

How the United States Can Combat Russia's Kleptocracy

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Executive Summary

Russian President Vladimir Putin's regime is characterized by a combination of secret police and organized crime, which the late scholar Karen Dawisha named "kleptocracy." This kleptocracy can be seen as a system of three key circles. The first circle is authoritarian control over the state, including law enforcement and the courts. The second circle is the big state companies that Putin controls through their chief executives, his loyal appointees, who extract funds from the companies for their personal benefit. The third circle consists of Putin's old friends from the St. Petersburg business world who obtained companies that greatly benefited from public procurement and asset stripping from the big state companies.

This system cannot function without a fourth circle, offshore assets. Ironically, the Kremlin's executive control of the courts has deprived Russia of real property rights, and not only ordinary rich Russians but also its rulers transfer their assets abroad to keep them safe. They have three requirements for their money's destination: the country must have sound rule of law, allow anonymous ownership, and have deep asset markets, because their assets are substantial.

Many years of fighting against shell banks and repeated financial crashes have minimized money laundering through dubious jurisdictions. Today, few countries with sound rule of law allow anonymous ownership on a large scale. Generally speaking, the only ones that do are countries with Anglo-American legal systems. The remaining financial centers of significance are Cyprus, Malta, Dubai, Singapore, Hong Kong, the British Virgin Islands, the Cayman Islands, the United Kingdom (UK), and the United States. So far, the financial flows seem to overwhelmingly end up in two countries, the United States and the UK.



St. Petersburg, the city where Putin developed close relationships with his inner circle of kleptocrats. *Photo credit: Good-FreePhotos.com.*

In the United States, the concentration of large amounts of anonymous capital owned by Kremlin kleptocrats is a major national security threat. The assets they have stashed here mean these kleptocrats can buy many American decision makers. However, the United States can defend itself against these kleptocrats if it mobilizes the will to do so. The obvious weapon is requiring transparency of business ownership and of capital flows. The European Union (EU) adopted an anti-money laundering directive in 2015, which is supposed to lead to the revelation of all beneficiary owners of assets in the EU. The United States should do the same. It should also introduce controls of monetary inflows that now bypass ordinary bank regulation—namely, asset flows into real estate in the United States and flows that pass secretly through law firms on the basis of attorney-client privilege. To enforce this transparency, the enforcement agencies, notably the US Treasury Financial Crime Enforcement Network, need to be greatly expanded.

Introduction

Under President Vladimir Putin, Russia has been transformed into an authoritarian kleptocracy.¹ Putin has successfully fused the old secret police, the KGB, with organized crime—first in his home city of St. Petersburg, and then in the whole of Russia. His Kremlin now controls the state through law enforcement agencies, the courts, and the big state companies.

The aim of this regime, however, is not developing the Russian nation, but maintaining the power of the ruling elite and immensely enriching it. The irony is that having abolished the rule of law in Russia, the ruling elite cannot secure its own property rights in the country, and must keep its assets in safer places abroad. These assets are vast and can be deployed for all kinds of subversive political purposes abroad, such as the corruption of leading politicians in other countries and the financing of election interference, cyber aggression, mercenaries, and many other activities.

¹ I have greatly benefited from conversations with the late Boris Nemtsov, Vladimir Milov, Andrei Illarionov, Evgeniya Albats, Gary Kalman, and Clark Gascoigne for this report.



Sergei Ivanov, a former KGB general, member of the Russian Federation Security Council, and close associate of Vladimir Putin. *Photo credit: Wikimedia Commons.*



Igor Sechin, CEO of state oil company Rosneft and a loyal associate of Vladimir Putin. *Photo credit: Wikimedia Commons.*

The Kremlin's skill and ingenuity in these activities must not be underestimated. Since 2014, the Atlantic Council has published several reports on various forms of nefarious Russian interference abroad. This issue brief focuses specifically on one crucial aspect: how the Kremlin and its cronies transfer money abroad, and what can be done to expose and disarm that system, for the sake of greater national security.²

The first section of this issue brief explains the nature of the Russian kleptocracy. Section two shows how capital flows out of Russia. Section three offers an assessment of the size of the assets transferred out of Russia. Section four presents what has been done to stop Russian money laundering. Section five focuses on the key problem: the proliferation of anonymous companies. Section six discusses current US efforts to combat Russia's kleptocracy. Section seven concludes with policy recommendations for how large flows of anonymous Russian money can be brought under control in the United States.

1. The Nature of Russia's Kleptocracy

President Vladimir Putin's regime has from the outset been characterized by its simultaneous use of secret police and organized crime. Putin himself played a major role in developing this model, much of which

was done stealthily. For years, Putin claimed that he favored private enterprise and a free economy, until finally it became clear that he did not.

During Putin's second term, 2004–2008, it appeared as if he aspired to state capitalism, which was coined "Russia, Inc."³ Andrei Illarionov, Putin's personal economic advisor, 2000–2005, has formulated possibly the best characterization:

Russia today is not the same country it was only six years ago, when Vladimir Putin became president. Back then, the country was unsettled, tumultuous, and impoverished, but it was free. Today Russia is richer—and not free.

A new model of Russia has taken shape. The state has become, essentially, a corporate enterprise that the nominal owners, Russian citizens, no longer control....State-owned companies have become the assault weapons of this corporate state. Having mastered the main principle of state corporatism—"privatize profit, nationalize loss"—they have turned to taking over private-sector companies, sometimes at cut-rate prices. Their victims include major industrial companies like Yuganskneftegaz, Sibneft, Silovye Mashiny, Kamaz, OMZ, and Avtovaz.⁴

2 Some relevant reports are: Anton Barbashin, "Improving the Western Strategy to Combat Kremlin Propaganda and Disinformation," June 11, 2018; Daniel Fried and Alina Polyakova, *Democratic Defense Against Disinformation*, March 5, 2018; Alina Polyakova et al., *The Kremlin's Trojan Horses 2.0*, November 15, 2017; Alina Polyakova et al., *The Kremlin's Trojan Horses*, November 15, 2016; Alan Riley, *Ukraine v. Russia and the Kleptocrats*, April 5, 2016; Maksymilian Czuperski et al., *Hiding in Plain Sight: Putin's War in Ukraine*, October 15, 2015.

3 Andrei Illarionov, "Russia, Inc.," *New York Times*, February 4, 2006, <https://www.nytimes.com/2006/02/04/opinion/russia-inc.html>.

4 Andrei Illarionov, "Russia, Inc.," *New York Times*, February 4, 2006, <https://www.nytimes.com/2006/02/04/opinion/russia-inc.html>.



Hong Kong is one of the financial hubs through which Russians channel their illicit funds. *Photo credit: Wikimedia Commons.*

However, this was hardly real state capitalism, because it did not serve the state. The ultimate beneficiaries of the state's largesse were not the Russian people but Putin and his friends. The Russian dissidents Yuri Feltshinsky and Vladimir Pribylovsky named it "The Corporation," in their 2008 book of the same name.⁵ The *Guardian's* Moscow correspondent Luke Harding gave more details in his 2011 book, *The Mafia State*.⁶ Masha Gessen presented a similar picture in her 2012 book.⁷ But it was the late scholar Karen Dawisha who gave it the appropriate name, titling her book *Putin's Kleptocracy*.⁸

The system is quite distinct, as Putin has built it carefully and with great skill during his long presidential terms. It can be seen as three circles. The first circle is authoritarian control over the state, including law enforcement and the courts. The central parts of that circle are the federal state administration, with its vertical of power, and the Federal Security Service (FSB).

However, the entire law enforcement system, including the courts, prosecutors, investigative committee, national guard, and Ministry of Interior, works under Putin's direct control, each component led by one of his close associates. The three most powerful people in this circle appear to be the current chairman of the FSB, Aleksandr Bortnikov, and his two predecessors, Sergei Ivanov and Nikolai Patrushev. All three are KGB (*Komitet gosudarstvennoy bezopasnosti*) generals and Putin's contemporaries from St. Petersburg, and they are all currently members of the Security Council, Russia's top ruling body.

The second circle includes the big state companies that Putin controls by having appointed his loyal associates as chief executives. These executives extract large funds from the companies for their personal benefit. The most important state companies dominate the energy sector, banking, transportation, and the armament industry. Five state banks hold nearly two-thirds

5 Yuri Feltshinsky and Vladimir Pribylovsky, *The Corporation: Russia and the KGB in the Age of President Putin* (New York: Encounter, 2008).

6 Luke Harding, *Mafia State* (London: Guardian, 2011).

7 Masha Gessen, *The Man Without a Face: The Unlikely Rise of Vladimir Putin* (New York: Riverhead Books, 2012).

8 Karen Dawisha, *Putin's Kleptocracy: Who Owns Russia?* (New York: Simon & Schuster, 2014).



Gazprom, which accounts for 2/3 of the gas sector in Russia, appears to be personally managed by Vladimir Putin. *Photo credit: Wikimedia Commons.*

of Russia's banking assets, and Gazprom accounts for two-thirds of the gas sector. The two leaders in this group are Igor Sechin, chief executive officer (CEO) of the giant state oil company Rosneft, and Sergei Chemezov, CEO of Rostec, a vast armaments company. Sechin served as Putin's assistant in St. Petersburg in the early 1990s, and Chemezov served with Putin in the KGB in Dresden in the 1980s. Gazprom appears to be managed by Putin personally.

The third circle consists of Putin's old friends from his youth and the business world in St. Petersburg. These men obtained companies that greatly benefited from public procurement and asset stripping from the big state companies. The four key cronies in this circle are Gennady Timchenko, the brothers Arkady and Boris Rotenberg, and Yuri Kovalchuk. Timchenko and the Rotenbergs have mainly made their fortunes building pipelines for Gazprom, while Kovalchuk has benefited from the cheap privatizations of Gazprom's non-core assets, such as its television channels and financial assets, notably Gazprombank. Kovalchuk manages Bank Rossiya, which operates as the spider in the cronies' financial web; all are shareholders in the bank.

All of the people mentioned in these three circles and several of their companies have been sanctioned by the United States as part of its sanctions regime in response to Russian aggression against Ukraine.⁹

Ironically, however, the Kremlin's executive control of the courts has deprived Russia of real property rights. In response, not only ordinary rich Russians but even its rulers need to transfer their assets abroad to keep them safe. They have three requirements for their as-



A Russian man displays a sign reading, "PUTIN KILLED NEMTSOV", while standing on the bridge where opposition politician Boris Nemtsov was shot to death at a rally the day after his murder. *Photo credit: Wikimedia Commons.*

sets' destination: the country must have sound rule of law, anonymous ownership, and deep asset markets, because their assets are substantial.

While the original three circles are commonly cited as key components of Russia's corrupt government, offshore assets are often overlooked. They comprise, however, a fourth circle in the Putin kleptocracy.

⁹ US Treasury, Office of Foreign Assets Control Specially Designated Nationals and Blocked Persons List July 19, 2018, <https://www.treasury.gov/ofac/downloads/sdnlist.pdf>.



Putins's cronies are shareholders in Bank Rossiya, which they use to manipulate and profit from state entities. *Photo credit: Wikimedia Commons.*

Russia's kleptocracy did not arise by chance. Putin and his associates have intentionally built this system, which makes them immensely wealthy and endows them with extraordinary political power. The system provides economic stability, though minimal economic growth. But the Kremlin is clearly satisfied with the regime and shows no signs of aspiring to any reforms, and it seems pointless to expect any major changes. Western policy should instead focus on what it can do about the fourth circle, offshore assets.

2. How Money Flows Out of Russia

Overwhelmingly, this offshore money is held in anonymous companies, which are widely used in countries with Anglo-American legal systems. This secrecy is not unique to Anglo-American countries, but it is greater there.

Traditionally, money often flows from Russia to Cyprus because of a late Soviet double-taxation agreement,

and Malta operates as a poor cousin of Cyprus and is often another early destination country. The funds then tend to flow through several jurisdictions, and in each of them money launderers add several layers of anonymous shell companies. Serious Russian dark money is hidden under twenty or thirty shell companies.¹⁰

The funds typically continue to the British Virgin Islands and the Cayman Islands, and finally land either in the United States—predominantly in Wilmington, Delaware—or in the United Kingdom. In 2015, the US Treasury assessed that \$300 billion a year was laundered in the United States,¹¹ while the UK National Crime Agency claims that \$125 billion is being laundered in the country each year.¹² These two countries are without comparison the biggest centers for money laundering in the world.

Most of the countries that allow anonymous companies on a big scale, such as Cyprus, Malta, and all of the

10 Evgeniya Albats, *Chisto konkretny kandidat* (Simply a Concrete Candidate), Interview with Sergei Kolesnikov, *Novoe Vremya*, February 27, 2012.

11 United States Department of the Treasury, "National Money Laundering Risk Assessment 2015," 2015, Washington, DC., <https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/National%20Money%20Laundering%20Risk%20Assessment%20%E2%80%932015.pdf>.

12 Margaret Hodge, "This is How to Curb Putin: Stop Welcoming Russian Kleptocrats," *Guardian*, March 16, 2018, <https://www.theguardian.com/commentisfree/2018/mar/16/how-to-curb-putin-russian-kleptocrats-salisbury-dirty-money>.



Bill Browder, visionary behind the Sergei Magnitsky Rule of Law Accountability Act, is an outspoken critic of Vladimir Putin. Photo credit: Wikimedia Commons.

Caribbean islands but the Cayman Islands, lack financial depth, that is, they do not have sufficiently large financial markets to absorb large assets. After the financial crash in Cyprus in 2013, the International Monetary Fund carried out a forensic study and found that Russian foreign direct investment that stayed in Cyprus itself was only \$14 billion.¹³ Money just passes through Cyprus and other offshore havens. Only the Cayman Islands has a large banking sector. Therefore, Russian dark money—like most other dark money—is likely to be predominantly in the United States or the UK.

In May 2018, the *Berliner Zeitung* revealed that a dozen companies belonging to Arkady Rotenberg, who is also sanctioned in the EU, owned major public and office buildings in Berlin, Frankfurt, Hamburg, and Munich worth about 1 billion euros (\$1.3 billion) through complex layers of shell companies.¹⁴

Russian opposition politician Vladimir Milov, who has an eminent understanding of Russian wealth, observes that ever since Western sanctions were imposed in 2014, Russians have increasingly channeled their funds to Dubai, Singapore, and Hong Kong. However, these havens have much less financial depth than the United States and the UK.¹⁵

If Putin were to lose power, he would need his offshore wealth to fight back. But all truly rich Russians, whether in government, part of the opposition, or just wealthy, want to keep their fortunes abroad, because Russia lacks secure property rights. Therefore, security, rather than return on capital, is the overwhelming concern; this is obvious from the many empty luxury buildings bought with Russian dark money in London's Belgravia, New York, and Miami.

¹³ International Monetary Fund, *Cyprus: Fifth, Sixth, and Seventh Reviews under the Extended Arrangement under the Extended Fund Facility*, June 4, 2015.

¹⁴ *Der Kudamm-Komplex im TV*, *Berliner Zeitung*, May 18, 2018.

¹⁵ Interview with Vladimir Milov on April 18, 2018.



Russian kleptocrats have used financial anonymity in places such as Wilmington, Delaware, to launder Russian money. *Photo credit: Wikimedia Commons.*

3. How Much Money Flows Out of Russia?

Since 1991, Russia has seen massive capital outflows. Official statistics show that these cumulative outflows amount to at least \$800 billion, and a National Bureau of Economic Research (NBER) study assessed the total private Russian holdings abroad at about that amount; the return on these funds is likely to have been very small, since the main objective is simply to hide them in a safe place.¹⁶ However, the nongovernmental orga-

nization (NGO) Global Financial Integrity has assessed the outflow as being up to \$1.3 trillion, adding under-invoicing to the official tally, but much of this money has returned to Russia.¹⁷

Russian capital accumulated abroad falls into several categories. One big chunk consists of money that has been more or less legally earned, but the owners do not trust the Russian banking system or the state,

¹⁶ Filip Novokmet, Thomas Piketty, and Gabriel Zucman, *From Soviets to Oligarchs: Inequality and Property in Russia, 1905-2016*, NBER Working Paper no. 23712, August 2017 Cambridge, MA: National Bureau of Economic Research.

¹⁷ Dev Kar and Sarah Freitas, "Russia: Illicit Financial Flows and the Role of the Underground Economy," Global Financial Integrity, February 13, 2013, <http://www.gfintegrity.org/report/country-case-study-russia/>.

afraid that the Russian government might try to confiscate their funds for extralegal reasons. It is kept secret specifically in defense against the lawless Russian government, and this money should not be considered illegal.¹⁸

Another category derives from management theft. Managers have taken out a large volume of funds from Russian enterprises through transfer pricing to evade taxes or to defraud shareholders. It is illegal, but it is not an obvious national security concern and is unrelated to US sanctions.

A third portion of the Russian flight capital belongs to the government elite. It may have been extracted through embezzlement of state funds, unpaid bank loans, extortion, or racketeering. This is the prime national security concern.

In 2008, the opposition activists Boris Nemtsov and Vladimir Milov assessed that Putin and his close circle of cronies looted the state gas giant Gazprom of a total of \$60 billion, or \$15 billion a year during 2004-2007. (Nemtsov was murdered outside the Kremlin wall in February 2015.) The four prime men are Gennady Timchenko, Arkady and Boris Rotenberg, and Yuri Kovalchuk.¹⁹ These Putin cronies transferred the wealth to themselves through public procurement, asset stripping, and stock manipulation.

It was in 2004 that Putin consolidated his power so that he could start tapping the Russian state as he really desired. Judging by the formation of his cronies' companies, it took them until 2008-2009 to come up to full speed. Since then, they seem to have maintained the same cash flow, to judge from the public procurement that is published in a data base by the Russian government. Meanwhile, the market value of Gazprom has fallen from \$369 billion in May 2008 to about \$55 billion at present, since investors realize that

Gazprom's profits are not adequately shared with its shareholders.

The rents from Gazprom have continued, suggesting an annual enrichment to this group of \$10-\$15 billion from 2006 to the present. In addition to the gains from Gazprom, a substantial flow from other public procurement, corporate raiding, unpaid loans from state banks, and extortion of private businesses should be added. A reasonable guesstimate would be an annual enrichment of Putin and his cronies of \$15-\$25 billion per year since 2006.

In April 2016, the Panama Papers were published. These offered hard evidence of the enrichment techniques of Putin's circle. For example, a childhood friend of Putin, the cellist Sergei Roldugin, received more than \$2 billion from Russian oligarchs and the state, presumably holding that wealth for Putin.²⁰ Much of the money came from stock and contract manipulation of Russian state companies. In 2010, a company linked to Roldugin bought shares of Bank Rossiya and sold them just days later to an unknown investor for a price that was 32 times higher than it originally paid.²¹ Private Russian businessmen gave Roldugin "donations," which might have been extortion; for example, \$259 million came from the private businessman Suleiman Kerimov.²² Kerimov was designated—an especially severe form of sanctioning—by the US Treasury on April 6 of this year. State banks gave loans never to be paid back; the Cyprus subsidiary of Russia's VTB bank had given Roldugin's company a credit line of \$650 million.²³

Since 2015, British financier Bill Browder has claimed that Putin possesses a personal wealth of \$200 billion.²⁴ In July 2017, Browder specified in a testimony to the US Congress, "I estimate that [Putin] has accumulated \$200 billion of ill-gotten gains from these types of operations over his seventeen years in power. These funds have in all probability been transferred to

18 Bill Browder has eminently illustrated the behavior of the Russian government. Bill Browder, *Red Notice: A True Story of High Finance, Murder, and One Man's Fight for Justice* (New York: Simon & Schuster, 2015).

19 Boris Nemtsov and Vladimir Milov, *Putin i Gazprom (Putin and Gazprom)*, *Novaya Gazeta*, 2008.

20 Luke Harding, Revealed, the \$2 billion offshore trail that leads to Vladimir Putin, *Guardian*, April 3, 2016.

21 Roman Anin, Russia: Banking on Influence, *Organized Crime and Corruption Reporting Project*, June 9, 2016, <https://www.occrp.org/en/panamapapers/rossiya-putins-bank/>.

22 Roman Anin, Olesya Shmagun, and Dmitry Velikovskiy, The Secret Caretaker, *Organized Crime and Corruption Reporting Project*, April 3, 2016.

23 Ibid.

24 Adam Taylor, "Is Vladimir Putin hiding a \$200 billion fortune?" *Washington Post*, February 15, 2015.

offshore havens.”²⁵ Browder claimed that after Mikhail Khodorkovsky’s conviction in 2005, which amounted to Putin’s complete victory over the prior oligarchs, Putin demanded 50 percent of the wealth of the remaining oligarchs.²⁶ It is possible, but unclear, whether Putin’s extortion is really this large, rendering any assessment of the wealth of Putin and his nearest cronies uncertain.

An alternative method of assessing Putin’s personal wealth is to assess the capital flows of which he may have been part. To judge from the examples given by his junior partner Sergei Kolesnikov, who defected in 2010, in each corrupt deal in which they were involved, Putin and his chief partner each got almost half of the revenues, while several junior partners such as Kolesnikov received a few percent of the loot.²⁷ Our guesstimate of the Putin crony capital outflow is \$15-\$25 billion a year since 2006—that is, a total of \$195-\$325 billion. Assuming that Putin’s share is half, he would have transferred \$100-\$160 billion to offshore havens. These numbers are lower than those offered by Browder. Naturally, we cannot know, but regardless, the size of these assets is enormous.

4. What Has Been Done to Stop Russian Money Laundering

Money laundering has been a rising concern in the West for three decades. In 1989, the Western community set up the Financial Action Task Force (FATF) to combat illegal money flows. It was attached to the Organization of Economic Cooperation and Development (OECD). The basic idea of FATF was “follow the money” and it established the principle “Know Your Customer” (KYC). In 1990, the US Treasury Department set up the Financial Crimes Enforcement Network (FinCEN) for this purpose.

Still, government interest was limited until the terrorist attacks of September 11, 2001. At that point, the United States became serious about fighting dirty money and adopted the Patriot Act, which contains strict rules against money laundering and swiftly eliminated most of the global shell banks. Nearly two-thirds of all international transactions are carried out in US dollars, and each dollar passes through the big banks in New York. Therefore, the United States has jurisdiction over most of the global financial system and can thus impose US law upon all of the big global banks that operate in US dollars.

FATF, the US Treasury, and the Patriot Act have together led to a major cleaning up of dark money in the world. Even Switzerland has been forced to abandon its cherished bank secrecy. A little-noticed fact is that the global financial crisis caused a financial meltdown in most small Caribbean island jurisdictions, only leaving two British territories, the British Virgin Islands and the Cayman Islands, as significant financial centers.

Thus, the concern is no longer money laundering through banks, even if that happens from time to time. The main problem is instead what passes outside of the banking system. In the United States, there are four major reasons for this vast inflow of dark money. The most important is the legal use of limited liability companies (LLCs) with anonymous owners. They are primarily incorporated in Delaware, but also in Nevada, Wyoming, and South Dakota.²⁸ Second, real estate was originally included in the 2001 Patriot Act, but after half a year, the US Treasury granted a temporary exemption for real estate that is still in force. Money laundering through US real estate is now assessed at \$100 billion a year.²⁹ The US Treasury can end this exemption with a single executive decision. A third avenue for dark money is law firms, which are allowed to take in dirty money under attorney-client privilege.³⁰

25 Bill Browder, “Testimony to the Senate Judiciary Committee,” *Atlantic*, July 25, 2017.

26 Ibid.

27 Evgeniya Albats, *Chisto konkretny kandidat* (Simply a Concrete Candidate), Interview with Sergei Kolesnikov, *Novoe Vremya*, February 27, 2012.

28 Casey Michel, “The United States of Anonymity,” Briefing Paper, Kleptocracy Initiative, November 2017, Hudson Institute.

29 Ben Judah and Belinda Li, “Money Laundering for 21st Century Authoritarianism: Western Enablement of Kleptocracy,” Briefing Paper, Kleptocracy Initiative, Hudson Institute, December 2017, p. 24.

30 Rachel Louise Ensign and Serena Ng, “Law Firms’ Accounts Pose Money-Laundering Risk,” *Wall Street Journal*, December 26, 2016.

Finally, the US government's capacity to investigate dirty money, through FinCEN, is minimal. In 2013, it employed only 350 people.³¹

Delaware is the world's dominant center for the generation of anonymous enterprises. In 2017, almost 200,000 entities were set up there, and more than half of them were LLCs. This brought Delaware annual revenues of \$1.3 billion, more than a quarter of the state's annual budget.³²

The vast amount of dark money coming from Russia is a major national security concern. Since it is anonymous and deeply hidden, it is very difficult to trace. It can be deployed for political and propaganda purposes, as well as for corruption. At present, for example, it is not possible to detect whether the Russian front organization The Right to Bear Arms has given substantial donations to the National Rifle Association, or whether Kremlin sources have financed major political figures in the United States.

A general understanding among the Russian elite is that ever more wealth is concentrated with President Vladimir Putin and his closest friends who have been sanctioned (Gennady Timchenko; Arkady, Boris, Roman, and Igor Rotenberg; and Yuri Kovalchuk). At present, Vladimir Milov guesses that half of the annual \$30-\$50 billion outflow of Russian dark money belongs to the Putin circle.³³ A plausible guess is that at least one-third of Russian dark money is located in the United States. The real situation is only known to these people.

It's clear, however, that the circle of sanctioned Putin cronies holds billions of dollars in this country. These fortunes should have been frozen, but apart from the very public freezing of Viktor Vekselberg's assets, hardly any funds have been frozen. This lack of law enforcement implies a major national security risk.

5. The Need to Combat Anonymous Companies

Now that the global banking system has been cleaned up, the new focus has become anonymous companies, given their large numbers and the vast amounts of money that flow through them. Today, anonymous companies stand out as one of the greatest national security threats to the United States. These billions in dark foreign money can be used to buy anything and anybody in the country, and law enforcement will be none the wiser.

The European Union has taken this concern seriously. In May 2015, it adopted its Fourth Anti-Money Laundering Directive.³⁴ This requires all of the EU's twenty-eight member countries (as well as Iceland, Liechtenstein, Norway, and Switzerland) to adopt laws that force all enterprises within their jurisdiction to reveal their ultimate beneficiary owners by entering into a central registry in each country. The registries can be open to the public or just to law enforcement agencies. The directive defines a beneficiary owner as somebody who owns at least 25 percent of an entity. Usually, EU members obey EU directives, but often only after some delay, so this process is now proceeding throughout the whole EU, including the UK and Cyprus.³⁵ As a result, it will become much more difficult for the ownership of companies to remain secret.

Since the UK is the focal point for anonymous ownership in Europe, and also the main stage for subversive Russian activities, including murders, its debate about secret wealth has been particularly intense. The UK does follow the EU directive, but the UK government has also taken a couple of additional steps. In 2018, the UK legislated a new tool, "unexplained wealth orders," which gives British law enforcement the right to claim such property in a civil recovery process if it can prove that the wealth cannot possibly have been honestly earned. It remains to be seen to what extent this law will be utilized. In May 2018, the British parliament took a further step, legislating that fourteen British overseas territories, including the British Virgin Islands and the

31 Ben Judah and Nate Sibley, "Countering Russian Kleptocracy," Briefing Paper, Kleptocracy Initiative, Hudson Institute, April 2018, p. 9.

32 Samuel Rubinfeld, "Delaware Backs Overhaul of Shell-Company Rules," *Wall Street Journal*, June 25, 2018.

33 Interview with Vladimir Milov on April 18, 2018.

34 European Commission, "DIRECTIVE (EU) 2015/849 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing," May 20, 2015, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015L0849>.

35 Dan Sabbagh, "UK to Introduce Public Ownership Registers for Overseas Territories," *Guardian*, May 1, 2018.

Cayman Islands, have to set up public ownership registries for all companies by the end of 2020.³⁶

6. US Efforts to Combat Russia's Kleptocracy

In recent years, the United States has sanctioned and designated a substantial number of Russian citizens and entities. These sanctions have proven remarkably ineffective, as minimal amounts have been frozen. That a foreign power in all probability controls billions of dollars which can be used for any political purpose or diversion is an impermissible risk to US national security. It is ironic, because plenty of such assets are likely to be in this country, but the US government does not possess enough information about sanctioned Russians' possible assets in the United States. Moreover, the US government does not have the correct tools and capacities to trace them. This issue brief suggests where the problems lie and how they could most easily be resolved. Its focus is not tax evasion but national security.

The relevant US sanctions against Russian citizens and entities are to be found in three legal acts. In December 2012, the US Congress adopted the Sergei Magnitsky Rule of Law Accountability Act, under which forty-nine people have been designated. They are not allowed to visit the United States and any of their assets detected here would be frozen. Since March 2014, a large number of Russians have been designated because of their role in Russia's aggression against Ukraine, and their assets should also have been frozen. These executive orders were included in the Combating America's Adversaries Through Sanctions Act (CAATSA), which was signed into law by President Donald Trump on August 2, 2017. And in December 2016, President Barack Obama signed the

Global Magnitsky Human Rights Accountability Act.³⁷ So far, one Russian citizen has been designated under this act.

In the United States, only three cases of asset seizures from Russian entities appear to have been publicized. One was the Russian broadcasting company CTC Media, Inc., which was a Delaware-registered company and listed on the Nasdaq stock exchange. After its majority owner Yuri Kovalchuk was designated on March 20, 2014, CTC was instructed to let its dividends go into a frozen account, but hardly anything was paid.³⁸ In January 2016, the US Security and Exchange Commission initiated its delisting,³⁹ but it had had little activity in the United States besides its stock trading.⁴⁰

The second case was money laundering by the Russian real estate company Prevezon in New York real estate. The identified sum of nearly \$2 million was traced to the Magnitsky loot of \$230 million, and the acting US attorney for the Southern District of New York settled for a fine of \$5.9 million.⁴¹ And then there is Viktor Vekselberg. On April 6, 2018, the US Treasury surprisingly designated him, a respected businessman who was never seen as particularly close to the Kremlin, resulting in an immediate freezing of \$1.5-\$2 billion.⁴²

In the United States, significant measures have been undertaken within the current legal framework. On August 22, 2017, FinCEN required "US title insurance companies to identify the natural persons behind shell companies used to pay for high-end residential real estate in seven metropolitan areas," including Miami-Dade, Broward, Palm Beach, New York, and Los Angeles, all of which are favorite Russian destinations. They start at different price levels, but in South Florida, for example, the starting level is a piece of real estate

36 Dan Sabbagh, "UK to Introduce Public Ownership Registers for Overseas Territories," *Guardian*, May 1, 2018.

37 "The US Global Magnitsky Act: Questions and Answers," Human Rights Watch, September 13, 2017, <https://www.hrw.org/news/2017/09/13/us-global-magnitsky-act>.

38 Alan Katz, Jesse Drucker, and Irina Reznik, "Putin Pals Dealing with U.S. Firms Make Sanctions Useless," Bloomberg, June 25, 2014.

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worth \$1 million. These checks focus on cash and wire transfer payments.⁴³ So far, however, this tool seems to have yielded little in terms of detection, but suspicious sales have plummeted, so these checks have scared dirty money away. More transparency and enforcement are needed.

In the US Congress, several bipartisan legislative initiatives are under way to reveal the beneficiary owners of all companies. Since the states are reluctant to take on the task of registering the owners of all companies, the main idea is that the US Treasury (FinCEN) should be entitled to collect information on all beneficiary owners of corporations or limited liability companies from states that do not collect this information themselves.⁴⁴

7. Policy Recommendations

In order to enhance US national security, several major measures are needed to combat money laundering in the United States. While no silver bullet exists, many measures are likely to be highly effective. It suffices to point out that when the Patriot Act of 2001 prohibited the activities of shell banks in the United States and imposed the Know Your Customer (KYC) rule, not only US banks but all banks that do business with the United States adopted such standards. US law is effective when adopted and implemented.

- The intelligence community should assess how much laundered Russian money is held in the United

States and how much of that is held by sanctioned individuals and entities.

- The US Congress should adopt legislation prohibiting the formation of new anonymous companies in the United States, and existing anonymous companies should be required to provide the names of their beneficiary owners within a certain period of time. FinCEN could be charged with assembling this information. At present, several draft bills exist.
- The temporary exemption granted to real estate in the Patriot Act should be ended, which the US Treasury secretary can do through an executive decision. All financial flows into the United States should go through regulated financial institutions.
- International money transfers of any kind should no longer be considered subject to attorney-client privilege, but should be required to go through regulated financial institutions.
- With its expanded tasks, FinCEN should be given far greater resources to be able to implement stricter anti-money laundering regulations.
- Cash payments of more than \$10,000 should no longer be legal; all large payments should go through regulated financial institutions.

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