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Brief

Russian Money Laundering as a Grey-Zone Tactic

Money Laundering Series, No. 1

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In recent years, money laundering scandals have disrupted Baltic financial markets and focused attention on institutions that have turned a blind eye to high-risk transactions. Danske Bank's investigation into its Estonian branch in 2017 revealed that it allowed approximately USD $229 billion to be laundered through its doors before closing. A 2019 report claimed that Swedbank was also involved, allowing $5.8 billion in transactions to travel between the two banks from 2007 to 2015.[1] The Latvian government fined its third-largest lender, the Swedish SEB bank, just under $2 million in 2019 for sanctions violations and poor anti-money laundering controls.[2] And former Governor of the Central Bank of Latvia Ilmārs Rimšēvičs came under fire in 2019 for bribery, reportedly related in part to inhibiting anti-money laundering efforts.[3] While the Baltic states have since taken steps to correct domestic finance and investment laws, the scale of the Danske Bank and Swedbank scandals highlight the need for integrated multilateral reforms.

The Kremlin's foreign policy toolkit includes 'hybrid' measures of social, political, and economic influence abroad.[4] These measures satisfy a desire to destabilise the Baltic states and others without engaging in a costly kinetic war.[5] Money laundering provides a mechanism for enabling other means of hybrid warfare and creating socio-economic difficulties in a target country while profiting involved officials in the Kremlin.

The result of money laundering is wealth that appears unconnected to illicit activity

This policy brief is the first in a series of two examining the Kremlin's use of money laundering in the Baltic states and Europe at large. It explores how Moscow circumvents economic sanctions and advantages itself through money laundering, which is a factor associated with political instability and that exaggerates other threats, such as economic disruption, organised crime, and terrorist financing.[6] A second brief proposes a policy response: the application of machine learning technology to help EU-based banks combat money laundering.

The Kremlin's Motivation

Money laundering—used to make illicit money appear 'clean' and circumvent economic sanctions—is a widespread phenomenon; an estimated 2-5% of the global annual GDP is believed to be associated with money laundering.[7] The most popular and accessible framework for understanding how it works is three-part: 1) placement, 2) layering, and 3) integration.[8] During "placement," launderers move dirty money away from its origins and into the legitimate financial system. When "layering," launderers disguise the money's origins through a series of legal monetary transactions. The money is then "integrated" back into the legitimate economy or directly into the hands of the owner. These steps often overlap. The result: wealth that appears unconnected to illicit activity.

Political officials and business elites connected to the Kremlin take advantage of these methods for personal gain and to support the state.[9] Putin's government partly functions as a 'kleptocratic tribute system,' involving a set of oligarchs and political leaders who obtained influence and wealth through rent-seeking behaviour in exchange for political loyalty.[10] Money laundering offers a means for officials who were sanctioned after the annexation of Crimea and other actions that violated international norms to access the international financial system, whether for personal profit or in support of state objectives.

The Scale of the Threat

While it is difficult to know the exact sums involved, the scale of Russian money laundering is enormous. Money laundering is conducted away from public view, making it difficult to quantify. However, if the multi-billion-dollar Danske Bank, Swedbank, and SEB Bank scandals are any indication, the volume of laundered money could be in the trillions. The 2020 Basel Anti-Money Laundering Index rated Russia at 5.51 (10 being a domestic environment that is highly conducive to money laundering and terrorist financing and 0 being most resilient), placing it 89th out of 141 countries and 10th of 16 European and Central Asian countries. Meanwhile, Estonia and Lithuania scored much higher: Estonia ranked 1st and Lithuania ranked 11th out of 141 countries globally.[11] Similarly, Russia was scored 30 out of 100 in Transparency International's 2020 Corruption Perception Index (CPI), placing it 129th out of 179 countries.[12]

Although money laundering transactions are not easily traced, the Kremlin's connections to the practice are still apparent. For example, the Troika laundromat, which operated from 2006 to 2013, allowed Russian political higher-ups to profit from complacent oversight. The Organized Crime and Corruption Reporting Project (OCCRP) found that a private Russian investment bank had used shell companies in the British Virgin Islands to establish a record of transactions and then transferred $4.8 billion out of the system through a Lithuanian bank, Ukio Bankas, which had a reputation for accepting risky deals. Many of those who received money from the 'laundromat' were members of the Russian political elite with ties to Putin.[13]

In 2016, the European Central Bank revoked the license of Trasta Komercbanka, a private bank headquartered in Latvia, for its involvement in laundering around $13 billion that was shown to have originated in Russia. The OCCRP estimated the total amount 'cleaned' through the implicated Russian 'laundromat' at $20.8 billion. The laundromat involved 112 accounts in eastern Europe during the initial placement of funds, and all accounts contained money earned from state contracts or Russian state-owned enterprises. Reporters were able to trace some of the funds, alleging that "heavy users of the scheme" were members of the Russian elite with connections to the state apparatus as well as members of Putin's inner circle.[14] These events illustrate a general pattern of Kremlin-linked money laundering efforts inside Europe as a tool in Moscow's 'hybrid' toolkit.

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Money Laundering and Baltic State Security

Kremlin-sponsored money laundering presents a significant economic, strategic, and security threat to the Baltic states and their western allies in at least three ways:

1) Money laundering allows sanctioned oligarchs, or members of the Russian elite, to access the global financial system from which they are otherwise banned. Many of these individuals launder state money at the behest of Putin, who is estimated to control a quarter of the one trillion US dollars Russia stores abroad, and many are tied to state-owned resources that support the Russian security apparatus.[15] Former Estonian Minister of Finance Martin Helme reinforced this connection in 2019, stating that the two types of money that come from Russia are that which is stolen and that which is "very closely entangled" with Russia's security services.[16] The UK's Intelligence and Security Committee of Parliament has also noted that "it is widely recognised that Russian intelligence and business are completely intertwined."[17] Through kleptocracy, Putin and his partners can fund operations abroad such as espionage, terrorism, bribery, and disinformation that destabilise the Baltic states and their EU partners and NATO

Allies.[18] Western officials who turn a blind eye to money laundering are thus supporting the skirting of their own sanctions.

2) Corruption undermines democracy and creates disillusioned citizens.[19] According to US political sociologist Larry Diamond, "Endemic corruption poses the single most urgent internal threat to democracy."[20] However, through money laundering, the Kremlin has endeavoured to make the exportation of corruption an external threat as well. Money laundering, and corruption more generally, can be used to capture a state official's interest; it can amplify societal fractures; or, if left unchecked, can reduce faith in governing institutions.[21] All three Baltic states fare well on the 2020 CPI, but recent scandals that exposed the vast scope of illicit funds laundered through Baltic banks reflect continued Russian money laundering efforts.[22] These could pose a strategic problem for the Baltic states and their allies, especially should it shake faith in the credibility of democratic governance.[23]

EU members must band together to detect illicit activity and dissuade future attempts at financial evasion, strategic corruption, and grey area tactics

3) Money laundering creates economic risks for a state's financial and private sectors. Widespread money laundering can lead to states with powerful reserve currencies cutting off transactions. This was the case in 2018 when the US denied dollar funding or the opening of new accounts in the US to ABLV Bank, Latvia's third largest lender, resulting in a run on the bank and its failure.[24] More generally, financial institutions risk failure due to inadequate management of their operations associated with non-predictable deposits and withdrawals of illicit wealth. Money laundering can also undermine the legitimate private market. Front companies which integrate illicit and legally obtained funds to make the business appear more legitimate, for example, often sell goods and services at artificially low prices, as they are subsidised by illicit funds. This gives front companies a competitive advantage over small businesses that cannot absorb losses incurred as a result. Other risks include monetary instability, distortion of supply and demand factors, and loss of tax revenue. Once a country is known to host money laundering, it becomes harder to attract 'clean' investments due to uncertainty about market stability. In time, a 'race to the bottom' effect can develop, as the realisation of a shadow economy and poor foreign investment prospects beget more of the same.[25]

Multinational Response

Money laundering schemes use cross-border institutions and an opaque web of international transactions to avoid detection by any one domestic authority. The ease of shifting money across borders was clearly demonstrated in the Danske Bank and Swedbank investigations. The repercussions of these hybrid tactics reach far beyond the Baltic states, evidenced by the UK Golden Visas (2010-14) and the Cyprus Golden Passports (2008-20) scandals.[26] The best defence against money laundering, therefore, is a coordinated multinational effort. Beyond reactive punitive measures, EU members must band together to detect illicit activity and dissuade future attempts at financial evasion, strategic corruption, and grey area tactics. Effective anti-money laundering efforts can exist at many levels. International organisations, national governments, civil society, and investigative media can all contribute to cohesive anti-money laundering policies that increase transparency, decrease deniability, and dissuade future Kremlin-sponsored money laundering attempts through European institutions. A follow-on brief will discuss a possible multinational response: a federated autonomous deep learning algorithm through which investigators could identify suspicious transactions without compromising data security or privacy.

Endnotes

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