Modification pillar of anti-money laundering regime in Russia
in the context of global AML standards

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**Abstract**

The paper examines the approach taken by Russian government to control money laundering by creating the preventive framework which has undergone significant changes over the past six years. With respect to the prevention of money laundering, the discussion involves a review of international standards and norms which constitute the global AML regime. Recognizing the need for adding the domestic dimension to the studies of international regimes with the help of two-level game theory, the paper further analyzes the preventive pillar of the domestic AML regime in Russia in comparison with the global standards. It concludes that the federal law, which is the cornerstone of the domestic AML regime, as well as institutional framework created in Russia, both formally comply with the international norms.

The analyses of the practical implementation of the AML legislations in the financial institutions focus on legislative base for the regulated, behavioral patterns of the banks in the AML prevention, and the conflicts and debates, lately emerged within the domestic AML regime. This paper aims to show how new regulations have influenced both domestic AML regime and its main actors. The paper concludes that the existent domestic regime lacks interaction and communication between its actors which leads to the breach of the main principle and goal of a regime – cooperation.

The paper argues that the representatives of banking community in Russia could play the role of epistemic community proposed by the cognitive theory of international regimes. Given the functions of epistemic community it could foster better understanding of the context and purposes of the AML regime, thus, decreasing uncertainty and facilitating cooperation between the parties. The paper will conclude with the recommendation of the future research about how risk-based approach to banking regulation of the AML prevention rather than traditional rule-based compliance method can be effective.

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List of abbreviations

<table>
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<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>115-FZ</td>
<td>Federal law № 115-FZ “On Combatting Legalisation (Laundering) of Criminally Gained Income and Financing of terrorism”</td>
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<td>AML</td>
<td>Anti-money laundering</td>
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<td>ARB</td>
<td>Association of Russian banks</td>
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<td>ASROS</td>
<td>Association of regional banks of Russia</td>
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<tr>
<td>Basel Committee</td>
<td>Basel Committee on Bank Supervision</td>
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<td>CB</td>
<td>Central Bank of the Russian Federation (the Bank of Russia)</td>
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<td>CDD</td>
<td>Customer Due Diligence</td>
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<td>CFT</td>
<td>Combating of Financing terrorism</td>
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<tr>
<td>Egmont Group</td>
<td>The Egmont Group of Financial Intelligence Units</td>
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<td>FATF</td>
<td>The Financial Task Force on Money Laundering</td>
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<td>FFMS</td>
<td>Federal Financial Monitoring Service</td>
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<td>FIU</td>
<td>Financial Intelligence Unit</td>
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<td>FMC</td>
<td>Federal Monitoring Committee of Russian Federation</td>
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<tr>
<td>40 Recommendations</td>
<td>The Forty Recommendations on Money Laundering issued by FATF</td>
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<tr>
<td>FZ</td>
<td>Federalny Zakon [Federal law]</td>
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<td>FT</td>
<td>Financing of terrorism</td>
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<td>GPML</td>
<td>Global programme against ML</td>
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<td>EAG</td>
<td>Eurasian Group</td>
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<td>EUR</td>
<td>Euro</td>
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<tr>
<td>KYC</td>
<td>Know Your Customer</td>
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<tr>
<td>KYE</td>
<td>Know Your Employee</td>
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<td>MF</td>
<td>Ministry of Finance of Russia Federation</td>
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<td>MICA</td>
<td>Moscow International Currency Association</td>
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<td>ML</td>
<td>Money laundering</td>
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<td>MONEYVAL</td>
<td>Council of Europe the Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures</td>
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<tr>
<td>NCCTs</td>
<td>Non-Cooperative Countries and Territories</td>
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<td>SAR</td>
<td>Suspicious activities reports</td>
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<td>STR</td>
<td>Suspicious transactions reports</td>
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<tr>
<td>RF</td>
<td>The Russian Federation</td>
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<tr>
<td>RSPP</td>
<td>Russian Union of Producers and Entrepreneurs</td>
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<tr>
<td>Rosfinmonitoring</td>
<td>Federal Financial Monitoring Service</td>
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<tr>
<td>UN</td>
<td>The United Nations</td>
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<tr>
<td>UNDCCP</td>
<td>UN Office for Drug Control and Crime Prevention</td>
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<td>USD</td>
<td>American dollar</td>
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1. Introduction

1.1. Introduction

“Consider this analogy: Pour a glass of water and release a drop of ink into it. Gradually, the ink will mix with the water, dissolving to the point of invisibility. That is the problem banks face. They know dirty money is in their system, but they cannot separate it from the clean money”.2

Nigel Morris-Cotterill3

Money laundering has, undoubtedly, become a significant issue not only in international community but also in domestic jurisdictions.4 What is money laundering? According to the US President’s Commission on Organized Crime Report “The cash connection: organized crime, financial institutions, and money laundering (1984)”, money laundering as a concept which appeared in the 1980s is defined as “the process by which one conceals the existence, illegal source, or illegal application of income, and disguises that income to make it appear legitimate”.5

The key element in the fight against money laundering is international cooperation in creating international anti-money laundering regulations which would help to evaluate and monitor the countries’ financial systems. Indeed, it will be impossible to curb money laundering without international cooperation and regulation. However, the measures taken by the governments on the domestic level seem not less important. To fight the system of illegal finance, governments use different tools. One of them is the cooperation of the investigators with banks through their reporting to the governments about suspicious transactions and clients which can be involved in money laundering. The banks being part of any financial system are the primary actors most possibly influencing the prevention of money laundering. This particular research is devoted to the survey on the fight against money laundering in Russian Federation. To be more specific, the paper does not have the aim either to examine the reasons of money laundering or the sources of illegal finance. Hence, the paper mainly focuses on the effectiveness of

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international actions taken in fighting money laundering, as well as the practices which are used in Russian banks. To make the main aim of the paper clear to the readers, the research is mainly focused on the activities of bank financial institutions in the fight against money laundering in Russian Federation.

To help the readers follow the logic of this research the paper is structured as follows. The first chapter describes the importance of the research problem as well as defines the research areas questioned throughout the paper with the consideration of research limitations. Chapter 2 briefly describes the theoretical framework built in the research. It prepares the readers to understand the analyses presented in the research from the theoretical perspective. Chapter 3 is devoted to the global standards in the fight against money laundering. The comparative approach is used to first describe the current anti-money laundering regime on the domestic level. Further, the analysis of the main anti-money laundering law is presented in the context of international standards used in the fight against the crime.

Chapter 4 closely deals with the deeper analysis of the domestic actors of the prevention constituent of the Russian anti-money laundering regime. It consists of three analytical parts tied up by one logical chain. Firstly, the analysis of the legislative base for the banks adopted by the regulator according to the federal law presented in the previous chapter is conducted. Secondly, the practices of implementation of the anti-money laundering legislation in banks are studied together with the practitioners' perceptions about the relatively new phenomenon. Thirdly, the research resents conflicts and debates among the parties involved in the domestic anti-money laundering regime. Finally this leads to conclusions about functioning of the domestic regime in general.

Chapter 5 looks at the empirical results from theoretical perspective. It raises the theoretical discussion about the concept of international regimes, and particular, operates the views of cognitive approach in theories of international regimes. It also opens discussion about the need for the new approach to the AML procedures in financial institutions and more cooperation between the actors of the AML regimes while the concluding chapter summarizes the results of this particular research and gives incentives and ideas about the future discussions.

1.1.1. The definition of the problem and its importance

The worldwide efforts to combat money laundering and the financing of terrorism have become of great importance lately. Why has the fight against money laundering become one of the main concerns for the international community? First of all, the focus of the governments of most countries moved to the fight against money laundering (ML) and financing terrorism (FT) especially after the events of September 11, 2001. These two problems – ML and FT - have become the global problems “...that not only threaten security, but also compromise the stability, transparency, and efficiency of financial sys-
tems, thus undermining economic prosperity”. Moreover, the terrorist attacks of September, 11, 2001 caused a new revived interest to ML and “... started a new round of anti-money laundering (AML) initiatives around the world.”

Secondly, the countries implementing the AML methods can avoid unpleasant social and economic consequences especially in the process of development. The uncontrolled financial flows allow laudners to conduct their illegal activities such as corruption, illegal arms sales, smuggling, and organized crime activities such as drugs trafficking and prostitution, bribery and computer fraud schemes which all have dramatic social effects. It is not surprising, that ML inclines to instability in some economic sectors. It can also harm financial sector itself. In the opinion of Paul Allan Schott, “a reputation as a money laundering or terrorist financing haven ... could cause significant adverse consequences for development in a country.” He points out that to keep a good reputation is economically important for a country, otherwise the harmful effects such as significant limitations in economic cooperation or in attraction of foreign capital are likely to occur.

It is clear that to create a single global regulation is quite a hard task due to countries’ development peculiarities and specifics. One of the important attempts to create AML global regulations was made by the FATF (The Financial Task Force on Money Laundering). Its forty recommendations issued in 1990 “... formed the basis of counter laundering legislation in its own 31 member states and in many others.” The Forty Recommendations are supported by more than 130 countries and are considered to be one of the most significant international AML standards. The FATF recommendations were elaborated by the international community along with other AML standards such as the United Nations documents, the documents issued by the Basel Committee on Banking Regulations and Supervisory Practices and they have been considered to be international AML norms and standards.

Why is the research problem important to Russia? The need to counter the problem of ML emerged with the market reforms. With the process of market reforms the

9 Ibid.
country found itself in the reign of the shadow economy, results of predatory privatization and criminal process of market redistribution. The financial liberalization led to significant capital flight combined with increasing social inequality. The new Russian capitalism was characterized by economic instability or chaos, critical criminal situation and destroyed institutional capacities of state-building. Banking sector was characterized as the accumulation of illegal and criminal funds that needed to be dealt with. Moreover, the globalisation process and opening of the financial markets showed the need for changing the situation. It was important to start to raise accountability and reputation of the domestic markets internationally. Eradicating of the shadow economy and the fight against ML are two connected issues that require numerous changes beginning with the repairs of the legal system and ending with social changes. According to the UN Global Programme against Money Laundering, lawlessness, the shadow economy and tax evasion became a part of people’s everyday lives.12

The peculiarities of the new Russian domestic AML regime place the special focus on the financial institutions. Why is it important to look at the activity of bank financial institutions? The crucial point here is that the considerable AML legislation measures taken by the government of Russian Federation since the year of 2001 have been connected with the activity of the financial system. It is explained by the fact that the banking instruments are most often used by money launderers to pursue their goals. In this country it is the Bank of Russia or Central Bank (CB) authority to work out and issue AML by-laws and coordinate the cooperation with the financial institutions and the supervisory organization – the Federal Financial Monitoring Service (FFMS).

1.1.2. Limitations of the research
The AML regime, either global or domestic, has two pillars – prevention and enforcement pillar (Figure 1).13 The particular research will be limited to the prevention pillar of the AML regime, both international and domestic.

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According to Stessens, the preventive AML measures adopted at the international level and contained in internationally recognized documents are focused on the financial institutions, most important and numerous of which are banks. He stresses that focusing of the preventive measures on the financial institutions is explained by the nature of the money laundering phenomenon for several reasons. First of all, the financial institutions are most attractive to money launderers as they are “the main transmitters of money”, secondly, financial system is highly globalized which makes it easier to be used by the money launderers, and finally, the secrecy obligations that banks have before their customers and their operations sometimes contradict the AML measures they have to undertake. The latter fact is of course an obstacle in implementation of the AML rules in the financial institutions. The analysis of the prevention pillar of the AML regime in this particular research focuses only on the banks as core financial institutions of any financial system.

1.1.3. Research questions
To briefly summarize the aim of the research the following research questions are formulated:
1. To what extent does Russian AML legislation comply with the accepted international norms and standards?
2. How effective is ML prevention performed by financial institutions in Russia and in this context what are the obstacles to the creation of an effective AML regime in the country?

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1.2. Methodology

To achieve the research goals mainly qualitative analysis is used. The following research methods that are associated with qualitative research, according to Bryman, are used in this paper – the collection and qualitative analyses of texts and documents, and qualitative interviewing.\(^{15}\) For some part of the thesis such as for the analysis of the legislative base for the banks quantitative research method is used. The empirical data is accumulated in the tables, data calculation is made and the diagram is created for the reader to have visual presentation of the results.

1.2.1. Data collection

For the first part of the research, the emphasis is placed on external secondary sources and published material on the global AML regime. The main sources that are relied on in collecting the research data include the information from textbooks, articles and journals concerning the AML issue which were not that many, though, and mainly official documents from international organizations, such as listed above.

One of the main difficulties connected with the analyses of the documents constituting the federal legislation of Russian Federation was that the access to these documents provided through the legislation database in Russian Federation called Consultant Plus (which is “…the largest service network operating in the Russian market of information and legal services”, and “…which main activity is distribution of legal information”)\(^{16}\) was quite limited. Some of the documents were available on the official site of the company in open access. Mostly, a special Internet version of the Consultant Plus was used as being more informative and broad. However, accessing the database during the working days was limited as most of the documents were unavailable at that time. This caused some sort of constraint, and took more time and effort than was planned.

In the research it was reasonable to use mass media outputs such as newspapers and magazines as well. Some of the materials were available in the Linkoping University library or through the University library website but not much. The sources of Russian origin were taken from the websites of Russian newspapers or journals, both online versions and from libraries. The difficulties in interpretation were taking place as well. Further to this, internet web sites were used to collect data from different sources or simply to get access to the official documents.

It seemed appropriate to use comparative analyses based on the data, collected from in-depth study of the internal banking documents concerning the fulfillment of the federal laws and directives as well as observing banking practices. For this purpose, the activities of several banks were analyzed. There were two reasons to choose particular


banks. First of all, the banks are different in size. It is important to consider the banks that are different in size because the problems with law compliance usually arise in small or medium sized banks, as the first chosen bank for this research, whereas the opponent bank participating in the research is included in the list of 8 biggest banks which in 2004 concluded the mutual convention of AML law compliance and cooperation in this field. Secondly, several regional branches of medium-sized banks were included in the research as it is also important that usually the branches should follow the instructions of the head offices, but they are often entitled to create their own regulations and rules and moreover, they are reporting to the regional supervisory body, thus, to almost another organization which has sometimes its own rules, procedures and practices. The last important motive is determined by the possibility to get an access to the resources necessary for the research.

To some weaknesses of the chosen method already outlined above one more must be added: it should be noticed that Russian articles and books, if to compare with the sources from other countries, have another way of looking on the issues. That can cause some obstacles in gathering and interpreting information. In this sense, it is important that both international and Russian sources are be utilized for the analysis. Here it must be noted that the research was mostly based on primary sources as for example, official documents, but not commentaries or reviews of them. Original legal documents of the Russian Federation were collected in tables independently. The structures of the tables were created by the author to have the possibility of further analyses of collected data. In sum, using primary sources helped the author to avoid biased information and led to original analyses of relevant information. The sources cited in the current research were critically judged to avoid utilizing biased or invalid information.

1.2.2. Interviews

Another research method used in the second part of the research consisted of the series of semi-structured or unstructured interviews with the competent representatives of the compared banks both private and by the phone. The interviews were conducted in July 2007 in or from Moscow. The wishful interview with a representative of the CB was not possible but some information was taken from the official representatives’ interviews to mass media. Before conducting the interviews, secondary data were carefully studied in order to gain reliable knowledge about the problem. Though interviews are considered to be a commonly used method of social research, Bryman points out that “…certain
problems associated with it have been identified over the years.”\textsuperscript{18} Among the problems he names the acquiescence when respondents agree or disagree with a set of questions and items. This agreement or disagreement can cause different level of commitment to work. The same problem arises when the social desirability effect occurs.\textsuperscript{19} This effect can make the interviewer’s attitude to the respondent answers biased and lead to the false interpretation of the results.

Another of the possible weaknesses of this method is that respondents may have personal or organizational constraints on what to say and what not to say or to categorize the same problems differently, depending on who is inquiring. This can reduce the reliability of the results. In addition, the issue is delicate. The legal provisions require from the banks the appointment of the person responsible for the bank AML activity. This person’s name should be kept in secret or at least not to be revealed to the clients of the organization. In this atmosphere of secrecy, the interviewees were sometimes unwilling to answer the questions. Moreover, the translation from Russian to English might have affected the results interpreted and delivered to the audience.

1.3. Review of the relevant literature

1.3.1. Empirical literature

In order to answer the questions mentioned above, a literature-based research was conducted. In recent times, a considerable body of literature on money-laundering issue has been published by international organizations such as the United Nations, FATF, World Bank, the IMF, etc., most of which are of juridical character. For describing the international AML regime the numerous internationally accepted documents such as texts and reports published by international organizations were used. Not being the aim of this particular research, the description was limited. Nevertheless, Table 1 which can be found in Appendix 1 contains the main international standards and norms in the AML sphere. Close attention was received by the documents which mostly concern prevention of ML and thus, participated in the comparative research of the domestic AML law compliance presented in Chapter 3. Thus, the empirical literature consists of the AML regulatory and supervisory principles and standards published by the United Nations, i.e. United Nations Convention against Transnational Organized Crime, Political Declaration and Action Plan against Money Laundering, United Nations Global Programme against Money Laundering; published by Basel Committee on Banking Regulations and Supervisory Practices such as Statement on Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering and Customer Due Diligence for Banks;


\textsuperscript{19} Ibid., p.127.
issued by FATF such as The Forty Recommendations and some others as well as a range of other information about the AML activities worldwide.

The analysis of the compliance of the AML federal legislation with the international norms was based on the federal law No. 115-FZ “On Countering Money Laundering and the Financing of Terrorism” with the latest amendments effective 2007. The empirical part of the research was devoted to the study of the effectiveness of the domestic AML regime rested upon the by-laws and regulations issued by the supervisory and regulatory authorities for the main actors of the AML regime – financial institutions. The main documents are presented in Table 2 which can be found in Appendix 2 and are analyzed in Chapter 4.

1.3.2. Theoretical literature
Theoretical literature for this particular research consists of the writings of the theorists studying international regimes. The works of scholars of cognitive school of regime theory are the primary source for the theoretical framework of the thesis. The central idea will be the concept of AML regime developed by Guy Stessens, and also considered by Salva. The theory of regulation, to the extent that is suggested by Joseph Stiglitz and Bruce Greenwald, supports cognitive approach in this research. The two-level games theory of Robert D. Putnam is used to build the bridge between the international and domestic AML regimes. One of the concepts, which helps to form the theoretical framework, is the concept of international regulatory harmonization, proposed by Beth Simmons. More details about the works described here are though given in the section concerning theoretical framework. It is important to note that there is not so much theoretical literature about the issue of ML, although it is a hotly debated issue, but probably, mostly debated in the professional circles, not saying about the limited attention of scholars to the particular country’s AML activities.
2. Theoretical framework

This short chapter makes a brief description of some contemporary theories of international politics that will be utilized in creating particular theoretical framework. I believe that in this research it is useful to examine the problem of ML from a perspective of neoliberal institutionalism and particularly, the concept of international regimes. The following definition of international regimes, first proposed by Stephen Krasner, which combines all the aspects of this research, becomes the starting point of the discussion over the issue. According to Krasner, regimes are

... implicit or explicit principles, norms, rules, and decision-making procedures around which actors’ expectations converge in a given area of international relations. Principles are beliefs of fact, causation, and rectitude. Norms are standards of behavior defined in terms of rights and obligations. Rules are specific prescriptions or proscriptions for action. Decision-making procedures are prevailing practices for making and implementing collective choice. 20

Robert Keohane developed most widely discussed theory of international regimes which “… focuses on the institutionalization of a growing sector of international behavior and has been given the label “neoliberal institutionalism”.” 21 According to Keohane, “… a major function of international regimes is to facilitate the making of specific agreements on matters of substantive significance within the issue-area covered by the regime.” 22 He points out that the main reason of creating international regimes is to reach mutually beneficial goals by the governments. Without some regimes such beneficially valuable agreements could not be reached and that is why regimes are valuable for the governments. 23 Regimes can make the mutual aim more reachable if three dimensions are taken into consideration: if legal liability frameworks are provided, if information is available to actors and if other transaction costs are reduced. These conditions allow us to formulate the functions of regimes, according to Keohane. 24

Bearing in mind these functions of international regimes, the concept of AML regime developed by Guy Stessens is utilized throughout the research. 25 As the governments seem to be the central actors in international cooperation in the fight against ML,

23 Ibid.
24 Ibid.
domestic policies accepted in compliance with the country legislation system, including civil law, play the key role in formulating the foreign policy. According to Stephan Haggard and Beth A. Simmons, growing interdependence brings domestic and foreign policies more closely.26 Thus, international cooperation is considered from a two-level game theoretical perspective suggested by Robert D. Putnam.27 This perspective presumes that “At one level, representatives of different countries seek to reach or sustain international agreements; at a second level, those same representatives must build the political support required to sustain commitments and establish credibility.”28

One of the interesting authors analyzing global AML regime as a regulative regime is Beth A. Simmons and her concept of international regulatory harmonization.29 She suggests a model of regulatory harmonization in which she uses the combination of two variables and the idea of financial dominant centers – the initiators of “...“best practices” in supervision and regulation”.30 The case of AML is analyzed by the author using this framework. With the help of the model she analyzes the reasons of different states, other then dominant centers, to resist or support AML regulations, initiated by the dominant centers, i.e. the United States. The instruments used by the latter to reach regulatory harmonization in case of ML is “…peer pressure – to embarrass governments into adopting stricter controls over money laundering.”31 This instrument is used by the international institution – FATF – which evaluates its members and sanctions non-cooperative countries. “A multilateral institution, exerting strong peer pressure coordinated by the dominant centers, has been crucial to rule harmonization in this issue area.”32

The reasons to analyze domestic AML regime is additionally inspired by the ideas of Guy Stessens who emphasizes that international cooperation is important in the fight against ML because of “… the transnational nature of the crime phenomenon...”.33 His main idea concerning international AML regime is that as ML phenomenon is flexible and adaptable, and easily shifts to different economic sectors and geographical locations, it is important to understand that AML regime should be expanded. Stessens claims that those states that limited or underdeveloped their AML policies “will be

30 Ibid., p.594.
31 Ibid., p.607.
32 Ibid., p.609.
forced to extend their legislation in the future.”34 The role of regional AML regimes, thus, is crucial in international cooperation. However, there are still a number of non-cooperative countries, some of which are unable to cooperate, others, more problematic to the author’s opinion, are unwilling to contribute to the international fight against ML. Bearing this in mind, the reasons of non-cooperation between the actors of both international and domestic AML regimes are analyzed and conclusions about the effectiveness of AML regime are drawn.

These ideas seem to be useful in my research as they help to find out whether the national regulatory policy in ML is “correlated” with the international “regulatory innovation”, in other words, whether Russian AML legislation is created with all possible incentives to contribute to international cooperation in the fight against ML. At the same time it makes us turn to domestic actors and institutional arrangements that constitute the national AML regime. This incentive is supported by Sandeep Salva who, in his work “Money laundering and financial intermediaries”, considers financial institutions to be one of the main actors in the fight against ML.35 He shows the importance and necessity in careful study of the role of financial institutions in creating the effective AML regime and reveals the reasons of ineffectiveness of banks cooperation in the fight against ML. In their theory of regulation, Stiglitz and Greenwald propose that the reason of looking at the structure of banking institutions “... arises from a series of questions concerning policies that directly or indirectly affect those institutions...”36 It is also important because of their constant and rapid changing. The main idea of the authors is that analyzing the regulatory policy should begin with the analysis of “... how various regulations affect banks’ behavior...”37 Bearing this in mind, the domestic AML legislation in Russia, which is, in its nature, regulatory, is analyzed.

To better understand the incentives for cooperation and non-cooperation of the actors within the AML regime, the epistemic community approach within the cognitive stream of regime studies, which also emphasizes the role of the banking community in the AML regime, is utilized in this research. Intersecting with the assumptions of the theory of regulation it helps to explain the faults of the existing AML regime and probable ways to eliminate them. The important idea of Stiglitz and Greenwald is that regulators do not have relevant information that the regulated have; if they had, they could themselves do the job of the regulated. Thus, according to them, the regulator tries to control or affect the behavior of banks.38 The banks, on the contrary, respond to the regulation. As a result, the control mechanisms can be either effective or ineffective. The

34 Ibid., p.428.
37 Ibid., p.203.
38 Ibid., p.209.
analysis of controlling mechanisms and banks behavior in this research is necessary to show the level of interaction between the banks and the regulator measured on communication merit. The analysis of how they interact is useful to identify the reasons of ineffective cooperation.

At last, the discussion about the risk-based approach to AML regulation implementations is open to point to the practical purpose of this research. This new discussion shows the interest of the practitioners to the need of change of the AML regulatory regime. To sum up, the combination of these theories, ideas and approaches, described above, seems to be quite an interesting theoretical framework helping to investigate such an issue as international ML phenomenon.
3. Anti-money laundering regime

3.1. International AML regime

This chapter summarizes the global AML regime as it appeared about thirty years ago. It outlines the main documents adopted by international organizations which became globally accepted and recognized all over the world and have been considered to be international standards and norms in the fight against ML. The documents are outlined briefly as further in the research they will participate in more in-depth comparative analysis of the preventive pillar of both global and domestic AML regimes. However, it is not the purpose of this research to focus on all the documents or events that have been undertaken by the international organisations in the fight against ML. Table 1 in Appendix 1, in particular, its column 3 provides a chronological list of all the major developments of international AML regime.39

According to Reuter and Truman “the global AML regime has made progress in general area of prevention”.40 For many years, a number of international organizations have developed standards for combating ML. Many international agreements and resolutions outline similar standards or build upon each other. In this chapter, the international AML regime agreements emphasizing the four key elements of the prevention pillar – customer due diligence, reporting, regulation and supervision, and sanctions – will be distinguished.

The quick historical overview of the global AML regime lets the author start with the basic documents which were the beginning of recognition of the necessity of the regime. The United States have the full right to be considered the fathers of the AML regime. Particularly, the adoption of the US Money Laundering Control Act of 1986 which was one of the first AML laws, followed closely by similar laws in France, the United Kingdom, and a host of other countries.41 Indeed, recognizing the global character of the crime brought understanding that the anti-crime measures should also be global.

It is obvious that an international crime needs an international response. Following the column 3 of Table 1 enables to notice that the main international agreements were adopted or elaborated mainly from 1988 till 2002. Hence, in 1988 the United Na-

41 See United Nations International Money Laundering Information Network (IMoLIN) at http://www.imolin.org for a list of nations that have passed antimony laundering statutes.
tions adopted the Vienna Convention against illicit traffic in narcotic drugs and psychotropic substances, the first multilateral agreement that first showed the recognition of the connections of organized crime with ML issues\textsuperscript{42} although the term “money laundering” did not appear in the Convention. The main goal of the convention was to facilitate adopting domestic laws responding the main principles and rules of the international regime as well as ensuring international cooperation among the countries.\textsuperscript{43} The domestic laws that these countries were to enact in order to comply with the convention were to constitute the backbone of the global AML regime.

It is evident that the United Nations was the first international organization to respond to ML as a crime. It is the organization whose wide membership and ability to adopt international legally binding documents which must be implemented by the other countries gives it the status of the “number one” organization dealing with the money laundering issue.\textsuperscript{44} Besides the international conventions and documents, it maintains the Global Programme Against Money-Laundering which is maintained by the GPML Forum the purpose of which is “… express support for the AML, regulatory and supervisory principles and standards published by the [United Nations, Basle Committee on Banking Supervision, IOSCO, IAIS, FATF, and G7]”.\textsuperscript{45}

The significant result of the US initiatives for the international AML regime was that the Basel Committee on Banking Regulations and Supervisory Practices in 1988 issued a Statement on Prevention of criminal use of the banking system for the purpose of ML which appealed to the international banking community which are the main intermediaries in the financial activities which can be used as tools for the activities defined as ML. The principles stated in the document referred by the Committee as “ethical principles” were to encourage the banks to implement measures that now constitute the three elements of the prevention pillar of international AML regime – customer identification, compliance with law and cooperation with law enforcement authorities.\textsuperscript{46} The Core Principles for Effective Banking Supervision issued by Basel Committee contain the “know your customer” (KYC) principles which were closely connected to the issue


\textsuperscript{43} See the United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

\textsuperscript{44} About the activity of the UN and the legal instruments issued by this organization, see Money laundering and the financing of terrorism: The United Nations response, United Nations, Office for drugs and crime. Available at http://www.imolin.org/pdf/imolin/UNres03e.pdf (9 August 2007).

\textsuperscript{45} About UN GPML Forum (United Nations Global Programme against Money Laundering Forum see IMoLIN. Available at http://www.imolin.org/imolin/en/unof.html#unof (9 August 2007).

of ML\textsuperscript{47} and are widely used in the banks policies of customer identification nowadays. Moreover, the paper on Customer Due Diligence for Banks\textsuperscript{48} issued later on in October 2001 defined the KYC standards which are, in terms of the paper, “…most closely associated with the fight against money-laundering” and “…are critical in protecting the safety and soundness of banks and the integrity of banking systems”.\textsuperscript{49} In addition, Basel Committee supports the FATF Forty Recommendations and advises banks to adopt them and comply with them.

Apparently, the basis of the international AML regime is the FATF Forty recommendations which are considered to be a settler of international AML regime, particularly, the prevention pillar.\textsuperscript{50} The Financial Action Task Force on Money Laundering is an intergovernmental organization which was established in 1989 as a response to ML as an international crime.\textsuperscript{51} FATF Forty recommendations which were released in 1990 are considered to be the main guideline for all participants of the AML process. Concerning preventive pillar of the AML regime, the Forty Recommendations are the main document setting international standards; it is the document followed by all bodies in their AML activities. The fact, that the FATF list of non-cooperative countries and territories (NCCTs) has been diminishing for the last several years and since October 2006 has contained no countries\textsuperscript{52}, speaks in favor of the effectiveness of the measures taken by the countries in the fight against ML. One of the main functions of FATF is monitoring countries cooperation and progress in the fight against ML. It releases annual reports including the NCCTs reports evaluating the countries’ situation and giving the recommendation on its improvement.

The importance of the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, adopted in Strasbourg in 1990 and revised in 2005 is recognized by the international community. In 2005 the Convention appeared as reconfirmed - Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism. It contains the provisions recommending the domestic jurisdictions to adopt measures which are necessary in the fight against ML. Thus, the Convention in its Article 9 defines

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\textsuperscript{49} Ibid., p.2.
\textsuperscript{51} About FATF, see http://www.fatf-gafi.org/ (9 August 2007).
\textsuperscript{52} Information about that see at http://www.oecd.org/document/4/0,3343,en_32250379_32236992_33916420_1_1_1_1,00.html (9 August 2007).
\end{flushleft}
laundering offences which recognition should be adopted in domestic laws. The Convention defines the principles of international cooperation and states that “[T]he Parties shall mutually co-operate with each other to the widest extent possible for the purposes of investigations and proceedings aiming at the confiscation of instrumentalities and proceeds.” The recognition of the international cooperation between the countries or jurisdictions is expressed by signing of the Convention, which is a significant move in the mutual international response to the phenomenon of ML as a crime.

Wolfsberg AML Principles on Private Banking and Wolfsberg AML Principles for Correspondent Banking (together referred to as Wolfsberg Principles) which were elaborated by the leading world banks in the year of 2000 are not binding, nevertheless are recognised by most financial institutions as a guide in their AML activities. They show the banks concerns about the issue as well as the recognition of the banks responsibility to participate in the AML regime. According to Haynes, several basic reasons lead to the formulation of the Wolfsberg principles. First of all, the idea behind it contained the possibility to create common understanding of the AML regime which would result in eliminating of the uncertainties and differences between domestic regimes which hinder the running of multinational banks. This is, apparently, connected with the reputational and management risks that banks bear. Another main reason of formulating the Principles is the attempt to avoid strict regulation and shift to the self-regulation in this field. Self-regulation involves more understanding and responsibility which seems to be the main goal, although, often unachievable, pursued by the regulator.

In sum, the global regime by nature should have internationally recognized legal foundation with which the domestic regimes are consistent in terms of laws and standards. This condition will provide effective cooperation among jurisdictions. The practice shows that the contemporary global AML regime is well-established. FATF standards are broadly accepted and supported by most of the jurisdictions which implemented most of the leading principles in their national legislation which is proved by the blank NCCTs list since 2006. However, the paradox is that effective implementation of AML standards and rules is difficult not only to achieve but also to assess. The goal to make domestic jurisdictions uniform is very unlikely because of different institutional, legal and contextual environment in different countries as well as different interests, perspectives, capacities and priorities. The following chapter will analyze the domestic AML regime existing in Russia nowadays in the context of international standards.

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54 Ibid.


56 Ibid.
Again, the focus will be placed on the prevention pillar in spite of the fact the enforcement pillar is even more complex and less elaborated in the contemporary global regime.

3.2. Domestic AML regime in Russia as part of international AML regime

The global regime consists of domestic AML regimes and it is evident that domestic legislation on its own would be inadequate as ML has global nature. It is interesting enough that the regimes created in different countries are far from uniform. However interesting that might be, it is not the aim of this thesis to do comparative analyses of the different domestic regimes that constitute and influence the global regime. The aim of this chapter is to see if the Russian domestic AML regime in its prevention pillar is compatible with the global regime. What are the discrepancies of the domestic regime in relation to international standards? To answer these questions the main features of the domestic AML regime as a part of international regime will be outlined here. The column 2 of Table 1 in Appendix 1 chronologically lists the major developments in the domestic regime since the year of 1990 and will allow the reader to follow the author’s analysis of these developments. The analysis of the prevention pillar of the domestic regime with the focus on banking regulation will be conducted in the next chapter and will include only documents adopted by the Russian regulator in accordance with international standards and norms.

One of the most significant steps towards creating domestic AML regime was the ratification of the main conventions and international documents that constitute the global AML regime. The first document which was paid attention was the UN/International Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances which was ratified with the Decision of the Supreme Court № 1711-I in 1990. This fact for the first time showed a shift towards the country’s understanding of the necessity to take part in the international AML regime. However, looking at the column 2 of Table 1 makes it obvious that the start in creation of the domestic AML regime was far much later than one of the global regime. The next step after ratifying the above convention in 1990 was taken only in 1997 and was expressed in the Article 174 of the Criminal Code which designated ML as a criminal offence. However, the amended Article 174.1 entered into force only in 2002 – the year which can be assumed as the starting point of Russian AML legislation development. The Convention ETS 141 - Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime was ratified in 2001 together with the creation of the project Federal AML law, particularly, Federal law № 115-FZ “On Countering Money Laundering and the Financing of Terrorism” which entered into force from the 1st February 2002.

Up to the year of 2002 most international Conventions which are considered the documents expressing the international AML standards had been ratified and attempts
to implement their provisions had been made. The main document which received significant attention from Russian legislators elaborating the AML legislation was the FATF Forty Recommendations. The FATF Annual report 2002-2003 already highlighted the compliance of the domestic regime with “essential FATF recommendations” and expressed the content to the attempts of elaborating the proper legislation which allowed the country to be de-listed from the FATF NCCTs list. As soon as Russia became a FATF member, it took an active position in collaborating to the new legislative AML initiatives. The 2003 revised Forty Recommendations brought significant changes to Russian legislation including identification of not only customers, but also real beneficial owners, spreading the requirements of defining and reporting suspicious activities on non-financial organizations and paying more attention to the “politically exposed persons” (in terms of FATF). Thus, the new Forty Recommendations facilitated amendments to the AML legislation in RF and the Ordinance 173 was issued to publish the FATF list of NCCTs by the intelligent body. The FATF NCCT list was widely used in the currency control regulations as well.

The important international organization to rely on is considered to be the Council of Europe with its main document mentioned above - Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism which was amended in 2005 with the dimension of financing terrorism (FT). This document put significant emphasis on strict requirements of internal control rules for financial organizations with the purpose of customer identification and reporting of the suspicious transactions, stricter rules and regulations concerning confiscation of the criminally gained income. Article 13 of the Convention emphasizes the necessity of developing national AML regimes in its prevention pillar through developing comprehensive legal and institutional frameworks according to “applicable international standards”. Particular attention in the document is addressed to the FATF Forty Recommendations and as long as the Convention considerably coincides in its provisions with the FATF Forty Recommendations, joining it was not followed by significant changes in Russian AML legislation. The important place of the Convention in the global AML regime is obvious in terms of defining the principles of international cooperation in the AML activities not only for prevention but also for the enforcement pillar. Chapter IV of the Convention emphasizes the essence of mutual cooperation, mutual assistance of domestic jurisdictions in prevention through sharing information, elaborating common principles and following international norms, in investigation,

57 See Table 1 in Appendix 1.
provisional measures such as seizing and freezing of assets, in confiscation, as well as considers the provisions connected with the refusal and postponement of cooperation.60

Wolfsberg principles seem to be recognised and familiarized with by the banking community in Russia. First of all, the regulator tried to help the banks to pay attention to the international document by issuing the letter 105-T about the principles. The CB recommended the banks to familiarize themselves with the existence of the document. Moreover, after the attention to the principles was drawn, the 8 biggest banks in Russia in 2004 concluded the mutual convention of AML law compliance and cooperation in this field.61 The convention expressed the willingness of the banks to follow the main tendencies in the international AML activities as well as the recognition of the necessity to preserve good reputation of the banking community in the country.

Thus, described above international norms reflect the main tendencies in the development of Russian AML legislation in accordance with globally accepted standards in this sphere. Compliance with these international norms is the universal criteria of assessment of the effectiveness of national AML regimes. According to the international expert assessments, Russian Federation has created an effective domestic AML regime62 including institutional and legal frameworks. In the FATF Annual Report 2002-2003 the substantial progress in the development of the domestic AML regime having enough possibilities of accepting the country into the FATF network was emphasized as well as the recommendations on the further development of the regime were made.63 It is arguable, however, that the substantial development of the prevention pillar of the domestic regime started only after 2002.

3.2.1. Institutional framework

The institutional framework development included creation of the Federal Financial Monitoring Service (Rosfinmonitoring) as the Financial Intelligence Unit (FIU) which is the main player in the AML regime actively cooperating with international bodies in building the effective system of combating the legalisation64 (ML) and FT since 2002 when it became the member of Egmont Group.65 Thus, in elaborating its principles and aims, identified in the main legislation documents such as the Decree № 314 which

60 Ibid., chapter IV.
63 Ibid.
64 The term legalisation is widely used in Russian AML legislation and refers to ML (see 115-FZ).
transformed Federal Monitoring Committee, created in 2002, to the FFMS (Rosfinmonitoring), the Ordinance № 186 of the Government of the Russian Federation (RF) was adopted which defined the authority of the Ministry of Finance of the Russian Federation (MF) to control Rosfinmonitoring. The Statute of Rosfinmonitoring which was ratified by the Ordinance № 307 of the Government of RF, Rosfinmonitoring relies on international practices and tendencies.

The next important actor in the preventive pillar of the AML regime is a supervisory body which regulates credit organisations. As the research mainly focuses on the financial institutions and their role in the AML process, it must be pointed out that the Bank of Russia (CB) received the authority of supervision over the financial institutions according to the 115-FZ. CB functions as a regulator building the legal framework for the credit institutions (mainly banks) in all of the four elements of the prevention pillar – it defines the characteristics of suspicious transactions, issues regulations on customer identification and reporting of the suspicious transactions by the banks, as well as it is involved in the application of sanctions towards the banks for non-observance of the federal AML legislation. Although it is the prerogative of the Rosfinmonitoring to improve the legislation framework, the regulations and rules issued by CB and regulating the activity of the main actors in AML measures – banks - have not been adjusted with the authorized body. Until the year 2007, this collision has become the main reason of the debates and conflicts which will be discussed in the next chapters of this research. The supervisory activities of CB will also be analyzed in the following chapters of this research.

The banks are recognized as the next actors logically appearing in this AML chain. “It seems clear that the role of financial intermediary as concerns money laundering must be carefully scrutinized in order to develop a coherent and effective anti-money laundering regime”\(^{67}\). The successful fight against ML is impossible without closer cooperation between Rosfinmonitoring as FIU, CB as a supervisory body and banks as financial organizations in Russia. This main perception of the necessity of the cooperation of all the actors taking part in the AML activities was expressed by these organizations at the third international conference held in 2005 on contemporary tendencies in the development of the AML regimes – international and domestic.\(^{68}\) This thesis was also assumed as the main principle of The Concept of the National Strategy

\(^{66}\) See Table 1 in Appendix 1.


on Combating Legalisation (laundering) of Criminally Gained Income and Financing of Terrorism which was worked out and signed by the President of RF in 2005.69

3.2.2. Legislative framework

The internal legal framework was created by the joint efforts of the main regulators of the domestic AML regime – the President and the Government of Russian Federation, the FFMS, CB and MF. The basis of the Russian AML legislation is the Federal Law №115-FZ “On Combating Legalisation (Laundering) of Criminally Gained Income and Financing of Terrorism” (115-FZ) which entered into force in 2002. The law, however, has been subject to several amendments, such as 2003 amendments on adding the dimension of "combating the financing of terrorism" to 115-FZ and all other legislative documents, 2004 amendments on the right to refuse to open bank account (88-FZ), 2006 amendments about the rules of identification of natural persons (147-FZ) and amendments concerning changes caused by the adoption of the Federal law № 35-FZ “On combating terrorism” (153-FZ) and finally, 2007 amendments concerning the rules and regulations elaborated by CB as an authority supervising credit institutions to be approved by the authorized body responsible for the AML/CFT measures - Rosfinmonitoring (51-FZ).70 The last amendment became the result of the debates between CB and credit institutions represented by interest groups caused by the numerous discrepancies in the regulator’s legislative documents.

The subordinate legislation created by the regulators and based on 115-FZ regulate the financial activities which can be connected to ML. Concerning banks, the main legislation was adopted by the regulator shortly after enforcing of 115-FZ. This legislation will be scrutinized in chapter 4.1. “Legislative base for the banks”.

3.3. Compliance of the prevention pillar of the domestic AML regime with international standards (analysis of 115-FZ)

“All preventive anti-money laundering measures adopted at an international level are focused on the role of financial institutions”.71 Keeping the four key elements of the prevention pillar in mind, the paper uses comparative approach to discuss the obligations imposed by the international standards and domestic legislation on financial insti-


70 See Federal Law № 115-FZ “O protivodeistvii legalizatsii (otmyvaniyu) dohodov, poluchennih prestupnym putem, ifinansirovaniyu terrorizma [On Combating Legalisation (Laundering) of Criminally Gained Income and Financing of Terrorism]” (115-FZ). Available at http://base.consultant.ru/cons/cgi/online.cgi?req=doc;base=LAW;n=67646;div=LAW;mb=LAW;opt=1;ts=8B86AF1DF0EA86B25101B1BCAD1805B (in Russian) (7 July 2007).

tutions. The strictest requirements apply to the core financial institutions such as banks. All the banks are required to have compliance with the AML legislation in customer identification, reporting, internal control rules; they are subject to supervision and regulations, and to sanctions for non-observance of the AML legislation.

The cornerstone of Russian AML regime is the Federal law 115-FZ “On Combatting Legalisation (Laundering) of Criminally Gained Income and Financing of Terrorism”. The law is applied to individuals and legal entities that deal with money or other property and is a base for the secondary legislation which is created by the regulators. The provisions of 115-FZ are to be tested in this chapter for their compliance with the international standards and norms.

The key concept of Russian AML legislation is the legalisation (laundering) of proceeds of crime which is defined in Article 3 of the law as a process of bringing a legal appearance to the possession, use or disposal of money or other property, received as a result of committing an offence. The scope of the law concerns all kinds of offences, except, surprisingly, several offences, specified in the Criminal Code of the Russian Federation. Russian AML law provides a list of measures for countering legalisation (laundering) such as compulsory control, compulsory internal control procedures, a ban on informing clients and third parties about the measures taken to counter the legalisation, and “other measures provided by federal laws”. Banks as financial institutions are included in the list of organisations dealing with money or other property by Article 5 of the federal law.

With respect to customer due diligence, most international AML documents contain an obligation for the banks to identify their customers “before or during the course of establishing a business relationship or conducting transactions for occasional customers”. FATF Forty Recommendations define the occasions or situations in which the customer due diligence (CDD) should take place. This statement shows the pure preventive nature of this measure which can also avoid the involvement of the financial institution in ML process itself. The preventive identification should be applied not only to identifying of customers but also to identifying the beneficial owners. The requirements of

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72 See Article 3 of 115-FZ.
73 The offences that are not subject to AML measures are specified in Articles 193, 194, 198, 199, 199.1, 199.2 of the Criminal Code due to articles’ own responsibilities established by the code. These offences include failure of repatriation of currency from abroad, evasion of customs or tax payments by natural or legal persons, dereliction of duties by a fiscal agent to calculate, deduct or transfer taxes, and hiding money or other property assigned to pay taxes or fees, correspondingly.
74 See Article 4 of 115-FZ.
75 The organisations dealing with money or other property will be referred to as “organisations” further in this chapter.
identification should be applied by the financial institution to all new clients, both legal and natural persons.

Customer identification is expressed in Basel Committee Statement on Customer due diligence for banks with a reference to the obligation to create a comprehensive “Know-Your-Customer” (KYC) system. In its document Basel Committee recommends to apply a risk-management approach to the bank’s customers and their transactions. “The inadequacy or absence of KYC standards can subject banks to serious customer and counterparty risks, especially reputational, operational, and legal and concentration risks.” The same issues of customer and beneficial owner identification are addressed in Wolfsberg principles with the necessity of keeping and updating of the information which is an important dimension as Russian legal documents emphasize that it is not necessary to identify the customer for the second time and further. Article 13 of the 2005 Council of Europe Convention on laundering, search, seizure and confiscation contains general provision of customer identification with the reference to the FATF Forty Recommendations.

Article 7 of Russian AML law requires the organisations to identify their customers as well as beneficiary owners. It provides the list of client data collected by the organisations concerning both legal and natural persons. The rules to identify beneficial owners are limited by the requirement to “undertake sound and available in the given circumstances measures”. According to the law, financial institutions are required to collect personal information about the customers for all transaction except those designated in items 1.1 and 1.2 of Article 7. According to these articles client identification can be ignored in case of occasional client operations conducted without opening of a bank account, such as tax payments, payments for municipal services or such if the payment does not exceed 30 000 rubles or currency cash operations (purchase or sale of foreign currency) in the amount under 15 000 rules. The identification is, however, required in case of any suspicion of legalisation (laundering) of illegal earnings present. On regular basis, financial institutions must inquire customer information when opening new accounts.

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78 Ibid. p. 3.
81 See Article 7 of 115-FZ.
82 According to the currency exchange rates established by CB on a daily basis, 30 000 rubles/15 000 rubles equals to USD 1220/610 correspondingly.
According to the international norms, if a financial institution is unable to identify its customer it should refrain from establishing business with it. Item 5 of Article 7 prohibits the banks to open anonymous accounts\textsuperscript{83}, open accounts without physical presence of a client\textsuperscript{84}, refrain from relationship with the banks outside RF who do not have physical presence in the territories they are registered (“shell banks” in terms of FATF Forty Recommendations Glossary\textsuperscript{85}). Moreover, according to item 2 of Article 7 financial institutions have the right to refuse opening bank accounts when there is no possibility to properly identify the customer.\textsuperscript{86}

In spite of reflecting of the idea of the customer identification in Russian AML, the concept of KYC is not mentioned in the Federal law. Although the term KYC is not used in the main AML law, the principles of the customer identification are grasped and further developed by the regulator. Particularly, giving CB a role of AML regulator and supervisor for financial institutions, the federal law transmitted the task to further clarify the main concepts of international norms to the domestic AML regime. Identification programmes suggested by CB in its Regulation 262-P contain the regulatory rules on customer identification as well as risk assessment procedures.

The financial institutions are also required under item 4 of Article 7 of 115-FZ to maintain the records of their clients identity for a period of 5 years from the date of termination of the relationship between the client and the financial institution. This requirement corresponds with FATF Recommendation 10, Basel Committee 2-26, and article 9 of Wolfsberg AML Principles on Private Banking. The record-keeping for transactions is required by Article 7 of the federal law as well as the requirement to provide information about the transactions that are subject to compulsory control and suspicious operations upon the inquiry of the authorized body. These requirements do not concern transactions and operations conducted before enforcing of the federal law.\textsuperscript{87}

Turning to reporting requirements, in order to increase the probability of successful ML cases investigations, the AML regulations impose an obligation on financial institutions to file and report money transactions which attain the prescribed amount as well as to report suspicious transactions that can be found related to ML. In Russian AML law all transactions fall into two categories – those that exceed designated amount and thus, are subject to compulsory control, and those that can be identified as suspicious, irrespective of amount.

\textsuperscript{83} This requirement complies with Basel Committee Customer due diligence for banks, Article 2.1.-30, and FATF Recommendation 5.

\textsuperscript{84} This requirement complies with Basel Committee Customer due diligence for banks, Article 2.2.6.-45.

\textsuperscript{85} This requirement complies with FATF Recommendation 18.

\textsuperscript{86} This requirement complies with FATF Recommendation 5.

\textsuperscript{87} Federal law 115-FZ entered into force on the 1\textsuperscript{st} February 2002.
The approach taken by the Russian legislators in the AML is a combination of a threshold approach and prudential offences approach as defined by FATF.\textsuperscript{88} Thus, the obligations of controlling of the transactions depend on the amount of money as well as the type of a transaction. Compulsory control transactions are listed in item 1 of Article 6 of the AML law. As a threshold for these transactions Russian AML law requires an amount in excess of 600 000 rubles in one transaction or series of transactions conducted during one day, except for the transactions with immovable assets the threshold for which is 3 000 000 rubles.\textsuperscript{89} Besides the threshold requirement the transactions that are subject to compulsory control are listed in the law and include quite a wide range of operations such as operations in cash, transactions via banking accounts\textsuperscript{80}, transactions with securities, precious metals, jewelry or such, money from lottery or gambling participations, provisions of loans, etc. moreover a transaction of any amount is subject to compulsory control if at least one of the parties participates in extremist activities according to the official list established by the government of RF. Article 6 requires compulsory control transactions reports to be submitted by the financial institutions directly to the authorized body (FIU) no later than the next working day after its accomplishing.

For the second group of transactions which are under the compulsory reporting amount, the financial institutions decide, what an unusual or suspicious transaction is according to the compulsory internal control rules, which must be elaborated by the financial institutions together with the programmes for their implementations according to Article 7 of the federal AML law. Within these programmes the financial institutions collect the data about the transaction which have unusual character, have no apparent economic or obviously lawful purpose and report them to the authorized body if there is a suspicion that these transactions are accomplished for the purpose of legalisation (laundering) of illegal earnings or financing of terrorism. The internal controls as a part of programmes against ML elaborated by financial institutions besides the requirements of customer and transaction identification, record-keeping, and reporting of suspicious transactions should include on-going training programmes, appointment of compliance officers and internal audit functions.\textsuperscript{91}

Concerning transactions identification and reporting requirements it is obvious that they are concurrent with international norms, which, particularly, are expressed in FATF Recommendation 19, Wolfsberg Principles, and Council of Europe Convention. However, a weakness of a threshold approach can be seen. Thus, international norms

\textsuperscript{88} See FATF Forty Recommendations, Recommendation 1. Available at http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF (15 November 2007).

\textsuperscript{89} The amount of 600 000 rubles/3 000 000 rubles equal approximately USD 24 500 or EUR 16 800/USD 122 500 or EUR 84 000 correspondingly (in 2002 when the law was adopted this amount equaled USD 20 000 or EUR 22 000/USD 100 000 or EUR 110 000 correspondingly.)

\textsuperscript{90} Special attention is paid to the first operation conducted by a legal entity via its bank account within the first three months after its opening.

\textsuperscript{91} These requirements comply with FATF Recommendation 15.
establish suspicious transaction threshold as USD/EUR 15 000 for a single operation or series of operations that appear to be linked.\textsuperscript{92} It is obvious that such a requirement is vital to be harmonized between different jurisdictions. The discrepancy is that it can be possible that a transaction that can be considered an offence in one jurisdiction, fails to pass Russian monetary threshold.\textsuperscript{93}

As a part of ML prevention, core financial institutions such as banks are subject to substantial supervision that includes examinations according to different regulations. According to FATF Recommendation 23, the regulators should apply the same regulatory and supervisory measures to the phenomenon of ML as they apply for prudential regulation.\textsuperscript{94} To reach this aim, supervisors should elaborate guidelines and “provide feedback which will assist financial institutions … in applying national measures to combat money laundering and terrorism financing, and, in particular, in detecting and reporting suspicious transactions.”\textsuperscript{95} Moreover, supervisors should have “adequate powers to monitor and ensure compliance by financial institutions with requirements to combat money laundering … including the authority to conduct inspections.”\textsuperscript{96}

In Russian AML regime, CB is a supervisor for financial institutions. As a sole supervisory body for the financial institutions CB has powers for prudential regulation and supervision according to the Federal law 86-FZ “About Central Bank of the Russian Federation (Bank of Russia)”. Concerning AML, according to Article 7 of 115-FZ CB has powers to work out the rules for elaborating internal controls by financial institutions; to elaborate the programmes of the AML implementation, training of personnel, client and beneficial owner identification; and transaction reporting by the financial institutions. Speaking about reporting, CB plays the role of some kind of an intermediary between the FIU and the financial institutions. In spite of the fact that STRs are sent by the financial institutions directly to Rosfinmonitoring, CB establishes the rules and guidelines on this issue. Speaking about sanctions, if an institution failed to comply or implement AML regulations, rules, guidance procedures it can be subject to informal or formal administrative actions by the regulator. “They [supervisors] should be authorized … to impose adequate administrative sanctions for failure to comply with such requirements.”\textsuperscript{97}


\textsuperscript{93} The monetary threshold in the US, for example is USD 10 000. See D C Lindner, “Money laundering between states: a comparison of international money laundering control mechanisms”, Defense Counsel Journal, 74, 1, 2007, p.56.

\textsuperscript{94} See FATF 40 Recommendations, Recommendation 23.

\textsuperscript{95} See FATF 40 Recommendations, Recommendation 25.

\textsuperscript{96} See FATF 40 Recommendations, Recommendation 29.

\textsuperscript{97} Ibid.
Summing up this chapter, several conclusions can be drawn. First of all, the four important elements of the AML prevention are distinguished in Russian federal legislation. Second, the main AML law that lies in the basis of the domestic AML regime is, in general, formally compatible with the internationally accepted AML norms and standards. It, nevertheless, has its own specifics in terminology, ways of expressing its provisions, style and approach. It is seen from the comparative analysis that most provisions are in a formal compliance with the international documents and most requirements of international organisations are reflected in the federal law. Third, it is important to note that core financial institutions are not directly applied by the federal law, but mainly through secondary legislation adopted by the regulator. Being subject to prudential regulation the banks have CB as a supervisory body in the AML field as well. CB as the only supervisory and regulatory body for financial institutions besides creating AML legislation has the powers to monitor compliance and apply sanctions for non-observance of the federal (and, particularly, its own) AML legislation. As follows from the analysis the supervisor’s powers seem to correlate with the requirements of the international regime. According to Ali, adequate supervision of financial institutions is an important element in the suppression of the financial crime. The principle of adequacy is expressed by international norms as well, as it was mentioned above. It is, however, arguable that adequacy of powers or sanctions of a supervisor is something universally perceived and, moreover, something that could be assessed as such.

99 See note 96.
4. Analysis of the prevention pillar of Russian domestic AML regime with the focus on the core financial institutions – banks

While domestic regulation systems play substantial role in combating money laundering activities, the role of the regulator quite heavily impact a country’s AML policies. The paper will reveal these impacts using the analysis of the domestic regulator’s legislation and its implementation in the financial sector. For the purpose of the analysis of the prevention pillar of the domestic regime, table 2 was organized in the way that it contains all essential documents adopted by the supervisory authority regulating the activity of the financial institutions – the Central Bank (CB) – in chronological order.\textsuperscript{100} The concept “essential documents” is referred to here because the analysis does not touch all numerous documents adopted by CB after Federal Law 115-FZ entered into force and considers only the main documents which are the basis of the regulator’s AML legislation. The analysis of these documents shows which elements of the prevention pillar are emphasized and which are underestimated or require more legislative attention. Further on, the reader’s attention is drawn to some discrepancies existing in the regulator’s legislative documents. The next section analyzes the behavior of the financial institutions in their attempts to implement the AML legislation into practice. One of the sections of this chapter focuses on the debates and conflicts dominated in the banking community with the emergence of the domestic AML regime. Finally, the conclusions will summarize the empirical findings of the research which are then discussed from theoretical perspective in the next chapter.

4.1. Legislative base for the banks

The strongest emphasis is placed by the legislator on core financial institutions as banks which are required to have comprehensive AML compliance programmes and are subject to federal AML regulations. As already noted, the financial institutions are regulated and supervised by CB. As table 2 demonstrates the 62 regulator’s documents are analyzed in this paper with the focus on the four elements of the prevention pillar of the AML regime - Customer due diligence, Reporting, Regulation and supervision, and Sanctions.

Chart 1 found below which reflects Table 2 is presented to show the most addressed issues in the domestic legislation. According to the chart, fifty percent of all the documents address the issue of identification of suspicious operations and their reporting, and training. These issues are grouped in one of four constituents of the prevention pillar of the AML regime. However, training has been paid far less attention than identi-

\textsuperscript{100} See Table 2 in Appendix 2.
fication and STR reporting despite the fact that it is emphasized by the international standards.

Within the prevention pillar, customer due diligence element generally received significant emphasis. At the same time it is important to note that the list of documents as it is explained below consists of legislation as well as the clarifying non-binding documents issued by CB with the purpose of only recommendation. However, the banks perceive all of the documents as binding as they generally face the difficulties in interpreting the legislation.

![Chart 1. AML issues raised in the AML legislation from 2001 to 2007](chart)

It is seen from the chart 1 and table 2 that all four elements of the prevention pillar are addressed in CB’s legislative base for the financial institutions in Russia. Nevertheless, the extent to which they are comprehensively applied by the financial institutions in Russia is in doubt. There has been a lot of criticism on the CB AML legislation lately and the following analysis reveals the discrepancies in the legislation.

The second column of table 2 gives the reader an overview of the regulator’s legislative base. It shows that the first AML regulations were adopted by the regulator in the year of 2001 right after 115-FZ was signed. In spite of the fact that 115-FZ entered into force from the 1 February 2002 some regulations mostly concerning internal control rules and customer identifications were already elaborated by the CB. This practice would not seem extraordinary as the history of the CB legislative activity happened to show controversial practices and behaviors. The first regulations elaborated by the CB are not in force nowadays and have been replaced by numerous amended regulations, although some of them are of the same contents.

Table 2 also observes that among the documents which are binding (however, it is difficult to distinguish ones even for bankers themselves), there are quite a lot of so called information letters or circular letters clarifying the rules of compliance with the AML legislation. For instance, CB issues circular letters on different issues including AML practices which prove the great number of banks enquiries about the issue. Taking
a careful look at the contents of information letters demonstrates that the enquiries made by the banks show inconsistencies between the AML legislation and the real practices of the banks that face difficulties in implementing the AML provisions into everyday work. Some of the documents are written in such a way that they can be interpreted in a dual way. The collisions go further. Thus, some documents issued by CB contain provisions allowing the banks to follow these documents only in the parts which comply with the federal legislation (115-FZ). It can be argued that some parts of some documents are acknowledged to be incompatible with the federal legislation. It is also obvious that the most addressed issues expressed by the banks are the suspicious transaction identification and customer identification.

The most addressed issue from CB’s side is reporting. The year 2002 was the most “prosperous” year on this issue. This meant that the legislation adopted by CB, first, was not accompanied by the comprehensible technical tools for transactions identification and reporting. Secondly, there was no clear understanding of the new AML measures implementation in the banks. CB, on the other hand, was quite dissatisfied with the quality of reports that it received from most banks which it expressed in its reports. Thus, in the year of 2003 it continued the attempts of improving the quality of the reports by clarifying vague provisions of its regulations, and making the banks understand the AML legislation it issued. To solve this problem, it issued a number of clarifying letters about customer and transaction identification, made some amendments to its main regulations and adopted one of its most significant documents concerning elaborating of internal control rules in banks and banking groups (Regulations № 242-P). These amendments were also caused by the adoption of revised 2003 FATF Forty Recommendations and the fact that the country became the FATF member in 2003. Moreover, CB issued some non-binding documents grasping banks’ attention on the international standards and norms, for example, the Directive about Wolfsberg Principles mentioned in the previous chapter. Further on, with the new FATF Forty Recommendations entering into force, CB abolished some of the documents and adopted new ones (for example on the issue of supervising and inspection by CB of the compliance with the AML legislation in the banks). Still, the emphasis in 2003 was paid to the transactions identification and submitting of STRs.

These main tendencies continued in the year 2004; however, the attention was also turned to the lack of training of the banks’ staff on the AML legislation as the Directive on qualifying requirements for the officials responsible for internal control rules was elaborated. The Regulations on the customer and beneficial owner identification in

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101 See Directive № 112-T of 23.08.2006 (in Russian). Available at http://base.consultant.ru/cons/cgi/online.cgi?req=doc;base=LAW;n=62450;div=LAW;mb=LAW;opt=1;ts=B A5E2BDB5DC9312CBF6F0FE2927BDF0 (8 July 2007).

102 Interview with the Chief Accountant of a Moscow bank.

103 See Table 2.
the financial organizations brought the new dimension emphasized in international documents (the 2003 revised FATF Forty Recommendations) – the dimension of identification of beneficial owners. However, the main focus of the banks, according to the interviewees was placed on the beneficial owner identification not earlier than in 2005 as there had been no clear understanding and technical tools to implement this measure.\(^{104}\)

The Directive on organization of legal and reputational risk management systems in the banks put emphasis on risk management with the focus on the risk of losing business reputation in case of non-observance of the AML legislation, non-cooperation with the regulator, having ineffective internal control rules and deviation from participation in the AML regime.\(^{105}\) The recommendations also referred to the necessity of elaborating by the banks of not only “Know Your Customer” (KYC) system but also “Know Your Employee” (KYE) system. Moreover, the new legislation on currency regulations entered into force in the end of 2003 liberalizing the currency operations had the main purpose of record keeping, identification of suspicious operations and identification of real beneficial owners.\(^{106}\) The growing desire to comply with globally accepted AML norms was expressed in the new Directive № 99-T on Recommendations on elaboration of the internal control rules for combating laundering of criminally gained income which was adopted instead of abolished Directive № 137-T and contained the reference to the international practices and standards set by the FATF and Basel Committee on Banking Regulations and Supervisory Practices.

In overall, the year of 2005 and the year of 2006 in the context of AML measures applied by the regulator, however, can be characterized as follows: with the same speed as the international standards were directed towards clarification of the AML procedures, CB seemed to move towards making them more complex. The Directives adopted by the regulator were quite controversial, showed instability of the regulator’s opinion on the issue, non-transparency of its regulations provisions, and moreover, unwillingness of taking responsibility for the non-binding recommendations it generously gives to the financial institutions. For instance, Directives 12-4-7/1118, 12-4-7/1119, 12-T, 17-T and some others\(^{107}\) contain the provisions referring to their advising non-binding character as Central Bank refers to Rosfinmonitoring’s function to be the main AML legislative body. However, the paradox is that it is CB who has the authority to issue AML legislation for the banks, make inspections in the banks and moreover, to apply sanctions which will be discussed later on in our analysis. Further on, the interviews show that the banks use the directives (especially 12-T and 17-T) as the guide to action as they do not

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104 Interview with employees of the three banks.

105 See Directive № 92-T on organization of legal and reputation risk management in banks. (In Russian) Available at [http://base.consultant.ru/cons/cgi/online.cgi?req=doc;base=LAW;n=54347;div=LAW;mb=LAW;opt=1;ts=B76F20EE56418B03B181EBCC7D25F68C](http://base.consultant.ru/cons/cgi/online.cgi?req=doc;base=LAW;n=54347;div=LAW;mb=LAW;opt=1;ts=B76F20EE56418B03B181EBCC7D25F68C) (8 July 2007).

106 Interview with the Head of the currency operations department in a Moscow bank.

107 See Table 2.
want to be punished by the regulator. Moreover, the good example of ambiguous interpretation of CB’s Directives can be the Directive № 12-1-3/804 which shows discrepancies in its legislation.108

The Directive № 97-T adopted in 2005 caused a lot of concerns in the banking community. It contained the recommendations on the measures undertaken by the banks in suspending the clients transactions in accordance to the article 7 of the 115-FZ. This issue being addressed in the first version of 115-FZ, however, was not paid attention neither by the banks nor by the regulator. The banks considered the issue being controversial with the Civil Code of Russian Federation in the sense that unilateral suspension of contract is unacceptable. Later on, taking into considerations these concerns, CB issued the Directive № 12-4-7/1571 of recommendation character referring to the article 7.12 of the 115-FZ which stipulates for non-sanction of the banks. The situation shows the inconsistency and contradictions of the whole legal system of RF. Another evidence of that is the fact that still, even though the banks are guaranteed by the federal law not to have the civil liability emerged for the suspension of clients transactions and are required to suspend them, this can not be applied to the transactions of crediting of the clients accounts.109

Even more attention from the banking community received CB’s Directive № 98-T on the Recommendations № 59 concerning sanctions towards the banks for non-compliance with 115-FZ. The Directive 98-T, which was not officially published110 and have a non-binding character, contains the list of offences and sanctions which can be put on the banks for non-compliance with 115-FZ. This list of possible offences in the AML legislation is presented in the next section of this chapter and is used to analyze the behavior of the banks in the AML activities. The Directive 98-T also refers to the Instruction № 59 which gives CB a full authority to choose the method of sanctioning concerning the character of the infringements. The paradox is that the implementation of the Directive № 98-T being non-binding is regulated by the Directive № 157-T which confirms the advisory character of the document. This legislation paradox brought the situation in which CB has all the authority to go beyond its power in applying sanctions against the banks for non-compliance with the AML legislation as the Federal Law “About Banks and banking Activities”, which gives CB the right to withdraw banking licenses, does not limit the list of infringements of the AML legislation. This discussion, however, will be followed in one of the next sections of this chapter.

108 The Directive is devoted to the single operation of lending by a natural person to a legal entity and caused a lot of discussions as it seemed to have dual interpretation and inconsistency with 115-FZ.
110 The legal documents adopted in RF are considered to have entered into force only after official publication in special journals.
The analysis of the documents adopted by CB in 2006 and 2007\(^{111}\) shows that most of them are non-binding recommendations concerning observance of 115-FZ and CB’s documents especially addressing the issues of the transactions identifications and reporting. It proves that the regulator is still proactive in the field of AML activities. However, the effectiveness of its attempts to build the cooperation relationship with the banks is under the question.

To sum up, the analysis of the legal documents presented in Table 2 and conducted in this section envisages several facts. First, the main legislative basis has already been elaborated by the regulator so far. Second, as soon as it was done, there appeared the necessity of implementation of this basis into real practice of the banks. Third, there are still a great deal of misunderstanding and misperceptions by the banks of the main provisions of the AML legislation in Russia. Forth, this misperception is conditioned by the discrepancies between the legislation and the possibility of its implementation. Fifth, these discrepancies seem to affect the cooperation between the regulator and the regulated, which is one of the main principles of the effective functioning of the AML regime. There is a question: is there unwillingness or inability of the banks to cooperate with the other participants of the preventive AML activity in Russia? The next section will reveal the behavior of the main actors in preventing ML – banks – in trying to comply with the AML legislation and implement it in practice.

4.2. Behavior of the banks

This section is based on the analysis of the main violations that are reflected in CB legislative documents (in particular, CB’s Directive 98-T which was analyzed in the previous section of this chapter) addressing the regulated banks, on the interviews obtained from the mass-media as well as on the personal interviews with the bankers of different rank from several banks. The chosen banks include a top-ten bank, participating in the mutual convention of AML law compliance and cooperation in this field\(^{112}\), a small-sized bank and several regional branches of medium-size banks.

Table 3 presented in Appendix 3 summarizes the violations of 115-FZ as defined by CB. As discussed above the Directive 98-T represents a non-binding recommendation or guidance to CB’s employees responsible for the inspections concerning the AML legislation implementation in the banks. As also discussed above, even the recommendations issued by CB are perceived by most of the banks as binding and are widely used

\(^{111}\) See Table 2.

by them in implementation of the AML rules and procedures. The list of violations enclosed to the Directive 98-T which is called as “Model list of AML legislation violations and recommended sanctions” is used in this research as a base to analyze the behavior of the banks. Column 2 of Table 3 lists the “model” violations\textsuperscript{113}, and the next three columns which are categorized Bank 1, Bank 2 and Bank 3 according to the grouping of the chosen banks described above contain behavioral patterns of the chosen agents. The results of this analysis will be presented from the behavioral perspective in order to reveal the common attitudes and perceptions of the banks towards the legislation. The analysis will also reveal the reasons of particular attitudes as well as it will show the discrepancies in the regulator-regulated relationship.

According to the federal AML law 115-FZ all financial institutions, particularly, banks, have the obligations for the implementation of the AML procedures inside the organization.\textsuperscript{114} In particular, article 7 of 115-FZ requires the banks to elaborate the internal control rules as well as designate the compliance officer responsible for the AML procedures. The failures by the banks to fulfill the regulatory obligations are considered by the regulator as the AML legislation violations which are subject to sanctions. The analysis of the banks behavior was conducted with the help of Table 3 which was taken as the base in observing the banks behavior.

To start with, table 3 demonstrates that while every bank fulfills the obligation of appointing the compliance officer and establishing internal control rules, the deadline set by the regulator for these procedures is in some cases neglected. The practice has shown that the documents are signed post factum and the necessary amendments to the AML internal documents are failed to be made at a proper time. This concerns mostly the small-sized or medium-sized banks where the AML legislation is not yet properly perceived by the personnel.

Further on, all financial institutions are required to establish the AML program that includes the following internal AML policies, procedures and controls: designating the compliance officer, detecting and investigating money laundering activities, determining suspicious operations that fall into compulsory control, as well as unusual transactions and suspicious operations, filing timely reports about them, instituting constant employee training programs. As the AML program concerns such a wide range of activities, it is presumed that the quality of the internal control rules predetermine the effectiveness of the bank’s AML performance. The legislation prepared by the regulator, as was discussed in this paper, leaves the banks a great degree of freedom in interpreting the suspicious and unusual transactions which they have to report what differs greatly from one institution to another. At this point it is important to note that the provisions of the law are not clearly expressed, for instance, the provisions of CB’s 99-T and

\textsuperscript{113} The translation of the word “primernyi” which is used in describing the list of violations can, however, be interpreted not only as “model”, but as “inaccurate”, “inexact” or “incomplete” (author’s note).

\textsuperscript{114} See 115-FZ.
262-P regulations that concern the recommendations on the internal control rules, identification of customers and beneficiary owners. The formulations such as “proper identification” or “possible measures” certainly gives freedom in interpretation and are found dissatisfying by the banks as they increase their risks of being easily found the reason to be accused in the violation of the law as the regulator can consider any action (or non-action) of the bank in clients or beneficiary owners identification as being “not proper” or not enough.

Banks are required to know their customers not only at a client level but at a transaction level monitoring the clients’ accounts movements. Article 6 and 7 of 115-FZ require the financial institutions to maintain records of suspicious financial transactions and report them as well as unusual operations any time a financial institution decides it is unusual. According to Lee, transaction monitoring is an essential part of the AML program. The reporting of the suspicious transactions obligation is fully executed by the banks but sometimes is accompanied by the disrespect of the deadline. However, according to the statistics, there is a constant improvement in the banks performance expressed in increasing quality of the reports and number of the operations reported. According to the CB’s “Banking sector and banking supervision development in 2006 report” the number of the reports sent by the banks in 2006 including both suspicious and unusual transactions doubled comparing to the year of 2005 (from 3 million to 6.1 million STRs). According to the same report, sixty three percent of the reports contain information about unusual transactions. The great number of the reports sent by the banks, on the one hand, is explained by both improvements in technical equipment and programming tools, and skills in better understanding of the AML techniques, which took time to be developed by the banks. On the other hand, there is a negative reason of the increasing number of the reports which shows the banks’ intention to avoid mistakes and “underreporting”.

The failures of some banks to include some transactions in the reports depend on the technical abilities and different degrees of technical advancements of the programming tools used in determining the transactions. Improving automation of the AML procedures is a current issue in the financial community and is as important as hiring highly-qualified AML department personnel. To take one example, in the case of determining terrorist participation in an operation the probability of errors made by the officers who check the terrorist lists manually increases greatly and sometimes even leads to ignoring of this procedure due to the lack of time or simple unwillingness of the

115 See Table 3 offence 10 and 11.
116 J Mountain, “Is the regulatory burden becoming too much for financial institutions?”, European Business Forum, no.21, spring 2005, p. 84.
This kind of behavior is observed in the small-sized banks while the big banks have better technologically provided processes allowing them to minimize the risk of making a mistake.

On the contrary to compulsory reporting obligation, the obligation of the keeping records and reporting of the cases of the refusal of opening bank accounts by the banks is ignored by them in most cases as this obligation is believed to cause additional costs and troubles by the personnel and perceived as unnecessary disturbance in the working process. Moreover, this kind of behavior can be explained by the mentality of the officers who basically happen to believe that the effort of doing some job is not worth unless there is a risk that undone job can be revealed and punished. Indeed, if the records of refusal of opening accounts cases are not kept by the bank (and consequently, the reports of these cases are not sent to the supervisory authority), how can it be checked and punished?

Proper following the AML procedures inside the financial institution requires not only formal recognition of the federal law and the regulator’s recommendations but the deeper understanding of the importance of the international recommendations. “Specialised expertise is required to develop, implement and administer appropriate compliance programs…” This brings attention to the problem of the personnel qualifications and training in the AML activity. According to the law banks must have comprehensive training programs for their staff. The research showed that if this problem is given a great deal of attention in the big bank where there are constant training sessions provided for the staff, all new employees are required to pass the introductory AML procedures course and there observed a principle of personnel maximum involvement into the AML process, the small-sized and regional branches are not concerned about training obligation to the same extent.

Constant training process is, however, essential for the effectiveness of the AML activities. The “maximum involvement” approach is effective in primarily increasing the personnel understanding of the necessity of the bank activity in prevention ML. It is also important in avoiding the offences such as informing the clients about the AML rules established by the bank with the intention to help the customers to avert from performing the suspicious transaction. Unfortunately, this situation is still observed in small-sized and regional banks which “fight for the clients at any price”. The lack of knowl-

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119 See Table 3 offence 18.
120 The appropriate Russian proverb explaining such kind of behavior “Ne poiman, ne vor” which particularly means that the thief who has not been caught stealing can not be considered a thief was found difficult by the author to translate. The strong tradition to follow “wise” Russian folklore proverbs and sayings has been always a part of people’s mentality.
122 See Table 3 offence 8.
123 See Table 3 offence 9.
edge of the basic AML requirements forces the same categories of the banks to break the provision prohibiting the compliance officer to perform additional functions and tasks except the AML functions.\textsuperscript{124} The latter violation is typical for small- or medium-sized banks due to the lack of staff and their intention to save resources.

All in all, in spite of the fact that most professionals recognize the importance of the AML procedures, few of them admit that they truly understand the necessity of these new responsibilities. Most of them admit that the AML measures are still perceived by the banks as the extra burden which has changed the way the banks function and the nature of the bank as a financial institution. It is certain that the new legislation has had an impact on the banks' behavior in recent years. Many professionals cited that it has changed the way they treat customers. The clients are not treated as the business partners any more but as the material that must be scrutinized, investigated and always put under suspicion. On the other hand, they admit that clients feel in the same way - there is a growing deal of mistrust and suspicion that leads to misinterpretation of the main principles of conducting business.

There is still a need for the building of the compliance culture. AML compliance is perceived by the most bankers as a part of everyday work. However, they admit that the reason they implement AML measures is not because they want to but because they have to. The lack of understanding roots in the vague legislation, ambiguous definitions and explanations from the regulator and supervisory authorities about the AML global regime. The common perception of the bank officers is that compliance is the responsibility of the compliance officer or compliance department. It is an inevitable conclusion that the effectiveness of an AML program in a financial institution depends on the personnel maximum involvement into the process. Thus, compliance should become a part of the job function of every employee. Although bankers admit the importance of the training process, a lot has to be done to improve the situation. Very few small-sized or even medium-sized banks have introduced the comprehensible system of training of the personnel.

According to Markov, there are certain tendencies in the banks categorization due to their AML implementation behavior. He distinguishes so called “good middle-class banks” with conservative culture, quite big capital and good reputation which are most prone to respect the AML legislation.\textsuperscript{125} According to the author, those who violate the legislation fall into two groups – small-sized banks which often ignore the AML legislation even showing the obvious characteristics of being involved in ML activities and big- or medium-sized banks either with the share of state capital or with the “protection” from the supervisory bodies.\textsuperscript{126} The results of this research also prove that the

\textsuperscript{124} See Table 3 offence 3.
\textsuperscript{125} M Markov, “Problemy finansovogo monitoringa v bankovskoi sphere [Problems of financial monitoring in banking]”, Banking law, no.3, 2007, p.7.
\textsuperscript{126} Ibid.
banks have the flaws in implementing AML preventive measures into practice for different reasons. The next section discusses the conflicts that have been raised in banking community in recent time.

4.3. Conflicts and debates

The proposal of the new amendments to the AML legislation concerning the right of the regulator to apply stricter and tougher sanctions for non-compliance by the banks with the AML regulations in October 2006 opened the debates within the banking community criticizing the new AML legislation provisions. The debates were heated by the supporting interest groups such as Association of Russian banks (ARB)\(^\text{127}\), Association of regional banks of Russia (ASROS)\(^\text{128}\), Moscow International Currency Association (MICA)\(^\text{129}\), Russian Union of Producers and Entrepreneurs (RSPP)\(^\text{130}\), Project of National Development\(^\text{131}\) all criticizing the current domestic AML regime. The proposed amendments of allowing the regulator to withdraw the license for the second case of AML legislation violation by the banks were argued to lead to the mass banking licenses withdrawal due to the vague provisions of the AML legislation.\(^\text{132}\) The intense response of the banking community put the debates to the parliamentary hearings and showed the defects in functioning of the domestic AML regime when it comes to the implementation of the current domestic AML legislation. It also revealed the conflicts of interests between the actors of the regime discussed in this section leading to the conclusions about domestic regime functioning.

Following the discussions of the previous section of this research, there may be several conflicts of interests designated after several years of the functioning of the AML regime in Russia. First of all, the conflict between the regulator (CB) and the regulated (financial institutions - banks) breaks the main principle of the effective AML regime - the principle of the cooperation between the actors. As seen from the research the regulator’s legislation base adopted for the banks is far underdeveloped and ambiguous. Having so many definitions, regulations and rules, unfortunately, do not make the task of implementation of the AML procedures by the banks easier. On the contrary, the vague definitions increase the risk of ambiguous interpretations of the legislation provisions which lead to the law violations.

\(^{127}\) See the official site of ARB - http://www.arb.ru.

\(^{128}\) See the official site of ASROS - http://www.asros.ru.

\(^{129}\) See the official site of MICA - http://www.mmva.ru.

\(^{130}\) See the official site of RSPP - http://rspp.ru.

\(^{131}\) See the official site of Project of National Development - http://www.prorazvitie.ru.

Lately, the regulator has established that a number of Russian banks have failed to comply with the AML regulation and applied sanctions for non-compliance. According to Mamontov, the president of MICA, fifty three out of sixty banks which lost their licenses in 2006 were punished for non-compliance with the AML legislation. Indeed, this research revealed that every bank participating in the research including the big one has been found not fully compliant with different AML regulations. This statistics shows that the regulator is active in the AML sphere but it often goes far beyond its power when it comes to the AML implementation. It is not a secret that the situation of unlimited power leads to the cases of corruption and empowerment of the CB inspectors. Even the procedure of the license withdrawal held by the CB without a bank’s acknowledgement violates banks’ basic right to be protected in court.

Wishing to regulate the conflict between CB and the financial institutions, the latter appealed to the former with the proposal to suspend sanctioning for non-compliance established before the year 2006 when the legislation was most complicated and procedures were not clear. CB’s refusal to respond to the plead of the banks caused the deterioration of the situation and led the bankers to the assumption that the license withdrawing according to the AML legislation violations is another way of cleansing in the banking community. “CB became not a regulator but a force structure whose functions are not regulation and supervision but investigation, proving guilty, prosecution and punishment. Its requirements make the banks to become crime detection agents.”

The first conflict leads to another conflict of interest – the conflict within the banks. On the one hand, a bank is a financial institution aiming to get profit from the financial operations. On the other hand, the AML legislation has indeed changed the nature of the financial business. The banks are forced to limit their operations often refusing their clients and losing their profit. The dilemma of banking secrecy revealed the inconsistency of the AML federal legislation with the civil law. As discussed in the section “Legislative base for the banks”, the general non-compliance of the AML legislation with the civil law also concerned the suspension or refusal by the banks to conduct some

136 Ibid.
operations which caused their civil and financial liabilities before the clients.\footnote{The amendments to 115 FZ attempted to solve these dilemmas by “allowing” the banks to refuse their clients and to break bank secrecy with no civil responsibility emerging in this case (see 131-FZ dated 30.10.2002). This, however, does not eliminate the problem of general accountability of Russian laws.} Cost-benefit dilemma questions the banks’ willingness to comply with the AML rules. While compliance with all the regulations is highly costly, the benefits are not clearly designated.

The emergence of the domestic AML regime has indirectly led to the conflicts of interests between the CB and investors and creditors of the financial institutions. The sanctions applied by the CB to even financially accountable and stable financial institutions harm their reputation as well as the reputation of their investors. It increases the risk borne by the investors as well as the risks borne by the customers. Maintaining “good” reputation in the eye of the regulator has become a primary task of the banks in Russia. After regulator’s accusations of the banks AML non-compliance and withdrawal of banking licenses in 2004, the American banks reacted by closing correspondent accounts for most of the Russian banks. The situation led to the banking crisis which swept away a considerable amount of small-sized banks from the market and even harmed a number of medium-sized banks.\footnote{A Cherepanov, “Borba s otmyvaniem dohodov: realnye tseli i posledstviya [Fight with money laundering: real aims and consequences]”, Banking, no.3, 2006. Available at http://www.prorazvitie.ru/show.php?action=show_stat_prn&mykey=432 (29 October 2007).} Eventually, the nature of the current domestic AML regime stands against the main purpose of CB stated in the Federal law “About Central Bank of Russian Federation” which is “to maintain the stability of banking system and protect the interests of investors and creditors.”\footnote{See article 56 of the Federal law “About Central Bank of Russian Federation”.}

Finally, the peculiarities of the domestic AML regime have caused the conflict of interests between CB as a regulator and Rosfinmonitoring as a FIU. “CB does not let the government to control its supervision”.\footnote{D Butrin, “CB zashitit sebya ot izbytochnyh soglasowania [CB protected itself from excessive coordination]”, Commersant, no.20 (3596), 2007. Available at http://www.kommersant.ru/doc.aspx?docsid=741240 (29 October 2007).} CB is argued to go beyond its authority in the AML sphere. It also seems that Rosfinmonitoring plays much less important role in the domestic AML regime. The excessive power of CB is expressed not only in the sole decision-making in sanctioning the financial institutions, but in the right to adopt the AML legislation without coordination with other actors involved in the regime. The main idea of cooperation between the actors within a regime is violated by the domination of one actor which seems to enjoy the domination and unlimited power. According to Booksman, the first deputy general prosecutor, and Zubkov, the former head of Rosfinmonitoring, the regulations adopted by CB without consultations with the banks and

\[\text{\footnotesize 137 The amendments to 115 FZ attempted to solve these dilemmas by “allowing” the banks to refuse their clients and to break bank secrecy with no civil responsibility emerging in this case (see 131-FZ dated 30.10.2002). This, however, does not eliminate the problem of general accountability of Russian laws.}\]
\[\text{\footnotesize 139 See article 56 of the Federal law “About Central Bank of Russian Federation”.}\]
Rosfinmonitoring itself are indeed weak and ambiguous in their interpretation which creates the situation favorable for the corruption prosperity.\textsuperscript{141}

Fortunately, the debates launched by the banking community as discussed above led to the amendments to the 115-FZ which implemented co-decision procedure between CB and Rosfinmonitoring for adoption of the new AML legislation for the financial institutions.\textsuperscript{142} Although most regulations have already been adopted by the regulator, the amended provisions do not concern these documents, but contain the condition of their validity till the year of 2009. It is hoped that the implemented co-decision and coordination procedure between the actors will affect the quality of the regulations adopted by the regulator. Apparently, the conflict of interests between them substantially hinders the development of the effective domestic AML regime. However, the improvements have one big shortage – there is still a great need for the involvement in the co-decision procedure of the actors playing the main role in preventive AML procedures – financial institutions.

4.4. Conclusion

The discussion raised in this chapter revealed the main actors’ perceptions and behavior in the domestic AML prevention. The attention here was focused on the three main aspects of implementation of the AML procedures – regulator’s legislation, behavior of the actors and the conflicts of interests between them. The main concluding remark is that the practices so far has showed the failure of the financial institutions to comply with the AML regulation. The question arises as to why do the financial institutions fail to meet the expectation of the regulator to comply with its rules?

The research reveals several reasons for failing to comply with the AML regulations. First of all, the study of the legislative base shows that, apparently, the rules that are easy to write are, however, often hard to implement. Simply speaking, the discrepancies are explained by the fact that the rules are written by the theorists but implemented by the practitioners whose views vary greatly for different reasons. The main reason is that the regulators’ vision is much more limited comparing with the view of the practitioners’. The ambitions of the regulator to make the banks go far beyond their obligations are clearly seen as well as it is exaggerated by the unwillingness of the former to provide better clarification on the AML regulation implementation and take responsibility for its actions. The research showed that most of the interviewees agreed that as the AML laws are too flexible to different interpretation and basically do not explain what is allowed and what is not absolutely allowed, the state must have provided better understanding and clarity in the implementation of its rules.

\textsuperscript{141} M Builov, ”\textit{Nadzor na vashu golovu} [Supervision to your misfortune]”, \textit{Commersant Dengi}, no.7 (613), 26.03.2007. Available at \url{http://www.kommersant.ru/doc.aspx?docsid=745286} (29 October 2007).
\textsuperscript{142} See Federal law 51-FZ dated 12.04.2007.
Secondly, the study of the perceptions of the idea of AML by the professionals showed that most practitioners do consider the AML regulations to be important. However, it is important to understand that the bankers see money from different perspective than the regulator. Whether regulator likes it or not the bankers will never spend a great degree of time focusing too much on the origin of the money which is being offered to them for investment, or to put it simply, as a profit source. It means that most professionals do not see the financial crime in the same way as the regulator.

What also became obvious from interviews is that the AML compliance activities are driven by fear rather than common sense and desire to contribute to the fight against money laundering. From a financial institution view, the main fears of non-execution of the regulation are not fines or bad publicity but the worst outcome which presupposes withdrawal of banking license with the possibility of criminal investigation by the authorities leading to prosecution and possible imprisonment. This (not better implementation of the regulations) explains the increased number of reports sent by the banks to Rosfinmonitoring. Moreover, the vast majority of them consider that the impact of the preventive measures that are so well executed in the banks is too small.

At the same time, the research among the bankers reveals that there are still a great number of the financial institutions, especially small ones or regional banks or branches that do not believe that the ML is an important issue as such. The research also showed that outside the banks’ compliance departments the AML regulations are perceived as an additional burden and an obstacle to conduct business. The KYC procedures as they are organized in Russian banks are considered to be counter-productive and costly practices and the AML rules implementation in general is perceived to cause significant costs and efforts by the banks.

Thirdly, the research revealed the conflicts that were discussed in this chapter and showed that the main principle of the effective functioning of any regime – cooperation – has been questioned in the case of AML domestic regime. The preventive goals of AML are not relevant for a bank’s decision. Banks do not take part in discussions on the improvements of the AML legislation, while the regulator enjoys unlimited authority in supervision and sanctioning. Rosfinmonitoring seems to play less important role in the prevention of the money laundering than CB. The banks being tied up with the excessive supervision from the regulator seem to have no intentions to contribute to the idea and goal of AML, neither do they think of creating their own AML strategy. How to apply the never-ending AML rules and not be punished for that is now a big concern for the banks.
5. Theoretical discussion and implications of the results

As the international community clearly recognized that the problems of ML are transnational and require a coordinated approach the creation of international AML regime was in line with their primary objectives. Indeed, the nature of the money laundering crimes lies in the sphere of transnational relations and the ground idea of the contemporary liberal institutionalism that regimes are the “…mechanisms for delivery the effective governance of international or transnational relations.”143 Indeed, in today’s global world, the more integrated and connected the global financial system becomes, the easier it is for launderers to move dirty money across borders.

5.1. International regimes

The theory of institutionalism which is a core theory, explaining international regimes, leads to the reasons of the regime creation by the states. According to Keohane, the regimes are important, first of all, because they can facilitate reciprocal agreements and the enforcement of these agreements creating “…a more favorable institutional environment for cooperation” in spite of the absence of the world government.144 The essence of the institutionalism suggests that the international organizations, if we perceive them as “sets of practices and expectations rather than in terms of formal organizations with imposing headquarters buildings”, are the gateway to pursuing own interests of the stakeholders by providing information and reducing the costs of transactions, thus “…facilitating interstate agreements and their decentralized enforcement.”145

The effectiveness of any regime can be evaluated from two points. First, to see if a regime is effective one should look at the extent to which its members follow norms and rules. Second, one should also look at the extent to which the objectives or purposes of the regime are achieved. The study of any regime comprises these two ideas. The global AML regime, thus, can be investigated from these two perspectives considering the two pillars of the regime, mentioned in this research. The prevention pillar of the global AML regime induces to investigate the effectiveness of the regime by studying its members’ compliance with its principles and norms while studies of the enforcement pillar show if the prime objectives of the global fight against ML are attained. This particular research paper has limited its scope to the study of the prevention pillar of the AML regime focusing on the financial institutions that play the most important role in the regime that facilitate international efforts and cooperation in the fight against ML, and, consequently, are the main actors in the prevention of ML.

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143 B Rosamond, Theories of European integration, Palgrave, Basingstoke, 2000, p. 167.
145 Ibid.
5.1.1. **Regime theories**

The studies of international regimes have emerged long ago and have counted different schools of international relations theorists. According to Hasenclever et al., three distinct approaches to analyze regimes emerged assuming that regimes can be identified and studied using behavioral, cognitive or formal criteria, using respectively, interest-based (or neoliberal), knowledge-based (or cognitive), and power-based (or realist) approaches.\(^{146}\) In spite of existence of numerous theories studying international regimes and approaches used to analyze international regimes, there has been little attention paid by the scholars to the domestic dimension of a global regime. As Haggard and Simmons conclude, there has been neglect of domestic dimension of international cooperation.\(^{147}\) Following the scholars, I propose that the effectiveness of the global AML regime as any other depends on the effectiveness of the constituents of the international regime and vica versa.

It can not be argued that the rising interdependence and globalisation makes us take into consideration not only international dimension of international regimes but also look at its national components – domestic jurisdictions. One of the scholars studying international regimes, Oran Young, gives the definition of interdependence as the “extent to which events occurring in any given part or within any given component unit of a world system affect (either physically or perceptually) events taking place in each of the other parts or component units of the system.”\(^{148}\) Consequently, growing interdependence eliminates the borders between international and domestic policies, and domestic politics become part of the collective action in reaching specific goals. International regimes are created when cooperation or collective action is needed, and regimes facilitate cooperation. When a regime fails to achieve its prime purposes or lacks effective cooperative mechanisms, the studies of constituent parts are needed.

It is obvious that the variables used in different approaches to the studies of international regimes are important to answer different questions about the regimes. The same approaches and methods can be applied to the study of domestic regimes with the purpose of regulatory harmonization.

5.1.2. **International vs. domestic regimes - the need for harmonization**

The rules and regulations that a regime creates must be harmonized. The harmonization is not an easy task as the task to assess the effectiveness of an international regime is


even more difficult but necessary for understanding of the demand for harmonization. However, if to start analyzing an international regime by parts, there can be an understanding about what is wrong and how to treat it.

This particular research consists of two parts. First, the formal domestic regime is studied as it was created according to the international norms and standards. The results have shown that the domestic regime, formally institutionalized, complies and fits into the global AML framework. What makes the governments create regimes? Why do governments want to have their domestic AML regimes in compliance with a global one? Beth A. Simmons has tried to answer these questions suggesting a framework that explains mechanisms that drive regulation harmonization within different regimes. In her work she concludes that in case of AML regulations, the framework, based on the analysis of two variables – the incentives of other regulators to emulate or diverge from the new regulation, initiated by a “dominant center” on the one hand, and the reaction of the initiator or externalities on the other, works as follows. As a new regulation is always initiated by a dominant center, there is always reaction of other regulators involved in the regime – both negative and positive. According to the nature of this response, the dominant center corrects the strategy to spread its influence, as the domestic center has already determined its interests in the issue-area.

Thus, in case of the AML regime the initiator (which is the USA as discussed in this research) has faced resistance as most jurisdictions have been concerned with different dilemmas. Indeed, the banking secrecy or cost-benefit dilemmas have created the resistance to adopt AML legislations and, thus, to cooperate. Simmons continues that the dominant center’s response to the high degree of divergence in AML efforts was to establish a multilateral institution which uses only one instrument – “peer pressure” – to make governments to adopt the AML regulations. It is significant to say that in this situation such a mechanism to facilitate cooperation between the countries in ML area has worked, as the considerable progress in spreading of the AML rules have been seen. However, Simmons notes that still the AML process of the development of the AML regime has been “slow, partial and … highly politicized process”.

This particular study of the domestic AML regime shows that the process of institutional arrangements has been quite complicated and took a long time. In the period of establishing of the regime, the country was included in the list of NCCTs, and the process of adopting international norms has been observed by the multilateral organization – FATF. A lot of changes in legislation had to be made and a new institutional AML framework had to be built according to FATF recommendations. It is undoubtful that

150 Ibid., p.607.
151 Ibid., p.616.
the new AML regulations and institutional arrangements influenced all actors of the domestic AML regime.

In addition, as Putnam puts it, “we need to move beyond the mere observation that domestic factors influence international affairs and vica versa, and beyond simple catalogs of instances of such influence, to seek theories that integrate both spheres, accounting for the areas of entanglement between them.”\textsuperscript{152} In pursuit of this aim, the two-level approach is suggested by the author to be applied to international cooperation. At one level, the government representatives try to comply with the international AML agreements and at the same time they seek to obtain support from the real actors – financial institutions – who play the most important role in the AML regime. These two processes should happen at the same time. As Putnam notes, the crucial point is that “central decision makers (“the state”) must be concerned simultaneously with domestic and international pressures”.\textsuperscript{153}

On the international level, the willingness of the government to comply with international AML rules and regulations is connected with rising levels of interdependence of Russian economy and politics with the international system. Undoubtedly, that today the state depends on the international system. Compliance with the AML rules means to show common interest in the problem of ML and FT. It also means that the country acknowledges the necessity of maintaining of its reputation. Non-compliance, on the contrary, is dangerous as it can cause both sanctions from the multilateral institutions and even greater costs that can emerge from refraining by other countries from economic cooperation. The case of a banking crisis caused by closing by American banks relationships with a number of Russian banks empirically illustrates this argument. Moreover, as discussed above, there are international mechanisms, such as peer pressure, which “promotes” maintaining of the AML regime. In addition, the impact of uncertainty is crucial in creating regimes.\textsuperscript{154} It is uncertainty that makes the governments to agree with international agreements, especially those already created by the initiator, as happened in the case of AML regime.

To understand regimes at the domestic level it is important to analyze different actors including, according Putnam, “parties, social classes, interest groups, legislators and even public opinion, not simply executive officials and institutional arrangements.”\textsuperscript{155} If interest-based and power-based theories of international regimes mainly


\textsuperscript{153} Ibid., p.431.


help to understand the regimes emergence and maintenance, as well as their forms and structures, knowledge-based (or cognitive) approach seem to question the convergence in the constituents of an international regime, and thus, the possible reasons of divergence within them.

5.1.3. Cognitive approach to the studies of international regimes

The increasing complexity of the problems that need international responses such as ML or FT makes it difficult for the decision makers to choose the right means to achieve identified goals. It is inevitable that even if there is a mutual goal to fight ML and international agreements that must be fulfilled there is divergent understanding of the reality. This diversity, on the international level, can make “rule-governed cooperation” difficult or even impossible if the rules are applied differently.156 Through two-level game approach the same diversity of interests and understandings can hinder cooperation at the national level. The empirical research showed that the diversity of shared interest and understanding does not only hamper cooperation between the actors of the domestic AML regime but causes conflicts of interests as discussed in the previous chapters.

Taking the cognitive approach as a theoretical base I will further try to explain the failures of the domestic AML regime from the theoretical perspective. The core concept of any regime is cooperation. Cooperation is needed to make regimes work. Without joint efforts to fight ML as an international crime, a crime without borders, this task would be unachievable. However, in the complex and interdependent world it is impossible just to ignore the particular parts of the global AML regime. The effectiveness of its constituents, domestic regimes, directly affects the attained collective goals. Again, according to Milner, consideration of domestic politics is significant in understanding international cooperation.157 Thus, the approach used by cognitivists to analyze international regimes must be applied to domestic regimes as well.

The cognitivists assume that uncertainty is an integral part of our reality. This idea reflects Oran Young’s concept of the veil of uncertainty which accompanies decision makers.158 In international regimes the reduction of uncertainty leads to higher cooperation. If diversity makes cooperation impossible because the rules are applied inconsistently, as argued above, the convergence, on the contrary, will facilitate cooperation. Using the cognitivists’ philosophy the following assumption can be made – reach-

ing convergence would eradicate uncertainty about the issue and the other actors and thus, bring higher cooperation between the actors of the regime. Convergence of the perceptions of the reality between the actors of any regime at different levels – international and national – could be reached, according to cognitivists, through three main channels – ideas and shared understandings, learning and epistemic communities.\(^{159}\)

In case of the AML regime all three channels seem to be essential elements in functioning of the regime. The domestic AML regime created several years ago still envisages lack of shared understanding or a common idea about the purpose of the regime. Simmons’s analytical framework, discussed above, seems to ignore the necessity of all the actors of a global regime to understand the common idea of the regime which is created by a dominant center.\(^{160}\) Hasenclever points out that Peter Hass also argues that knowledge is not necessarily to be shared by all the actors if there is a hegemon in the issue-area.\(^{161}\) This argument can be agreed with on the stage of regime formation. However, regime maintenance is more important as soon as it was created, no matter how. Here, shared ideas and knowledge help to explain the actors the content of the regime.

As we have seen from the empirical research the main actors of the domestic AML regime, and, particularly, its prevention pillar, are financial institutions. What happened on the stage of the regime creation was mere lack of shared understandings about the future regime’s aims, goals and the means to reach them. The banks faced the new legislation which brought significant burdens and the necessity to elaborate new compliance mechanisms. The purpose of this new legislation, as seen from the empirical research, shares no common understanding of the AML rules outside the compliance departments of the banks. Meanwhile, the new regulations sowed confusion about compliance mechanisms with the “mysterious” norms which contradict constitutional law and common banking principles and practices. It is also true that shared understanding have not fully been reached and proved the correlation between the effectiveness of the regime and primarily, shared understandings of its content and aim.

Following the line of cognitivists’ argument, the empirical research proved the argument that epistemic communities must play a key role in creating internationally shared understanding of the AML regime. Here again, we return to the evidence that systemic-level factors are very important. It means that again, “cooperation may be unattainable because of domestic intransigence, and not because of the international sys-


\(^{161}\) Ibid., p.216.
Following this argument the international cooperation can be successful if domestic actors support internationally accepted agreements. In other words, international agreements “can only be implemented if key domestic actors concur”. Consequently, the consent between the actors with the new AML regulations would decrease uncertainty between them through shared understanding.

5.1.4. Epistemic community approach

The importance of analysis of the domestic actors such as financial institutions in this research is confirmed by the cognitivists’ ideas of epistemic community which were pioneered by Ernst B Haas and John Gerard Ruggie. According to Adler and Haas, “between international structures and human volition lies interpretation.” The studies of ideas of epistemic communities enable us to abstract and erase the “artificial boundaries between international and domestic politics.” The epistemic community approach is distinct within the cognitive approach. It distinguishes epistemic community from other groups as well as it emphasizes the influence that these knowledge-based groups can have on decision makers. Haas introducing the approach calls for the necessity of comparative studies of countries in which the epistemic community has been active or not. Moreover, Hasenclever et al. argues that “more research is clearly needed to demonstrate when and how epistemic communities and consensual knowledge affect policy coordination.”

Before making any particular theoretical assumptions within our research, we need to turn to the concept of epistemic community proposed by Haas. According to the author, epistemic community is a knowledge-based network of experts who play an essential role in “articulating the cause-and-effect relationships of complex problems, helping states identify their interest, framing the issues for collective debate, proposing specific policies and identifying salient points for negotiation.”

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163 Ibid.
165 Ibid., p.367.
166 Ibid.
is different from any other groups emphasized by Putnam\textsuperscript{170}; however, it conglomerates the main functions of all of them. The important distinction of epistemic community is that it is, according to Haas, “a combination of having a shared set of causal and principled (analytic and normative) beliefs, a consensual knowledge base, and a common policy enterprise (common interests)…”\textsuperscript{171}

According to the theoretical concept of epistemic community, it becomes evident from the empirical research that the domestic banking community would perfectly fulfill the role of such epistemic community. I assume that epistemic community would include the representatives of the regulator, banking practitioners as well as interest groups such as ARB, ASROS, MICA, RSPP, and such, discussed in the previous chapters and which are represented by experts in banking.\textsuperscript{172} The epistemic community approach is evidently addressed to the creation of regimes; nevertheless, I argue that this approach is perfectly suitable for analyzing the failures of the domestic AML regime. The purpose of such analysis could be the attempts to repair the faults and erase deficiencies of the existing regime. As Haggard and Simmons note, “Knowledge and ideology may then become an important explanation of regime change…”\textsuperscript{173}

How can the epistemic community approach be applied to the AML regime? I assume that the banking community playing the role of epistemic community could have a great influence on the AML regulations elaborated by the government. It is often true that the decision makers having to act under uncertainty have poor or unclear understanding of complex issues. Who is hypothetically the best to know how to implement different AML procedures into the banks’ everyday practices? The AML legislation introduced to its main executors without their advice was on its way to failure. It is also true that the vague AML legislation created the situation of formal compliance which is based on the fear of sanctions rather than on common sense. Moreover, the empirical research showed that there was no integrally working system of ML prevention as it was supposed to be. Rather, the AML procedures have been highly ineffective, AML legislation is ambiguous and sanctions posed on the financial institutions are severe.

As Haas fairly notes, “it often takes a crisis or shock to overcome institutional inertia and habit and spur them (decision makers) to seek help from epistemic community.”\textsuperscript{174} The empirical prove of this argument exposes the validity of using this approach to the study of the AML regime. Conflicts that have been tearing up the actors of

\textsuperscript{170} See ref. note 155.
\textsuperscript{172} See chapter 4.3.
the domestic AML regime so far, have moved the decision makers from the dead point by making them to amend the AML legislation to some extent. However, the degree of understanding of the necessity to consult epistemic community by the decision makers is extremely low. The importance of epistemic community is, nevertheless, essential.

According to Hasenclever, the epistemic community has functions of policy innovation, policy diffusion, policy selection and, in overall, regime persistence.\textsuperscript{175} There are two arguments empirically supporting this hypothesis. First, experts are profound in defining the results of any event, including policy implementation, as decision makers generally “are unable to assign numerical probabilities to the various answers of what will happen…”\textsuperscript{176} Even theory of bank regulation proposed by Joseph Stiglitz and Bruce Greenwald suggests that the important idea is that the regulators act in the conditions of uncertainty and do not have relevant information that the regulated have; if they did, they could themselves do the job of the regulated.\textsuperscript{177} In connection with that, the regulator tries to control or affect banks behavior applying controlling mechanisms which can be either effective or not. The analysis of the controlling mechanisms of the regulator and behavior of the banks in attempts to comply with the AML rules revealed that the level of interaction between the banks and the regulator is low what leads to ineffective cooperation within the domestic regime as a result.

Second, epistemic community can influence policy innovation through their possible influence on the development of new regulations based on shared principles and standards.\textsuperscript{178} The possibility of the banking community to participate in the process of the AML legislation development is an important proposition. The authoritative function of the state, thus, remains the same. If the AML regulations would be adopted by the regulator with the consultations of the banking community, it would have been much effectively implemented into banking practices. In connection with that, the important question of legitimizing of the new policies by the executors arises when an epistemic community justifies a particular policy adopted by the government.\textsuperscript{179}

The legitimacy of the new regulations and consent within the epistemic community are two essential elements for the influencing the government. Haas hypothesizes: “The strength of cooperative agreements will be determined by the domestic power

\textsuperscript{179} Ibid., p.389.
amassed by members of epistemic community within the respective governments.”

The central point is that growing interdependence leads to the situation when groups at the national level have regime interests. It means that epistemic community can become a strong actor at the domestic level. Rising levels of interdependency also lead to the need for communication. Cognitivists assume that for regimes to be successful, the divergence between their members can be overcome through communicative action.

The Wolfsberg AML principles emerged in 2000 as a response of international banking community to the problem of ML support the idea of creating common understanding of the AML regime which would result in decreasing the uncertainties about the issue and diversity between the domestic regimes which hinder the business activity of, first of all, multinational banks. It is also reputational concern which drives the banking community to develop shared understanding about the issue. The joint declaration against ML which was signed by eight biggest banks in Russia, some of them being multinational, expresses the principles which would guide their professional activity concerning AML. The mainstream of these principles is expressed in sharing experience in ML prevention, common approach to the AML procedures, such as KYC, suspicious transactions identification and reporting, etc. Among the aims of the group there is elaboration of joint proposals on improvement of legal and normative base in the field of ML for the Bank of Russia and Rosfinmonitoring.

In sum, the epistemic community approach focuses on the impact that a network of experienced specialists can have on decision makers at, both, domestic and international level. It is evident from this research that the lack of decision makers’ attention to such kind of epistemic community in the domestic regime has led to the situation where misunderstanding and even conflicts between the actors prevail and hinder the main principle in the fight against ML – cooperation. Consensus and shared understanding and knowledge are needed to cause positive changes within the regime. The ability of epistemic community to alter perceptions and frame the context for collective response to the international problem of ML is essential for the effectiveness of the global AML regime.

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5.2. Regulation or risk-based approach?

The last discussion which is likely to appear in this research is the transformation of the regulatory approach from regulation based on rules to one that is based on risks. It has been argued by the scholars that the effective regime presupposes the compliance achieved.\textsuperscript{183} The studies of regimes have had a focus on the problem of compliance in the regulatory regimes. The compliance in the AML regime is based on the regulative rule-based approach. Moreover, compliance is closely connected to the cost-benefit dilemma, and the actors would tend, first, to violate the regulations if the probability of being caught is low and second, if benefits from compliance do not exceed the costs.

The recent studies of international AML regime have contrasted the risk-based approach to the regulatory approach based on rules. Most scholars have envisaged the deadlock in the development of the global AML regime, and what is more important, its ineffectiveness.\textsuperscript{184} The risk-based approach proposed by FATF 40 Recommendations has found its way to the AML procedures and practices in some regimes. However, eventually, FATF set out rule-based AML system.\textsuperscript{185} As Killick and Parody conclude, the term risk-based have been widely expressed in the revised FATF 40 plus 9 recommendations, however, the meaning of this term has remained obscure.\textsuperscript{186}

The proponents of the risk-based approach in the AML regulation have found preconditions for its implementation for the future AML regimes. First of all, as Geiger and Wuensch point out, the results of the existing AML prevention are disappointing – the crimes closely connected with ML still prosper. Meanwhile, banks being the main actors involved in ML prevention face high burdens.\textsuperscript{187} Moreover, they admit, that the rule-based approach could not follow the new methods and technologies used by money launderers and the regulators failed to “formulate detailed ML criteria”.\textsuperscript{188}

Second, as Ross and Hannan observe, overregulation which often replace regulation leads to additional costs, inflexibility and poor regulatory performance.\textsuperscript{189} As was discussed in this research, the main focus is placed by the banks to the compliance with the AML regulations rather than to the meaning of the collective action. On the one


\textsuperscript{188} Ibid.

hand, the authors name reporting overload as the main disadvantage of the regulation system. Increased number of reports, as was argued in the previous chapters, in our case does not mean the better performance in the AML efforts by the banks. Rather, it is explained by the lack of clear transaction identification criteria which leads to excessive reporting by the banks. On the other hand, as Jackman notes, there is a fine line between sufficient regulation and overregulation. He agrees that overregulation can worsen the results achieved from ML prevention. He names two effects that regulation has. The first one is that the practitioners tend to decrease their willingness to find AML solutions. Second, there is a tendency for inaction when the answer the practitioner is looking for rather than making her own judgment in decision-making is not found. The probability of inaction is, though, low, but again the excessive reporting occurs.

Third, as Edwards and Wolfe argue, “there is a need for the regulator and the banks to work as partners...” This argument is closely connected with the argument of excessive regulation. The empirical research points to the lack of cooperation between the regulator and financial institutions, as the banks consider sanctions posed on them by the regulator to be too severe especially in the situation when the regulator is unwilling to establish clearer AML criteria. This situation causes the excessive power of the regulator, conflict between the regulator and the banks, and as a consequence the lack of cooperation between them. Non-cooperative environment facilitates ineffectiveness of the “stereotyped identification regime”.

Finally, it is most important that while the costs of ML prevention for the society and economy are high, the benefits are not clearly seen. First of all, some authors argue that there is no data on ML showing the “inverse relationship between the degree of regulation and amount of ML taking place”. Mere demonstration of compliance by the financial institutions and “adequate regulatory control” by the government is not the objective of the AML legislation. It is true as the costs of regulation borne by financial institutions are high and the benefits are relatively small. Here, the idea of Ross and

191 Ibid., p.109.
192 Ibid., p.110.
196 Ibid.
Hannan that the AML efforts should be proportionate to the risks involved\textsuperscript{197} is highly vivid. This research has shown that the banks bear high implementation costs which increase the “cost of money” and, particularly, lead to the higher cost of loans.\textsuperscript{198} On the contrary, the benefits of compliance are usually seen as “flowing from the costs that are otherwise avoided”.\textsuperscript{199} Obviously, reputation is the only benefit resulting from compliance, although in practice, the benefit of compliance is the possibility to avoid severe sanctions from the regulator.

On the contrary, the proponents of the risk-based approach as a new AML strategy call for the move from the regulation based compliance with rules to the approach based on the assessments of risks. One of the arguments pro risk-based approach is that it is argued to erase the deficiencies caused by the regulation approach and discussed above. Moreover, however paradoxical would it sound, the risk-based approach would move the responsibility from the regulators to financial institutions.\textsuperscript{200} This move involves better understanding of the complex issue and AML decisions that are different from the traditional rule-based approach. The last and, what is more important, the main argument for transferring the responsibility to the financial institutions is that the latter already have considerable experience in risk management and have developed tools and practices that can be implemented in AML.\textsuperscript{201} Finally, as this research revealed the need for more detailed exchange of information between all actors of the AML regime, the important element of effective risk-based AML system which definitely argues for the move towards it is communication and information sharing between all actors of the AML regime.

6. Conclusion and further research

Although years have passed since the international AML regime was established to curb internationally recognised crime of ML, there is a common opinion that the current ML prevention framework fails to reach its original goal, which is to reduce predicate offences. This particular research paper, aimed at the prevention pillar of the AML regime, reveals only one side of the regime — prevention and does not discuss the other — enforcement pillar. Prevention of ML, however, has been acknowledged to be most important in the fight against ML.

Theories of international regimes considered in this research proved the need for analyzing domestic regimes as parts of international regimes and in their context. It is argued that including domestic dimension in analyses of international regulatory regimes is essential for facilitating international cooperation between diverse domestic structures. The need for harmonization of divergent domestic regulatory regimes has been showed to be essential for the international cooperation, objected by the regime creation. To understand the logic of this research, the two level game theory pointed at the government as, on the one hand, an authoritative foreign policy decision-maker and on the other hand, a sort of an intermediary between actors of both domestic and international AML regimes.

At the international level, as revealed in this research, the government seeks to comply with the global AML standards and norms for different reasons, such as rising economic and political interdependence in the world of globalisation, country’s reputational concern, great deal of uncertainty and international pressure from the regime initiator. Although international pressure has been used as the main incentive to streamline the AML processes, as it was concluded in this research, problems still persist with the efficacy of the international AML regime.

At the domestic level, as it was argued, for the regime to be successful, the government has to find support for its new policies from the regime participants, and to be more exact, to gain legitimacy of its decisions. Closer attention to the analysis of the AML practices of financial institutions, particularly, banks, was paid in this research for two reasons. First, it is empirical evidence that the banks are the main actors in the ML prevention. Second, the theoretical assumption about the role of bank practitioners as epistemic community gives incentives to look deeper at their actions in ML prevention in different countries, and particularly, in Russia.

It has been revealed in this research that although years after implementation of the AML regulations in Russian have passed, more amendments are needed. The paper clearly demonstrated that so far, practitioners in banks have found problems not only in the practical implementation of the regulator’s AML rules, but also, what is more important, in complying with them. The important fact is that the banks have no option but to
Comply with the domestic AML regulations. However, it is desirable, according to the empirical findings of this research, for AML regulations for banks to be further improved. As compliance with the AML rules emerges as the most pressing issue for the financial community, it would be better if Central Bank as the regulator could set out the rules which would bear transparency and clarity for their implementation. Moreover, it would be the demonstration that the regulator applies its rules in an even manner among all the regulated, particularly banks.

Moreover, it has been found in the empirical research that the lack of interaction between the regulator and the regulated hinders the development of the AML regime in Russia. It can be argued that CB should not issue the legislative documents without the consultations with Rosfinmonitoring and the regulated banks which have to comply with its never-ending regulations. The conflicts revealed in this research seem not to be won by the regulator with the attempts to apply stricter rules and regulations. Rather, CB should seek for the cooperation and partnership with the regulated. Taking into account the cognitivists theoretical assumptions, I believe that if the government wants to introduce a new regulation, it should do it in a transparent way, taking into consideration the opinion of those who are to implement the regulation into practice. There should be the place for the new changes to be debated, cost evaluated and reasonably assessed. As research has stressed, the traditional authoritarian approach which is used by the regulator nowadays simply leads to the communication and cooperation problems.

To facilitate cooperation, future research should be fostered at both domestic and national levels. It is essential to share knowledge about the regime characteristics, network links and connections, institutional and legal frameworks, and behavioral patterns of all the participants of the AML regime. On the one hand, government agencies should gather and openly provide detailed information about the efficacy of the preventive measures taken and results gained from the collective action, as well as the impact that the new regulations have on participants’ behavioral patterns. On the other hand, international bodies should focus their research at the domestic jurisdictions to reveal the context of domestic AML regimes as well as the needs for their improvement or development.

The decrease of uncertainty through knowledge sharing would foster cooperation between research, operational expertise and action at both levels. As the role of banking community is paramount in the prevention of ML, its support to decision-making and to design of supervisory strategies could be provided by better-structured knowledge and interaction between the actors. It would be also important to turn attention to the new approaches to banking regulation in the sphere of AML prevention as most experts consider the risk-based approach to be the most valid to guarantee most focused and efficient ML prevention. The resources should be allocated to the ML prevention proportionally to the risks the banks are facing. It is argued to lead to a better
use of resources and cost-benefit dilemma solving, tend to reduce bureaucracy and eventually, enable more laundered money to be ceased.

To sum up, despite practical difficulties it seems that Russia is trying to meet international norms and standards in the fight against money laundering. Banks as financial institutions undoubtedly bear great responsibility in combating this crime. As the best tool against ML relies not only on joint work within the international community, but also on the domestic laws and actors; compliance with international standards is essential to fight against such a crime, as well as the exchange of information and shared knowledge among the parties is crucial. In this case the Russian saying that the severity of Russian laws is compensated by non-compliance with them, which has dominated the Russian reality from old times, would not dominate in such even the global issue-areas as the fight against money laundering any more.
References


202 Legal documents adopted by the Bank of Russia, analyzed in this research, are listed in Table 2 of Appendix 2.


Directive № 92-T on organization of legal and reputation risk management in banks. (In Russian) Available at http://base.consultant.ru/cons/cgi/online.cgi?req=doc;base=LAW;n=54347;div=LAW;mb=LAW;opt=1;ts=B76F20EE56418B03B181EBCC7D25F68C (8 July 2007).

Directive № 112-T of 23.08.2006 (in Russian). Available at http://base.consultant.ru/cons/cgi/online.cgi?req=doc;base=LAW;n=62450;div=LAW;mb=LAW;opt=1;ts=BA5E2BDB5DC9312CBEF6F0FE2927BDF0 (8 July 2007).


Federal Law № 115-FZ “О противодействии легализации (отмыванию) доходов, полученных преступным путем, и финансированию терроризма [On Combating Legalisation (Laundering) of Criminally Gained Income and Financing of Terrorism]” (115-FZ). Available at http://base.consultant.ru/cons/cgi/online.cgi?req=doc;base=LAW;n=67646;div=LAW;mb=LAW;opt=1;ts=8B86AF1DCF0EA86B25101B1BCAD1805B (in Russian) (7 July 2007).


Rosamond, B, Theories of European integration, Palgrave, Basingstoke, 2000, p. 7.


Special Internet version of ConsultantPlus
http://base.consultant.ru/cons/cgi/online.cgi?req=home


The official site of Council of Europe http://www.coe.int/t/e/legal_affairs/legal_co-operation/combating_economic_crime/5_money_laundering/General_information/About_MONEYVAL.asp#TopOfPage.

The official site of FATF, see http:// www.fatf-gafi.org/.

The official site of FFMS at http://www.fedsfm.ru/eng/


Appendix 1. Table 1. Evolution of the AML regime in Russian Federation and globally

<table>
<thead>
<tr>
<th>Year</th>
<th>Russian Federation&lt;sup&gt;203&lt;/sup&gt;</th>
<th>Globally&lt;sup&gt;204&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>1980</td>
<td>Offshore Group of Banking Supervisors (OGBS) established</td>
<td></td>
</tr>
<tr>
<td>1986</td>
<td>Inter-American Drug Abuse Control Commission of the Organization of American States established</td>
<td></td>
</tr>
<tr>
<td>1988</td>
<td>ICPO-Interpol resolution on economic and financial crime</td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>Statement of Principles (Basel Committee)</td>
<td></td>
</tr>
<tr>
<td>1989</td>
<td>UN (Vienna) Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>RF ratified UN/International Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Decision of the Supreme Court № 1711-I)</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>Financial Action Task Force (FATF) established</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>Caribbean FATF established at Aruba meeting of Canicom</td>
<td></td>
</tr>
<tr>
<td>203 Column 2 of Table 1 is created by the author with the help of several sources: The FFMS at <a href="http://www.fedsfm.ru/eng/">http://www.fedsfm.ru/eng/</a>; International Money Laundering Information Network IMoLIN at <a href="http://www.imolin.org/imolin/index.html">http://www.imolin.org/imolin/index.html</a>; ConsultantPlus at <a href="http://www.consultant.ru/sys/english/">http://www.consultant.ru/sys/english/</a>; The Financial Action Task Force (FATF) at <a href="http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html">http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html</a>; Council of Europe at <a href="http://www.coe.int/t/e/legal_affairs/legal_co-operation/combating_economic_crime/5_money_laundering/General_information/About_MONEYVAL.asp#TopOfPage">http://www.coe.int/t/e/legal_affairs/legal_co-operation/combating_economic_crime/5_money_laundering/General_information/About_MONEYVAL.asp#TopOfPage</a> (13 November 2007).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
<td>Related International Instruments/Agreements</td>
</tr>
<tr>
<td>------</td>
<td>----------------------------------------------------------------------</td>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>1997</td>
<td>Article 174 of the Criminal Code enacted</td>
<td>International Money Laundering Information Network (IMoLIN) established</td>
</tr>
<tr>
<td></td>
<td></td>
<td>OECD report on Harmful Tax Practices</td>
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<tr>
<td></td>
<td></td>
<td>Asia/Pacific Group on Money Laundering (APG) established</td>
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<tr>
<td></td>
<td></td>
<td>UN Political Declaration and Action Plan against Money Laundering</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model Regulations Concerning Laundering Offenses Connected to Illicit Drug Trafficking and Other Serious Offenses released</td>
</tr>
<tr>
<td>1999</td>
<td>RF signed ETS 141 - Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, Strasbourg</td>
<td>Model Legislation on Laundering, Confiscation and International Cooperation in Relation to the Proceeds of Crime (for civil law jurisdictions) released by the UN Office for Drug Control and Crime Prevention (UNDCCP)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions entered into force</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG) established</td>
</tr>
<tr>
<td></td>
<td></td>
<td>UN Convention for the Suppression of the Financing of Terrorism</td>
</tr>
<tr>
<td>2000</td>
<td>FATF First review of NCCTs identified Russia as NCCT</td>
<td>Wolfsberg Global Anti-Money Laundering Guidelines for Private Banking (Wolfsberg Principles) issued</td>
</tr>
<tr>
<td></td>
<td>RF signed UN/International Convention for the Suppression of the Financing of Terrorism of 1999</td>
<td>FATF Report on Non-Cooperative Countries and Territories (NCCT)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>OECD list of 35 tax havens with harmful tax practices released</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Model Legislation on Money Laundering and Proceeds of Crime (for common law jurisdictions)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(UNDCCP) Okinawa G-7 Summit endorses G-7 Finance Ministers’ Report on Actions Against Abuse of the Global Financial System</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Regional Task Force on Anti-Money Laundering in Latin America (GAFISUD) established</td>
</tr>
<tr>
<td></td>
<td></td>
<td>UN (Palermo) Convention Against Transnational Organized Crime</td>
</tr>
<tr>
<td>Year</td>
<td>Event Description</td>
<td>Document/Action Description</td>
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<tr>
<td>------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>2001</td>
<td>ETS 141 - Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime is ratified (Federal law № 62-FZ)</td>
<td>Report on Customer Due Diligence for Banks (Basel Committee)</td>
</tr>
<tr>
<td></td>
<td>Amendments to Federal Law 395-1 &quot;On banks and banking&quot; about sanctions applied to the banks for non-observance of the AML law adopted (121-FZ) but not entered into force</td>
<td>FATF Eight Special Recommendations on Terrorist Financing released</td>
</tr>
<tr>
<td></td>
<td>Federal law № 115-FZ &quot;On Combating Legalisation (Laundering) of Criminally Gained Income and Financing of Terrorism&quot; is signed but not entered into force</td>
<td>FATF Consultation Paper on Revisions to Forty Recommendations released</td>
</tr>
<tr>
<td></td>
<td>Federal law № 115-FZ &quot;On Combating Legalisation (Laundering) of Criminally Gained Income and Financing of Terrorism&quot; entered into force</td>
<td>Wolfsberg Statement on the Suppression of the Financing of Terrorism</td>
</tr>
<tr>
<td></td>
<td>Amendments to Federal Law 395-1 &quot;On banks and banking&quot; about sanctions applied to the banks for non-observance of the AML law adopted (121-FZ) entered into force</td>
<td>Wolfsberg Anti-Money Laundering Principles for Correspondent Banking</td>
</tr>
<tr>
<td></td>
<td>FFMS Committee of Russian Federation (FMC) is established (Presidential decree № 1263)</td>
<td>International Association of Insurance Supervisors (IAIS) Anti-Money Laundering Guidance Notes for Insurance Supervisors and Insurance Entities</td>
</tr>
<tr>
<td></td>
<td>The Statute of the FMC is adopted (Ordinance № 211 of the Government of RF)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The Regulations on submitting the information to the FCM by the organizations involved in operations with monetary funds and other assets are adopted (Ordinance № 245 of the Government of RF)</td>
<td></td>
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<tr>
<td></td>
<td>The Regulations on submitting the information to the FCM by governmental organizations (Ordinance № 425 of the Government of RF)</td>
<td></td>
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<tr>
<td></td>
<td>The Recommendations on elaboration of internal control rules by organizations (Ordinance № 983-R of the Government of Russian Federation)</td>
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<tr>
<td>Year</td>
<td>Event</td>
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<tr>
<td>2003</td>
<td>FMC elaborated the model agreement of cooperation with the competent foreign authorities in combating money laundering (Ordinance № 1405-R)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>RF is removed from the FATF list of NCCTs</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Federal law № 130-FZ amended article 15.27 of the Code of Administrative Offences</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Russia becomes a member of EGMONT Group</td>
<td></td>
</tr>
<tr>
<td></td>
<td>RF ratified UN/International Convention for the Suppression of the Financing of Terrorism of 1999 (Federal law № 88-FZ)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Federal law №114-FZ &quot;On suppression of extremist activity&quot; is adopted</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>All the regulations were amended by adding the dimension of “financing of terrorism” by adding the dimension to 115-FZ</td>
<td></td>
</tr>
<tr>
<td></td>
<td>New 2003 FATF Forty Recommendations released</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The Regulations about defining of the list of natural and legal persons participating in extremist activities (Ordinance № 27 of the Government of RF)</td>
<td></td>
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<tr>
<td></td>
<td>UN Convention Against Corruption</td>
<td></td>
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<tr>
<td></td>
<td>The Regulations on registering in FMC of the organizations involved in operations with monetary funds and other assets and have no supervisory body and reporting (Ordinance № 28 of the Government of RF)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Wolfsberg Statement on Monitoring, Screening, and Searching</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Russia becomes a member of FATF</td>
<td></td>
</tr>
<tr>
<td></td>
<td>UN Convention against Transnational Organized Crime and its Protocols</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ordinance № 173 is signed to define and publish the FATF list of NCCTs by the FMC</td>
<td></td>
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<tr>
<td></td>
<td>Ratification of the Shanghai Convention on combating terrorism, separatism and extremism</td>
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</tr>
<tr>
<td></td>
<td>Federal Law &quot;Regulation on exchange and exchange control&quot; № 173-FZ entered into force</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>EAG (Eurasian Group) is founded by Belarus, Kazakhstan, Kyrgyzstan, China, Russia, Tajikistan</td>
<td></td>
</tr>
<tr>
<td></td>
<td>FATF Forty Recommendations revised</td>
<td></td>
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<tr>
<td></td>
<td>Decree № 314 transformed FMC to the FFMS (Rosfinmonitoring)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ordinance № 186 of the Government of the RF defined the authority of the Ministry of Finance to control Rosfinmonitoring</td>
<td></td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
<td>Notes</td>
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<td>--------</td>
<td>----------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------</td>
</tr>
<tr>
<td>2003-2005</td>
<td>MOLI-RU project fully financed by the European Commission</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>The Regulations on submitting of the SARs to Rosfinmonitoring by lawyers, notaries, other individual professionals and accountants is adopted (Ordinance № 82 of the Government of RF)</td>
<td>UN/IMF Model legislation on Money Laundering and Financing of Terrorism (for civil law systems)</td>
</tr>
<tr>
<td></td>
<td>The concept of national strategy on combating legalisation (laun-</td>
<td>Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism revised</td>
</tr>
<tr>
<td></td>
<td>dering) of criminally gained income and financing of terrorism is worked out and signed by the President of RF for the next five years</td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>Federal Law № 35-FZ &quot;On Suppression of Terrorism&quot; is adopted</td>
<td>Anti-Money Laundering Database (AMLID) 2nd round of Legal Analisis</td>
</tr>
<tr>
<td>2007</td>
<td>MOLI-RU-2 co-financed by the European Commission and Council of Europe. 3d round of mutual assessments</td>
<td></td>
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</table>
Appendix 2. Table 2. Issues of the prevention pillar addressed in the essential documents of the Bank of Russia (CB) regulating financial organizations (banks)

<table>
<thead>
<tr>
<th>№</th>
<th>Document</th>
<th>Data</th>
<th>Number</th>
<th>Customer due diligence and Record keeping</th>
<th>Suspicious operations identification, Reporting and Training</th>
<th>Regulation and Supervision</th>
<th>Sanctions</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Directive on Recommendations on elaboration of the internal control rules for combating laundering of criminally gained income (not in force)</td>
<td>Nov-01</td>
<td>137-T</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
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<tr>
<td>2</td>
<td>Recommendations on supervising by the Bank of Russia over banks executing 115-FZ (not in force)</td>
<td>Nov-01</td>
<td>160-P</td>
<td></td>
<td>X</td>
<td></td>
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<tr>
<td>3</td>
<td>Temporary recommendations on amending the internal control rules in the organizations involved in money-management activities (not in force)</td>
<td>Nov-01</td>
<td>161-P</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Recommendations on safety of the submitting of the reports to FMC through the telecommunication system of the Bank of Russia</td>
<td>Jan-02</td>
<td>16-1301/200</td>
<td></td>
<td>X</td>
<td></td>
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<tr>
<td>5</td>
<td>Reports about the low-quality reports submitted by banks</td>
<td>Feb-Oct 2002</td>
<td>1</td>
<td>X</td>
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<tr>
<td>6</td>
<td>Information letter clarifying the execution of 115-FZ</td>
<td>Aug-02</td>
<td>1</td>
<td>X</td>
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<tr>
<td>7</td>
<td>Regulations of cash-transactions</td>
<td>Oct-02</td>
<td>199-P</td>
<td>X</td>
<td></td>
<td></td>
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<td>8</td>
<td>Information letter on execution of 115-FZ</td>
<td>Nov-02</td>
<td>2</td>
<td>X</td>
<td></td>
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<tr>
<td>9</td>
<td>Regulations on submitting of the reports to FMC by banks</td>
<td>Dec-02</td>
<td>207-P</td>
<td>X</td>
<td></td>
<td></td>
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<tr>
<td>10</td>
<td>Directive on supervising by the Bank of Russia over banks executing 115-FZ (not in force)</td>
<td>Dec-02</td>
<td>177-T</td>
<td>X</td>
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<td></td>
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<td>11</td>
<td>Regulations on reporting by financial organizations to</td>
<td>Dec-02</td>
<td>207-P</td>
<td>X</td>
<td></td>
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<tr>
<td></td>
<td>the supervisory body</td>
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<tr>
<td>12</td>
<td>Information letter clarifying 207-P</td>
<td>Dec-02</td>
<td>5</td>
<td>X</td>
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<td></td>
<td></td>
</tr>
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<td>13</td>
<td>Directive on Bank of Russia recommendations on shell banks</td>
<td>Jan-03</td>
<td>12-T</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
</tr>
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<td>14</td>
<td>Amendments to Directive 137-T (not in force)</td>
<td>Jan-03</td>
<td>6-T</td>
<td>X</td>
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<td>Jul-03</td>
<td>103-T</td>
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<td>117-T</td>
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<td>19</td>
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<td>Aug-03</td>
<td>105-I</td>
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<td>Amendments to Regulations on sanctions as withdrawal of banking license (revocation of credit organization)</td>
<td>Aug-03</td>
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<td>23</td>
<td>Regulations on elaborating of internal control rules in banks and banking groups</td>
<td>Dec-03</td>
<td>242-P</td>
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<td>183-T</td>
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<td>113-I</td>
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<td>About USA PATRIOT act</td>
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<td>Directive on supervision over customer identification in internet-banking</td>
<td>Apr-07</td>
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<td>Directive on reporting</td>
<td>Apr-07</td>
<td>12-5-3/739</td>
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<td>61</td>
<td>Directive about the Wolfsberg Group Statement</td>
<td>May-07</td>
<td>69-T</td>
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<td>62</td>
<td>Monetary policy trends for 2007</td>
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<td>Issues raised</td>
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Appendix 3. Table 3. Banks’ behavioral patterns

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<th>Violation type</th>
<th>Bank 1</th>
<th>Bank 2</th>
<th>Bank 3</th>
</tr>
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<tr>
<td>1</td>
<td></td>
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<tr>
<td>The bank does not appoint responsible compliance officer</td>
<td>no(^{207})</td>
<td>no</td>
<td>no</td>
</tr>
<tr>
<td>2</td>
<td></td>
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<tr>
<td>The bank appoints compliance officer who does not meet qualification requirements listed in 1486-U</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<tr>
<td>3</td>
<td></td>
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<tr>
<td>The compliance officer has other working responsibilities</td>
<td>no</td>
<td>yes</td>
<td>yes</td>
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<td>4</td>
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<tr>
<td>The bank does not have approved AML internal control rules or does not make amendments to them</td>
<td>no</td>
<td>yes</td>
<td>no</td>
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<td>5</td>
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<tr>
<td>The AML internal control rules are approved by the head of the bank after the deadline</td>
<td>no</td>
<td>yes</td>
<td>no</td>
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<td>6</td>
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<tr>
<td>The bank did not submit the AML internal control rules for the CB approval</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<tr>
<td>The bank submitted the AML internal control rules after the deadline</td>
<td>no</td>
<td>yes</td>
<td>no</td>
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<td>8</td>
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<tr>
<td>The bank does not have comprehensive training programme for its personnel</td>
<td>sometimes</td>
<td>yes</td>
<td>yes</td>
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<td>9</td>
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<tr>
<td>The bank informs its clients or third parties about the AML measures undertaken by the bank</td>
<td>no</td>
<td>yes</td>
<td>yes</td>
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<td>10</td>
<td></td>
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</tr>
<tr>
<td>The bank does not properly identify its clients</td>
<td>sometimes</td>
<td>sometimes</td>
<td>sometimes</td>
</tr>
<tr>
<td>11</td>
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<tr>
<td>The bank does not undertake all possible measures to identify beneficial owners</td>
<td>sometimes</td>
<td>yes</td>
<td>yes</td>
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</table>

\(^{205}\) The column 2 of Table 3 refers to the list of AML legislation violations presented by the CB in its Directive 98-T.

\(^{206}\) Banks participating in the research: bank 1 - a top-ten bank; bank 2 - a small-sized bank; bank 3 - several regional branches of medium-size banks which have the same behavioral pattern.

\(^{207}\) Behavioral patterns:

- **Yes** - Common behavior
- **No** - Not common behavior
- **Sometimes** - Happens in several cases
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<td>The bank does not renew the beneficiary owners list</td>
<td>no</td>
<td>yes</td>
<td>yes</td>
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<td>13</td>
<td>The bank does not keep records of suspicious transactions</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<td>14</td>
<td>The bank does not keep records of <em>unusual</em> transactions</td>
<td>yes</td>
<td>yes</td>
<td>yes</td>
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<td>15</td>
<td>The bank does not keep records of <em>refusal of opening bank accounts</em></td>
<td>no</td>
<td>yes</td>
<td>yes</td>
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<td>16</td>
<td>The bank does not send STRs</td>
<td>no</td>
<td>no</td>
<td>no</td>
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<td>17</td>
<td>The bank sends STRs after the deadline</td>
<td>no</td>
<td>sometimes</td>
<td>no</td>
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<td>18</td>
<td>The bank does not report transactions with terrorist participation</td>
<td>no</td>
<td>yes</td>
<td>yes</td>
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<td>19</td>
<td>The bank reports above transactions after the deadline</td>
<td>no</td>
<td>sometimes</td>
<td>sometimes</td>
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<td>The bank does not report the cases of refusal in the opening of the bank accounts</td>
<td>sometimes</td>
<td>yes</td>
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Notes