

House Financial Services Committee  
*Monetary Policy and Trade Subcommittee*

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# A Legislative Proposal to Impede North Korea's Access to Finance

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## Introduction

Chairman Barr, Ranking Member Moore, and distinguished members of this subcommittee, thank you for the opportunity to address you today on this important issue.

My testimony will begin with an update on the nature of North Korea sanctions, provide examples of North Korea's illicit financial activities, and propose ideas to combat those activities.

Often, U.S. policy toward North Korea gets stuck in the provocation-response cycle whereby a North Korean provocation is met with strong rhetoric and/or a token increase in sanctions, which is repeated over and over. These scattershot responses have not, to date, added up to a serious and effective sanctions policy because they are driven by the momentary need to look tough, rather than by a clear strategy for denuclearizing the Korean peninsula. In practice, the Kim regime can keep distracting the United States with its repeated provocation. We should break this cycle and ensure that the U.S. response to every North Korean provocation advances our ultimate goal.

Regrettably, many experts call for the acceptance of North Korea as a nuclear weapons state and insist that the U.S. can protect itself with a policy of deterrence. To evaluate the effectiveness of deterrence, one must be clear about such a policy's goals. Some suggest the United States has successfully deterred Pyongyang over the last 25 years, since there has been no second Korean war. But the goal should be deterring North Korea from actions that threaten the U.S. or its allies. On that score, deterrence has had a mixed record at best. For example, Pyongyang killed over 40 South Korean sailors when it sunk the *Cheonan*, maintains a robust relationship with Iran, built a nuclear reactor in Syria that Israel destroyed in 2007, and launched a ballistic missile directly over Japan. Unfortunately, this is a short list of the failures of deterrence.

At some point, Washington will need to consider the Kim regime as the obstacle to achieving denuclearization of the Korean peninsula, and sanctions can decrease the threat from the regime in a way that negotiations cannot.

## The Nature of North Korea Sanctions

In testimony before this subcommittee in July, I provided conclusions from a quantitative and qualitative review of North Korea sanctions.<sup>1</sup> This year, the Trump administration started to sanction North Korean international business partners. Since March 31, the U.S. has sanctioned 43 persons, of whom 86 percent operate outside North Korea and 54 percent are non-North Koreans who facilitate North Korea's sanctions evasion.

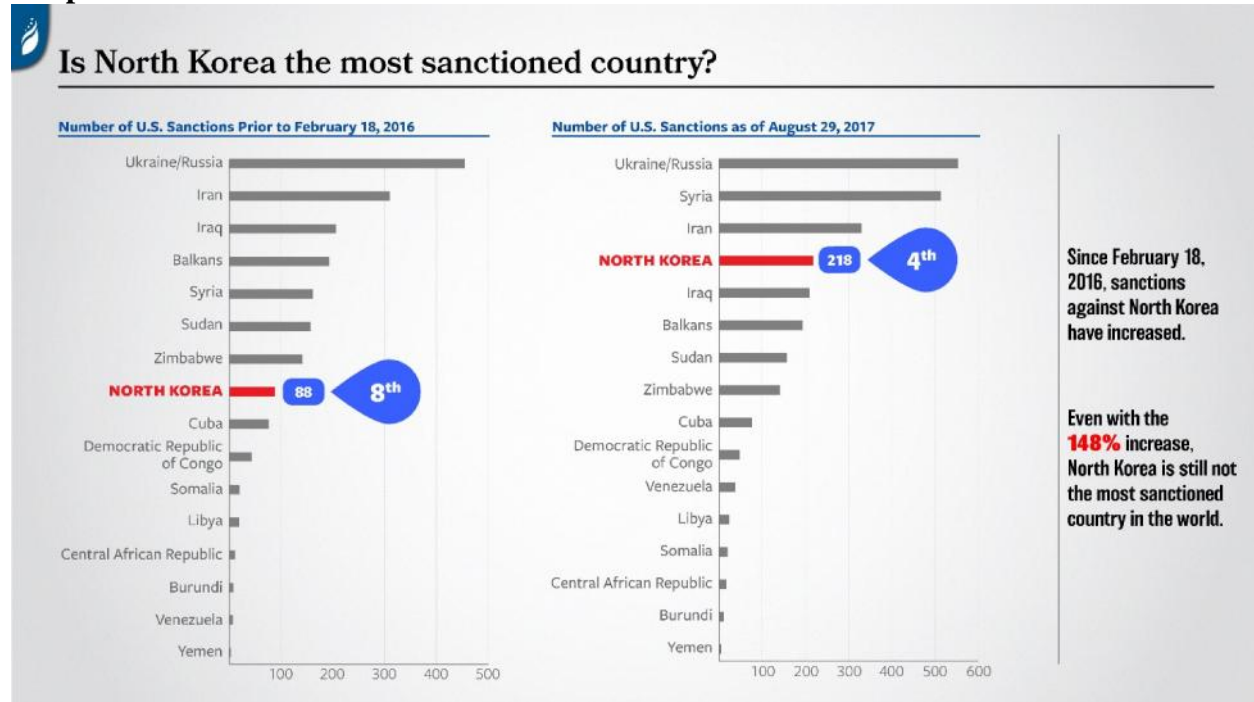
A quantitative review of U.S. sanctions reveals that North Korea currently sits fourth on the list of countries with the most sanctioned entities. North Korea has moved up one position since my July testimony, placing it behind Ukraine/Russia, Syria, and Iran – even after the lifting of numerous sanctions on Iran to comply with the Joint Comprehensive Plan of Action (JCPOA), as the 2015

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<sup>1</sup> Anthony Ruggiero, "Restricting North Korea's Access to Finance," *Testimony before House Committee on Financial Services, Subcommittee on Monetary Policy and Trade*, July 19, 2017. ([http://www.defenddemocracy.org/content/uploads/documents/Anthony\\_Ruggiero\\_Testimony\\_HFSC.pdf](http://www.defenddemocracy.org/content/uploads/documents/Anthony_Ruggiero_Testimony_HFSC.pdf))

nuclear deal is formally known – and ahead of Iraq (see graphic 1).<sup>2</sup> North Korea sanctions have more than doubled since the North Korea Sanctions and Policy Enhancement Act came into effect on February 18, 2016. Prior to that date, North Korea ranked eighth, behind Ukraine/Russia, Iran, Iraq, the Balkans, Syria, Sudan, and Zimbabwe.

**Graphic 1**

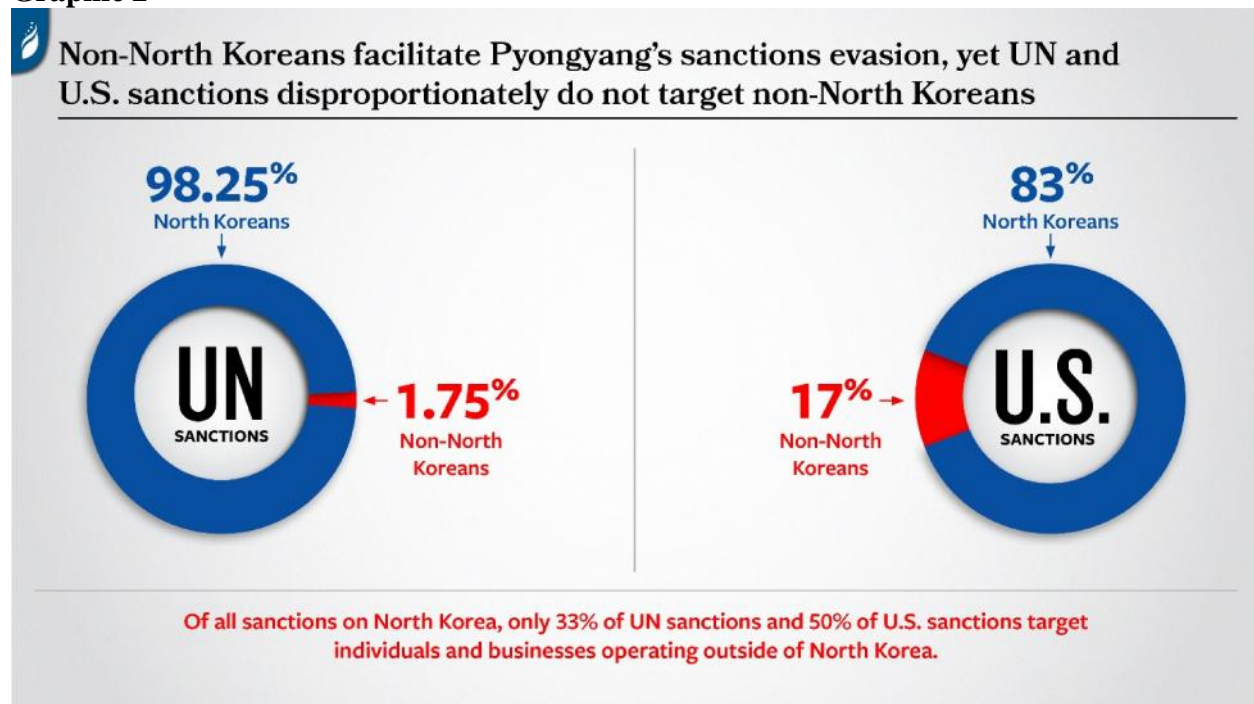


<sup>2</sup> The review of sanctions included those entities and individuals listed on the U.S. Department of the Treasury’s Office of Foreign Assets Control Specially Designated Nationals list. The Ukraine/Russia sanctions category includes persons sanctioned under the Sergei Magnitsky Rule of Law Accountability Act and persons subject to the Ukraine-related Directives. U.S. Department of the Treasury, Specially Designated Nationals List, accessed through August 29, 2017. (<https://sanctionssearch.ofac.treas.gov/>)

A qualitative assessment of the sanctions imposed on North Korea reinforces the conclusion that it has not been targeted aggressively, since U.S. sanctions barely touch the international business networks – especially in China – on which Pyongyang relies to evade most restrictions. The Trump administration’s recent efforts have focused on Pyongyang’s international business and non-North Koreans, but there is still more to do.

Even the UN acknowledges that North Korea uses “non-nationals of [North Korea] as facilitators, and rel[ies] on numerous front companies” to generate “significant revenue” for North Korea.<sup>3</sup> In testimony before this subcommittee, I noted that 47 percent of U.S. sanctions targeted persons located/conducting business outside of North Korea. That number has now increased to 50 percent. In July, only 12 percent of those persons were non-North Korean; that number has increased to more than 17 percent (see graphic 2). The UN sanctions numbers are worse. In July, only 27 percent of all designated persons were located or conducting business outside of North Korea, a number that has improved to 33 percent. In July, only 2 percent of those persons were non-North Korean, yet that number has dropped to 1.75 percent.

**Graphic 2**



<sup>3</sup> United Nations Security Council, “Report of the Panel of Experts established pursuant to resolution 1874 (2009),” February 27, 2017. (<http://undocs.org/S/2017/150>)

## North Korea's Financial Activities

A review of the Treasury and Justice Departments' actions against North Korea's financial activities reveals three main methods Pyongyang uses to finance its sanctions evasion. The first method was used by Dandong Hongxiang Industrial Development, which was sanctioned by Treasury and indicted by Justice in September 2016 (see graphic 3).<sup>4</sup> The method was also used by Dandong Zhicheng Metallic Materials, which was sanctioned by Treasury and subject to an asset forfeiture request for more than \$4 million filed by Justice in August.<sup>5</sup> Both companies' illicit activities were initially exposed by the innovative data-mining organization C4ADS.<sup>6</sup>

The scheme begins with North Korea shipping a commodity to a Chinese company – in these examples, coal is used. The Chinese company sells the item and pockets a significant profit. The money owed to the North Korean exporter remains in China, which allows North Korea to use it to purchase goods. Each side keeps a ledger that tracks debits and revenue, which allows North Korea to purchase goods from its Chinese trade partner's accounts; the Chinese partner receives additional profit from facilitating these sales. Most sellers want payment in U.S. dollars, which requires hiding Pyongyang's role to continue the transaction. This is the point at which Chinese firms and individuals use accounts in Chinese banks to transfer money to front companies in China and other jurisdictions to create the illusion of a transaction between the seller and China, when North Korea is the real destination. This fraudulent scheme tricks U.S. banks into processing the transactions, and Chinese banks are either complicit or fail to ask about Chinese companies' business with North Korea.

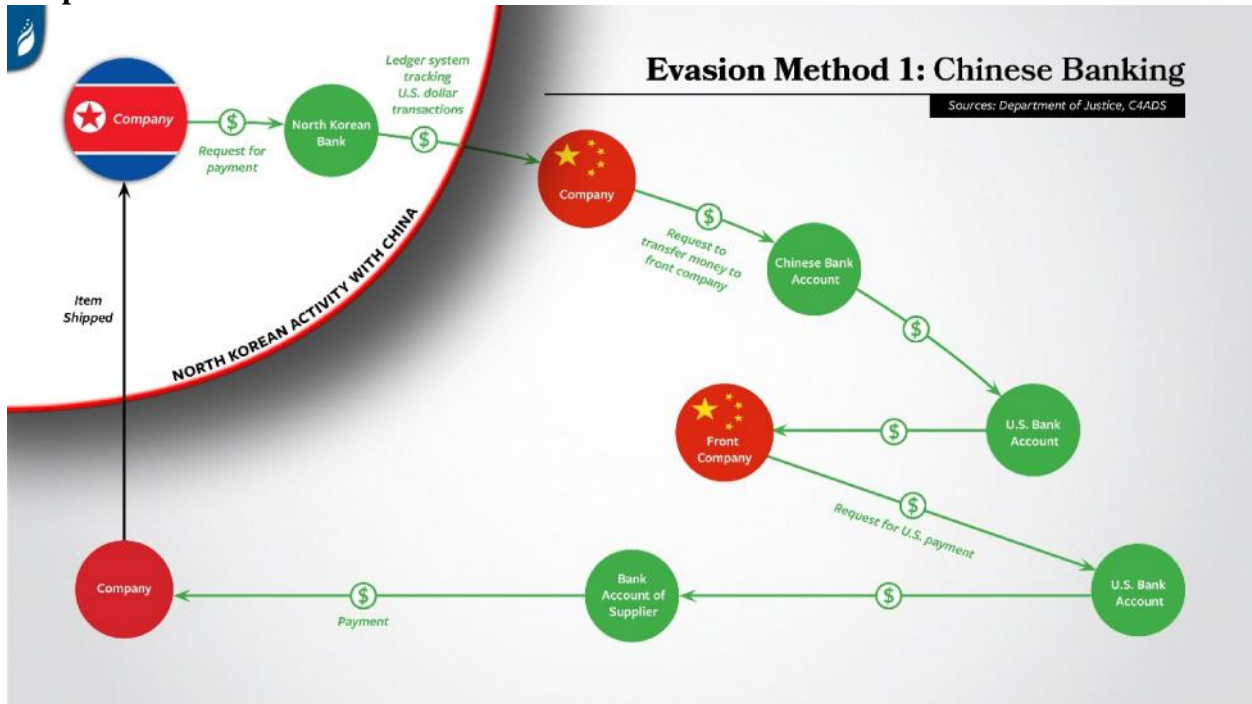
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<sup>4</sup> U.S. Department of the Treasury, Press Release, "Treasury Imposes Sanctions on Supporters of North Korea's Weapons of Mass Destruction Proliferation," September 26, 2016. (<https://www.treasury.gov/press-center/press-releases/Pages/j15059.aspx>); U.S. Department of Justice, Press Release, "Four Chinese Nationals and China-Based Company Charged with Using Front Companies to Evade U.S. Sanctions Targeting North Korea's Nuclear Weapons and Ballistic Missile Programs," September 26, 2016. (<https://www.justice.gov/opa/pr/four-chinese-nationals-and-china-based-company-charged-using-front-companies-evade-us>)

<sup>5</sup> U.S. Department of the Treasury, Press Release, "Treasury Targets Chinese and Russian Entities and Individuals Supporting the North Korean Regime," August 22, 2017. (<https://www.treasury.gov/press-center/press-releases/Pages/sm0148.aspx>); *United States of America v. Funds Associated with Dandong Chengtai Trading Limited*, No. 1:17-cv-01706 (D.D.C. August 22, 2017). (Accessed via PACER)

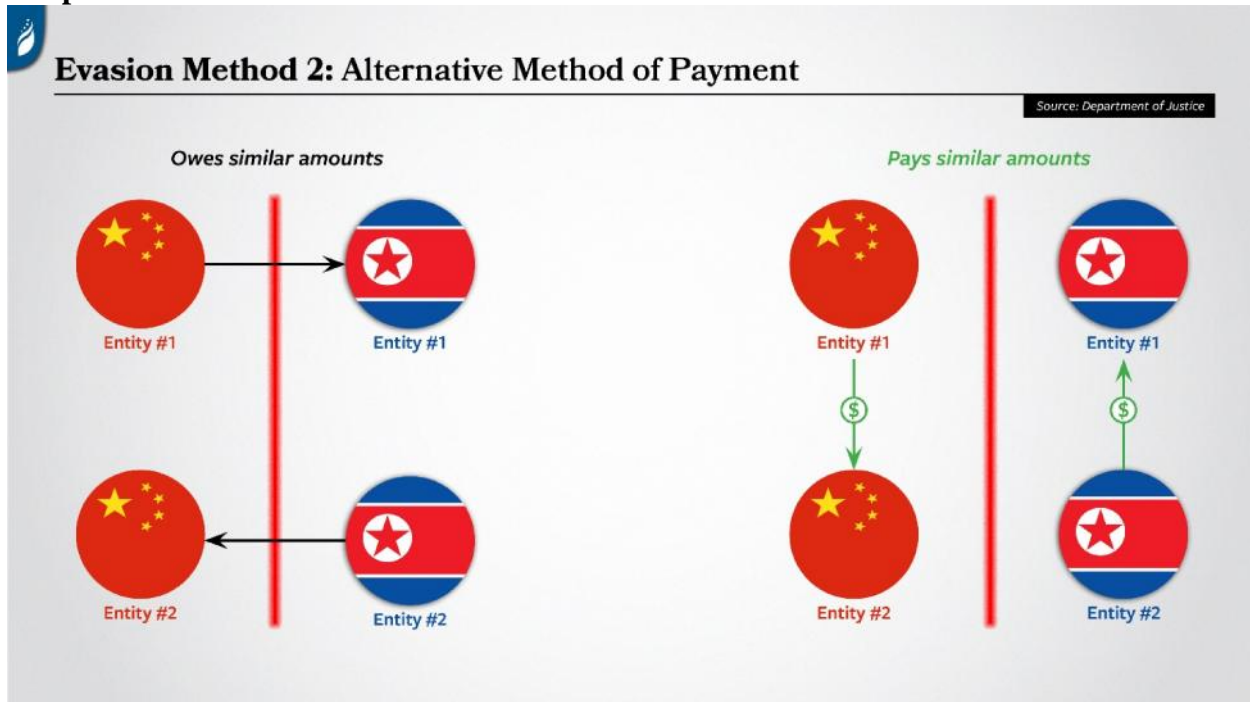
<sup>6</sup> "In China's Shadow: Exposing North Korean Overseas Networks," *The Asan Institute for Policy Studies and C4ADS*, August 2016. (<https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/57dfe74acd0f68d629357306/1474291539480/In+China%27s+Shadow.pdf>); "Risky Business: A System-Level Analysis of the North Korean Proliferation Financing System," *C4ADS*, June 2017. (<https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/59413c8bebbd1ac3194eafb1/1497447588968/Risky+Business-C4ADS.pdf>)

Graphic 3



The second method was identified by the Justice Department following an interaction with an unnamed North Korean defector (see graphic 4).<sup>7</sup> The scheme is simple: Chinese companies pay each other using the credits of one North Korean company to pay the debt of another North Korean company. It is unclear if these transactions involve U.S. dollars, but they have the benefit of avoiding money transfers between China and North Korea that could be subject to increased scrutiny. Chinese banks likely facilitate these payments between Chinese companies, and asking additional questions about the nature of the business relationship between these companies and North Korea could identify that these are problematic transactions prompting additional scrutiny.

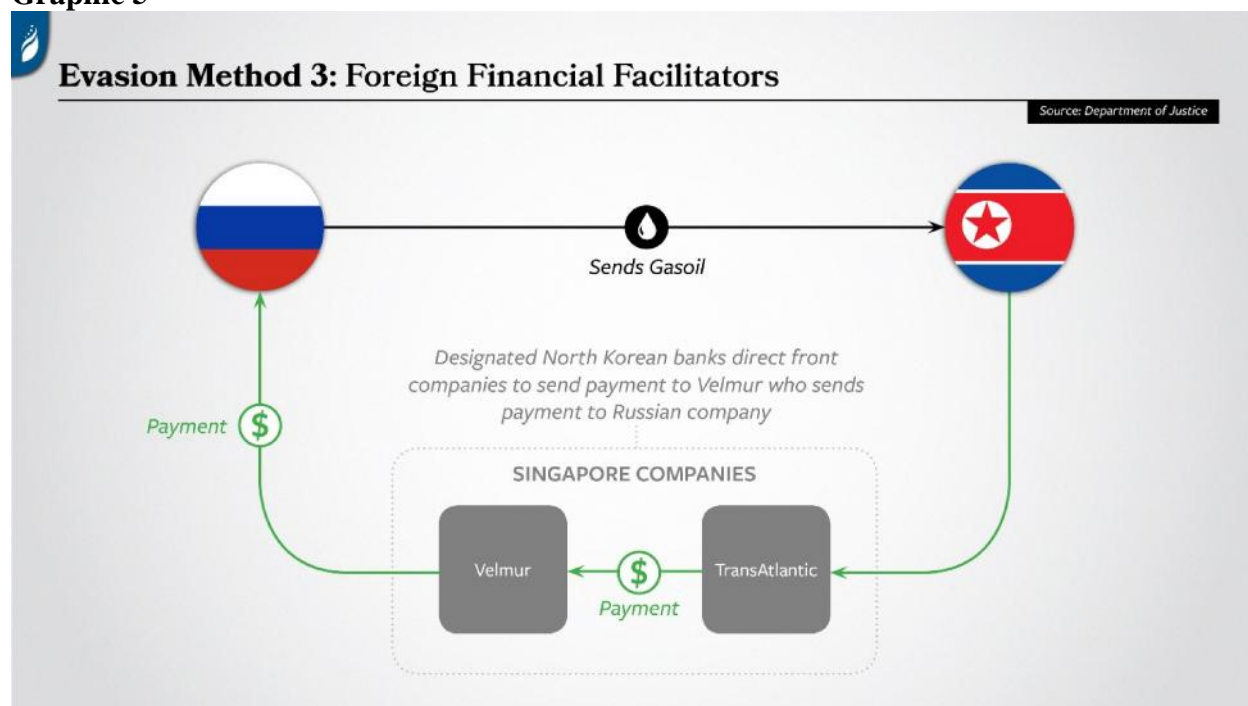
**Graphic 4**



<sup>7</sup> *United States of America v. Funds Associated with Dandong Chengtai Trading Limited*, No. 1:17-cv-01706 (D.D.C. August 22, 2017). (Accessed via PACER)

The third method was used by a Russian company to receive payments from North Korea for the shipment of oil (see graphic 5). Independent Petroleum Company (IPC) was sanctioned by the Treasury Department in early June for signing a contract to provide oil to North Korea and reportedly shipped over \$1 million worth of petroleum products to North Korea.<sup>8</sup> IPC shipped gasoil to North Korea and IPC requested payment from North Korea in U.S. dollars, but a direct transaction between Russia and North Korea using U.S. dollars is nearly impossible. IPC and North Korea devised a scheme to create two companies in Singapore to create the illusion of transactions between Singapore and Russia. The scheme obscured North Korea's involvement and furthered Pyongyang's ability, with assistance from a Russian company and Russian individuals, to violate U.S. law. The Justice Department requested forfeiture of almost \$7 million and fines for these alleged violations of U.S. laws.<sup>9</sup>

### Graphic 5



<sup>8</sup> U.S. Department of the Treasury, Press Release, "Treasury Sanctions Suppliers of North Korea's Nuclear and Weapons Proliferation Programs," June 1, 2017. (<https://www.treasury.gov/press-center/press-releases/Pages/sm0099.aspx>)

<sup>9</sup> *United States of America v. Funds Associated with Velmur Management PTE. Ltd.*, No. 1:17-cv-01705 (D.D.C. August 22, 2017). (Accessed via PACER)



## Addressing North Korea's Financial Activities

The U.S. approach toward North Korea's financial activities should take a page out of the Iran sanctions playbook where banks were forced to make a choice: stop doing business with Iran, or lose access to the U.S. dollar and risk the U.S. freezing their assets and labeling them as doing business with a state sponsor of terrorism intent on developing a nuclear weapon. The banks' business with North Korea is a small percentage of their overall business and they will not risk working with Pyongyang over Washington.

The Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA) provides a good model for North Korea financial sanctions, provided there are modifications to fit the current situation.<sup>10</sup> CISADA required the Secretary of the Treasury to cut foreign financial institutions off from the U.S. financial system if they knowingly processed transactions for Iran's Islamic Revolutionary Guard Corps or the Government of Iran's proliferation activities, money laundering, and other activities. Only two banks were sanctioned under CISADA, China's Kunlun Bank and Iraq's Elaf Bank, but the law was used by Treasury to achieve compliance from other foreign financial institutions.<sup>11</sup> The Treasury Department lifted sanctions against Elaf Bank nine months after designating it, after Treasury verified a "significant and demonstrated change in behavior." This illustrates the important lesson that financial sanctions are not simply punitive, but can lead to rehabilitation.<sup>12</sup>

The North Korea-Iran comparison is useful, but North Korea's financial activities are different than those Washington faced with Iran. The primary difference is the role of China in North Korea's known illicit financial transactions. Given the size of the Chinese economy and the U.S.-China relationship, sanctions against Chinese financial institutions should be carefully calibrated. But that does not mean Washington should shy away from protecting its own financial system.

A successful financial sanctions approach will focus on increasing the efforts of U.S. and foreign financial institutions to search for North Korea's illicit financial activities. While Pyongyang is experienced in hiding its activities behind front companies, the linkage can be found. C4ADS used data analysis tools to find multiple China-North Korea trade relationships, an effort that could certainly be duplicated by the largest Chinese banks.<sup>13</sup> In many cases, Chinese companies are not even hiding their relationships with North Korea. For example, Dandong Zhicheng Metallic

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<sup>10</sup> Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Pub. L. 111-195, 124 Stat. 1312, codified as amended at 22 U.S.C. §8501. (<https://www.treasury.gov/resource-center/sanctions/Documents/hr2194.pdf>)

<sup>11</sup> U.S. Department of the Treasury, Press Release, "Treasury Sanctions Kunlun Bank in China and Elaf Bank in Iraq for Business with Designated Iranian Banks," July 31, 2012. (<https://www.treasury.gov/press-center/press-releases/Pages/tg1661.aspx>)

<sup>12</sup> U.S. Department of the Treasury, Press Release, "Treasury Removes Sanctions on Iraqi Bank," May 17, 2013, (<https://www.treasury.gov/press-center/press-releases/Pages/j11949.aspx>)

<sup>13</sup> "In China's Shadow: Exposing North Korean Overseas Networks," *The Asan Institute for Policy Studies and C4ADS*, August 2016. (<https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/57dfe74acd0f68d629357306/1474291539480/In+China%27s+Shadow.pdf>); "Risky Business: A System-Level Analysis of the North Korean Proliferation Financing System," *C4ADS*, June 2017. (<https://static1.squarespace.com/static/566ef8b4d8af107232d5358a/t/59413c8bebbd1ac3194eafb1/1497447588968/Risky+Business-C4ADS.pdf>)

Material Co. Ltd., which was sanctioned by Treasury and is subject to an asset forfeiture request by Justice from late August, advertised on its Alibaba site: “We are a professional company of trading the North Korea Briquettes, choose us, trust us” and highlighted the sale of North Korean coal in U.S. dollars.<sup>14</sup> Chinese financial institutions certainly could have found that same information if they wanted to ask the right questions. Facing significant fines or losing access to the U.S. dollar should heighten Chinese banks’ desire to start asking those questions.

### **Additional Recommendations**

In testimony before this subcommittee in July, I provided nine recommendations for U.S. policy on North Korea:<sup>15</sup>

#### Recommendation 1: Sanction Additional Chinese Banks.<sup>16</sup>

Recommendation 2: Sanction Chinese and Russian Facilitators of Pyongyang’s Sanctions Evasion. Russia has emerged as a key node in North Korea’s sanctions evasion, and any effort to combat Pyongyang’s activities should include sanctions against Russian entities and individuals.<sup>17</sup>

Recommendation 3: Block the Revenue North Korea Receives from Overseas Laborers. In early August, Kuwait stated that it employs over 6,000 North Korean workers and said it has no plans to reduce that number, contradicting the State Department’s 2017 Trafficking in Persons report.<sup>18</sup> The Russian government admitted in late August that it employs 40,000 North Korean workers in timber processing and construction.<sup>19</sup> UN Security Council Resolution 2371 unfortunately only caps the number of overseas North Korean workers, despite stating the revenue is used in

<sup>14</sup> The Justice Department noted that “Alibaba is one of the largest e-commerce websites in the world. It is headquartered in China.” *United States of America v. Funds Associated with Dandong Chengtai Trading Limited*, No. 1:17-cv-01706 (D.D.C. August 22, 2017). (Accessed via PACER); U.S. Department of the Treasury, Press Release, “Treasury Targets Chinese and Russian Entities and Individuals Supporting the North Korean Regime,” August 22, 2017. (<https://www.treasury.gov/press-center/press-releases/Pages/sm0148.aspx>)

<sup>15</sup> Anthony Ruggiero, “Restricting North Korea’s Access to Finance,” *Testimony before House Committee on Financial Services, Subcommittee on Monetary Policy and Trade*, July 19, 2017.

([http://www.defenddemocracy.org/content/uploads/documents/Anthony\\_Ruggiero\\_Testimony\\_HFSC.pdf](http://www.defenddemocracy.org/content/uploads/documents/Anthony_Ruggiero_Testimony_HFSC.pdf))

<sup>16</sup> Anthony Ruggiero, “Severing China-North Korea Financial Links,” *Center for Strategic & International Studies*, April 3, 2017. (<https://www.csis.org/analysis/severing-china-north-korea-financial-links>); Anthony Ruggiero, “Time for Trump to Get Tough on China,” *Politico*, July 6, 2017.

(<http://www.politico.com/magazine/story/2017/07/06/donald-trump-china-north-korea-215343>)

<sup>17</sup> Anthony Ruggiero, “North Korea sanctions are finally getting serious,” *Fox News*, August 25, 2017.

(<http://www.foxnews.com/opinion/2017/08/25/north-korea-sanctions-are-finally-getting-serious.html>)

<sup>18</sup> Jon Gambrell, “Kuwait Says North Korean Workers Welcome Then Refutes Itself,” *Associated Press*, August 11, 2017. ([https://www.bloomberg.com/news/articles/2017-08-11/kuwait-says-north-korean-workers-welcome-then-refutes-itself?utm\\_content=politics&utm\\_campaign=socialflow-organic&utm\\_source=twitter&utm\\_medium=social&cmpid%3D=socialflow-twitter-politics](https://www.bloomberg.com/news/articles/2017-08-11/kuwait-says-north-korean-workers-welcome-then-refutes-itself?utm_content=politics&utm_campaign=socialflow-organic&utm_source=twitter&utm_medium=social&cmpid%3D=socialflow-twitter-politics)); U.S. Department of State, “Trafficking in Persons Report 2017,” June 2017.

(<https://www.state.gov/documents/organization/271339.pdf>)

<sup>19</sup> Polina Nikolskaya and Katya Golubkova, “Russian-North Korea projects foundering because of missile tests: minister,” *Reuters*, August 28, 2017. ([http://www.reuters.com/article/us-russia-northkorea-trade-idUSKCN1B81BO?utm\\_campaign=trueAnthem:+Trending+Content&utm\\_content=59a4451504d3010ce4152a6b&utm\\_medium=trueAnthem&utm\\_source=twitter](http://www.reuters.com/article/us-russia-northkorea-trade-idUSKCN1B81BO?utm_campaign=trueAnthem:+Trending+Content&utm_content=59a4451504d3010ce4152a6b&utm_medium=trueAnthem&utm_source=twitter))

Pyongyang's nuclear weapons and missile programs.<sup>20</sup> The Countering America's Adversaries Through Sanctions Act mandates the president to impose sanctions on persons that employ North Korean workers, and Washington should lead an effort to end North Korean slave labor.<sup>21</sup> The U.S. should then build a coalition of like-minded countries that commit to not accept North Korean overseas laborers. China and Russia would block a UN ban on payments to North Korea, but exposing the terrible work conditions and links between the revenue and the prohibited programs could pressure Beijing and Moscow to alter the payment mechanism and provide the money directly to the laborers, while continuing to import North Korean laborers.

Recommendation 4: Pursue an Offensive and Defensive Cyber Strategy.<sup>22</sup>

Recommendation 5: Impose Mandatory Inspections for all North Korean Ships.

Recommendation 6: Use U.S. and Partner States' Authorities to Enforce UN Sanctions.

Recommendation 7: Address Iran-North Korea Cooperation.

Recommendation 8: Implement Restrictions on Tourist Travel to North Korea.<sup>23</sup> The State Department has restricted the use of U.S. passports for travel to North Korea starting September 1, except under limited conditions.<sup>24</sup> This is a good step forward, but Congress must ensure it is being implemented and that it is not adversely affecting the operations of humanitarian organizations who care more about the North Korean people than the Kim regime.

Recommendation 9: Address North Korea's Human Rights Abuses.<sup>25</sup>

## Conclusion

Pyongyang's provocations, including its ICBM tests and sixth nuclear test, deserve increasingly harsh responses from Washington. A sanctions approach that focuses on North Korea's financial

<sup>20</sup> United Nations Security Council, Resolution 2371, August 5, 2017. ([http://www.un.org/en/ga/search/view\\_doc.asp?symbol=S/RES/2371\(2017\)](http://www.un.org/en/ga/search/view_doc.asp?symbol=S/RES/2371(2017)))

<sup>21</sup> Countering America's Adversaries Through Sanctions Act, 115 U.S.C. (<https://www.whitehouse.gov/legislation/hr-3364-countering-americas-adversaries-through-sanctions-act>)

<sup>22</sup> Samantha Ravich and Anthony Ruggiero, "The growing North Korean cyber threat," *Fifth Domain Cyber*, June 12, 2017. (<http://www.defenddemocracy.org/media-hit/samantha-ravich-the-growing-north-korean-cyber-threat/>); Samantha Ravich, "State-Sponsored Cyberspace Threats: Recent Incidents and U.S. Policy Response," *Testimony before the Senate Foreign Relations Committee*, June 13, 2017. ([http://www.defenddemocracy.org/content/uploads/documents/6132017\\_Ravich\\_Testimony.pdf](http://www.defenddemocracy.org/content/uploads/documents/6132017_Ravich_Testimony.pdf))

<sup>23</sup> Anthony Ruggiero, "North Korea Takes another American Hostage," *Foundation for Defense of Democracies*, April 24, 2017. (<http://www.defenddemocracy.org/media-hit/anthony-ruggiero-north-korea-takes-another-american-hostage/>)

<sup>24</sup> U.S. Department of State, "United States Passports Invalid for Travel to, in, or Through the Democratic People's Republic of Korea," 82 Federal Register 36067, August 2, 2017. (<https://www.gpo.gov/fdsys/pkg/FR-2017-08-02/pdf/2017-16287.pdf>); U.S. Department of State, "Notice of Information Collection Under OMB Emergency Review: Request for Approval To Travel to a Restricted Country or Area," 82 Federal Register 36065, August 2, 2017. (<https://www.gpo.gov/fdsys/pkg/FR-2017-08-02/pdf/2017-16286.pdf>)

<sup>25</sup> Anthony Ruggiero, "Don't let North Korea's nukes overshadow human rights abuses," *The Hill*, April 28, 2017. (<http://thehill.com/blogs/pundits-blog/foreign-policy/331061-dont-let-north-koreas-nukes-overshadow-human-rights-abuses>)

activities has the best chance of success, and combined with Washington's efforts to build a coalition of likeminded countries to increase other sanctions will protect the U.S. and its allies from the Kim regime's dangerous nuclear weapons and missile programs.

On behalf of the Foundation for Defense of Democracies, I thank you again for inviting me to testify and I look forward to addressing your questions.