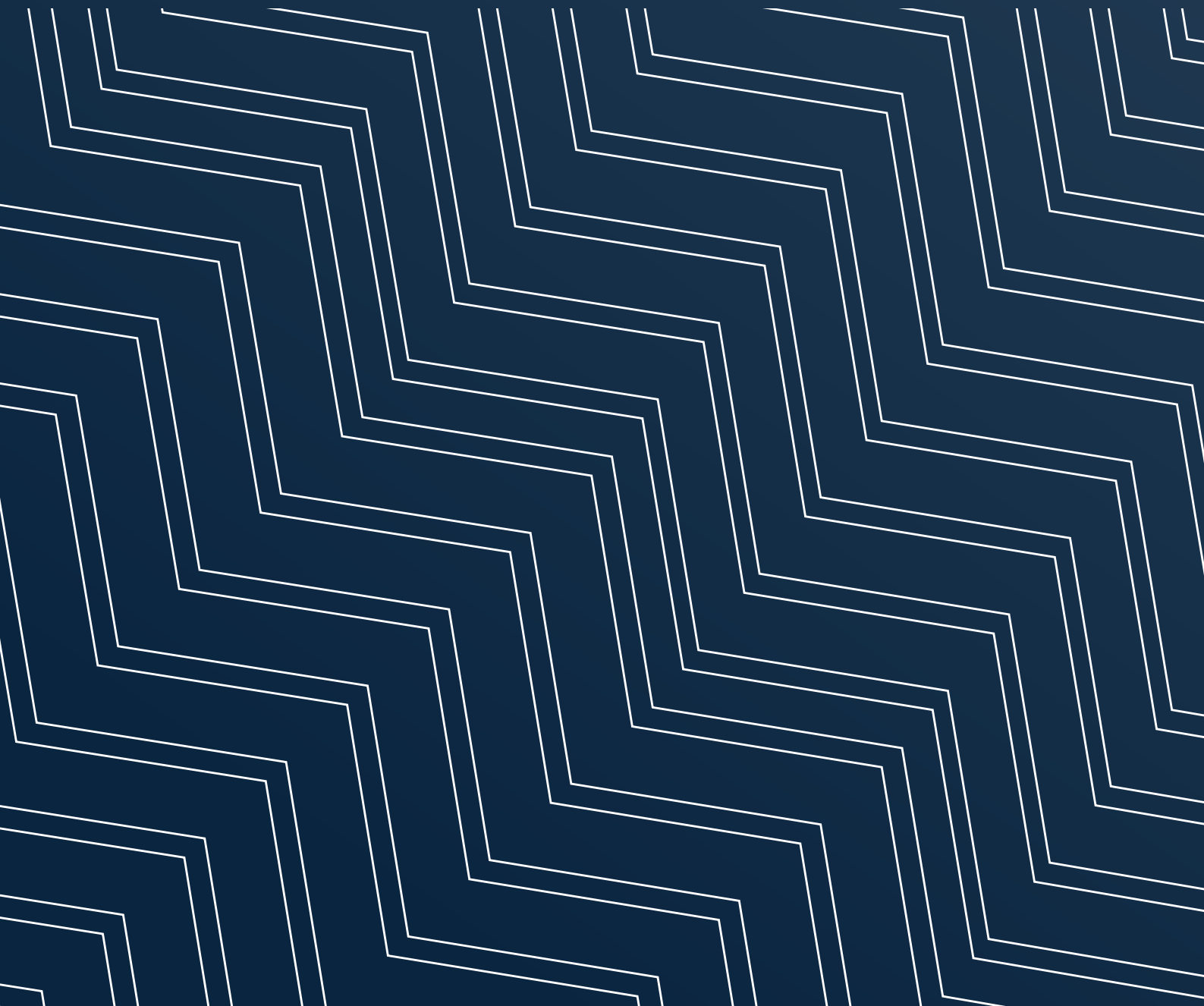


Whitepaper

# CONTEXT-DRIVEN SANCTIONS SCREENING AS A SMARTER COMPLIANCE APPROACH FOR FINANCIAL INSTITUTIONS FIS



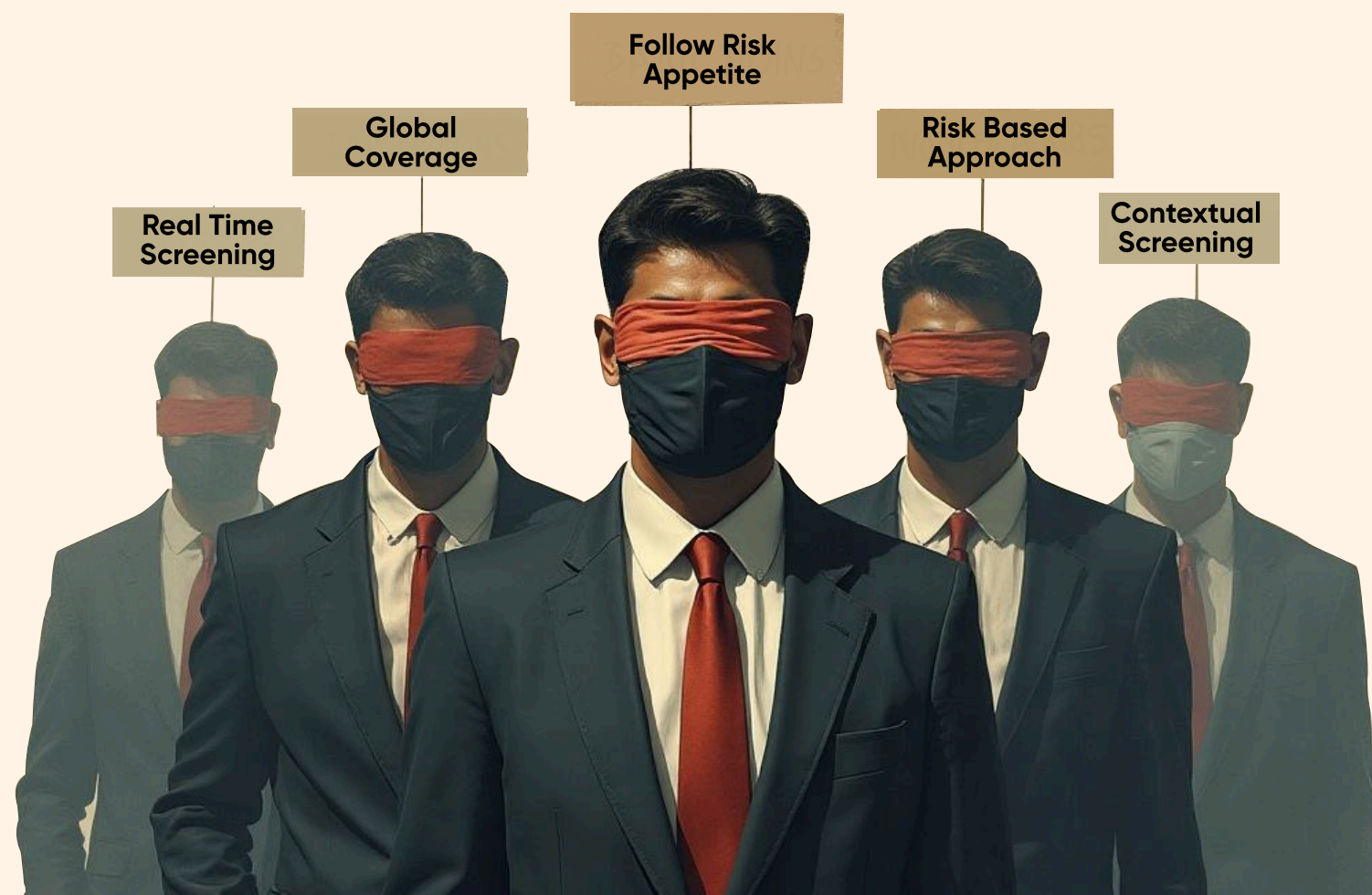
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# Introduction

Financial institutions (FIs) are facing increasing pressure when it comes to complying with rapidly evolving global sanctions regimes. The legacy, list-based sanctions screening solutions often lack contextual intelligence, leading to higher false hits. This not only exposes FIs to excessive de-risking but also leads to enforcement risks as well.



Due to the lack of context-driven sanctions compliance, the Cypriot banks terminated business relationships with over 72,000 sanctioned and non-sanctioned Russian and Ukrainian clients between 2014 and 2023.

Ultimately, the deposits from Russia and Ukraine significantly dropped by 83% and 71%, respectively. The risks of over-reliance on legacy sanctions methods without proper contextual analysis is highlighted here.

# Geopolitical Volatility and Trade Wars

## Challenging Times for Banks to Comply with Sanctions

The geopolitical landscape is undergoing a significant shift due to the growing regional alliances and rising economic tensions. Russia's invasion of Ukraine, the war in the Gaza region, and ever-changing political dynamics between the US and China are increasing the regulatory compliance challenges for global businesses that have to comply with conflicting sanctions regimes while navigating business growth.

The recent surge in trade wars has intensified the need to scrutinize cross-border transactions. Such trade conflicts overlap with the global sanctions, which create a regulatory dilemma as the impacted financial institutions are required to navigate legal prohibitions cautiously to keep up with the global regulations.

Moreover, third-country violations of Russian sanctions have further prompted the US government to expand the scope of secondary sanctions. These actions not only targeted the primary violators but also those enabling indirect circumvention.







Under the presidency of Joe Biden, the US issued an unwavering number of sanctions on different countries, such as Russia, Venezuela, Yemen, and Iran, reflecting Biden's emphasis on enforcing compliance through the secondary sanctions mechanism.

Due to such aggressive enforcement of secondary sanctions against third countries, multinational corporations, compliance professionals, and financial institutions are re-evaluating traditional sanctions screening approaches.

Legacy systems that rely solely on list-based screening without incorporating contextual risk assessment are proving insufficient.

# Political Volatility and Extraterritorial Sanctions

Global sanctions compliance enforcement has long been entangled with the evolving geopolitical tensions, and the United States's secondary sanctions are a prominent paradigm of extraterritorial sanctions. The United States' imposition of secondary sanctions dates back to the Cold War, which has greatly triggered friction with global allies.

In 1982, the Reagan administration's sanctions on a Soviet gas pipeline provoked economic backlash from the EU nations, which ultimately led to the reversal of the particular policy within the year.

Similar resistance was observed in 2017 when the US Department of the Treasury designated China's Bank of Dandong for facilitating money laundering operations in North Korea. This move, which was viewed as a unilateral overreach by China, halted future plans for broader financial banking sanctions.

These geopolitical differences highlight the difficulty in enforcing extraterritorial sanctions without undermining economic relationships. The traditional sanctions compliance tools fall short to address the following measures:

- Political Insensitivities
- Scope and Applicability of Specific Sanctions
- Jurisdictional Overlaps



While states may come up with counter-legislative instruments to counter the influence of secondary sanctions, the real challenge is faced by the financial institutions complying with the diverse sanctions regimes.

The financial institutions face heightened scrutiny in managing compliance across the diverse sanctions regimes. In order to ascertain the accurate risk level of a customer, they need to ensure that they fall under a sanction regime that is within the scope of their risk exposure or they have complete information to make a particular decision.

Most legacy tools only indicate whether an entity is sanctioned, without revealing the context, relevance, and depth of that designation.

Due to these concerns, the financial institutions fail to determine if a particular person is sanctioned in a specific country and how and why those entities impact the specific risk environment based on the country's risk appetite.

To counter these shortcomings, AML Watcher provides compelling context-driven sanctions compliance solutions that extend beyond the binary screening methods. AML watcher offers detailed labeling of sanctions that covers all the primary, secondary, and jurisdictional reach.

With clear contextual insights, financial institutions across the globe can seamlessly filter out the noise to ensure informed decision-making that aligns with the region's particular regulatory obligations.

# Secondary Sanctions Risk

## A Consequence of Economic and Geopolitical Influence on Sanctions Policy

The United States is able to implement its primary sanctions regime on international financial institutions due to the dominance of the US dollar in international transactions. In response, countries like Russia and China are continuously on the lookout to develop financial systems in order to reduce overall regulatory reliance on Western-dominated markets.

Geopolitical sanction divergence also creates strategic alliances between several countries. Due to the United States' strict secondary sanctions implications, Russia and China strengthened their economic ties to mitigate the influence of Western sanctions. Due to such regional partnerships, the trade between the two countries reached approximately \$240 billion in 2023.

Russia's System for Transfer of Financial Messages (SPFS) and China's Cross-Border Interbank Payment System were primarily designed to handle international transactional activities. Such efforts were initiated to reduce the reliance on Western sanctions in order to establish a financial firewall against geopolitical pressure.

In November 2024, the US Department of the Treasury's OFAC designated more than 50 Russian banks, such as Gazprombank, and over 40 securities registrars. The objective of this action was to curtail Russia's access to the foreign financial system due to its ongoing conflict with Ukraine.

Corresponding to this case, OFAC issued an alert where FIs were warned of the US's secondary sanctions if they directly or indirectly used Russia's System for Transfer of Financial Messages.



# Global Regulatory Divergence in Sanctions Enforcement

The scope of global sanctions enforcement varies significantly across different jurisdictions due to the functioning of divergent regulatory bodies. The difference in these regulatory frameworks lies in the jurisdiction's distinct legal structures, enforcement mechanisms, and political priorities.

While the United States maintains a strict sanctions stance through the Office of Foreign Assets Control (OFAC), the other jurisdictions prioritize divergent approaches based on their specified legal structures. Here's an overview of how sanctions compliance differs in different jurisdictions:



## United States

Due to the United States' economic power, geopolitical influence, and global compliance impact, its regulatory operations impact the global financial activities. Through OFAC, the United States implements some of the most aggressive sanctions compliance measures, including extraterritorial sanctions in the form of secondary sanctions.

Such extraterritorial measures impact the global functioning of financial and non-financial institutions, leading to the creation of friction with counter jurisdictions with opposing regulatory ideas. These measures include:



## Primary Sanctions:

Originating during World War I, the United States' primary sanctions restrict US locals and entities from engaging in any financial activity with sanctioned organizations and individuals. In 2024, OFAC subjected 3,135 entities to the primary sanctions, marking a 25% rise from the previous year. Additionally, the country's primary sanctions also have an extraterritorial reach due to the dominance of the US dollar as currency.



## Secondary Sanctions:

The United States emphasizes the implementation of secondary sanctions in order to extend the sanctions enforcement to the non-US entities that directly or indirectly engage with the sanctioned parties. In 2023, approximately 4,500 entities were targeted under the United States' secondary sanctions programs.

In light of the recent development, the US Treasury designated Russia's System for Transfer of Financial Messages (SPFS) as a key sanctions evasion mechanism. Under OFAC's Executive Order 14024, the foreign FIs engaging with SPFS are at risk of being subjected to the United States' secondary sanctions measures.

The US regulatory authorities have expressed concerns about China's regional currency clearing house infrastructure, most particularly on the systems that enable trade settlement in yuan with the targeted sanctions regimes. Since these platforms may enable sanctioned entities to bypass global sanctions, the US Treasury emphasizes greater scrutiny under the secondary sanctions framework to prevent evasion.



## United Nations

Under Chapter 7 of the United Nations Charter, the UN sanctions are authorized by the UN Security Council. However, the scope of enforcement of UN sanctions is limited since these measures must be approved by the permanent member states.

Depending on the member states, these sanctions are enforced as per the framework of national legislation, which often leads to varying degrees of compliance issues.



## European Union

The European Union (EU) does not impose secondary sanctions. However, this department prioritizes humanitarian considerations along with primary sanction measures. EU's sanctions compliance programs counter the extraterritorial measures implemented by the United States.

The European Union's Blocking Statute prohibits European entities and institutions from complying with the United States' secondary sanction measures that are incompatible with the European Union's legislative framework. This statute protects the EU entities from external financial threats while maintaining the member states' legal sovereignty.



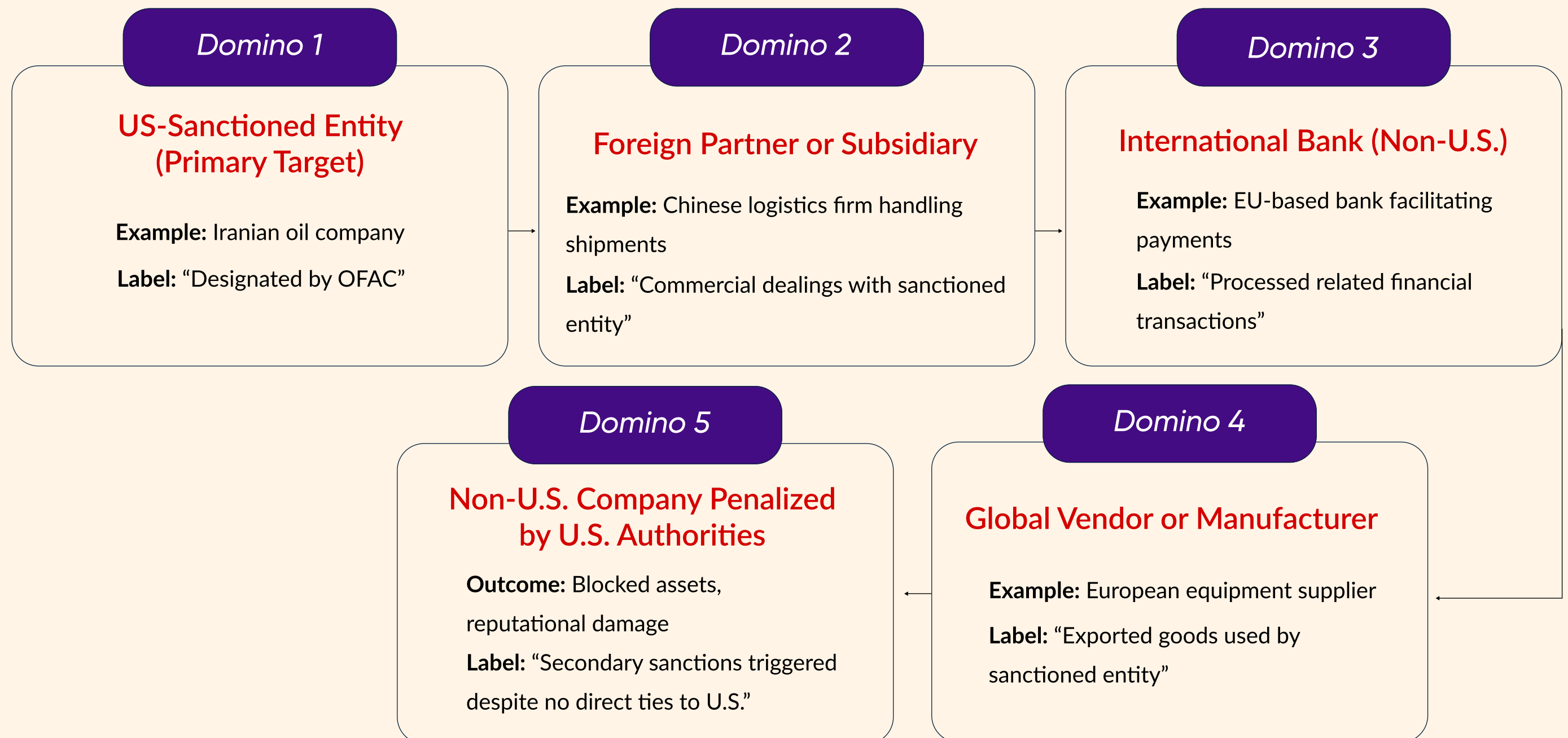
## Other Jurisdictions

Similar to the EU's Blocking Statute, China also uses a counter-sanctions mechanism in which the regulators target the entities that show compliance with the United States and other countries' sanctions that are implemented against Chinese interests.

The United Kingdom and Canadian regimes operate independently on sanctions measures with the specified jurisdiction-specific strategic priorities.

# How Secondary Sanctions Travel Across Borders

## THE DOMINO EFFECT





# Jurisdictional Conflicts

## US Secondary Sanctions vs. EU Blocking Statute

The US secondary sanctions have been impacting global economic operations since the Cold War. These sanctions escalated in the 1990s, following the implementation of laws such as the Helms-Burton Act and the Iran and Libya Sanctions Act (ILSA). These sanctions often force foreign forces to cut ties with non-US-sanctioned entities.

In response to such extraterritorial efforts, the European Union formulated a Blocking Statute in 1996. Officially recognized as the Council Regulation (EC) No 2272/96, this law particularly blocks the United States' extraterritorial efforts on European businesses.

The European companies are stuck in the middle of this jurisdictional clash. The dilemma of complying with the US sanctions results in the violation of EU laws, while keeping up with the EU rules leads to the risk of facing US retaliation. (In the form of lack of access to the United States markets)

### Total SAs Departure from Iran's South Pars Project

In 2018, the US government reinforced sanctions on Iran after it departed from the Joint Comprehensive Plan of Action (JCPOA). In response to these sanctions, the renowned French energy conglomerate, Total SA, withdrew from the South Pars project in Iran.

Total France prioritized compliance with the United States' regulations while neglecting the EU's opposing remarks enacted under the Blocking Statute. The French company stated that it would not risk losing its substantial interests in the US market.

Due to such shortcomings, it is evident that companies adhere to a more adaptive sanctions screening approach, known as context-driven sanctions screening, to address the discrepancies of the global sanctions incompetencies.



# Complying with Conflicting Sanctions Regimes

## Challenges for Banks

Due to the evolving economic and political dynamics, ensuring compliance with the varying global sanctions regulations presents several challenges for financial and non-financial institutions.

The establishment of multiple regulatory power centers has complicated the enforcement and adherence to varying sanctions regimes for businesses that aim at international expansion or businesses with customers in multiple jurisdictions.

## The Need for Context-Driven Sanctions Screening

The legacy sanctions screening tools fail to account for the broader risk context in the complex global financial framework.

In a multipolar world, the financial institutions (FIs) must identify a web of divergent sanctions regimes that may present conflicting or overlapping regulatory rules. The FIs are heavily exposed to jurisdictional inconsistencies as the geopolitical powers become more disturbed due to the divergent sanction rules. Therefore, ensuring compliance with one regime may risk violating the other.

The limited context awareness of the traditional sanctions screening modules is prone to false positives, which trigger unnecessary alerts and often result in risk level avoidance. This makes the context-aware screening not just beneficial but also necessary for global financial operations.



## Screening in Line with Risk Appetite and Risk Exposure

It is crucial to understand that just the identification of a customer's name on a particular sanctions list is insufficient for precisely assessing the entity's risk profiles. What truly matters is whether that name appears on the list that aligns with the company's risk appetite.

For Instance, A European bank might not need to screen an entity against all the available sanction lists, but only those pertinent to its operations, such as the Office of Foreign Assets Control (OFAC), United Nations Security Council (UNSC), and other particular sanction bodies.

Thereby, it is crucial for the AML Compliance Officers to clearly define the risk appetites and tailor sanctions screening protocols to cater to the lists corresponding to the firm's regulatory requirements.





# SFSA COMPLIANCE SHORTCOMINGS

The Swedish Financial Supervisory Authority (SFSA) initiated an in-depth assessment of the sanctions compliance programs across 19 banks in 2024. The findings revealed a critical gap in the detection of high-risk entities, largely due to banks' overreliance on outdated screening databases and poorly configured systems.

This report highlighted that several banks missed exact matches from global sanctions lists, exposing them to significant regulatory risk. A major concern for European FIs is the lag in updating sanctions data, particularly in scenarios where updates are first announced but take considerable time to reflect in structured databases.

This time lag creates a blind spot where sanctioned entities may continue transacting undetected. The SFSA realized that failing to capture real-time updates severely undermines the effectiveness of compliance framework and reinforces the need for adaptive, context-aware screening mechanisms that go beyond list matching





## Screen Smartly with Secondary Sanctions Labelling

The United States' secondary sanctions present extensive global challenges, such as the loss of US market access. AML compliance officers must thoroughly monitor whether a specific entity falls under a secondary sanctions risk alert.

Furthermore, the unavailability of clearly labeled and non-contextual measures leads to uncertain risk assessment. With AML Watcher's clearly defined secondary sanction labeling, the Money Laundering Reporting Officers (MLROs) spend less time in reviewing the relevance of sanctions with clearly mentioned scope, which saves valuable time and promotes accurate compliance decision making.

## Key Contextual Measures to Identify Multiple Risk Dimensions

Beyond mere name screening operations, context-driven sanctions compliance caters to a wider range of risk indicators, addressing the shortcomings of the legacy screening solutions.

For Sanctions Compliance Officers, the lack of context can lead to prolonged review times, increased false positives, and ultimately, poor decision-making.

Moreover, the lack of complete context around the relevance of a sanctions regime to a certain entity often results in de-risking, which is a move that may seem safe but can result in revenue loss and strained client relationships for FIs.

### How Unnecessary De-Risking Can Cause Financial Institutions' Revenue Losses?

De-risking without proper contextual understanding can stimulate FIs to cut ties with legitimate clients. This not only compresses the overall customer base but also blocks necessary access to the profitable markets and long-term revenue streams.

## Here Are The Critical Risk Dimensions Addressed By The Context-Driven Screening Solutions:

### Secondary Enforcement Exposure:

With AML Watcher's context-driven sanctions screening technology, individuals and organizational entities can assess whether their affiliates and counterparties are subject to secondary sanctions risks. This protects the companies from indirect penalties that might emerge due to secondary sanctions avoidance.

### Asset Immobilization Effects:

The company's sanctions compliance programs should be capable of examining whether the entity is subject to asset freeze. Failure to track asset control measures may result in compliance breaches and operational disruptions. AML Watcher's context-driven tech offers an advanced chip that clearly flags whether a client is subject to asset freeze measures, giving compliance teams the precise intel to act swiftly.

### Travel Bans:

Global organizations must stay informed of the entities that are subject to the travel restrictions, particularly those mentioned in the domestic sanctions lists where travel bans are more strict. AML Watcher's context-based screening tools make this easier by incorporating a Travel Ban Chip. This allows the compliance teams to identify sanctioned entities and take appropriate actions with full context.

### Trade Risk Considerations:

In the sectors where the trade of unauthorized goods may lead to extensive penalties, like the defense industry, thorough scrutiny is to be ensured. All the transactions related to the trading of technologies, goods, and services must be thoroughly screened to prevent compliance risks.

### AML Watcher's Context-Driven Screening Solution

A Must-Have for Instant Payment Providers in the Fast Lane

Real-time payment service providers play a crucial role in initiating instant cross-border transactions. However, this speed must be balanced with effective sanctions compliance obligations, specifically those aligned with the evolving international regulatory framework, like EU restrictive measures, which are applicable in the SEPA Instant Payments ecosystem. Furthermore, it is essential for the real-time payment service providers to quickly assess the customer's risks for their association with EU sanctions.

Given the urgency of these payments, the reliance on the conventional name-based screening tools often results in manual review delays, customer dissatisfaction, and false positives.

AML Watcher empowers the EU's payment service providers and big banks to quickly process transactional activities and save review time by enabling context-driven sanctions screening. With AML Watcher, businesses can ensure the flagging of only relevant hits, which drastically reduces the review time without compromising compliance standards.

## How Context-Driven Sanctions Screening Empowers Compliance Teams

### Traditional Sanction Screening Challenges

- Endless false positives
- Manual deep dives into the scope of sanctions relevance
- Limited insight into the risk posed by each sanction
- Costly for FIs
- Higher review time
- Increased compliance cost
- Resource overuse

### AML Watcher's Context-Driven Screening Approach

- Advanced Labelling: Tags entities by risk type, jurisdictional conflicts, and sanction relevance
- Full Legal Context: Includes relevant executive orders & global law cross-references
- Real-Time Intelligence: Continuously updated geopolitical risk signals
- Fewer false positives
- Time Saving: 80% less review time
- Saving on compliance costs
- Perfect for instant payment service providers

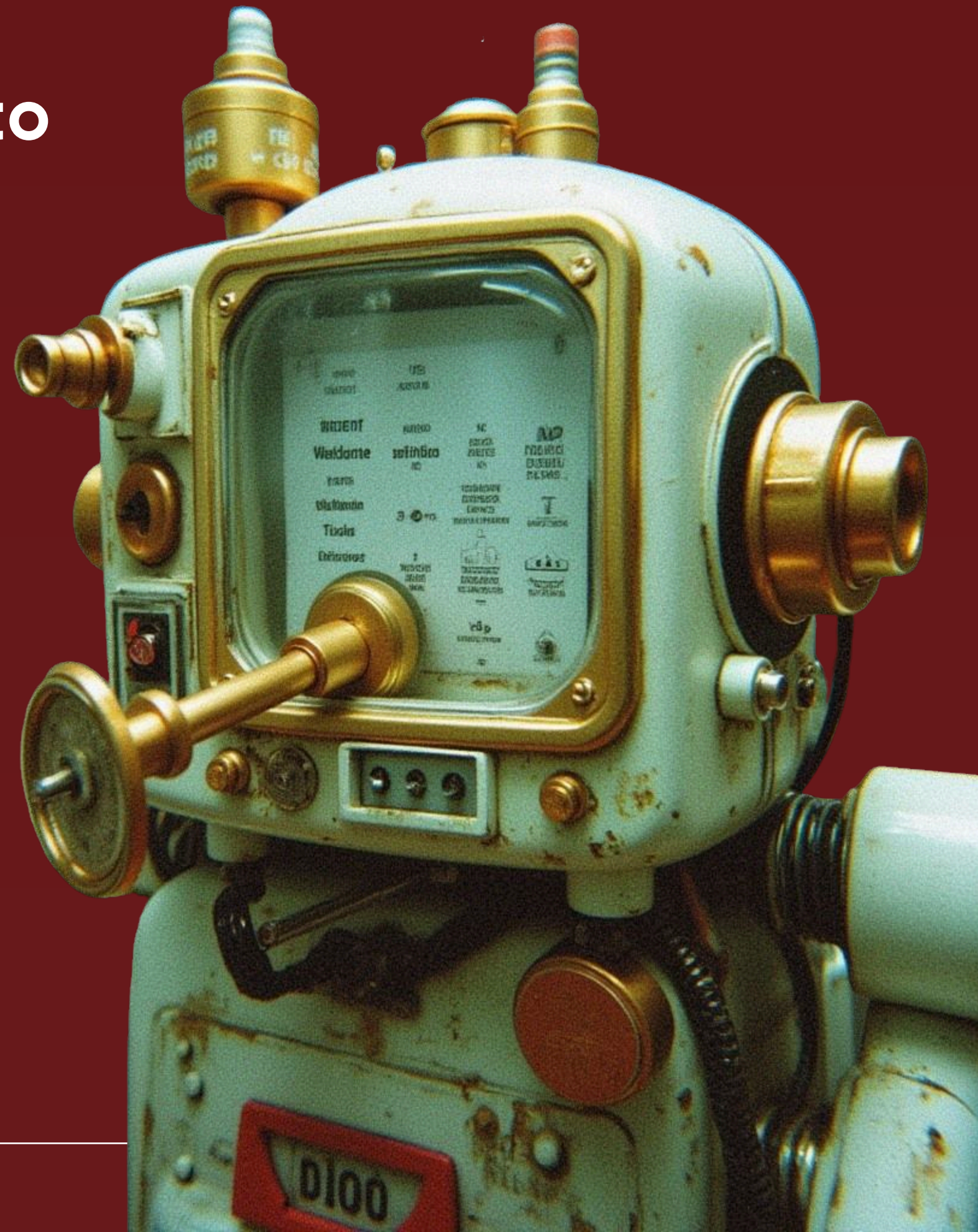


# Updating Sanctions Databases According to Official Changes Without Delays

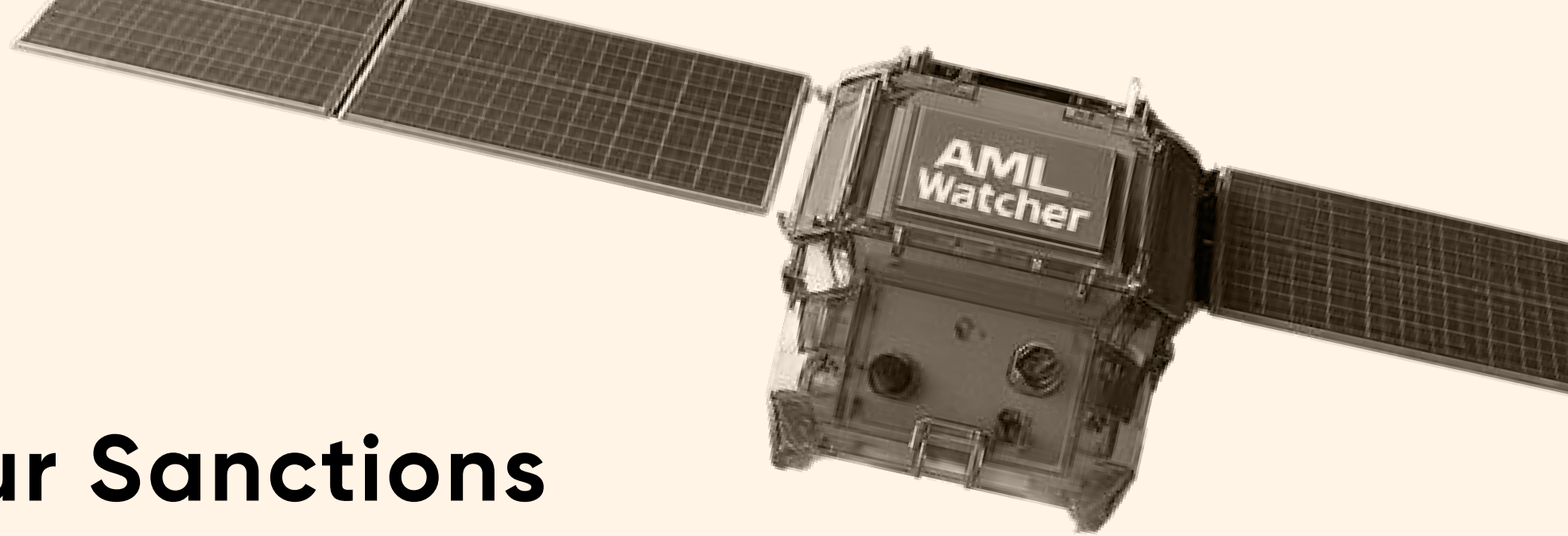
Sanctions updates are not always immediately reflected in official designated lists. For instance, an entity may be mentioned in an OFAC press release but may take hours or even days to appear on the official SDN list, creating temporary blind spots in traditional, list-reliant screening systems.

AML Watcher proactively bridges this gap through its adverse media screening framework, which monitors and incorporates official press releases and credible media coverage in real-time. This ensures that new designations and removals are detected as soon as they are announced, not just when they are formally listed in structured databases.

SANCTION ROBOT MACHINE INGESTING  
CHAOTIC DATA AND OUTPUTS UPDATED  
SANCTION LISTS







# Future Proof Your Sanctions Compliance With AML Watcher

With globalization, the economic dynamics continue to evolve, making adherence to jurisdictional sanctions measures complex and challenging. Thereby, institutions must prioritize contextual understanding to promote seamless and risk-free international business expansion.

With AML Watcher's custom search profiles and clear labeling of the sanctioned entities, secondary sanctions risks related to an entity can be identified, as it gives the EU-based financial institutions a preview of whether a specific sanction rule has a clash with the EU Blocking Statute or not.

Entrust AML Watcher to capture data insights and sanctioned entities from databases that others might miss. Wondering how it's done?

Through The Following Key Aspects:

- Custom search profiles
- Secondary sanctions assessment
- Entity categorization

There is no doubt that the future of sanctions compliance is in intelligence. Therefore, adapting the context-driven systems that ensure geopolitical analysis is crucial to preventing compliance risks.

# ABOUT US

At **AML Watcher**, we aim to support more than 10,000 businesses in their fight against rising FinCrime by creating a secure and compliant financial world where they can thrive.

## CONNECT WITH US:

For more information, visit:



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