



FedFin Client Report

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Senate Banking Considers Targeting Chinese Banks

Client Report: **SANCTION12**

Executive Summary

In this report, we focus on the implications for the financial industry of today's Senate Banking Committee hearing on increasing sanctions on North Korea. Although senators indicated that this hearing will be the first of a series and many are still exploring the impact of new sanctions, it is clear that there is bipartisan consensus on the need to take additional action and that sanctioning Chinese banks is now seen as the most likely route to pressuring North Korea. While much of the questioning simply aimed to better understand the possible effects of different types of sanctions, there was notable pressure from several senators and witnesses to impose sanctions on banks that are deemed either to willfully do business with North Korea or to fail to perform proper due diligence. Legislation, including S. 1591 introduced by Banking Committee Members Toomey (R-PA) and Van Hollen (D-MD), was also discussed. These bills are modeled on the Iran sanctions and would impose escalating sanctions on banks that do business with the North Korean regime, ultimately cutting them off from the U.S. financial system. While many senators seemed interested in these bills, Ranking Member Brown (D-OH) and Warner (D-VA) asked the witnesses to expand on the possible costs of cutting Chinese banks off from the financial system given the systemic importance of their larger banks to China's economy. Sen. Warner also asked about limiting this provision to smaller banks. While Sens. Brown, Tester (D-MT) and Warren (D-MA) were critical of the Administration's handling of the crisis, witnesses stressed the importance of allowing the executive branch discretion in adjusting sanctions.

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Analysis

Opening Statements

Chairman Crapo (R-ID) called on China to use its economic influence to bring about change in North Korea and said that de-escalating the North Korean nuclear threat will involve a reassessment of the U.S.-Chinese relationship. He noted that he considered the purpose of this hearing to support the strongest sanctions that will enable the crisis to be solved through diplomacy.

Ranking Member Brown argued that President Trump's criticism of South Korea plays into North Korea's hands, saying that Congress should require the Administration to set policy goals and measure whether China and other countries are making sufficient progress to curtail sanctions violations. He also called for further sanctions that target entities that evade current sanctions or violate human rights, and argued that walking away from the Iran nuclear deal would seriously undermine the credibility of the U.S. in dealing with the Kim regime.

Testimony

Former Obama Treasury official Adam Szubin of Johns Hopkins University argued that the crisis demands a severe response from the international community and that China is central to this. He said that the U.S. must use all the levers at its disposal to put a complete stranglehold on the North Korean economy, but also warned against codifying sanctions that do not allow the president to remove sanctions at his discretion.

Anthony Ruggiero of the Foundation for Defense of Democracies argued that Chinese banks help North Korea leverage the U.S. financial system to evade sanctions and that Treasury's sanctions targeting Chinese banks have so far been insufficient. He said that the Iranian sanctions regime offers a roadmap to putting effective pressure on North Korea.

John Park of the Harvard Kennedy School said that Chinese authorities are central to breaking apart the connection between Chinese businesses and North Korea. He argued for the U.S. to threaten the use of secondary sanctions on large Chinese banks and companies to induce them to use turn their anti-corruption campaign against corrupt Chinese party officials who work with North Korea. He also said U.S. offers of anti-narcotics and anti-counterfeiting assistance in combating these problems coming from North Korea could spur further Chinese cooperation.

Q&A

- **Scope of Bank Sanctions:** Sen Crapo asked whether North Korean business would simply migrate to other countries if sanctions only target Chinese banks. Mr. Ruggiero said that it could migrate to Russia but would likely not end up on the same scale. Sen. Warner questioned whether only going after smaller Chinese banks would be effective and Mr. Szubin said large and small violators should be targeted.
- **Financial Stability:** Sen. Brown pressed the witnesses on whether the sanctions could undermine Chinese bank stability and on these banks' interconnectedness with global markets. Mr. Szubin said that the most extreme sanctions such as cutting banks off abruptly from the U.S. financial system would undermine the Chinese financial system's stability. Sen. Reed (D-RI) asked whether China is willing to risk a financial crisis to maintain regional stability and prevent the collapse of the North Korean regime. Mr. Szubin said they value their economy more but said that North Korean stability was still a central interest to them. Sen. Toomey argued that any business China does with North Korea is trivial compared to losing access to the U.S. financial system and therefore they will likely choose to cut ties with the regime.
- **Chinese Ability to Identify North Korea Ties:** Sens. Rounds (R-SD) and Warner asked if China had the ability to identify individuals and businesses with North Korean ties. Mr. Ruggiero said their largest banks have the ability to do this and Mr. Park said China only needs to be incentivized to require this.
- **Other Sanctions:** Sens. Reed and Tillis argued that preventing the importation of oil and petroleum products into North Korea should be a priority. Sen. Rounds asked whether the U.S. should focus on this or financial sanctions and Mr. Ruggiero said financial sanctions would be more effective while Mr. Szubin said we should pursue whichever path is more likely to get Chinese buy-in.