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Citation: Defossez, Delphine (2017) The current challenges of money laundering law in Russia. *Journal of Money Laundering Control*, 20 (4). pp. 367-385. ISSN 1368-5201

Published by: Emerald

URL: <https://doi.org/10.1108/JMLC-09-2016-0041> <<https://doi.org/10.1108/JMLC-09-2016-0041>>

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The current challenges of money laundering law in Russia

1. Abstract

Globalization has turned the international financial systems into a paradise for money launderers. As much as globalization has expanded opportunities as never before, but, this expansion of opportunities has also resulted in new risks. Globalization has facilitated the move of billions of dollars a year by money launderers. This unexpected consequence of globalization presents serious challenges for legislators.

The new law on combating money laundering which brought some changes to the existing system was introduced in Russia in 2002. Even though it has improved greatly the regulation on money laundering, it has failed to efficiently combat terrorism. Overall, the Russian anti-money laundering regime has proved ineffective in terms of meeting its stated purposes of combating organized crime and terrorism. The limited success of the Russian anti-money laundering law stems largely from the fact that Russian banking system is structurally weak. The other main reason is the lack of regulatory compliance culture within the industry, weakening the effect of the law itself.

This paper starts from the premise that Russian made great effort to comply with international recommendations but that its law fails to efficiently deal with terrorism finance partly due to the fact that no consensus exists at international level as to the definition of the terrorism. Furthermore, the doubt persists as to the real aim pursued by Russian government while enacting the money laundering law.

2. Introduction

Globalization has turned the international financial systems into a paradise for money launderers. Indeed, globalization enhances the international integration of capital, technology, and information in a manner resulting in a single global market.¹ As much as globalization has expanded opportunities as never before, but, this expansion of opportunities has also resulted in new risks. Globalization has facilitated the move of billions of dollars a year by money launderers. This unexpected consequence of globalization presents serious challenges for legislators.

The new law on combating money laundering which brought some changes to the existing system was introduced in Russia in 2002. Even though it has improved greatly the regulation on money laundering, it has failed to efficiently combat terrorism. Overall, the Russian anti-money laundering regime has proved ineffective in terms of meeting its stated purposes of combating organized crime and terrorism. The limited success of the Russian anti-money laundering law stems largely from the fact that Russian banking system is structurally weak. The other main reason is the lack of regulatory compliance culture within the industry, weakening the effect of the law itself.

Russian authorities have been criticized for opportunistically having used the anti-money laundering regime as a tool to reform the banking system, which is an unconnected end to the

¹ Thomas L. Friedman, *The Lexus and the Olive Tree: Understanding Globalization* (New York, NY: Farrar, Straus, Giroux, 1999)

fight against terrorism and organized crimes.² As a result, the effectiveness of the money laundering regulations is undermined. Moreover, by using the regulation to achieve different aims, the legitimacy of the whole system is put at stake.

This paper starts from the premise that Russian made great effort to comply with international recommendations. The country has enacted laws to regulate money laundering at national level. But has failed to enact laws that are dealing with terrorism finance. The doubt persists as to the real aim pursued by Russian government while enacting the money laundering law. This paper will examine the current challenges that Russian law is facing. Part one will briefly summarize the problem that money laundering possesses worldwide. The rationale for regulating money laundering will be given. Within part two that is dedicated to Russia, first a brief summary of money laundering in Russia will be given. Then, the focus will shift to the specific Russian laws on money laundering, especially the money laundering law of 2001 which will be discussed in length. Finally, with regard to Russia, the current challenges will be examined, with an emphasis on terrorism, the banking system and lack of compliance culture.

3. Money laundering a worldwide problem with worldwide solutions

Money laundering started to be seen as a serious problem during the US war on drugs. Indeed, as Raymond Kelly, Commissioner of the US Customs Service, stated, "we will not win the war on drugs by following the tons of cocaine and heroin and marijuana that move through our streets. We will win it by following the billions of drug dollars that move through our financial system."³ With the US war on drugs, the international community started to realise that some of the greatest problems of our century should be combatted at the root of the problem in order to have a long-term effect. This focus on money laundering and later on terrorist financing have motivated significant international cooperation, sometimes even involuntary cooperation.⁴ Many countries have adopted an American style of anti-money laundering regulations, rendering the combat increasingly homogenized.⁵ This American influence is best exemplified by the fact that the international cooperation in the fight against money laundering and terrorist financing is ensured by the US-run FATF. The non-cooperative countries and territories (NCCT) project which created "blacklists" of countries that failed to regulate money laundering set by FATF, was commenced by FATF.⁶ Interestingly '[...] although the basis for the FATF is not a binding international treaty but an agreement, it had provided the basis for an embryonic system to police the behavior of countries, including both members and non-members'.⁷ Indeed, these blacklists have serious repercussions, as often foreign economic aid and foreign

² Alexandra V. Orlova, 'Russia's anti-money laundering regime: law enforcement tool or instrument of domestic control?' (2008) 11 *Journal of Money Laundering Control* 210

³ Beare, M.E., "Searching for wayward dollars: money laundering or tax evasion -- which dollars are we really after?", (2002) 9 *Journal of Financial Crime*, p. 259

⁴ Beare, (n 2); Gilligan, G.P., *Regulating the Financial Services Sector*, (The Hague, 1999), p. 22; Naylor, R.T, "Follow-the-money methods in crime control policy", in Beare, M.E. (Ed.), *Critical Re-flections on Transnational Organized Crime, Money Laundering, and Corruption*, (University of Toronto Press, 2003) pp. 262-7

⁵ Cuellar, M-F., "Criminal law: the tenuous relationship between the fight against money laundering and the disruptions of criminal finance", (2003) *Journal of Criminal Law & Criminology* 93, p. 376; Orlova (n 1), p.211

⁶ Eizenstat, S.E. (2001), "Congressional Hearing on the (USA) Administration's 'National Money Laundering Strategy for 2001'", A testimony on 26 September 2001, available at: <www.fas.org/irp/congress/2001_hr/092601-eizenstat.html> (last visited 20 August 2016).

⁷ Cuellar (n 4), p. 377

capitals are withdrawn from that country. This, in turn, leads to a general slowdown of all financial transactions and destabilisation of the country's financial system, as foreign banks treated transactions coming from a country on the blacklist as suspicious.⁸

As Cuellar has noted '[...] the fight against money laundering is designed not just to punish a few people who happen to get caught with money after committing a crime, but to punish instead the larger infrastructure that allows domestic and global criminal networks to profit from and finance crime.'⁹ Targeting money laundering is, therefore, a vital tool in helping the authorities to disrupt the financing of criminal activities.

Regulating money laundering has a direct impact on the state itself, as it preserves the integrity and stability of the financial system.¹⁰ Moreover, in a sense money laundering is undermining the power of the state as capitals from illicit origins penetrate domestic financial systems.¹¹ However, sometimes at national level, governments enact anti-money laundering regulations in order to pursue broader goals. Russia is a vivid example of such a use of the regulation to pursue unrelated goals.¹²

4. Russia

a. Money laundering in Russia

The increased attention given to money laundering at international level have led to an increased attention given to Russia, alongside with an increase international pressure. Russia has faced enormous international pressure to bring its anti-money laundering regime into compliance with the Recommendations issued by the Financial Action Task Force (FATF). Indeed, Russian law was outdated and was not able to cope with the new international reality anymore. Part of the pressure arose in response to investigation that was reported in the American press in 1999. These reports claimed that more than US \$4 billion had been laundered through an account in the Bank of New York (BONY), coming from Russian organised crime. After a larger investigation, the amount was raised to between US\$7 and 10 billion.¹³ During the trial, the former BONY Senior Vice President, Lucy Edwards, and her husband Peter Berlin pleaded guilty to various charges including money laundering.¹⁴ Interestingly, the Russian authorities refused to make the results of their investigation on the BONY scandal public.¹⁵ Therefore, it remains a doubt as to the amount of capitals that was laundered coming from Russia.¹⁶ This

⁸ Levi, M. "Controlling the international money trail: a multi-level cross-national public policy review", (2003) Future Governance Research Initiative, p. 6; Naylor, R.T., *Wages of Crime. Black Markets, Illegal Finance, and the Underworld Economy*, (McGill-Queen's University Press, 2002), p.133

⁹ Cuellar (n 4), p. 324

¹⁰ Johnson, J. and Lim, Y.C.D., "Money laundering: has the financial actions task force made a difference?", (2002) 10 *Journal of Financial Crime* 1, p.7

¹¹ Favarel-Garrigues, G., *Domestic Reformulation of the Moral Issues at Stake in the Drive against Money Laundering: The Case of Russia*, UNESCO, (Blackwell Publishing Ltd, 2005), p. 530

¹² Favarel-Garrigues (n 10), p. 538-9

¹³ Robinson, P.L. and Burger, E.S., "The regulatory framework and potential implications of the Bank of New York money-laundering scandal for Russia and the United States", *Russia Business Watch*, 1999/2000

¹⁴ O'Brien, T.L., "Respite for bank of New York, then back in thicket", *The New York Times*, 18 February 2000, <<http://www.nytimes.com/2000/02/18/world/respice-for-bank-of-new-york-then-back-in-thicket.html>> (last visited on 20 August 2016); Neumeister, L., *Ex-bank Exec, Husband Plead Guilty in Russian Money Case*, The Associated Press, London, 16 February 2000.

¹⁵ Orlova (n 1), p.212

¹⁶ Robinson and Burger (n 12)

scandal shook the US and brought up a fear of a Russian organised crime menace.¹⁷ Furthermore, the scandal led to more pressure on Russia to pass legislation in line with the Forty Recommendations of FATF.

Even though they complied with this demand and enacted legislation more in line with the FATF standards, Russia has been strongly criticised for the way it uses money laundering regulation to pursue various domestic political aims, such as reforming the banking industry, controlling political activists or even controlling the business community.¹⁸

b. The regulation of money laundering

Since 9/11, measures to combat money laundering and terrorist financing have become increasingly harmonised across jurisdictions. However, as will be argued later, without an international uniform definition and international measures, national measures are just of temporary help. As mentioned above, Russia has been subject to intense international pressure to bring its anti-money laundering regime into compliance with the Recommendations issued by the Financial Action Task Force (FATF). Indeed, Russian law was outdated and was no more able to cope with the new international reality.

i. The old regime

Prior to the reform of Russia's money laundering regime, money laundering was rudimentarily addressed in Article 174 of the Criminal Code. The Criminal Code was the first post-Soviet Criminal Code and was adopted by the State on 24 May 1996, approved by the Federation Council on 5 June 1996, and signed by the President on 13 June 1996. It officially entered into force on 1 January 1997.¹⁹ The old Article 174 was written in very broad terms leading to confusion over its scope of application. This confusion was also seen in the judgments of the courts, that avoided going out of their comfort zone and ended just convicting minor civil offenders of money laundering.²⁰

Due to the external pressure, on 1 February 2002, the anti-money laundering legislation, officially called the legislation on Countermeasures Against Legalization (Laundering) of Proceeds from Crime, entered into force.²¹ This law incorporated many of the FATF's 1996 recommendations as well as the most important provisions of the Strasbourg Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime of 1990. Additionally, the legislation *on Amendments and Additions to Legislation of the Russian Federation in Connection with the Adoption of the Federal Law on Counter-measures Against Legalization (Laundering) of Proceeds from Crime* was enacted simultaneously. This particular piece of legislation amended, amongst other sections, Article 174 of the Criminal Code in order to bring this provision in line with the new anti-money laundering regime. Article 174 was

¹⁷ Manney, R., "Money-laundering: the global threat to the integrity of financial systems", (2002) available at: <www.wilmott.com> (last visited on 20 August 2016), p.3

¹⁸ Favarel-Garrigues (n 10), p. 539

¹⁹ Butler, W.E. (Ed.), *Criminal Code of the Russian Federation*, (Simmonds & Hill Publishing Ltd, 1997), p.2

²⁰ Orlova (n 1), p.213

²¹ European Commission for Democracy through law, 'Federal law on combating extremist activity of the Russian Federation', Opinion no. 660 / 2011, 2012.

further amended by the Federal Law entitled on *Additions and Amendments to the Criminal Code of the Russian Federation* No. 162-FZ, which entered in force on 11 December 2003.²²

ii. The federal Law 'on Combating Money Laundering' of 2001

One of the most important piece of legislation regarding money laundering in Russia is the federal Law 'on Combating Money Laundering'. The federal Law 'on Combating Money Laundering' or also referred to as the 'Money Laundering Law', dated from 13 July 2001 and was signed by the President Vladimir Putin on 7 August 2001. The money laundering law came into force on 1 February 2002. The money laundering law mostly follows the recommendations made by the Financial Action Task Force on Money Laundering, an inter-governmental body having as its main goal the developing and promoting of policies to combat money laundering at national level.

Before the money laundering law, the definition of money laundering was vague, leading to confusion. The new law clarified some basic principles in the definition of money laundering. Since the definition was changed, there was a need to amend the Criminal Code to reflect those changes. The amended Criminal Code defines money laundering as follows: 'the conclusion of financial operations and other transactions with money or other property on a large scale, knowingly obtained by criminal means (excepting crimes under arts 193, 194, 198 and 199 of the Russian Criminal Code) for the purpose of giving lawful character to ownership, usage and disposal of the indicated money or other property'. The old Article 174 of the Criminal Code only referred in very broad and general terms to an illegal source of money. Such broad definition caused problems as legally earned funds which had been wrongfully retained through tax evasion or obtained in contravention of currency control legislation, for example tax or currency control violations, were falling under the term money laundering. As a result, the old s.174 was mainly criticised for the confusion over its scope of application that existed.²³

The new definition, however, is more narrow and only refers to a criminal source of money, therefore making it clear that only earning derived exclusively from criminal activities leads to money laundering. As a result, crimes such as the non-return of funds in foreign currency from abroad or evasion of liability to pay taxes and insurance premiums to the state are exempted. With the money laundering law, Russian law is more in line with international standards. In practice, the changes brought by the money laundering law means that a who fails to pay taxes can only be held liable for tax evasion and not for money laundering. Tax evasion cannot itself convert lawfully earned funds into funds derived from criminal means.

Since the old definition in Article 174 was so broad, courts tended to concentrate on minor offenders having obtained funds from committing civil or administrative crimes rather than criminal offences. As a direct result, until the money laundering law, there has been only few convictions. In 1999, there were only 105 convictions related to money laundering in the whole

²² "O Vnesenii Izmenenii I Dopolnenii v Ugolovnyi Kodeks Rossiiskoi Federatsii" (in Russian), Federal law numero No. 162-FZ

²³ Alexandra V. Orlova, 'Russia's anti-money laundering regime: law enforcement tool or instrument of domestic control?' (2008) 11 *Journal of Money Laundering Control* 210, p.213

Russia. Most of their offenses were minor.²⁴ With the new law, this changes as in order to be convicted of money laundering, the person needs to have committed a crime.

In order to effectively combat money laundering, the money laundering law requires any cash or deposit transactions involving over 600,000 Roubles (approximately US\$20,000) to be reported to a central executive agency, the Federal Financial Monitoring Service which is Russia's Financial Intelligence Unit.²⁵ The same holds true for any kind of transaction deemed suspicious and suspected of having a link with a criminal activity. Real estate transactions are not included in this provision.²⁶ However, if one of the parties to the transaction is identified as participating in extremist activities, it can either be a person or an organization, then such transaction must be reported to the Federal Financial Monitoring Service, regardless of the amount involved. The same holds true if one of the parties is controlled or under the influence of an organisation or individual listed as participating in extremist activities.²⁷

Financial institutions have a prevalent role to play under the money laundering law. Indeed, financial institutions are required to supervise and report any suspicious transaction, which is a mandatory reporting requirement embodied in Article 5. In addition to that, the institutions, conducting transactions with money, are obliged to keep internal record and have customer identification procedures. The institutions are required to develop internal control measures mechanisms that effectively combat money laundering. Confidentiality and staff training is also another important requirement. But the most important is that the internal control measure must establish criteria to identify suspicious transaction.²⁸ The rules governing a financial institution's internal record keeping and reporting of suspicious transactions include an obligation to perform increased due diligence on all complex or unusual patterns of transactions which have no apparent economic or lawful purpose.²⁹ Regardless of whether the transaction is subject to mandatory reporting, if the result of an internal control raise a suspicion as to the real aim of the transaction, the financial organization must report such suspicious activity.³⁰ The institution has a relatively short time frame for reporting, as it is allowed only one working day after the transaction was made or after the result of the control has demonstrated a suspicious transaction.³¹

The meaning of financial institution is not limited to banks but also includes securities market professionals, insurance and leasing companies and other non-credit organisations which deal with the transmission of money. The law has a really brought scope and includes also real estate agencies, lawyers, notaries and companies providing legal and accounting services.³² The financial institutions are protected for any liability resulting from a breach of any restriction on disclosure of information imposed by the money laundering law. Indeed, the financial institution is under no obligation to warn its customers that the institution transferred

²⁴ European Committee on Crime Problems (CDCP), 'Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures (PC-R-EV) (2003), First evaluation report on the Russian Federation', (2003) available at: www.coe.int/T/E/Legal_Affairs/Legal-co-operation/Combating_economic_crime (accessed July 2016).

²⁵ Article 6

²⁶ Max Gutbrod and Alexander Titov, 'Russia: New Money Laundering Law' (2002) 7 JIBFL 304

²⁷ Article 6(2)

²⁸ Article 7(2)

²⁹ Article 7(1)(3)

³⁰ Article 7 (3)

³¹ Article 7(1)(4) in conjunction with Article 7(3).

³² Article 5

information relating to the customer's account to the competent authorities. Financial institutions must know the actual identity of their customers and are not allowed to open or keep anonymously held accounts, as it was previously the case. The organization has the right to refuse to open an account on two grounds; first if the person or the legal entity wanting to open the account fail to submit the adequate information which would identify the customer. Second, if information regarding the activity of the person as participating in terrorist activities exists.³³

The records of suspicious transactions subject to mandatory reporting and customers suspected of suspicious transaction must be kept by the institution for at least five years.³⁴ Moreover, the financial institution can suspend debit operation for two working days. Then the Federal Financial Monitoring Service has the authority to suspend financial transactions for a further five working days if the suspicions are well grounded.³⁵ Russian government will draw up a blacklist of non-co-operative jurisdictions, which will correspondingly bear special scrutiny upon report of any suspicious transactions.

Following the measure already taken by a number of other countries, a specialized governmental agency, internationally known as financial intelligence units or FIU, will be created to handle money laundering issues. The Russian FIU will be a central federal agency responsible for the receiving, reviewing and analyzing of information received. When the information is of relevance, the FIU will transfer it to the competent authorities concerning suspected money laundering activities. Moreover, the FIU will cooperate with the competent foreign authorities, under the relevant international agreements. The major areas where such cooperation will take place are the areas of collection and exchange of information, investigation of cases send by foreign authorities and enforcement of foreign court decisions. The sharing of confiscated property with other countries, is possible, certainly when the confiscation is the result of a joint case among these countries.

However, with the FATF's 2003 Recommendations it soon started to be obvious that the amendments were not sufficient. As a result, the money laundering legislation underwent further amendments during the years that followed its enactment.³⁶ Certainly so, since the first version of the law did not include terrorist financing and therefore was viewed as outdated as international terrorism was rising.

iii. Criminal code

In the current version of the Criminal Code, there are provisions to deal with both professional money laundering as well as self-laundering. Article 174 paragraph 1 focus on third party laundering, meaning laundering of money from criminal activities by persons that are not involved in the commission of the crime. Such offence is punished by a fine amounting to up to 120,000 Roubles or an amount equivalent to the amount of the earnings or other revenue of the convicted person for a period of up to one year. It reads as follows: "Legalization

³³ Article 7(5)

³⁴ Article 7(4)

³⁵ Article 8

³⁶ Federal Law No. 115, as amended by Federal Law No. 112-FZ, from 25 July 2002, as further amended by the Federal Law No. 131-FZ, from 30 October 2002, as further amended by the Federal Law No. 88-FZ, from 28 July 2004

(Laundering) of Monetary Means or Other Property Acquired by Other Persons by Criminal Means:

“1. The performance of financial operations and other transactions with monetary means or other property known to have been acquired by other persons by criminal means (with the exception of offences defined in sections 193, 194, 198, 199, 199.1 and 199.2 of this Code) for the purpose of giving a legal appearance to the possession, use and control of such monetary means or other property.”

Self-laundering is also included. Self-laundering is when the perpetrator of the offence launders the money coming from his own criminal offence. Article 174.1 (1) reads as follows: “1. The performance of financial operations and other transactions with monetary means or other property acquired by a person as a result of a person committing a crime (with the exception of offences defined in sections 193, 194, 198, 199, 199.1 and 199.2 of this Code) or the use of such monetary means or other property in order to effectuate entrepreneurial or other economic activity.” Such crime is punished by a fine amounting to up to 120,000 Roubles or an amount equivalent to the amount of the earnings or other revenue of the convicted person for a period of up to one year.

A common feature of both paragraphs is that they exclude the same type of offences. Indeed, the sections listed as excluded are sections about tax evasion. Section 193 refers to the failure to return means in foreign currency from abroad, while section 194 focuses on evasion of customs payments. Section 198 refers to tax evasion by citizens while section 199 focuses on tax evasion by organisations. The failure to carry out the duties of a tax agent is laid down in section 199.1, while concealment of monetary means or property of an organisation or an individual entrepreneur that is subject to taxation and/or collection, is dealt with in section 199.2. However, if the offences listed in one of these sections is combined with another criminal offence, such as forgery or fraud, then the person will still be convicted of money laundering.³⁷ The exclusion of these offences has been strongly criticised, since these offences generate large profits.³⁸

1. The court practice

Courts applied Article 174 and 174.1 inconsistently. As a result, in 2004, the Supreme Court of Russia issued guiding instructions to be followed uniformly throughout the country by the lower courts, for money laundering cases.³⁹ The Supreme Court noted the difference between Article 174 and 174.1. Indeed, in Article 174 (1) there is a sentence, ‘legal appearance to the possession, use and control of monetary means or other property, acquired as a result of criminal activity’, which is absent from Article 174.1(1).

The Supreme Court also highlighted the inconsistency between the wording of Article 174.1 and Article 3 of the money laundering law which defines the term laundering as "giving a legal appearance to the possession, use and control of monetary means or other property, acquired as a result of criminal activity", using the same wording as in Article 174(1).

³⁷ Schaer, M, ‘New Russian money laundering legislation’, (2001) 29 International Business Lawyer, p.370

³⁸ Sher, O., ‘Breaking the wash cycle: new money laundering laws in Russia’, (2003) 22 New York Law School Journal of International and Comparative Law 640, p.643

³⁹ Guiding Instructions No. 23, from 18 November 2004

The guiding instruction also raised the *mens rea* of the third-party offender. Indeed, in order for a third party to escape liability, it must be demonstrated to the court with sufficient evidence that the third party knew, and not should have known, that the money that he was laundering came from criminal activities. Such higher *mens rea* standard makes it easier to be escaped as recklessness is not enough to convict the person of money laundering under Article 174(1).⁴⁰ In the eyes of the Supreme Court, simply disposing of a property acquired as a result of a crime should not be considered as laundering, as long as there was no intent to make the property appear as legitimate. Another common mistake made by the lower courts included classifying rent payments and food purchases made with money derived from criminal activities as money laundering, when no attempts were made to give legitimate appearance to the money of these criminal activities. It even went to the point where someone was accused of money laundering for purchasing food worth 20 Roubles, which is equal to less than \$1US.⁴¹

As Orlova stated: ‘The actual numbers of money laundering prosecutions under these two Criminal Code provisions are relatively small. For instance, in 2001 under s.174 (third-party laundering), there were 73 convictions; in 2002 -- 27 convictions; and in 2003 -- 11 convictions. Three individuals were convicted under s.174.1 (self-laundering) in 2003. All these individuals received suspended sentences (Supreme Court's Bulletin, 2005b). According to MVD statistics, in 2004 the number of convictions for both ss.174 and 174.1 rose to 85; in 2005 to 238; and in 2006 to 1,824’.⁴² It can be noticed that, after the 2004 reform of the Criminal Code, the number of convictions for money laundering has dramatically increased. Indeed, the amendments made to the Criminal Code eliminate the requirement of large-scale money laundering for both articles. Until 2004, convictions were only made for large scale money laundering.⁴³

Still ‘Overall, the number of offences registered under s.174.1 (self-laundering) far exceeds those registered under s.174 (third-party laundering). For example, in 2005 police registered 524 offences under s.174 and 6,937 offences under s.174.1, for a total of 238 convictions overall’.⁴⁴ This shows the tendency of the courts to prosecute self-laundering instead of third-party laundering, meaning that these prosecutions are linked with other offences rather than just than the commission of economic crimes. ‘A review of cases involving organised crime charges further reveals that only very few of them involved charges of money laundering as well. Hence, it appears that the Russian courts, for the most part, do not prosecute cases connected with professional laundering involving organised criminal entities’.⁴⁵

c. The current challenges

Surprisingly, in a few year period, Russia has gone from being on the FATF's "blacklist" of non-compliant countries to becoming a full-fledged member of the FATF, adopting the international recommendation and adapting it to its own anti-money laundering regime. However, doubts persist as to the effectiveness of anti-money laundering measures as tools to stop the spread of terrorism and organised crimes. Certainly so when some have started to show mistrust as to the real aims pursued by the Russian government.

⁴⁰ Supreme Court's Bulletin, Supreme Court's Bulletin, No. 2, 28 February 2005

⁴¹ Orlova (n 1), p.215

⁴² Orlova (n 1), p.215

⁴³ Supreme Court's Bulletin, *Supreme Court's Bulletin*, No. 1, 4 February 2005

⁴⁴ Orlova (n 1), p.215

⁴⁵ Alexandra V. Orlova, ‘Russia's anti-money laundering regime: law enforcement tool or instrument of domestic control?’ (2008) 11 *Journal of Money Laundering Control* 210, p.215

Russia greatly improved its money laundering law, now allowing for proper combating of money laundering. Even though Russia already made great efforts, the international cooperation should still be enhanced. Overall, the Russian anti-money laundering regime has proved ineffective in terms of meeting its stated purposes of combating organised crime and terrorism. The limited success of the Russian anti-money laundering law stems largely from the fact that Russian banking system is structurally weak. The other main reason is the lack of regulatory compliance culture within the industry, weakening the effect of the law itself.

i. Terrorism: a global problem hard to solve at just national level

The major effect that the money laundering law had was to amend various existing laws, such as the Criminal Code, with the new definition of money laundering, the Banking Law and the Securities Market Law, in respect of the new system for reporting suspicious transactions. However, all these amendments were implemented in 2002, some of which are no longer reflecting the current reality. For instance, barely anything is written in relation to financing terrorism through money laundering. One of the reasons for this omission is that at the time the laws were amended and the money laundering law was enacted, international terrorism was at its starting point. The perception of terrorism changed after the September 11th 2001 attacks.⁴⁶ The acts of terrorism perpetrated on September 11th were not, in themselves, the catalysts leading to the development of new international laws. In fact, few international conventions were adopted post 9/11. However, the September 11th represented the impetuosity that hastened the scope and reach of international counterterrorism law. The events triggered a new determination to ensure strict compliance with existing legislations.⁴⁷ Furthermore, there is a sentiment in Russia, which was until recently shared by numerous countries, that terrorist attacks only occur in other countries and that Russia is safe.

1. Terrorism a global problem

With regard to money laundering financing terrorism, one of the reasons it is very hard to legislate and regulate such an area is that there are no definitions of terrorism at international level, and terrorism is no longer restricted to the borders of one country. Terrorism as a global phenomenon exists since old days.⁴⁸ Yet modern day transnational terrorism is emerging as a global problem and damaging the monarchical, dictatorial and democratic states.⁴⁹ The coverage by the media of these contemporary acts of terrorism has further broadened the scope of its international aspect.⁵⁰ The complexity and difficulty of the issues cannot be denied; at a global level, the issues are different than at national level. International law can help to set up a framework, but terms of homeland defence to make the country less vulnerable have to be set by each country. The same holds true with regard to intelligence gathering information, criminal

⁴⁶ Jacqueline M. Gray and Margaret A. Wilson, 'Understanding the 'War on Terrorism': Responses to 11 September 2001' (2006) 43 *Journal of Peace Research* 23, p.23; Gilbert Guillaume, 'Terrorism and International Law' (2004) 53 *International and Comparative Law Quarterly* 537

⁴⁷ Guillaume (n 45), p.542

⁴⁸ Chris O. Opukri and Kimiebi Imomotimi Ebienu, 'International Terrorism and Global Response: An Appraisal' (2013) 1 *American Journal of Humanities and Social Sciences* 109

⁴⁹ Murphy, 'Legal Controls and the Deterrence of Terrorism: Performance and Prospects', (1982) 13 *RUTGERS L.J.* 465; see Evans, 'Perspectives on International Terrorism', (1980) 17 *WILLAMETTE L. REV.* 151

⁵⁰ Sayre, *Combatting Terrorism: American Policy and Organization. Address Before the Third International Civil Aviation Security Council*, in *Terrorism, Political Violence and World Order* 481,481 (H. Han ed.1984).

investigation, and prosecution. One important point is that terrorism in itself is just a concept, not even an ideology. Terrorism is more of a mean or a tactic to pursue ideological or political ends.

The problem is multi-dimensional and multi-layered therefore the response should hold the same characteristics. The motives, the size of the attack and the jurisdiction in which it was committed, define the scope of terrorist acts as national or international acts.⁵¹ An act of terrorism at a national level may be a response to national politics whereas international acts of terrorism are the purview of the international community to protect international peace, security and stability.⁵² As was recognised by the High-Level Panel, the strategy needs to incorporate coercive measures but at the same time, it needs to be broader.

The lack of a comprehensive international answer to terrorism is not recent. The quest started in 1972 with an Ad Hoc Committee on Terrorism established by the UNGA to develop legislation to prevent terrorism.⁵³ A consensus could not be reached among states. The dividing question was whether there was a need to distinguish the acts of terrorism from the national liberation movements.⁵⁴ The US point of view was that all terrorist acts should be condemned and objected to differentiate between terrorist acts.⁵⁵ Without such a consensus, it was impossible for the community to draft a definition that would please all the stakeholders involved. The community has attempted to define terrorism comprehensively but has not yet been successful.⁵⁶ The lack of a universally acceptable definition of terrorism is a big hurdle in devising effective counter terrorism measures. Indeed, in order to prevent and deter terrorism in future, the International community of nations needs to agree upon a universally acceptable definition.⁵⁷

2. The lack of a uniform definition on terrorism and its impact on the development of international law on terrorism financing and money laundering

A consensual definition of terrorism is indispensable in formulating appropriate legislation against terrorism.⁵⁸ Apart from the key motive that drafting a general definition would contribute to harmonizing national criminal laws, other benefits might be generated from a consensual and general legal definition. For instance, it will help in extraditing terrorists, identifying the appropriate evidence necessary for a conviction and it will assist in identifying the types of activities likely to result in a terrorism offence. Although there are agreements

⁵¹ Franck & Lockwood, 'Preliminary Thoughts Towards an International Convention on Terrorism', (1974) 68 AM. J. INT'L L. 69.

⁵² Opukri and Ebienu (n 47), p.111-112

⁵³ G.A. Res. 3034, 27 U.N. GAOR Supp. (1972); Guillaume (n 45)

⁵⁴ I B. Ferencz, An International Criminal Court: A Step toward World Peace 355 (1980), p.547.

⁵⁵ Ferencz (n 55), p.578.

⁵⁶ Heidi M. Schlagheck, 'The Importance of International Law in Counter-Terrorism: The Need for New Guidelines in International Law to Assist States Responding to Terrorist Attacks' (2006, LL.M Virginia Polytechnic Institute) p.25

⁵⁷ Paust, *A Survey of Possible Legal Responses to International Terrorism: Prevention, Punishment, and Cooperative Action*, 5 GA. J. INT'L & COMPo L. 431 (1975).

⁵⁸ J Rupérez, 'The United Nations in the Fight against Terrorism' (Paper delivered during the 132nd International Senior Seminar Visiting Experts' Papers) 2005.

<http://www.unafei.or.jp/english/pdf/RS_No71/No71_07VE_Ruperez.pdf> (last visited on 20 August 2016)

between states, usually extradition for political reasons, which is the case with terrorism, is rejected.⁵⁹

Terrorism remains a term that is extremely difficult to define. Some scholars ask why it is absolutely necessary to find a legal definition of the concept. For instance, Baxter says it is 'imprecise, ambiguous, and above all it serves no operative purpose',⁶⁰ regretting that a legal concept of terrorism had been inflicted upon academia. Higgins, another eminent international lawyer, observed that 'terrorism is a term without a legal significance. It is merely a convenient way of alluding to activities, whether of States or of individuals, widely disapproved of and in which either the methods used are unlawful, or the targets protected, or both'.⁶¹ Reflecting on the above statements, Walter questioned the necessity of finding a legal definition of the concept, suggesting that it would be preferable rather to define the criminal acts within terrorism.⁶² Scholars in politics, law, history, psychology, theology and criminology have tried and failed to devise a definition of 'terrorism'.⁶³ There is no agreement on the limits of the 'terrorism' phenomenon. For analysts, such as Bowel and Ganor, terrorism represents all sorts of violence except state violence. Yet, other scholars consider that people who defend a noble cause should not be classified as terrorists and, indeed, ought to be regarded as patriots.⁶⁴ There is no unanimity on what constitutes 'terrorism.'

Despite the proliferation of international laws, their assessments and legal frameworks concerning terrorism, such as the scholars considered above, these definitions do not yet possess what is required of a legal definition. This discussion demonstrates that the difficulties surrounding the ability of the international community in agreeing a formal legal definition of terrorism but also the profound need to reach such definition. The lack of definition has in part frustrated the capacity of international law to address terrorism and preparatory activities at the international level.

However, even without a definition of terrorism, a convention was enacted to deal with terrorism financing, namely the Convention for the Suppression of the Financing of Terrorism. The Convention requires the contracting states to be proactive in preventing financing terrorism. States are obliged to create accountability for the person caught financing terrorism. The Convention authorise the states to freeze terrorist funds. It is also the first convention that developed a sort of legal definition of terrorism. Indeed, in order to prohibit financing, the international community had to give at least a hint of what was terrorism.⁶⁵ Article 2 (1) (a) refers to previous counter-terrorism convention while Article 2 (1) (b) is read as followed:

⁵⁹ Commission On Human Rights, 'Specific Human Rights Issues: New Priorities, in Particular Terrorism', Sub-Commission on the Promotion, and Protection of Human Rights, Fifty- fifth session, Agenda item 6 (c)), p.26

⁶⁰ R. Baxter, 'A Sceptical Look at the Concept of Terrorism', (1974) 4 Akron Law Review. p. 380.

⁶¹ R. Higgins, 'The General International Law of Terrorism', in R. Higgins and M. Flory, *International Law and Terrorism*, (Routledge, 1997), p. 28

⁶² C. Walter, '*Defining Terrorism in National and International Law*', 2003, p.2.

<https://www.unodc.org/tldb/bibliography/Biblio_Int_humanitarian_law_Walter_2003.pdf> (last visited on 20 August 2016

⁶³ M. Williamson, *Terrorism, war and international law: the legality of the use of force against Afghanistan in 2001*. (Ashgate, 2009), p. 38.

⁶⁴ J. B. Bell, 'Trends in Terror: The Analysis of Political Violence' (1997) 29 *World Politics* 3, pp. 447-481, 449-455.

⁶⁵ Guillaume (n 45)

“(b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organisation to do or to abstain from doing any act.”

In criminal law terms, Article 2(1) (b) is addressing the *actus reus* of a terrorist act and the *mens rea*.⁶⁶ Article 2(1) (b) could really well be the basis of an international legal definition. Certainly so, since the Convention has been ratified by numerous countries. The main element missing in Article 2(1)(b) is the identity of the perpetrator, which might mean that the Article could be applied to both state and non-state entities.

3. Russian view on terrorism finance

Russian regime was changed to avoid excessive reporting by banks and it was established that transaction under 30,000 Roubles were excepted of reporting. This measure was criticised as many terrorist acts do not require large sums of money for their perpetration. As demonstrated above, terrorism is not a simple issue, main reason being the lack of international definition and consortium.

On top of the problem caused by the lack of consortium, a problem is associated with the tackling of both the issues of money laundering and terrorist financing within the same regime. While detection of money laundering involves criminal origins, monetary resources allocated to finance terrorism do not necessarily come from criminal origins. *Per se* the use of a law for two activities that do not have the same origin. The law tries to combat two crimes that are distinct with the same rules. “Thus, distinguishing money with "dirty" origins from money allocated for "dirty" purposes involves two fundamentally different detection strategies. "Dirty" money from organised criminal activity that is conducted as a business will appear differently within the financial system than the occasional monies (with sometimes legitimate origins) that are dedicated to individual terrorist acts.”⁶⁷ Methods that are useful for detecting money laundering may conflict with methods establishing whether a resource is used for terrorism finance purposes.

As explained above, no consensus exists at international level as to the definition of terrorism and modern terrorism does not restrain itself to national borders anymore. It is a global problem which needs global measures. This lack of coherence is also visible within the wording of the anti-money laundering law itself. Indeed, while Article 6.2 refers to ‘extremist activities’, Article 7.10 only refers to ‘terrorist activities’. Although these two terms are frequently used interchangeably, these two terms convey slightly different ideas. Indeed, extremist activities embody a wider array of crimes.

The term "extremist activities" is also defined in both section 282.1 of the Criminal Code and in Article 1 of the Federal Law On Combating Extremist Activities. In both these provisions, the term refers to the commission of various crimes motivated by ideological, political, racial, national or religious reasons. Moreover, s. 282.1 lists some of examples of extremist activities, which includes demonstration, vandalism, hooliganism, obstruction of the holding or participation in an assembly, meeting, procession, or picketing. Of course the incitement of

⁶⁶ Feridun Yenisey, ‘Some Legal Aspects of Terrorism in Western Europe and in Turkey’ (2004) 14 Kan. J.L. & Pub. Pol’y 643, p.645

⁶⁷ Orlova (n 1), p.220

national, racial or religious enmity is included in the list. Surprisingly enough, terrorism is not listed in s.282.1 as an extremist activity. However, Article 1 of the Federal Law On Combating Extremist Activities stipulates that terrorism is an extremist activity. The Federal Law On Combating Extremist Activities was further amended for the definition of extremist activities to include public libel of a government official or his family, public statements justifying or excusing terrorism.⁶⁸

These definitions are so broad that virtually any individual or organisation may be caught in an activity falling within the scope of the term extremist activities, certainly so, with the inclusion of ideological or political reasons as motives for such activities. The danger of having such a broad definition is that individuals or organisations, which are not conducting any activities linked to financing terrorism, may be placed on the extremist lists under Article 6.2 of the money laundering law. Therefore, it is entirely possible that an opponent of the Russian President, will be charged with money laundering offence, as happened with the unregistered National Bolshevik Party. This in turn once again shows how the anti-money laundering law might have been enacted to pursue other goals. Moreover, "the potential for abuse is quite clear, as measures directed against money laundering and terrorist financing are no longer restricted to a prescribed set of situations but instead may be employed to combat the nebulous threat of "extremism". As succinctly stated by Beknazar (2003):

[...] [t]he discourse on security in Russia does not clearly distinguish between terrorism and other forms of extremism and serious crime. Thus, an amorphous threat emerges from the discourse that incorporates concerns about "extremism" (religious and occasionally political), "banditry," criminality, general social disorder, and the rupture of national unity. References are often made to "the struggle against terror and extremism," rather than the war against terrorism."⁶⁹

ii. Structural weakness of the banking system

Through the money laundering law, the Russian government tried to reform the banking system. This, in turn, weakens the law as it is not its initial purpose. The Russian Central Bank's focus is on bureaucratic activity, rather than producing results.⁷⁰

1. The problem within the banking system

The Russian banking system is characterised by a few strong large state-owned banks and many small and medium-sized banks.⁷¹ Russian banks are either specialised or have a limited geographical focus.⁷² Russian banks are seen as limited geographically as they tend to concentrate in wealthier regions, such as Moscow and St. Petersburg, leaving other regions with a limited number of banks.⁷³ Even though Russia possesses a large amount of banks, very few are playing an important role in the Russian economy, as most of them are relatively small

⁶⁸ See Federal Law No. 148-FZ, from 27 July 2006

⁶⁹ Alexandra V. Orlova, 'Russia's anti-money laundering regime: law enforcement tool or instrument of domestic control?' (2008) 11 *Journal of Money Laundering Control* 210, p.225

⁷⁰ Jun Tang, 'Combating money laundering in transition countries: the inherent limitations and practical issues', (2010) 13 *JMLC* 3, 215-225, p.222

⁷¹ Camara, M.K. and Montes-Negret, F, "Deposit insurance and banking reform in Russia", World Bank Policy Research Working Paper 4056, 2006, p.7

⁷² Camara, and Montes-Negret (n 70), p.9

⁷³ Gnezditskaia, A., "Russian bank's profit strategies: the evidence from various types of banks", (2003) *Communist and Post-Communist Studies*, Vol. 36, p.166

without an important capital.⁷⁴ This, in turns, makes the Russian banking industry weak, certainly when Russian major companies prefer to borrow from foreign banks. As a result, Russian banks are often left with riskier borrowers.⁷⁵ On top of that, a distrust in banks has emerged in the Russian society, leading to a very low level of household deposits and people preferring keeping their savings at home.⁷⁶ Therefore, Russian banks need to find other sources of capital.

Most of the time, banks rely on few companies or a group of companies as a major source of capital, resulting in the companies dictating their ways instead of the banks.⁷⁷ As a result, banks have more of the role of treasury for big corporations rather than banks, as known elsewhere in the world.⁷⁸ This structure has more than one danger, but the main disadvantage that it creates is that since the withdrawal of one client can have severe consequences, banks are reluctant to report any suspicious behaviour on the side of this client.

The banking system has already been reformed but banks still struggle to attract a sufficient level of small deposit from workers, which would allow them to free themselves from the control exercised by major corporations.⁷⁹ However, these financial institutions are not used to deal with smaller investors and therefore, need restructuring which would be a challenge. Even the banks which are under state control, such as Sberbank, have problems with restructuring. Indeed, this bank was one of the last ones to propose credit cards.⁸⁰

However, in 2002, structural reforms of the banking system started with the change in the leadership of the Central Bank and the appointment of Andrei Kozlov as the deputy chairman. One of the first reforms that was introduced was the creation of a deposit insurance system in 2003, guaranteeing deposits up to 100,000 Roubles (US\$1,500).⁸¹ The other significant substantive reform was the reform of the framework for prudential supervisions, which was the major step taken in order to increase transparency in the sector.⁸² During this period, measures to facilitate the development of specific banking activities were taken. All these reforms had as their main goal to increase public confidence in the banking system. Russian government understood that to reinstitute trust in the banking system, it had to offer protection to small depositors and to try to avoid a similar outcome if a crisis occurred as the outcome of the 1998 banking crisis in which a large number of small depositors lost all their savings. Moreover, another important goal was to increase the choice of the customers by increasing the competitiveness of private banks vis-à-vis state banks. One of the measures taken to increase

⁷⁴ Camara, and Montes-Negret (n 70), p.7; Doronin, I. and Zakharov, A., "Russian banks in the transition period", in Gaidar, Y. (Ed.), (2003) *The Economics of Transition*, The MIT Press, London

⁷⁵ Tompson, W., "What kind of 'financial safety net' for Russia? Russian banking reform in comparative context", (2004) 16 *Post Communist Economies*, p.116

⁷⁶ Okhmatovskiy, I., "Banks in the Russian corporate network", (2005) 20 *International Sociology* 4, p.439

⁷⁷ Okhmatovskiy (n 75), p.439-440

⁷⁸ Chowdhury, A. "Banking reform in Russia: winds of change?", (2003) 6 *Policy Reform*. 2, p.94-95

⁷⁹ International Monetary Fund, 'Russian Federation: Financial System Stability Assessment' (2011) Report N° 11/291; • Chivers, C.J. and Kramer, A.E., "Russian Bank reformer dies after shooting", *New York Times*, 15 September 2006 < http://www.nytimes.com/2006/09/15/world/europe/15russia.html?_r=0> (last visited 20 August 2016)

⁸⁰ Shuster, S. "Potanin takes a swipe at government", *Moscow Times*, 20 June 2007 < <http://wsn.globalo.com/Russia/Shuster-Simon/Potanin-Takes-a-Swipe-at-Government>> (last visited on 20 August 2016)

⁸¹ Chowdhury (n 77), p.100

⁸² OECD, 'Economic Survey -- Russian Federation 2004: Banking Reform', OECD, Paris, 2004

such competitiveness was to encourage private banks to offer more attractive financial products.⁸³

The Central Bank was criticised with regards to the deposit insurance system. The system was first put in place only to allow healthy financial institutions within the system, which would have allowed to 'clean' the banking system of the weaker banks. However, after the mini-banking crisis of 2004, the Central Bank accepted various institutions that were not considered healthy. The deposit insurance system was seen as the chance for the Central Bank to tackle a long-lasting problem.⁸⁴ However, the major failure of the plan was that it was not capable of attracting a vast number of small depositors. This should not come as a surprise, as even before the system was introduced, state-controlled banks already guaranteed the full amount of the deposit but was rejected by the Russian population.⁸⁵

Despite the introduction of the deposit insurance system, banks did not become more independent and certainly not more competitive.⁸⁶ The major problem of this type of reform is that it has been imposed by the government and does not come from an internal desire of the banks to improve and develop their services.⁸⁷ The banks had never anticipated that compliance with money laundering laws would be very expensive.

2. Banking system and money laundering regulation

The regulation combating money laundering contains complex requirements which makes it more difficult for the banks to comply with them. The sanctions imposed in case of failure to comply are so small compared to, for instance, the United States. Only few banks lost their license in Russia due to money laundering.⁸⁸

Another problem, that will be discussed in more detail below, is that the culture of compliance is not that strong in Russia. This is exemplified by the fact that during the first years after the enactment of the money laundering law, many banks forgot to send any reports to the Federal Financial Monitoring Service, for the period of 2001-2004. Further, some of the banks only forwarded information when the transaction was subject to mandatory control requirements.⁸⁹ With the time passing, the use of the regime started to be smoother. Certainly so as the Central Bank issued a number of guiding instructions to help the banks, yet it also increased its compliance checks, leading to a drastic change. In order to avoid sanctions from the Central Bank, banks started to send more reports on transactions under mandatory control but also on suspicious transactions.⁹⁰ This compulsive reporting causes problem as the banks, by fear of sanctions, prefer reporting transaction regardless of whether there is any substantive possibility that such transactions may be connected to money laundering or terrorist financing. This in turn leads to the Federal Financial Monitoring Service (Russia's Financial Intelligence Unit) to be flooded with information. As a result, certain features of the regime have been altered in an

⁸³ Camara, and Montes-Negret (n 70), p.4

⁸⁴ Camara, and Montes-Negret (n 70), p.13

⁸⁵ Tompson (n 74), p.118

⁸⁶ Camara, and Montes-Negret (n 70), p.14

⁸⁷ Doronin and Zakharov (n 73), p.516

⁸⁸ Orlova (n 1), p.220

⁸⁹ Orlova (n 1), p.220

⁹⁰ Orlova (n 1), p.220

attempt to ease the burden on the banks. For example, one of the reforms is that banks are no longer required to conduct client or beneficiary identification if the transaction does not exceed 30,000 Roubles (US\$500).⁹¹ This measure was criticised as many terrorist acts do not require large sums of money for their perpetration.

3. How to ameliorate this system and the lack banks that are *Sharia* compliant.

Russian economy has suffered from the numerous international sanctions that it has been fined with. Indeed, after President Vladimir Putin's annexation of Crimea from Ukraine in March 2015, sanctions were imposed by the U.S, leading the world's biggest energy exporter on the edge of recession. Following these sanctions, Moody's Investors Service cut Russia's credit rating a bit further. The restricted access to international capital markets of Russia does not help to solve the problem. The key point is to restore the trust of small investors in banks, in order to avoid the control of the banks by large corporations. But, also to attract foreign investments as Russian ones are no more enough.

Russia has planned on opening its first Islamic bank in 2015 in order to attract *Sharia*-complaint funds. Russia had to pass a specific law to allow Islamic banking, aiming at attracting capital from Islamic countries. But some fears that such *Sharia*-compliant bank will not comply with anti-money laundering laws.

iii. Lack of compliance culture

The money laundering law requires financial institutions to scrutinize and report any suspicious activities. On top of that financial institutions should not allow customers to open or keep anonymous bank account. But since compliance with the law is no within the industry culture and often large sums of money are involved, financial institutions prefer closing their eyes. Even though there is a compliance obligation in the law, no mechanisms were put in place, within the law, to punish an infringement of such obligation.

Another reason for keeping money out of banks for small depositors, despite the deposit insurance system, is tax avoidance, which remains widespread.⁹² Other compliance issues faced by Russian banks concern procedures for verifying the identities of their customers as well as identifying beneficiaries of transactions. This type of procedures results in an increase in the cost of banking services, which deter small businesses and average persons to deposit money. As is emphasized by Levi and Reuter: "[...] part of the resistance to [the anti-money laundering measures] comes from the emotional and practical experiences of ordinary citizens who may find it difficult to open accounts because they lack the identification documents in their own names required by the money-laundering regulations, even though their intended business is small and not remotely connected to the transnational crime activity [...]."⁹³

The cash economy is prevalent in Russia, creating a great obstacle to bank compliance. Indeed, partially due to the lack of trust in the banking system, many deals are still done in cash. This

⁹¹ Federal Law No. 147-FZ

⁹² Tompson, W., "What kind of 'financial safety net' for Russia? Russian banking reform in comparative context", (2004) 16 Post Communist Economies, p.118

⁹³ Levi, M. and Reuter, P., "Money laundering", (2006) 34 Crime and Justice, p.293

in turns makes it very difficult for banks to detect when money with illicit origins is used in a transaction. Moreover, this cash economy leads to a high demand of cash on the side of the clients. Companies often use cash to pay the “grey” salaries to employees in order to avoid taxation requirements, as it is common practice for companies to underreport profits and salaries paid.⁹⁴ Many companies still lack transparency, making it difficult for the banks to identify the owners and beneficiaries of various transactions undertaken by these companies.

Bribery of state officials is another common practice in order to acquire lucrative contracts, even though this last few years this practice is diminishing.⁹⁵ This cash economy is very useful for money laundering, as the cash withdrawal is often the final stage of the laundering process, with this cash being reintroduced into the legitimate economy. Furthermore, this cash withdrawal can be then directed to finance terrorist operations. “Banks are forced to dole out stacks of rubles to keep their customers satisfied”.⁹⁶ This cash economy leaves smaller banks with relatively small capitalization and dependence on few important clients, making this banks particularly vulnerable to money laundering. As these banks are subject to the requirements of the anti-money laundering legislation, but they are also very reluctant to generate reports on transactions made to their best and most influential customers. This tension between the requirements of anti-money laundering legislation and clients’ demands has its roots in a much deeper problem that concerns the conflicting roles in which banks find themselves as a result of the imposition of the anti-money laundering regime. Banks have two roles that are not easily reconcilable, namely their role as profit makers and their role as law enforcer.

The effect of the money laundering legislation are minimal, as the compliance culture in Russia is not well developed. As Alexandra Orlova put it: “Given the problems of compliance experienced by the banking industry, the ability of Russia's anti-money laundering regime to disrupt organized criminal activities and to prevent the financing of terrorism is suspect”.⁹⁷

5. Conclusion

This paper has sought to demonstrate the current challenge Russia faces with regard to money laundering. The law is vague and leaves a lot of room to the monitoring authorities, and shows that the government did follow another agenda while enacting this law. This paper tried to show the reasons that lies beneath the rhetoric used to establish an anti-money laundering regime in Russia.

In Russia, the problems of compliance disrupt the effect that the anti-money laundering regime could have in preventing financing of terrorism and money laundering. Certainly so as courts are not concentrating on professional launderers or organized criminal entities but rather on self-laundering. However, self-laundering is a ‘disease’ that exists not only in Russia but also in the US for instance. The other important problem with this approach is that charge of self-laundering is overwhelmingly used against persons that are already condemned for other (small)

⁹⁴ Ledeneva, A.V., *How Russia Really Works: The Informal Practices That Shaped Post-Soviet Politics and Business*, (Cornell University Press, 2006), p.117

⁹⁵ Sally Stoecker and Ramziya Shakirova, *Environmental Crime and Corruption in Russia: Federal and Regional Perspectives*, (Routledge, 2013)

⁹⁶ Shuster, S., "Hitches and queries Tarnish Sberbank share sale", *Moscow Times*, 26 February 2007

⁹⁷ Alexandra V. Orlova, ‘Russia's anti-money laundering regime: law enforcement tool or instrument of domestic control?’ (2008) 11 *Journal of Money Laundering Control* 210, p.222

criminal offences. Often self-laundering transactions are no more sophisticated than depositing money in a bank or conveying property. These prosecutions do not concentrate on third-party launderers or leaders of organized criminal entities.

The Russian government complied with the FATF standards in order to stay away from the 'black list' but also to use them as a tool to modernize the Russian banking system. This practice is not just done in Russia. Indeed, even in the USA, where the FATF is born, "the rhetoric used to justify the anti-money laundering regime and the realities of the regime's usage do differ significantly".⁹⁸ This rhetoric is exemplified in Article 1 of the federal anti-money laundering legislation which establishes the aim of the law as to create "a legal mechanism to counteract the legalization (laundering) of incomes obtained by in self-laundering criminal means and the financing of terrorism". In the eyes of the Russian Supreme Court, prosecutions for money laundering are disrupting the financial base of organized crime and terrorism. Obviously, there is inconsistency between the stated goals of the money laundering regime and the realities of the courts', banks' and Central Bank's practices. This in turn can make one ask the real reasons of the implementation of the money laundering regulations and what are the goals that such regulations try to achieve in the Russian context. Certainly, when evidence suggests that the anti-money laundering regime is being used to pursue domestic political objectives quite unrelated to combating organized crime and terrorism.⁹⁹ Specifically, these objectives relate to reforming the banking industry and controlling the business community and political activists.

This political control is well highlighted with the extensive use made of Article 13 of the anti-money laundering law. Article 13 provides as a penalty, the revocation of the license if a bank is found in violation of certain provisions of the money laundering law. "Between the years 2004 and 2006, approximately 70 Russian banks had their licenses withdrawn due to violating these provisions".¹⁰⁰ Even though it was ten years ago, the situation has hardly changed. Furthermore, it proves that the law was probably passed to pursue unrelated aims. Although it has never been proven, rumors have circulated in 2005, that in fact the Central Bank was pursuing an agenda of its own and was withdrawing the license of banks it listed as weak.¹⁰¹ These speculations have led the population to even more distrust Russian banks than it already did before.

In both countries the problem is systemic and existed long before the money laundering law. However, some poor choices have led to lowering the confidence of the small investors, that was already quasi inexistent, in Russia. The response of the Russian government to this crisis and loss of confidence was to expand the deposit insurance plan to private banks as until then it was only available for state-sponsored banks. The deposit insurance scheme's main aim was to re-establish popular trust in the bank, but it failed to do so. Furthermore, dealing with terrorism together with money laundering in one single piece of legislation is not the smartest choice as these two problems have different roots and are conducted in different ways. But as explained also, no consensus exists at international level as to the definition of terrorism and

⁹⁸ Alexandra V. Orlova, 'Russia's anti-money laundering regime: law enforcement tool or instrument of domestic control?' (2008) 11 *Journal of Money Laundering Control* 210, p.223

⁹⁹ Favarel-Garrigues, G., *Domestic Reformulation of the Moral Issues at Stake in the Drive against Money Laundering: The Case of Russia*, (Blackwell Publishing Ltd, 2005), p.539

¹⁰⁰ Alexandra V. Orlova, 'Russia's anti-money laundering regime: law enforcement tool or instrument of domestic control?' (2008) 11 *Journal of Money Laundering Control* 210, p.223

¹⁰¹ Alexandra V. Orlova, 'Russia's anti-money laundering regime: law enforcement tool or instrument of domestic control?' (2008) 11 *Journal of Money Laundering Control* 210, p.223

modern terrorism is everything except national. It is a global problem which needs global measures. This lack of coherence is also visible within the wording of the anti-money laundering law itself. Indeed, while Article 6.2 refers to 'extremist activities', Article 7.10 only refers to 'terrorist activities'. Although these two terms are frequently used interchangeably, these two terms convey slightly different ideas. Indeed, extremist activities embody a wider array of crimes. Finally, the Russian banking system is weak and need reforms that are in no sense political but are made to cure the problems of the system itself.

Money laundering legislation has been used to send a strong signal to the business community in Russia that any actions against Putin's objective of re-establishing governmental control over important areas of the economy which would also help building a strong centralized state, will be prosecuted.