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Banks Should Raise Their Risk Ranking of Russia as Tensions with the U.S., EU Escalate

By [Brian Monroe](#)

Financial institutions should elevate their risk ratings on transactions with entities in Russia as tensions between it and the U.S. and Europe intensify, according to risk management analysts.

Diplomatic ties between Russia, the EU and U.S. have been strained since Russia invaded Georgia last month. In response, U.S. and EU leaders have warned of sanctions, although they have yet to detail what form they might take.

Though France brokered a cease-fire between Russia and Georgia after 10 days of fighting, Russia raised the ire of the U.S. and many EU politicians when it recognized the independence of breakaway Georgian states South Ossetia and Abkhazia.

And, U.S. and EU banks were already raising their risk rankings for their branches, clients and transactions tied to Russia, said Kenneth Rijock, a financial consultant with London-based World Check and former money launderer.

Among other things, financial institutions have reason to doubt that any conflicts they encounter in doing business in Russia can be fairly adjudicated in the Russian court system. The Bank of New York is currently embroiled in a court case in Moscow brought by the Russian Customs Service that is seeking \$22.5 billion from the bank for allegedly allowing \$7 billion to be laundered by a rogue employee.

Check again

In a note to investors, Swiss Bank UBS confirmed the pendulum has swung back to Russian business investments carrying a high degree of political risk, according to an article Thursday in London's Financial Times.

Among other things, banks should be wary of criminals trying to intersperse fraudulent transactions with money legitimately being taken in and out of banks in the region by residents fearful for their safety and the financial health of the economy, say compliance professionals.

It's vital for bank compliance officers, even if they have risk-rated their clients and businesses in Russia this year, to re-analyze and re-score those relationships – both to ensure they have not been infiltrated by criminals and to plan an exit strategy if economic sanctions are imposed, according to Rijock.

To do that, foreign banks, particularly those in the United States, may need to visit Russian banks in person or contract, preferably with someone who has experience with both law enforcement and Russian organized crime, to examine for suspicious activity, Rijock said.

Even then, he said, U.S. compliance officials will likely run into stumbling blocks, such as lack of beneficial ownership information for Russian businesses and weak due diligence and enhanced due diligence procedures because "half of the banks are under the thumb of organized crime."

Stepping forward, backward

That was changing when Russia added stronger anti-money laundering rules and deputy chairman of the Central Bank of the Russian Federation, Andrei Kozlov, closed dozens of dirty banks.

Kozlov, though, was found murdered in September 2006. Russian officials have speculated that Kozlov was killed by gangsters for his role in instituting anti-crime reforms to the Russian banking systems

Also, in July, a European anti-money laundering watchdog, Moneyval, stated Russia's financial intelligence unit is ineffective, the country is still plagued with corruption and has yet to convict anyone of money laundering.

These lapses, combined with Russia's saber-rattling with the U.S. and the EU, provide the "chaos that money launderers thrive in," Rijock said. Higher transactional volume in the region will also make Russian banks hard pressed to investigate every suspicious transaction, putting the onus on their U.S. correspondents.

"Muddy waters make it easier for financial crime to operate," he said.

Beware sanctions

Compliance officers also need to monitor what type of sanctions materialize against Russia, because that could mean scrutinizing customer data-bases for new individuals or entities, said Betsy Sue Scott, the former head of the U.S. Treasury Office of Foreign Assets Control's civil penalties division and owner of a consultancy in Reston, Va.

In the short term its unlikely there will be economic and trade-based sanctions imposed that would force financial institutions to exit the region, like those in place for Iran, since they are typically only adopted for countries considered "national security threats or those that sponsor terrorism," Scott said.

Even so, she stated it would be wise for banks to "review their risk management standards and assess how the situation would affect their customer base because if there is a shift" in tact against Russia and the relations with its neighbors deteriorates, "things can change at warp speed."

More likely in the sanctions arena is the U.S. or EU targeting the finances of Russian power brokers or high-ranking politically exposed persons.

Such a strategy could expose corrupt practices related to the government centralization of major industries that had previously gone private after the fall of the Soviet Union in the 1990s, Rijock said.

Even so, the resolve of countries calling for sanctions, many of which are "dependent on Russian energy, may disappear after a few nasty looks and tough speeches," said John Reynolds III, an attorney following sanctions regulations for Washington, D.C.-based law firm Wiley Rein LLC.

In the case of the United States, he said the country "doesn't want another major conflict with Russia because there are areas we are hoping for Russian cooperation, particularly regarding sanctions against Iran's nuclear program."