

Conference Report

Maximising Awareness of Russia's Threat to Global Financial System Integrity A Roundtable

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Russia's illegal war of aggression in Ukraine has brought to the fore the risks that Russia poses to international security and the integrity of the global financial system. After a year of repeatedly condemning the invasion, the Financial Action Task Force (FATF) finally announced its decision to suspend Russia's membership in its plenary in February 2023.¹ While welcoming the decision, Ukraine viewed this step as insufficient, calling instead for the expulsion of Russia from the organisation and urging the FATF to blacklist the country.²

In this context, the Centre for Financial Crime and Security Studies at RUSI convened a roundtable in May 2023 with a dozen experts with both public and private sector experience. The aim of the discussion, held under the Chatham House Rule, was to shed light on the risks Russia poses to global financial integrity and identify effective actions to counter these risks and strengthen the global financial system. This report reflects the main findings and conclusions from the discussion.

The Risk Russia Poses

The roundtable opened with a description of the risks Russia poses to the global financial system. Strong evidence shows Russia's involvement in a long list of predicate offences and its abuse of strategic institutions, such as its financial intelligence unit, to target political opponents.³ Even before its full-scale invasion of Ukraine, and despite a strong showing in the 2019 evaluation of its anti-financial crime measures undertaken by the FATF,⁴ Russia represented a high-risk jurisdiction for the global financial system. The failure of the FATF to effectively assess these risks enabled Russia to further undermine the integrity of the global financial system. There are strong arguments for blacklisting Russia. However, the workshop aimed to consider how the international community, particularly those countries that are not part of the sanctions coalition against Russia, might better recognise the value of other means to counter the risks Russia poses to the integrity of the financial system – including via sanction evasions.⁵ This might lead to enhanced restrictions on access to the international financial system.

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1. Financial Action Task Force (FATF), 'FATF Statement on the Russian Federation', 24 February 2023, <<https://www.fatf-gafi.org/en/publications/Fatfgeneral/fatf-statement-russian-federation.html>>, accessed 26 May 2023.
 2. *Reuters*, 'Ukraine Urges Financial Crime Watchdog to Expel Russia', 15 February 2023.
 3. Koos Couvée, 'Former FATF President Accuses Russia's FIU of Facilitating Money Laundering', ACAMS MoneyLaundering.com, 27 May 2021, <<https://www.moneylaundering.com/news/former-fatf-president-accuses-russias-fiu-of-facilitating-money-laundering/>>, accessed 26 May 2023.
 4. FATF, 'Russian Federation: Anti-Money Laundering and Counter-Terrorist Financing Measures', Mutual Evaluation Report, December 2019.
 5. European Commission, 'Press Statement by President von der Leyen with Ukrainian President Zelenskyy', 9 May 2023, <https://ec.europa.eu/commission/presscorner/detail/en/statement_23_2661>, accessed 26 May 2023.

In presenting such risks, participants voiced their concerns in three areas:

- Sanctions evasion.
- Financial crime activity (exploiting the financial system to launder the proceeds of crime).
- Leveraging third countries to introduce illicit finance into Western economies.

A particular concern in all cases is Russia's use of complex structures and procurement agents with networks stretching throughout the world.⁶ Russian efforts to build a new framework for sanctions evasion using devices such as a shadow tanker fleet, with opaque ownership, to help circumvent Western restrictions on Russian oil sales are an example of this.⁷ Participants pointed to the shadow network of actors and benign states facilitating such tactics. This presents a major source of concern to which private sector actors need to be alert.

On concerns over professional enablers and intelligence assets that facilitate financial crimes and sanctions evasion, participants noted that it might be challenging to disrupt lawyers due to the right to representation. However, they further noted that other actors, such as trust and company service providers, accountants and advisers should be placed under great scrutiny.

Further concerns focused on:

- The differences between money laundering and sanctions compliance requirements. For example, whereas money laundering risk is absolute (that is, you cannot be a 49% money launderer), banks can continue to provide services to a company that is 49% owned by a sanctioned individual/entity.
- The slow government response to closing gaps that Russia is exploiting, and thus the need for the private sector to assess risk more broadly than is currently narrowly defined in law (in particular, in sanctions law).
- Connected with the previous point, the need for legal certainty. Governments that call on the regulated sector to do more on sanctions than is strictly in legislation need to update their laws and regulations faster, and to harmonise their sanctions decisions (as one participant noted, why do sanctions regimes not align?).
- Alternative mechanisms for raising risk awareness with private sector actors from countries outside the allied sanctions coalition.

6. Financial Crimes Enforcement Network and Bureau of Industry and Security, 'Supplemental Alert: FinCEN and the US Department of Commerce's Bureau of Industry and Security Urge Continued Vigilance for Potential Russian Export Control Evasion Attempts', FinCEN and BIS Joint Alert, FIN-2023-Alert004, 19 May 2023, <https://www.fincen.gov/sites/default/files/shared/FinCEN%20and%20BIS%20Joint%20Alert%20_FINAL_508C.pdf>, accessed 20 May 2023.

7. David Sheppard, Chris Cook and Polina Ivanova, 'Russia Assembles "Shadow Fleet" of Tankers to Help Blunt Oil Sanctions', *Financial Times*, 2 December 2022.

Finally, mindful of the many risks that Russia poses to the integrity of the international financial system and those operating in it, participants concluded that Western countries should move beyond observing Russia merely as a money-laundering and sanctions issue to regarding its behaviour as a threat to national security. The fact that the Wagner Group is now reportedly set to be a proscribed organisation in the UK and other Western jurisdictions further reinforces this point.⁸

Having laid out an initial view of risks and challenges, the discussion turned to address the means through which Russia manages to sustain its financial and economic activity, in particular via the non-compliance and acquiescence of third countries.

The Role of Third Countries

The media has widely covered the role of third countries, and sanctions envoys from the US, the UK and the EU intensely focus their diplomatic engagement on them. For the purpose of this discussion, third countries are those that are not part of the Western sanctions alliance and, as a result, are still engaging in business with Russia and undermining the sanctioning efforts of Ukraine and its allies. This lack of sanctions compliance means that they are not only facilitating the funding and resourcing of the Russian military but also offering money-laundering opportunities for funds emanating from Russia. The discussion returned to this important point later.

Despite this clear combination of risks, a private sector participant expressed their disbelief at the number of clients still operating in or with Russia. While this may – on the face of it – be legal activity, by continuing to engage with Russia, the risk of being abused for sanctions evasion or money laundering is high. However, such companies often ignore these risks because of the lack of Western countries' enforcement action and the resulting lack of credible deterrence.

One finance expert noted that the fact that banks in third countries are turning to the use of currencies other than the US dollar, the euro and sterling as a means to continue trading with Russia in a way that is not technically in breach of sanctions indicates they are well aware of their behaviour. This change in modus operandi should be a clear red flag for Western companies and banks. It should, therefore, lead them to reassess the risk posed by businesses with such third-country counterparts.

Therefore, with governments in third countries choosing not to mandate the implementation of allied sanctions, alternative approaches need to be found via which the private sectors in these countries are encouraged to 'choose' not to provide trade and financial services to Russia. Such approaches may raise

8. Reuters, 'Britain Set to Ban Russia's Wagner Group - The Times', 10 May 2023.

awareness of the broader financial crime risks such actors will increasingly face if they continue to deal with Russia, while revisiting how Western sanctions are designed and implemented. The discussion then turned to these issues.

Making Sanctions More Effective

The current lacklustre implementation of sanctions by third countries and the resulting extensive opportunities for Russia to circumvent sanctions through their jurisdictions, as described above, reflect the need to reconsider the approach taken by the current sanctions regime. As one participant noted, it is a non-starter to try to impose Western will on some non-aligned countries. Thus, given that implementation by third countries requires a sovereign decision to follow extraterritorial sanctions regimes, the roundtable sought to identify possible opportunities for encouraging greater implementation and broadening the private sector's awareness of risk.

On this, a particular deficiency identified was that the current sanctions regime depends on encouraging the private sector to go beyond what the public sector legally mandates. In fact, participants criticised the mixed messaging from Western governments. The current public policy is not about completely cutting off Russia, and certain business sectors are allowed to continue to have activities with the country, creating complexity and loopholes. Yet, participants pointed to examples where Western governments ask businesses to sever all ties with Russia, without providing the necessary legal basis. The roundtable agreed that the public sector should mandate such measures and not rely on the voluntary decision-making – often based on reputation risk – of private businesses. Governments set the sanctions goalposts, and participants agreed that if governments want private actors to take decisions that are beyond the current set of rules, they must change the rules. Participants noted the current EU discussions on broadening trade restrictions to cover goods that are suspected of benefiting from third-country circumvention mechanisms as an example of such expanding goal posts.⁹

A widening of the goalposts would also drive greater compliance of the private sector in third countries as its circumvention activity would be increasingly at odds with its ability to maintain relationships with Western banks and other private sector actors that fear facilitating sanctions evasion via these connections.

However, notwithstanding the progress of Western governments in sanctions design since February 2022, several participants argued that governments were unlikely to take the steps necessary to broaden the applicability of sanctions sufficiently in a reasonable timeframe. Until then, the fact that banks have been

9. Sam Fleming and Henry Foy, 'Brussels Eyes Export Curbs to Close Russian Sanctions Loophole', *Financial Times*, 28 April 2023.

deputised by supervisory authorities for many years to police their own activities must be leveraged to make use of their capabilities to supplement governmental action.

Going Beyond Sanctions

A key issue on which participants agreed was that Western governments should use the correspondent relationships of banks in third countries with Western banks that are subject to the jurisdiction of sanctions-imposing countries to accelerate the impact of sanctions. Participants observed that correspondent banks are currently applying additional scrutiny but to a limited extent, and, as noted above, respondent banks are using alternative currencies to limit their exposure to the core correspondent relationships. For this reason, the discussion on enforcement should focus on correspondent banks or on their clients, the respondent banks in third countries.

Participants also suggested that banks based in Western countries could decide voluntarily to apply a higher level of due diligence on certain jurisdictions where sanctions circumvention is prevalent. Risk advisory information provided by Western authorities could encourage such decisions.¹⁰ Although respondent banks could argue that their actions are legal under their national law and could thus object to such pressure, the fact that they operate in countries where sanctions on Russia are not applied means that such action by Western banks could be justified on the basis of risk appetite, a core determinant of correspondent banking decision-making.

Furthermore, drawing attention to the contradiction between a bank's or corporation's environmental, social and governance commitments¹¹ and its continuing to provide financial services and trade relations to banks and companies that are facilitating sanctions circumvention and thus the resourcing and financing of the Russian military is another point of pressure.

The question of risk appetite, and the discrepancy between 'risk' in sanctions and money laundering highlighted an interesting dichotomy. Several participants observed that while there is zero tolerance to money laundering, processing transactions for companies that are 49% owned by a sanctioned individual is allowed. Inevitably, rules based on ownership percentages have led Russian oligarchs to simply change the share listed under their name to be just below

10. See, for example, Jersey Financial Services Commission, 'Joint Risk Statement to the Financial Services Industry: Customer Relationships Associated with Russia and Belarus', 18 March 2022, <<https://www.jerseyfsc.org/news-and-events/joint-risk-statement-to-the-financial-services-industry-customer-relationships-associated-with-russia-and-belarus/>>, accessed 20 May 2023.

11. Environmental, social and governance (ESG) policies have increasingly been promoted by Western banks and companies seeking to ensure that their business activities align with widely held ESG expectations and do not merely focus on profit.

the threshold, after which a bank is allowed to continue dealing with the company, in contrast with a case of money laundering.¹²

Another subject of debate at the roundtable was the negative publicity that stems from facilitating the evasion of sanctions. While negative publicity might not have the same reputational impact on banks and other private sector actors in third countries as in Western jurisdictions, reports in prominent media outlets will risk attracting unwanted attention from regulators and, importantly, compliance officers in correspondent banks. Thus, participants agreed that investigative journalists and civil society should be supported in their investigations so that reports of sanctions circumvention are brought to light and, in the words of one participant, 'act as an emergency break until such time as sanctions and regulation catch up'. Participants pointed to the recent Pernod Ricard case as a good example of how media pressure can encourage a change in strategy at a company with continued connections with Russia.¹³

Finally, several participants noted the impact of strong enforcement – or at least the credible threat of enforcement – and reflected on their experiences in dealing (or not) with Iran. The imposition of significant penalties by US authorities successfully drove banks, globally, into observing Iran sanctions regimes, and lessons should be learnt from these experiences, both on how enforcement can encourage wider compliance, but also the negative consequences of instilling an overly conservative assessment of risk in the banking community. A clear example shared in the discussion related to the unsuccessful efforts of the US and the UK to convince banks to re-engage with Iran after the nuclear agreement.¹⁴

The case of Iran was a recurring theme during the discussion on compliance of third countries due to the contrasts it presents with the current regime against Russia. The blanket disengagement mandated against Iran facilitated the implementation of sanctions. In contrast, as one participant noted, 'while Iran was not allowed on the pitch at all, Russia still is, and this significantly complicates matters'.

Alongside the use of 'sticks', participants also consider the need for 'carrots' to incentivise the alignment of third countries. For example, some pointed to rivalry in the Gulf for financial services and trade business and suggested that favouring those countries that support allied sanctions might fuel increased sanctions compliance.

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12. For example, the Office of Foreign Assets Control's (OFAC) 50 Percent Rule states that the property and interests in property of entities directly or indirectly owned 50 percent or more in the aggregate by one or more blocked persons are considered blocked. See OFAC, 'Frequently Asked Questions', <<https://ofac.treasury.gov/faqs>>, accessed 26 May 2023.
 13. Adrienne Klasa, 'Pernod Ricard Halts All Drinks Exports to Russia', *Financial Times*, 12 May 2023.
 14. Felicia Schwartz and Margot Patrick, 'US Secretary of State John Kerry Meets with European Bankers in Iran-Business Push', *Wall Street Journal*, 12 May 2016.

Fundamentally, participants agreed that while governments continue to develop new regimes to tighten the sanctions net, the key to driving greater sanctions compliance lies in the clear communication of risk, for example via the publication of risk statements.¹⁵ Perception of risk varies between allied and third countries, and thus allied countries should focus on highlighting to the private sector in these countries the risks posed to the integrity of the financial system by ignoring Russia's activity; and messaging to the private sector in allied countries the risks it runs when engaging with low-compliance third countries.

Participant Recommendations

To conclude the workshop, participants were asked to provide their 'game-changing' recommendations for policymakers and the private sector to consider:

1. A globally recognised company should be fined heavily for sanctions violations to showcase the consequences of a failure of effective implementation. Such approaches had worked well for the banking sector previously but currently there is a sense that there is no credible threat from enforcement, particularly in Europe. This must change. As one participant observed, 'you need to kill the chicken to scare the monkey'.
2. The staff and resources of agencies involved in the enforcement of sanctions should be increased to manage complex sanctions regimes across multiple jurisdictions against large economies such as Russia. Specifically in Europe, an 'EU Office of Foreign Assets Control' is needed to bring dedicated capacity to the monitoring of sanctions implementation and subsequent breaches.
3. Policymakers must understand that if they want to achieve more with sanctions, they must change the current rules to enhance the regime. The regimes have thus far worked quite well in enforcing public policy; to enhance implementation, public policy needs to change. Policymakers should not rely on the voluntary actions of banks and corporations.
4. The discrepancies between allied sanctions regimes must be addressed to remove obvious loopholes that individuals, entities and activities sanctioned in some, but not all, jurisdictions, can abuse.
5. The disparity in consequence for the private sector between facilitating money laundering and sanctions evasion needs to be addressed. Casting the Russia risk in the context of money laundering rather than sanctions circumvention and evasion will create greater impact with the private sector in third countries.

15. See, for example, Jersey Financial Services Commission, 'Joint Risk Statement to the Financial Services Industry'.

6. G7 countries need to develop thought leaders in the non-aligned community who can advocate for better sanctions implementation among their peers, rather than trying to bend these countries to Western will.
7. A more collaborative approach between governments in G7 countries and their private sector must be promoted. Risk advisories should be regularly published, and fusion cells should be established between law enforcement agencies and financial institutions to share essential intelligence that supports implementation.
8. The FATF should continue to deliver messaging on the risks posed by Russia to the integrity of the financial system and highlight the long-term consequences of maintaining financial engagement with Russia in the context of future Mutual Evaluations.¹⁶ The short-term gain from continuing to trade with Russia today might not outweigh the long-term consequences of dealing with a high-risk jurisdiction following exposure by a poor evaluation.
9. Third countries must be presented with attractive alternatives to continuing business relations with Russia to persuade them to align with Western sanctions regimes and their efforts to restrict the financing and resourcing of the Russian military.
10. Those campaigning against Russia's access to the global economy should learn lessons from how campaigners effectively and successfully forced the exclusion of Iran from the international financial system.

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16. Mutual evaluations are the decennial reviews undertaken by the FATF of all countries to assess their anti-financial crime standards.