



# Securing the Supply Chain: Implementing North Korea Sanctions Beyond Banking

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***Ensuring the global supply chain is not abused by North Korea to evade international sanctions requires a systemic approach. The current response is failing, and the involvement of a far greater range of private sector actors is urgently needed.***

The latest report published by the UN Panel of Experts established to monitor the implementation of sanctions measures against North Korea makes for alarming reading. Despite North Korea being subject to one of the most comprehensive sanctions regimes ever adopted by the UN, and the ongoing efforts by the US to put North Korea under a ‘[maximum pressure](#)’ sanctions campaign, the ability of the country to circumvent those restrictions in the pursuit of its nuclear ambition remains – seemingly – undiminished.

In their [March 2019 report](#), the UN Panel investigators drew the stark conclusion that North Korea’s sanctions evasion activities ‘render the latest UN sanctions ineffective’. These are the measures adopted primarily since 2016 to restrict North Korea’s ability to export commodities ranging from seafood to coal and to cut its import of crucial oil supplies, in addition to the existing restrictions on the import of goods and technology related to the development of the country’s nuclear programme.

Efforts to curtail the North Korean regime’s finances and isolate it from global markets have not forced North Korea to cease trading. Rather, as an increasing number of trading activities move from the legal to the sanctioned space, North Korea has adopted new evasion tactics as rapidly as sanctions have been agreed at the UN. One example is the use of ship-to-ship transfers, a way for the regime to circumvent sanctions against North Korea-flagged vessels and continue sending and receiving

restricted commodities by transferring them from/to non-sanctioned vessels in international waters. The UN Panel noted that ‘these transfers have increased in scope, scale and sophistication’ with illicit transfers of petroleum products to North Korea having ‘greatly accelerated’ in 2018.

Another consequence of expanded sanctions measures is the range of actors across the supply chain – from traders, shipping companies, freight-forwarders, insurance companies and commodity brokers – who now have a key role in implementing North Korea sanctions.

Notwithstanding this widening range of actors, it appears that rather than cracking down on all fronts to effectively implement sanctions measures, by including sectors such as seafood, textiles and agricultural products, the global community – led by the US – has been determined to focus on the one activity they perceive will matter most to North Korea, namely countering illicit ship-to-ship transfers used to import oil and export coal. Furthermore, within these two supply chains the implementation focus seems to be on a restricted number of actors.

Meanwhile, smaller private sector actors and those involved in non-oil and coal sector supply chains feel minimal imperative to do the sort of concerted thinking required to implement North Korea sanctions effectively. This is a role that still needs to be defined, and urgently, if the international community is committed to implementing the entire range of sanctions measures against North Korea.

## Sanctions Beyond the Banking Sector

When it comes to countering North Korea’s financial activities (known as countering proliferation finance, or CPF), this responsibility is covered by the Financial Action Task Force (FATF), the global standard-setter on issues of financial crime. In 2012 it added CPF to its mandate, requiring countries to effectively implement targeted financial sanctions against proliferators, including North Korea, without delay. These expectations are, in turn, ultimately implemented by the banking sector, for whom North Korean sanctioned individuals and entities have been a concern since at least 2006 when the UN first adopted asset-freezing measures against actors involved in North Korea’s nuclear programme.

At the time this responsibility was added, sanctions were – in contrast to today – relatively straightforward. However, since 2016, the picture has become far more complex. UN financial sanctions requirements now include activity-based sanctions which require constant vigilance and sophisticated analysis by banks to implement effectively. These include restrictions on relationships with North Korean financial institutions, the operation of bank accounts by North Korean diplomats or the establishment of joint ventures with North Korean entities.

In recent years, the banking sector has been scrutinised and penalised for failures (at best) to implement sanctions effectively and (at worst) providing schemes to circumvent restrictions.



The sector has therefore had the time and pressure to develop and implement strategies for dealing with North Korea sanctions exposure.

However, since 2016 the UN has expanded its North Korean sanctions regime to include restrictions on the earnings capacity of the country. This has involved adopting bans on the export of coal, iron ore and other key minerals; seafood, agricultural products, textiles and machinery; and North Korean foreign labour, all activities which previously provided the North Korean leadership with up to [\\$3 billion in annual revenue](#). The UN has also placed strict limits on North Korea's imports of oil and petroleum products, seen as key to the long-term functioning of the North Korean state apparatus.

Prior to this expansion, UN trade restrictions on North Korea focused primarily on preventing the regime from

procuring, shipping and acquiring illicit technology and dual-use items related to its development of nuclear weapons. In contrast, the trading activities added since 2016 are activities that would otherwise be unrestricted, unless carried out by North Korea, on behalf of North Korea or for the benefit of North Korea. This has meant that companies that have previously been untroubled by issues of sanctions compliance must now consider North Korea as part of their risk picture. Simply focusing implementation efforts on the banking industry is therefore no longer enough.

In contrast to the global financial 'supply chain', which merely involves the banking industry, the global network that supports the transport of goods and commodities relies on a range of industries, from the broker who sources the required commodities or the ship which transports them, to the ship

owner and the insurer of the ship itself, its cargo or its crew. One weak link in this supply chain can render the whole process vulnerable to abuse.

Notwithstanding the existence since 2016 of these more complex, activity-based sanctions on North Korea, awareness of their existence – and the restrictions and responsibilities they bring with them – is limited. For many in these industries North Korea sanctions risk is a new experience, one which, in some cases, they seem unwilling or unprepared, to accept. Furthermore, even those that recognise their expanded responsibilities struggle to determine how their business might be abused by North Korea and may therefore choose to decide that the risks illuminated in the Panel reports and the activities addressed in North Korea-related UN Security Council resolutions, do not apply to them.



## Insuring the Front Line

One example is the insurance industry. Despite [UN Security Council Resolution 2397](#), adopted in December 2017, mandating countries to restrict ‘provision of insurance or re-insurance services’ to any vessel involved in sanctions evasion on behalf of North Korea, the industry did not immediately adapt its practices in response. A [RUSI study](#) published in July 2018 highlighted how the sector was ‘hindered from fulfilling this role’ due to lack of risk awareness, and a reliance on screening against sanctions lists of designated entities and individuals, rather than attempting to proactively identify sanctions-evasion behaviour as many global banks have done.

These findings were echoed by the UN Panel of Experts who reminded member states that ‘insurance providers are financial institutions’ and therefore subject to the same requirements as banks to restrict North Korea’s illicit financing. Similarly, [updated guidance](#) by the FATF in February 2018 underlined the importance of extending CPF measures beyond banks to include insurance and trading companies. Furthermore, in November 2018 the UK and US governments co-hosted [an event](#) in London for the insurance industry to demonstrate how insurers can play a more active role in stopping North Korea’s illicit shipping practices, by monitoring the movement of vessels and the corporate networks that control them. Civil society initiatives such as RUSI’s [Project Sandstone](#), an effort to expose North Korea shipping networks using open-source data, can help insurers in this effort.

Yet the failure to secure the supply chain lies not only with the private sector actors that facilitate the global movement of goods. Governments and international organisations that supervise and monitor this activity also bear responsibility. For example, the lack of focus both from policymakers and sanctions-enforcement agencies on what insurers are expected to do to implement sanctions, means that they have not felt sufficient pressure to develop their understanding of North Korea sanctions as distinct from other sanctions risks.

Recent efforts by the insurance industry to adapt to this new reality should be noted. A Lloyd’s of London [bulletin](#) in April 2019 provided the industry with red flags and risk factors relating to North Korea’s shipping practices and noted that (re)insurers are ‘expected to understand their sanctions risk profile’. This is a significant step forward for an industry where awareness of the risks posed by North Korea gaining access to insurance products in the London insurance market has been low.

More of this guidance is needed, not just to insurers but across other industries, to reverse the false sense of security that North Korea sanctions do not affect them.

## Assessing the Status of the Global Response: Evolving, But Narrow in Scope

As the latest UN Panel report reveals, implementation of the UN’s North Korea sanctions regime remains fractured. Countries in Africa continue to undertake trade with and buy services from North Korea; North Korean diplomats and labourers continue to generate revenue for the regime; and supply chains continue to be vulnerable to abuse. But some positive initiatives have been developed or are under consideration to address certain hotspots of North Korean sanctions-evasion activity.

One such industry is the oil and refined petroleum products sector, a priority for the US government in particular. As part of the ongoing ‘maximum pressure’ sanctions campaign against North Korea, the US believes that restricting North Korea’s oil supplies will particularly damage the regime. The US government has issued advisories to private sector actors detailing North Korean illicit shipping practices, [most recently updated in March](#). Despite their relevance to many of the commodities North Korea may transport, the note particularly highlights the risk of ‘illicit ship-to-ship transfers of refined petroleum and coal’ and provides annexes with lists of vessels suspected

of having engaged in petroleum and coal transfers.

Recognising the importance of imported energy to the North Korean regime, considerable focus has been applied by the UN investigators to prevent illicit ship-to-ship transfers of oil and refined petroleum products to North Korea. All ships above a certain size are required to use an Automatic Identification System (AIS) transponder, a useful means by which their movements can be tracked. In its latest report, the UN Panel encourages member states to require their petroleum industries ‘to include end-use delivery verification measures and AIS screening as well as an “AIS switch-off” clause’ in all contracts, to deter (and be aware of suspected) ship-to-ship transfers. One major global commodity broker [is already taking this step](#).

The strategy thus far seems to focus efforts mostly on the larger, global commodity broker and oil-producers, with the expectation that policies adopted by those at the top of the supply chain will filter down to smaller companies in local markets and create a ripple effect of heightened awareness and monitoring. Similar efforts to push-down compliance best practice had positive effects in the banking industry.

Another area of heightened focus is coal. News stories have highlighted how North Korea continues to export its coal products, despite restrictions. In May 2019, the US government [announced](#) it was taking control of a vessel which in April 2018 had been seized by Indonesian authorities for shipping North Korean coal.

While this focus is justified – after all North Korea’s coal exports used to earn the regime upwards of [\\$1 billion](#) a year in income before 2016 – other high-income sectors have not received the same focus. For example, prior to sanctions measures restricting these exports, North Korea was estimated to earn an average of [\\$760 million](#) each year from textile exports, [\\$300 million from the export of seafood](#), and [\\$360 million from the export of iron, iron ore, lead and lead ore](#). Before the end of 2019, countries will need to expel the nearly 100,000 North Korean labourers working abroad, an activity

which generates \$500 million annually for the North Korean regime. North Korean workers are placed in a range of sectors including the construction and service industry, thus further expanding the range of private sector stakeholders who must become aware of North Korea sanctions for the first time.

The focus on oil and petroleum products and coal means some larger industry stakeholders directly involved in these supply chains, as well as the insurers and banks who work with them, have invested in staff and technology to monitor and detect North Korean ship-to-ship transfers, educating themselves about the risks and developing higher due diligence standards. However, this does not mean that these efforts have been successful in stopping North Korean sanctions evasion in those sectors.

The US has *estimated* that in 2018 alone North Korea successfully imported 'seven and a half times the allowable amount of refined petroleum', and the UN Panel report highlighted that when it comes to coal exports North Korea has 'switched most of its maritime-related coal trade to illegal ship-to-ship transfers' making them 'regularised and systemic in 2018'.

## So, What's to be Done?

The UN Panel of Experts continues to demonstrate that North Korea is able – with limited effort – to secure the funding, resources and commodities it needs to maintain its nuclear programme. Nascent efforts by the insurance industry and stakeholders involved in the oil and coal supply chain are attempting to close these gaps by adapting their due diligence and risk awareness as relates to North Korea. These efforts should be welcomed.

However, the authors' conversations with industry stakeholders and governments suggests that these efforts are far from universal, providing North Korea with plenty of space to continue hiding in plain sight.

In particular, current efforts are focused on key activities (ship-to-ship transfers of petroleum

and coal) among global players in those industries. Thus, while guidance from the US government on illicit ship-to-ship transfers is useful, it must go further to inform and mobilise the full range of stakeholders who should be involved in implementing North Korea sanctions.

For example, the authors' conversations with governments and private sectors around the world suggest that little, if any, attention has been paid to industries supporting the trade in luxury goods, seafood, food and agricultural products, textiles and fabrics, minerals, iron and steel – and even statues – all of which are prohibited trading activities with North Korea. Additionally, awareness of activity-based sanctions restrictions on joint ventures or dealing with North Korean designated entities and individuals, those controlled by them, acting on their behalf or for the benefit of them, are rarely considered beyond the banking sector. Even within the banking sector, the operationalisation of some obligations is behind. For example, the obligations to restrict North Korea's diplomatic bank accounts was passed by the UN in November 2016, but only in March 2019 did the Panel provide its recommendations for how countries should implement this obligation.

The action needed to combat the systemic problems outlined above are threefold. First, governments need to extend their outreach and guidance on North Korea sanctions implementation beyond banks, to include all supply-chain actors who may be exposed to North Korea sanctions risk. This also includes expanding awareness of North Korea sanctions implementation to local markets in regions such as Southeast Asia and Eastern and Southern Africa, where North Korean trade and financial networks are most active.

Second, those actors must in turn urgently consider how they might be exposed to North Korea's illicit activities. For example, transport companies specialising in the movement of seafood and agricultural products need to consider exposure to North Korea and put in place due diligence measures to ensure that

goods do not originate from North Korea. Others, like insurers, have a particular responsibility to prevent issuing insurance cover to vessels engaged in activities on behalf of North Korea.

Finally, it is important that this approach is joined up across the supply chain. If the international community truly wants to prevent petroleum products from reaching North Korea, it is not enough that only the world's largest commodity broker is committed to preventing this from happening. Others involved in the supply chain – insurers, banks, vessel owners and managers, terminal operators and storage facilities – need to be linked up to and coordinated with this commitment as well, supported by guidance from governments.

Over the past four years, RUSI has studied the response of the international community (both governments and their private sectors) to expanding sanctions requirements against North Korea, a response that fails to match the increasing breadth and complexity of these new sanctions regimes. Selected initiatives, such as prioritisation of the issue during the current one-year US Presidency of the FATF (until 30 June 2019) or the efforts by certain commodity brokers to restrict the opportunities for ship-to-ship transfers, are welcome. But the supply chain of goods and finance remains wide open to abuse by North Korea as global implementation has failed to match the ambition of policymakers and UN Security Council members. This needs to change as North Korea's commitment to its nuclear ambition remains undiminished.

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