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EUROPEAN COMMITTEE ON CRIME PROBLEMS
(CDPC)

Select Committee of Experts on the Evaluation
of Anti-Money Laundering Measures
(PC-R-EV)

FIRST MUTUAL EVALUATION REPORT ON THE RUSSIAN FEDERATION

SUMMARY

1. A PC-R-EV team of examiners, accompanied by colleagues from the Financial Action Task Force (FATF), visited the Russian Federation between 27-30 June 2000.

2. The Russian Federation has had to address many interrelated difficulties during the transition to a modern free market economy. A very rapid privatisation process, particularly in 1992-1993, was accompanied by capital flight on a massive scale. Equally throughout the transition cash has remained the most important means of payment. Moreover the 1998 banking crisis, which undermined popular confidence in the banking system, increased the volume of cash savings. Coupled with this is the problem of non-declaration of income, which is a major concern of the Russian authorities.

3. The years immediately following the dismantling of the Soviet regime saw a rise in criminality which presented, and continues to present, an enormous challenge to the law enforcement authorities. Organised Crime represents a serious threat. The detection and suppression of economic crime and corruption (often associated with the privatisation process), whether perpetrated by organised crime groups or individuals alone, has been an important priority for law enforcement. Economic crime is said to have risen by 25% in the last 4 years.

4. While cash smuggling across the borders (for placement outside the Russian Federation) is known to occur, more typically, money laundering is through the financial system – particularly via the large number of banks. Frequently money laundering involves the movement of illicit proceeds through "butterfly" companies (which exist only for short periods). Their bank accounts are used to transfer money for non-existent financial transactions to offshore centres. The laundered money is then returned for integration in the Russian Federation by investment in legal commercial business, the purchase of real estate, and the purchase of shares of enterprises, particularly in the privatisation process.

5. The most critical deficiency is the absence of comprehensive laws and regulations giving effect to international standards on the prevention of the use of the financial system for the purpose of money laundering. The authorities of the Russian Federation have recognised their vulnerability to money laundering and have taken several initiatives, particularly in the last 5 years, to address this issue. At the time of the on-site visit some of the foundations for an anti-money laundering system were being put in place but there are significant gaps which urgently need to be addressed. High-level commitments to rectify this situation urgently need following through with action on a number of fronts. At the time of the on-site visit the drafting of relevant preventive legislation and discussions concerning its content were under way. It was not clear, however, what the nature, scope and ambition of the proposed enactment and associated regulations would eventually be. It is of paramount importance that a comprehensive anti-money laundering law which meets FATF standards is adopted swiftly.

6. The Central Bank has taken some positive steps to address anti-money laundering issues through the promulgation of various guidance documents (notably Directive N°500, which may be helpful in identifying some potentially suspicious outward movements of capital). It has also made some efforts to encourage the banks to perform their own risk analyses, and made efforts through its Methodological Recommendations to encourage the banks to consider themselves what are suspicious transactions, from their knowledge of their own clients. The banks have not moved forward in this area and the current Methodological Recommendations do not meet FATF Recommendation 15, including the requirement of a mandatory suspicious transaction reporting regime, which should be incorporated into the preventive law for credit and financial institutions without any monetary threshold. Consequential provision should be made for the lifting of bank confidentiality where

suspicion of money laundering exists. Moreover there remains in the banking sector (and in the financial sector generally) much work to be done in education and training in order fully to sensitise all the players to the risks inherent in the money laundering threat and to build a real compliance culture. The development of an active partnership with the private sector, based on a common understanding of the money laundering threat, is crucial. At present the banking sector, like most other organisations were unwilling to acknowledge that money laundering took place in Russian banks. The financial sector's acceptance of due diligence and the concept of "increased diligence" as described in the FATF Recommendations will be critical.

7. The Russian authorities frankly admitted that their customer identification requirements do not meet the international standards. It is understood steps will be taken to remedy this. They are urgently needed, as the lack of clear and comprehensive customer identification requirements, especially the requirements to identify the real beneficial party, leaves the Russian Federation dangerously exposed to money laundering. The Russian Federation is strongly advised to put the prohibition on anonymous/bearer accounts (and possibly coded accounts) beyond doubt in legislation. They should also introduce clear and comprehensive customer identification and beneficial ownership requirements and 5-year record retention requirements, particularly in respect of accounts opened and transactions conducted on behalf of third parties. Action is needed to develop compliance inspection regimes with anti-money laundering obligations in the forthcoming preventive law (and with regard to customer identification and record keeping rules) by the existing supervisory authorities for undertakings for which they have responsibility. Consideration should be given to the creation of other supervisory authorities where none exist at present with similar inspection functions so far as anti-money laundering obligations are concerned. Auditors and bank examiners need to have access to all documents in the bank, including access to all transaction documents.

8. The Russian authorities should also review the licensing (and revocation) procedures for credit institutions (including exchange houses) and the insurance sector. In particular the Central Bank must have an extended right to deny/revoke licences. Stricter controls need to be introduced on company formation bearing in mind the ease with which *butterfly* companies can be created. The examiners support efforts being made in the Russian Federation to probe more deeply into proposals for new businesses.

9. The Russian Federation signed the 1990 Council of Europe Convention ETS N°141 on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (the Strasbourg Convention) on 07.05.99 but have not yet ratified this Convention. The Russian Federation criminalised money laundering for the first time in Article 174(1) of the new Penal Code, which entered into force on 01.01.97. It did so, in line with general international trends, on a broad basis and did not restrict the concept to drug trafficking. Article 174(1) envisages money laundering as capable of being committed in respect of funds (or possessions) acquired by knowingly illegal means. On one view this is capable of encompassing not only those actions which give rise to criminal charges but also those involving civil and administrative law liability. The examiners view this formulation as unnecessarily broad and very difficult to administer. Existing resources are unlikely to permit adequate investigative and prosecutorial resources to be devoted across the full range of predicate offences.

10. Article 174 appears to have been utilised in practice. Numerous investigations have been undertaken. The Russian authorities have advised that [Article 174] offences were registered and investigated as follows: in 1997, 241; in 1998, 1003; in 1999, 965. As a result 149 cases were submitted to the courts in 1997; 745 in 1998 and 679 in 1999. There were said to be 15 convictions involving money laundering in 1998 and 21 in 1999. The nature of the predicate

offences in these cases was not known. The wide disparity between the numbers of investigations compared with the numbers of convictions raises doubts as to the practical overall effectiveness of the current legal framework. Notwithstanding the above the examiners consider the language of Article 174 should be revisited urgently as part of the ratification process of the Strasbourg Convention to ensure that the criminal offence fully reflects the requirements of Articles 1 and 6 of that Convention. Indeed consideration should be given to the introduction of a comprehensive money laundering statute clearly focused on criminal proceeds. Equally the use of the "knowledge" standard in proving the mental element of the offence constitutes a major difficulty and should be revisited. Consideration should also be given to utilising negligent money laundering, as is envisaged in the Strasbourg Convention.

11. A positive feature is that Article 174 covers "own funds" laundering. However, a number of the prosecutions, of which the examiners were aware, appeared to involve charges of "own funds" laundering, brought together with charges against the same defendant for the predicate crime. The appropriate authorities must guard against prosecuting self-laundering at the expense of bringing money laundering proceedings independently against and affording priority to separate investigations involving professional money launderers.

12. The Russian Federation has in place an established system of confiscation though it does not fully correspond with the concept as it is envisaged in the major multilateral treaties. In any event the system appeared not to be routinely used in money laundering and other relevant cases. It is necessary therefore to identify what legislative changes are required to ensure that the confiscation and provisional measures regime corresponds to the wide concept of "proceeds" in the Strasbourg Convention and the 1988 UN Convention on Illicit Traffic in Narcotic Drugs and Psychotropic Substances (the Vienna Convention). Thereafter, in the process of ratification of the Strasbourg Convention, action should be taken in a timely fashion to ensure there is in place a system which enables the Russian Federation to identify, trace, freeze or seize and eventually confiscate criminal proceeds in their widest sense. As part of this process it should be ensured that effective and timely international co-operation can be granted and received in all cases and especially in relation to the tracing, seizing, freezing and confiscation of the proceeds of crime.

13. The Russian Federation is a party to the Vienna Convention and several other important multilateral instruments including the 1957 European Convention on Extradition and its First and Second Protocol. The 1959 European Convention on Mutual Assistance came into force in the Russian Federation in March 2000. The Russian Federation has designated a multiplicity of channels of communication in respect of requests for assistance by Letters Rogatory. It is recommended that the adequacy in practice of the current administrative arrangements in this regard be subject to consideration at the end of their first full year of operation.

14. On the law enforcement side generally the Russian Federation still has a long way to go before it can be said to have a real operational system in place to fight money laundering. At the time of the on-site visit the "*Interagency Centre for preventing Legalisation (Laundering) of Illegally Acquired Income*" (the Centre), established by an order of 14.05.99, and affiliated to the Ministry of the Interior, was acting as the focal point in the anti-money laundering effort. The Centre is an operating unit, drawing on representatives of relevant agencies, though in its present transitional state it appeared in some ways more akin to a working group of delegates from individual departments than a central FIU. That said, since its creation, it has achieved a considerable amount of financial analysis. It was understood to have initiated, as a result of its analyses, 442 criminal investigations for a variety of offences, including 132

criminal cases under Article 193 of the Penal Code (which criminalises capital flight), as well as money laundering. It was by no means certain however that the Centre would become the Russian Federation's FIU. While the decision on the structure and site of the FIU is a domestic matter the examiners urge a speedy final decision on the creation of a permanent and independent FIU, which should meet the Egmont definition, and be properly resourced in terms of personnel and IT to refer cases to law enforcement.

15. Investigation of money laundering matters is within the competence of many different agencies, each with their own perceptions of the money laundering problem. The examiners were left with the overall impression of investigative resources being spread thinly, which needs to be addressed. Consideration needs also to be given to the provision of additional gateways for law enforcement to obtain at an earlier stage banking information which is currently protected by bank secrecy.

16. It is necessary also to address the apparently common view that money laundering is an issue primarily related to economic, fiscal and revenue offences, as well as capital flight and non-declaration of income derived therefrom. Greater emphasis needs to be given on the investigative side (and resources to be provided) in order to ensure that the financial aspects of all major criminal proceeds generating offences are routinely investigated. Consideration should also be given to the provision of guidance to prosecutors on the use of Article 174, which, as well as encouraging them to use Article 174 independently of a charge for a predicate offence, should also ensure that proper priority is given to money laundering prosecutions and investigations in cases which arise in the context of serious crime beyond the economic/tax/revenue predicate. Priority needs to be afforded to investigations and prosecutions of money laundering cases which arise in the context of drug trafficking, organised crime and other serious profit generating criminal activities. Indeed, attacking organised crime and its profits through money laundering prosecutions (and the obtaining of significant confiscation orders) in respect of serious proceeds generating offences will be critical indicators of success.

17. The Russian authorities may also wish to set up a high-level co-ordination body *inter alia* to review periodically how the whole system is operating and to assess the effectiveness of new initiatives.

18. In this way the Russian Federation can make further progress towards the creation of an anti-money laundering system which meets international standards.

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