



Kilian Strauss

**The Situation of Financial Intelligence
Units in Central and Eastern Europe
and the Former Soviet Union**

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Abstract

The transition process in many countries in Central and Eastern Europe from a one-party state to a democratic system has been long and difficult and has frequently been accompanied by institutional instability. The judiciary and law enforcement bodies have been no exception. Both have suffered from a weak legal tradition in many countries of the region, weak implementation of existing legislation, limited operational effectiveness, corruption and the influence of informal personal networks. These developments can also be observed in the area of financial intelligence. Following the fall of the Berlin wall in 1989 and the events of September 2001, most countries of the region adopted legislation aimed at combating money laundering and terrorist financing, as required by their international commitments as well as EU entry requirements. In this context, most countries also set up the required institutions, notably a Financial Intelligence Unit (FIU).

Although the legislation and institutions are now in place in most countries, they still lack effectiveness. In some countries, there are weaknesses in inter-agency co-ordination and there are still very few convictions of money launderers across the region. This can be partly explained by the lack of experience, staff and means of the often rather young institutions. A more worrying observation is the fact that some FIUs are not sufficiently independent in their day-to-day work due to political pressure.

Another, equally worrying development, is the risk that some countries may abuse the financial intelligence for political purposes, for example by investigating the activities of opposition politicians, unchecked by national judiciaries that are not sufficiently independent.

This paper looks into the history and role of FIUs in Central and Eastern Europe and asks whether they are at risk of abuse at the hands of the powers that be. It also looks into mechanisms that could prevent such abuse and makes recommendations to improve the effectiveness of FIUs.

About the author

Kilian Strauss is an expert on governance and the transition process in Central and Eastern Europe. He has been actively involved in international efforts aimed at combating money laundering, terrorist financing and corruption in the region in different capacities, including as Head of the Good Governance Unit at the Secretariat of the Organisation for Security and Co-operation in Europe (OSCE) or as an expert for the Council of Europe. He studied economics, international relations and international law in France and is an alumnus of the Institut d'Etudes Politiques in Paris. He has lectured and published on issues concerning terrorist financing, corruption, EU Enlargement, the Russian enclave of Kaliningrad and the economic transition of Central and Eastern Europe. Other assignments include positions at the European Commission and ING Bank.



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Preface

About 20 years ago, Australia and the US established the first Financial Intelligence Units (FIUs). In the meantime, there are well over 120 such national units all around the globe. They have a central role in the Anti-Money Laundering and Counter-Terrorist Financing framework. Financial institutions and designated non-financial businesses and professions are required to report suspicious activity to the FIUs. The FIUs have the difficult task to analyse these reports and disseminate to law enforcement only those that are deemed to be triggering money laundering and terrorist financing investigations.

Suspicious activity reports have been instrumental in many asset recovery cases (e.g. the cases of Mr Abacha or Mr Montesinos, see www.assetrecovery.org). The world largest corruption case in terms of penalties imposed on a company, Siemens, was initiated by suspicious activity reports in Switzerland and Liechtenstein. The value of this system is proven – but FIUs also collect large amount of data that have not manifested any indications of crime. This poses serious challenges for data protection. By all means, it has to be avoided that such data is used for purposes that are not related to money laundering and terrorist financing. While many developed countries have established data protection regulation that limits the powers of FIUs in a reasonable way, the lack of such regulation in other regions increases the risk that data is used for political or other purposes.

Central and Eastern Europe and the countries of the former Soviet Union face particular challenges in fighting money laundering and terrorist financing. The progress that many of these countries have made in setting up FIUs is welcomed. Many FIUs have become important political players in their countries. The author of this paper lays down that there is also a risk of political abuse of these powers. One should also not underestimate the risk of corruption that still is perceived to be high in most of the countries discussed in this paper.

A careful balance has to be made between using the FIU model as a powerful tool to fight money laundering and terrorist financing and the necessary safeguards to protecting the rights of law abiding citizens. I hope that this paper can make a useful contribution to the policy debate in this area. I am particularly grateful to Kilian Strauss, the author of this paper. He is a well known expert on AML/CTF issues and on this region.

The study benefitted greatly from the comments of the peer reviewers Giuseppe Lombardo¹, Klaudijo Stroligo² and Patrick O’Sullivan³. I very much appreciate their contribution and collaboration.

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1. Introduction

After the fall of the Berlin Wall in 1989, many of the countries in Central and Eastern Europe embarked on a series of sweeping political and economic reforms with the declared aim of joining the European Union. The speed of the reforms and the lack of experience with such encompassing restructuring resulted in many places in the appearance of a temporary legal vacuum, which was exploited both by criminals and by persons with privileged access to national resources. The temporary instability also affected law enforcement bodies and the judicial system.

The absence of a strong legal tradition in many countries of the region often resulted in political and judicial systems with weak legal foundations, accompanied by frequent instances of conflicts of interest and high levels of corruption, especially in the successor states of the Soviet Union. To this day, weak judiciaries, corruption and political clientelism are present in many countries of the region.

In the area of combating money laundering and terrorist financing, most countries in Central and Eastern Europe have striven to meet international standards and have largely adopted the required national legislation and set up the required national institutions, including a Financial Intelligence Unit (FIU).

This paper will look into the history and role of FIUs in Central and Eastern Europe and look at their performance over the last few years. It will try to determine whether they are sufficiently effective and independent or whether they are at risk of abuse at the hands of national governments. It will also look into some of the most important problems and challenges to their operation and will take a closer look at the anti-money-laundering system in Russia. Finally, the paper will look into mechanisms that could increase the effectiveness of FIUs and prevent abuse.

2. Definitions of the relevant terminology

In this paper we will look at Financial Intelligence Units (FIUs) in 28 countries in Central and Eastern Europe (CEE) and the former Soviet Union (FSU).

For the sake of clarity, especially to those readers not familiar with either anti-money-laundering/counter-terrorist financing (AML/CTF) or the geographic region of Central and Eastern Europe and the former Soviet Union, here is a brief definition of the most important geographic and technical terms that will be used on the following pages:

Central Europe: group of new EU member countries, most of which used to be part of the Warsaw Pact: Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Bulgaria and Romania.

Commonwealth of Independent States (CIS): international organisation, composed of most of the former Soviet Republics. It includes Armenia, Azerbaijan, Belarus, Moldova, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan. (Georgia, formerly part of the CIS, left the organisation after the Russian-Georgian war in 2008.)

South-Eastern Europe: countries of the western Balkans, i.e. Albania, Bosnia-Herzegovina, Croatia, Macedonia, Montenegro and Serbia.

Central and Eastern Europe and former Soviet Union (CEE/FSU): as used in this paper, this term includes all of the above mentioned countries.

Financial Intelligence Unit (FIU):

An FIU is ‘a central, national agency responsible for receiving, (and as permitted, requesting), analysing and disseminating to the competent authorities, disclosures of financial information:

- (i) concerning suspected proceeds of crime and potential financing of terrorism, or
- (ii) required by national legislation or regulation, in order to combat money laundering and terrorism financing’.⁴

Financial Action Task Force (FATF) Recommendation 26:

Countries should establish an FIU that serves as a national centre for the receiving (and, as permitted, requesting), analysis and dissemination of Suspicious Transaction Reports (STRs) and other information regarding potential money laundering or terrorist financing. The FIU should have access, directly or indirectly, on a timely basis to the financial, administrative and law enforcement information that it requires to properly undertake its functions, including the analysis of STRs.⁵

4 Definition of a Financial Intelligence Unit as adopted at the plenary meeting of the Egmont Group in Rome in November 1996, as amended at the Egmont Plenary Meeting in Guernsey in June 2004, STATEMENT OF PURPOSE of the Egmont Group of Financial Intelligence Units, 23 June 2004.

5 FATF, available at www.fatf-gafi.org.

Types of FIUs⁶

The four most important types of FIUs⁷ are the following:

Administrative FIUs

Administrative FIUs are usually part of the structure, or under the supervision of, an administration or an agency other than law-enforcement or judicial authorities, usually the national bank or the ministry of finance. Sometimes, the administrative type constitutes a separate agency, placed under the supervision of a ministry or administration (autonomous) or not placed under such supervision (independent).⁸

Law enforcement FIUs

In some countries, the emphasis on the law-enforcement aspects of the FIU led to the creation of the FIU as part of a law enforcement agency, since this was the easiest way to establish a body with appropriate law-enforcement powers without having to design a new entity and a new legal and administrative framework.⁹

Judicial/prosecutorial FIUs

This type of FIU is generally established within the judicial branch of the country and most frequently under the prosecutor's jurisdiction.¹⁰

'Hybrid' FIUs

This type of FIU usually combines two of the above types of FIUs in an effort to combine the different advantages of them, for example by joining two agencies involved in combating money laundering.

A Glossary of the most important abbreviations used in this paper can be found in the Annex.

6 See also Annex 1.

7 IMF/World Bank Group, Financial Intelligence Units, An Overview, Washington D.C. 2004.

8 Ibid.

9 Ibid.

10 Ibid.

3. Brief historical overview of international and national efforts on countering money laundering and terrorist financing in CEE

The first international initiatives in the area of combating money laundering and terrorist financing date back to the late 1980s and early 1990s, mainly in connection with the fight against drug trafficking and the related laundering of illicit funds. The events of September 2001 focused the attention of the international community on terrorist financing and led to an intensification of its efforts aimed at fighting the phenomenon.

Among the first international anti-money-laundering instruments were the 1988 UN Convention against Illicit Trafficking in Narcotic Drugs and Psychotropic Substances (Vienna Convention)¹¹, as well as the 2000 UN Convention against Transnational Organised Crime (Palermo Convention)¹².

To this must be added the International Convention on the Suppression of Terrorist Financing, which came into force in 1999,¹³ as well as the UN Convention against Corruption, which came into force in 2005,¹⁴ the different EU Directives (three to date)¹⁵ aimed at combating money laundering and terrorist financing, as well as the relevant Council of Europe Conventions (notably the Strasbourg and Warsaw Conventions)¹⁶.

The backbone of all international initiatives aimed at fighting money laundering and terrorist financing are the standards set by the Paris-based Financial Action Task Force (FATF): the 40 Recommendations on Combating Money Laundering and the 9 Special Recommendations on Combating Terrorist Financing.¹⁷ The 40 Recommendations were first published in 1990 and have since become the most relevant set of international standards in the area of AML/CTF. They are mandatory for all 34 FATF members as well as all members of so-called FATF-style regional bodies (FSRBs), but equally for all UN members, following the adoption of UN Security Council Resolution 1617 (2005) of 29 July 2005,¹⁸ which recommends the implementation of the 40+9 Recommendations (as well as the relevant UN Conventions) under Chapter VII of the UN Charter. As a result, fighting money laundering and terrorist financing has become an important international commitment for all UN members.

After the fall of the Berlin Wall in 1989 and the collapse of the Soviet Union in 1991, the states of Central and Eastern Europe quickly embarked on a range of ambitious political and economic reforms, many of which with the eventual goal of joining the European Union (EU).

When communism fell, these countries had to rebuild their entire economic, political and judicial infrastructure after living for more than forty years in a one-party state.

11 Available at www.unodc.org/pdf/convention_1988_en.pdf.

12 Available at www.unodc.org/unodc/en/treaties/CTOC/index.html.

13 Available at <http://treaties.un.org/doc/db/Terrorism/english-18-11.pdf>.

14 Available at www.unodc.org/unodc/en/treaties/CAC/index.html.

15 Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of ML and TF, Official Journal of the European Union, 25.11.2005, L 309/15.

16 Available at <http://conventions.coe.int/Treaty/EN/Treaties/Html/198.htm>.

17 Available at www.fatf-gafi.org.

18 Available at www.un.org/Docs/sc.

Recreating a functioning democracy and market economy on the remnants of the old system could obviously not be done overnight. Intense efforts as well as painful steps were needed to bring the countries of the region closer to European and international standards.

The numerous and wide-ranging reforms touched upon all fields of life and included the restructuring and modernisation of the economic and political systems, as well as the judiciary and law enforcement bodies.

Politically encouraged and financially supported in their efforts by EU member states and the European Commission, as well as by a desire to live up to their international commitments, most countries in Central and Eastern Europe adopted legislation aimed at combating money laundering and terrorist financing and set up the required institutional framework, most importantly a Financial Intelligence Unit (FIU), to which national financial and non-financial reporting entities are to report suspicious transactions they encounter in their daily operations. In this they were supported by generous technical assistance provided by the major international organisations active in the region, above all the European Union and the Council of Europe, but also the European Bank for Development and Reconstruction (EBRD), the International Monetary Fund (IMF), the World Bank, the Organisation for Security and Cooperation in Europe (OSCE) and the UN Office on Drugs and Crime (UNODC).

In this context, most countries in the region also joined the respective FSRBs: the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures (Moneyval) for the states located in Central and South-Eastern Europe as well as the western CIS¹⁹ and the Eurasian Group on Combating Money Laundering and Terrorist Financing (EAG), which regroups most of the countries of the CIS.²⁰ Once accepted into these organisations, all member countries have to undergo regular so-called mutual assessments, which scrutinise the existence and effectiveness of their legislative and institutional framework.

Russia constitutes a special case, as it is the only country of the region, which is a member of both Moneyval and the EAG, as well as the FATF, and is therefore regularly assessed by all three organisations. Given its special status in the region, a separate chapter is devoted to Russia at the end of this paper.

Most FIUs of the region also have become members of the Egmont Group, the international organisation currently regrouping 116 national FIUs.²¹ The organisation was created in 1995 with the aim of assisting and encouraging the exchange of financial intelligence between the units. Membership of the Egmont Group, applications for which have to be assessed by existing Egmont members, allows national FIUs not only to exchange information with their counterparts in other countries, but also to develop formal and informal contacts and networks, which can be conducive towards their day-to-day operations. It also allows member FIUs to participate and benefit from the Egmont Group's technical assistance and training activities.

The only countries in the region, that have not yet established an FIU or whose FIUs are currently not members of the Egmont Group are Azerbaijan, Kazakhstan, Uzbekistan, Turkmenistan and Tajikistan.

19 Available at www.coe.int/moneyval.

20 Available at www.eurasiangroup.org.

21 Available at www.egmontgroup.org.

4. The current AML/CTF situation in Central and Eastern Europe

AML/CTF legislation in CEE/FSU

In line with their international commitments as members of the United Nations, as well as their membership of the respective FATF-Style Regional Bodies (FSRBs), almost all countries of the CEE/FSU region have adopted the required AML/CTF legislation and have enacted it. The only notable exception at the time of writing (May 2010) is Tajikistan, whose draft AML/CTF Law has been ‘under discussion’ for the last six years. As all countries in the region are members of the relevant FSRBs, their national AML/CTF legislation is assessed by evaluators in regular intervals, thus ensuring that the legislation meets the relevant international standards, or encouraging them to adjust their legislation and institutional framework accordingly.

Financial Intelligence Units in CEE/FSU – types and structures

As outlined above, nearly all countries of the region have created a Financial Intelligence Unit (FIU) over the past decade and most of these FIUs are also part of the Egmont Group, the international forum aiming at promoting co-operation among FIUs.

When setting up an FIU, the countries of the region have followed different models, based on national preference, legislation and not least the advice provided by international technical assistance. As a result, all types of FIUs can be found in the region (cf. definitions above).

Across Central Europe, South Eastern Europe and the CIS, the most frequently used type of FIU is the administrative type (20 countries out of 28, i.e. 71%, have opted for this model). There are six law enforcement type FIUs (21%, one of which is a law enforcement/hybrid type FIU), as well as two judicial/prosecutorial type FIUs.

The FIUs in the region are most frequently located in Ministries of Finance (10 out of 28), followed by national banks (4) and different law enforcement agencies (4). The remaining FIUs are either independent bodies (3) or located in other institutions, such as Prosecutor’s Offices (2) or other state committees (2).

A detailed overview of all countries of the region can be seen in the Annex.

Administrative FIUs

Opting for an administrative type FIU has a number of objective advantages, such as keeping a high degree of operational neutrality and of developing and maintaining a relationship of trust with the national reporting institutions, especially with banks. On the downside, there may be delays in applying law enforcement measures, such as obtaining additional intelligence on suspects.²²

By far the most important weakness of administrative type FIUs, however, is their lack of political independence, as this type of FIU is more frequently subject to the direct supervision of the institution it is part of (most often the Ministry of Finance or the Cabinet of Ministers, but also in some cases the secret service). This observation is particularly important for the FIUs in Central and Eastern Europe, as by far the most appointments for Heads of FIUs (22 out of 28, cf. chart in the Annex) in the region are

²² Financial Intelligence Units, An Overview, IMF, Worldbank Group, Washington, 2004, p. 10/11.

political and therefore may influence or limit the political independence of the institution (cf. below).

Law enforcement/prosecutorial type FIUs

The second most frequently used type of FIU in the region is the law enforcement type FIU, usually located in Ministries of Interior, National Police Headquarters or other Law Enforcement Agencies. The main concern with regard to this type and location is that, given the history of strong intelligence service involvement across the region, a law enforcement FIU may not be sufficiently independent from the institution where it is located, may face difficulty in developing relationships of trust with reporting institutions (especially banks) and may be more liable to abuse its privileged access to financial intelligence, for example by using it for politically motivated prosecutions. This is a risk that applies even more to judicial/prosecutorial FIUs, of which there are currently two in the region (in Latvia and Uzbekistan). An additional disadvantage of this prosecutorial FIUs is that they are usually not involved in drafting or amending AML/CTF legislation.

Degree of political freedom

When analysing the situation of FIUs in Central and Eastern Europe, it is important to take into account the general political framework, in which the national institutions and FIUs operate. Among the countries under consideration, ten are members of the European Union (EU) and five are EU accession candidates or potential EU candidates. This means that these fifteen countries are under relatively close scrutiny by the EU with regard to meeting their international commitments and especially with regard to making progress in the judicial area. As a result, most of these countries have achieved a relatively high degree of democratic accountability and political freedom, as confirmed by independent international indicators, for example by Freedom House.²³

In the annual 'Freedom in the World' chart, all countries and territories surveyed are rated as 'free', 'partly free' or 'not free'. According to the latest edition of Freedom in the World, released in January 2010,²⁴ all Central European countries that are also members of the EU (Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovakia, Hungary, Slovenia, Bulgaria, Romania) were rated as politically 'free' in 2009. This means that their political systems are implementing EU standards and will therefore not be considered in further detail in this paper.

Of the official and potential EU candidates, Croatia, Serbia and Montenegro were rated as free in 2009, as was Ukraine. Albania, Bosnia-Herzegovina, Macedonia and Moldova were rated as 'partly free', as were Armenia and Georgia. All other countries, i.e. Azerbaijan, Belarus, Russia and all countries in Central Asia, were rated as 'not free'. The focus of this paper will therefore be primarily on the countries of South Eastern Europe and the CIS.

23 Freedom House has been monitoring political rights and civil liberties since 1972 and publishes annual survey ratings and narrative reports on 193 countries and 15 territories.

24 'Freedom in the World 2010', available at www.freedomhouse.org.

5. The key challenges and weaknesses of FIUs in CEE

As described above, all countries of South Eastern Europe and the CIS are members of one of the two FATF Style Regional Bodies, Moneyval and the EAG, implying that their progress on combating money laundering and terrorist financing is assessed on a regular basis by these organisations.

With AML/CTF laws and institutions in place in almost all of the countries of the region, the countries in CEE/FSU have met most of their international commitments on paper, a fact that is often referred to. Yet the mere existence of legislation does not automatically imply its implementation and the presence of an institution does not imply that it is effective.

As a matter of fact, many mutual evaluation reports of the countries of the region highlight a number of significant weaknesses in national AML/CTF systems in general and the FIUs in particular. Some of these weaknesses are typical of transition countries, as some countries, especially the members of the CIS, have only recently created their national AML/CTF systems.

On the following pages, we will look in detail at some of the main weaknesses of FIUs highlighted in the respective mutual evaluation reports.

Limited effectiveness

Many mutual evaluation reports on the countries of the region point out the weak state of the existing AML/CTF regimes and frequently highlight the lack of effectiveness of their respective national FIU when evaluating FATF Recommendation 26.²⁵ There are, however, significant differences between countries, with some EU countries, such as Poland and Slovenia, receiving a ‘compliant rating’ on their FIUs in their latest evaluations.²⁶

In the countries in South Eastern Europe and the CIS, however, mutual evaluation reports frequently highlight the lack of staff, who in some cases receive relatively unattractive salaries,²⁷ making attraction and retention of qualified staff a big challenge. As a result, some FIUs lack crucial expertise, especially in the analytical field. They also suffer from high turnover and strong competition from the private sector. To this has to be added the lack of sufficient budgetary means and of comprehensive and effective ITC systems at a number of FIUs, which constitutes an important obstacle to the FIU performing its mandated responsibilities and tasks effectively.

While weak effectiveness can be observed in a number of countries of the region, it is difficult to quantitatively assess and compare the overall effectiveness of the different national AML/CTF regimes. While some numerical approximation can be done, for example by comparing the number of STRs and the number of cases passed on to law enforcement and the judiciary, and, among other things, the number of convictions this

25 Available at www.eurasiangroup.org/en/mers.html; www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Evaluation_reports_en.asp.

26 *ibid.*

27 EU Progress Reports on official and potential EU accession candidates, October 2009, http://ec.europa.eu/enlargement/how-does-it-work/progress_reports; Moneyval Mutual Evaluation Reports, www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Evaluation_reports_en.asp.

has resulted in, non-quantifiable elements, such as the degree of autonomy of an FIU or political will (or the lack thereof) are much harder to assess, if at all possible.

Weak inter-agency co-ordination

National inter-agency co-ordination with reporting entities and law enforcement bodies is often criticised in the mutual evaluation reports and is frequently described as weak, lacking clarity or being lengthy.²⁸

Some countries have created national AML/CTF co-ordination mechanisms, for example in the shape of an inter-agency AML/CTF co-ordination committee or AML/CTF working group. However, due to the recent creation of many of these mechanisms as well as a frequent lack of experience about fighting money laundering in other institutions, such as customs, non-financial institutions and the judiciary, as well as frequent difficulties in co-ordinating activities between different government agencies, evaluators suggest improvement in inter-agency co-ordination in many of the countries of the region.

Weak statistics

Many FSRB evaluation reports describe the national statistics produced on money laundering cases as weak or unreliable.²⁹

Although most countries produce statistics about their AML/CTF activities, the varying quality, criteria and standards make comparisons between countries difficult for both researchers and evaluators.

Among the few quantifiable and comparable factors of the effectiveness of an AML/CTF system are the number of suspicious transaction reports and the number convictions for money laundering.

Few suspicious transaction reports

One of the few quantifiable factors of the effectiveness of an AML/CTF system are the number of suspicious transaction reports (STRs) sent to FIUs from the national reporting institutions, mostly financial institutions (banks), insurances and other, non-financial institutions, such as casinos, real estate agents and notaries. Although the total number of STRs may constitute a numerical indicator of the effectiveness of a national AML/CTF system, the quantity of reports does not allow direct conclusions as to their quality and even less so about the potential for investigations, indictments and convictions that could ensue based on the information contained in the STRs. This depends also on the capacity of the FIU to analyse the reports and other information it receives and to provide law enforcement with quality intelligence to enable them to launch investigations possibly leading to successful prosecutions. This capacity depends crucially on the number of staff employed by an FIU, their professional expertise, access to information, as well as the presence of a comprehensive and effective IT system.

28 Available at www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Evaluation_reports_en.asp.

29 EU Enlargement Progress Reports, http://ec.europa.eu/enlargement/how-does-it-work/progress_reports.

One observation made in many evaluation reports about countries in the region, is that the number of STRs is low,³⁰ which can be put down to several factors, many of which are beyond the direct influence of the FIU. Among the most important factors are the following:

- lack of awareness by reporting institutions
- lack of experience by reporting institutions
- lack of staff and means in reporting institutions
- lack of trust towards the FIU
- lack of knowledge about reporting mechanisms
- weak institutional co-ordination

Although there is no automatic link between a low number of suspicious transaction reports and the number of investigations, indictments and convictions, as this also depends on a number of other factors, few STRs may mean low numbers of convictions in some countries.

Few convictions for money laundering and lack of confiscations

An important indicator of the effectiveness of a functioning AML/CTF system is the number of money laundering cases investigated following information provided by the FIU and in particular the number of resulting convictions or confiscations.

However, an objective analysis and comparison among the countries of the region is made extremely difficult by weak national statistics on money laundering investigations and convictions, as the numbers provided are often difficult to compare and because of the varying dates of the latest available figures.

Drawing on the available numbers from national statistics and the mutual evaluation reports from Moneyval and the EAG, the latest available annual numbers of convictions for money laundering vary from 0 in Moldova (figure from 2007), over 25 convictions in Ukraine (figure from 2008) to 262 in Russia (figure from 2008)³¹, as compared for example to over 1,000 convictions per year in the US,³² although direct comparisons of these numbers are not always possible. An objective comparison is complicated further by the fact that not all countries clearly separate convictions for money laundering from convictions for predicate offence or other related crimes.

What can however be observed in most countries of the region is a low number of convictions, which evaluators judge to be far below the potential of the national AML/CTF systems in place.

The reasons for the low numbers of convictions may vary from country to country, but in many countries they may be due to a lack of prosecutorial expertise and specialisation. According to observations made about some CIS countries in the US State Department's 2009 International Narcotics Control Strategy Report, 'Some prosecutors may close money laundering investigations and cases prematurely or arbitrarily, possibly because of lack of sufficient manpower or resources, corruption, a weak understanding of money laundering crimes, or a belief that other types of crimes

30 Moneyval Mutual Evaluation Reports www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Evaluation_reports_en.asp.

31 cf. chart in the Annex.

32 Available at www.fincen.gov.

should take priority over money laundering.³³

In the countries of Central Asia, there are currently no or few verifiable convictions for money laundering. It is particularly difficult to accurately assess their national AML/CTF systems, due to a lack of reliable statistics, weak law enforcement, a weak judiciary and high levels of corruption.

Corruption

Although there are big differences in the levels of corruption from country to country, as documented by the annual Corruption Perception Index of the international NGO Transparency International, there are persistently high levels of corruption in many countries of the region. Whereas some of the highest levels of corruption in the world can be found in Central Asia and some other CIS countries, there are also significant problems with corruption in some EU countries (e.g. in Bulgaria and Romania) and among EU candidates.

High levels of corruption give considerable ground for serious concern, as corruption affects many of the states' institutions and often reaches deeply into law enforcement bodies and courts, thus making efforts aimed at combating all aspects of serious crime, especially organised crime, money laundering as well as terrorist financing, dangerously ineffective.³⁴

High levels of corruption in many of the countries of CEE/FSU are often the result of the legal vacuum that emerged shortly after the collapse of the communist system and until democratic institutions and mechanisms could be created and became operational. According to independent studies and surveys, the sectors most affected by corruption are law enforcement and the judiciary, making fighting serious crime, including money laundering, and the effective implementation of existing legislation particularly difficult.³⁵

Although there have been notable improvements in fighting corruption over the last decade, especially in the countries in Central Europe, there is growing ground for concern elsewhere, as corruption scores in some countries have started to decline again after several years of progress. In some countries, the regression has been so pronounced that the EU has suspended subsidies and has called for further efforts by the states concerned.³⁶

There is also ground for concern that while the authorities in some countries are increasingly 'fighting petty corruption, they simultaneously seem to turn a blind eye to high level corruption and abuse of power', leading some experts to suspect that the same is happening with regard to money laundering.³⁷

More worrying yet is the political pressure exerted upon the judiciary in some countries of the region to drop or postpone corruption investigations against high level officials, leading to the conclusion by experts on the region that corruption cases are not the only ones dropped at the behest of the authorities, especially when individuals

33 International Narcotics Control Strategy Report, Vol. II, Money Laundering and Financial Crimes, State Department, 2009, available at www.state.gov/documents/organization/120055.pdf.

34 Transparency International, available at www.transparency.org.

35 Frankfurter Allgemeine Zeitung, 5 November 2001; Corruption in Russia, available at www.globalsecurity.org/wmd/library/news/russia/2000/russia/part06.htm.

36 Transparency International, available at www.transparency.org; V. D. Shkolnikov, Nations in Transit 2009, Democracy's Dark Year, available at www.freedomhouse.org.

37 Elizabeth Fuller, Nations in Transit 2009, Georgia, available at www.freedomhouse.org.

close to the regime in place are concerned.³⁸

The situation gets progressively worse the further east one goes. In Central Asia, where corruption levels are among the highest in the world³⁹, ‘corruption charges are frequently used against opposition figures or tend to be levelled against highly placed government figures after they enter into a personal or political rivalry with ruling elites or attempt to challenge the President’s authority’.⁴⁰

It is possible to assume that the same is happening with regard to money laundering, as in some countries of the region, the lack of progress in fighting corruption has been brought into a direct connection with lack of effectiveness in fighting money laundering, as high level corruption makes the co-ordination among different institutions difficult, hinders the work of law enforcement and makes thorough judicial investigations all but impossible.⁴¹

Political clientelism

The phenomenon of corruption is often closely linked to the existence of political networks and closely knit elite or power circles, which resulted from the transition from the command economy to market economies. In the power vacuum that emerged at the time of the collapse of the old system, many members of the former nomenklatura used the occasion to secure for themselves important shares in lucrative businesses and political positions.⁴²

One important aspect of this so-called ‘privatisation’ of power and resources has been a considerable subsequent weakening of the authority of the newly created states, described by some analysts as ‘the formation of a ‘soft state’ with little authority, dominated by political parties and their corresponding networks from the old days and a non-transparent, inefficient public sector which continued to control networks of posts to be distributed, continuing the notorious clientelism of the Communist days’⁴³.

The formation of this clientelist superstructure in many states of the former Warsaw Pact has resulted in a number of countries in a weak state apparatus and often ineffective law enforcement structures. One of the most visible aspects of these networks are the appointments to senior government positions, including in the area of law enforcement⁴⁴. This may also affect financial intelligence units, due their potential to highlight politically sensitive cases.

Lack of independence and abuse of power

According to a joint study by the World Bank and the Egmont Group of January 2010⁴⁵, at some 70% of FIUs worldwide, appointments for the position of Head of FIU are made internally by more senior officials of the institution within which the Unit is located. This means that the majority of FIU appointments are of a largely technical

38 Ditmir Bushati Nations in Transit 2009, Albania, available at www.freedomhouse.org.

39 Transparency International, available at www.transparency.org.

40 Bhavna Dave, Nations in Transit 2009 Kazakhstan, available at www.freedomhouse.org.

41 Matt Squire, Russian FIU making little headway in combating endemic corruption, available at www.moneylaundering.com, News, 25 July 2008.

42 Olga Kryshstanovskaya and Stephen White, From Soviet Nomenklatura to Russian Elite, *Europe-Asia Studies*, Vol. 48, No. 5 (Jul., 1996), pp. 711-733; K. Strauss, Beyond the Numbers, Study on obstacles to EU Enlargement, ING Bank, 2002; Irmina Matonytė, Elites in Soviet and post-Soviet societies, Kaunas University of Technology, Lithuania, 2002.

43 Kai-Olaf Lang, Systemtransformation in Ostmitteleuropa, *Aus Politik und Zeitgeschichte*, available at www.swp-berlin.org/common/get_document.php?asset_id=895.

44 Nations in transition 2009, Freedom House, available at www.freedomhouse.org.

45 Worldbank/Egmont Group Survey on FIU Governance, January 2010, worldbank.org.

nature. Correspondingly, only some 30% of appointments are of a political nature, made by the cabinet of ministers or the Head of State.

In Central and Eastern Europe, the opposite can be observed, as the majority of senior FIU appointments (around 80%) are political and are made either by a Minister, by the Cabinet of Ministers or the Head of State. This may point to a desire to make FIUs (appear) independent vis-à-vis other national institutions, but at the same time raises the question about the degree of genuine political independence of the institution, as a politically appointed Head can be removed if political circumstances change, for example after a change of government. Indeed, there have been cases of frequent changes of the Head of FIU in some countries.⁴⁶

Correspondingly, the appointment of senior officials by the Head of State, as practiced mostly in Central Asia, is often designed to ensure that the institution concerned 'remains under the control of the president, which makes it impossible for them to function as independent bodies'⁴⁷.

As a result of the sweeping political changes of the last twenty years, political clientelism can be found virtually everywhere in the region, even in new EU members, but the further east one moves, the stronger it gets.

It is therefore fair to presume that in countries run by authoritarian rulers with limited or no political freedom and high levels of corruption, efforts to fight money laundering follow the example of anti-corruption efforts, i.e. they are waged mainly on paper.⁴⁸

In particular the lack of independence of many FIUs in the region as well as the political pressure exerted on the judiciary could allow the conclusion that some FIUs may not be entirely free in their operations.

Should the FIU be genuinely independent, in some countries of the region there is political pressure exerted by the executive onto the judiciary over who to prosecute and convict, as for example outlined in a Council of Europe report from September 2009 on 'Allegations of politically motivated abuses of the criminal justice system in Council of Europe member states', or in a report by Freedom House, citing 'Evidence of growing pressure on judicial independence from the executive and legislative branches', going as far as saying that in Kyrgyzstan the 'judiciary is under almost total control of the executive'⁴⁹.

The extent of political influence over the FIU in Kyrgyzstan was highlighted by the recent political developments, when former President Bakiev and his son were investigated for corruption and money laundering only after they had fallen from power.⁵⁰

There have also been press reports about similar developments in other CIS countries, for example in Armenia, where former Foreign Minister Alexander Arzumanyan was arrested and investigated for money laundering in May 2007 in the run-up to a parliamentary vote and there were well-publicised suspicions at the time that the

46 Moneyval Evaluation Reports, available at www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Evaluation_reports_en.asp.

47 Bhavna Dave, Nations in Transit 2009, Kazakhstan, Freedom House, 2009.

48 Kazakhstan to address corruption, United Press International, 6 May 2009.

49 Council of Europe, Allegations of politically motivated abuses of the criminal justice system in Council of Europe member states, Doc. 12038, 29 September 2009; Oleksandr Sushko and Olena Prystayko, Nations in Transit, Freedom House, 2009; Erica Marat, Nations in Transit 2009, Kyrgyzstan, Freedom House, 2009.

50 RFE, Interim Kyrgyz Authorities Say Millions Seized From 'Bakiev Bank Accounts,' Alleged Embezzlement Plans RFE: 22.04.2010; RFE, Son Of Ousted Kyrgyz President Investigated For Corruption, 2 May 2010.

investigations were politically motivated. Two other former ministers were also investigated for money laundering at the same time.⁵¹

Anecdotal evidence from the region suggests that such instances of using AML/CTF mechanisms for political purposes may be more wide spread, yet there is very little documentary evidence to prove that this is the case. Yet given the strong influence of national political clans and elites, often dominated by former or current secret service agents in many of the countries of the CIS, such practices are likely to be more common. One could also draw the reverse conclusion that some circles, especially political elites and some connected businesses find it easier to escape prosecution due to their connections and may therefore consider themselves to be above the law. The lack of legal tradition across the region and the fact that the law does not always rule supreme may also make it easier for executive agencies, law enforcement bodies and FIUs to try to keep close control of financial transactions for political purposes. This is clearly a worrying tendency and will have to be monitored by the international community, above all within the framework of mutual evaluations.

At the same time, there are also other instances of abuse of power, to which an FIU can resort, for example the undue blocking or postponing of transactions. Anecdotal evidence exists of some countries' FIUs resorting to the frequent suspension of transactions without getting a follow-up court order, yet these are difficult to substantiate, due to weak, incomplete and statistics that are difficult to compare.

Data protection

An important factor in the day-to-day operations of FIUs is the way confidential data is handled, especially confidential financial data on individuals that has been received from financial institutions and other reporting entities, or from state bodies and supervisory authorities. While handling publicly available commercial data does not raise privacy concerns, financial and other confidential data must be protected by strict privacy laws. Unfortunately, given the weak legal systems and the weaknesses of FIUs pointed out above, the privacy of such data is far from guaranteed in many countries of the region.⁵²

In many countries in CEE/FSU, the absence of privacy laws or their weakness is often justified with the desire of 'increasing efficiency' for law enforcement bodies. The often ambitious goals of seeking to fight ML and TF result frequently in efforts to undermine existing privacy legislation, for example on banking secrecy.

The very sensitive and confidential nature of financial information means that FIUs need to institute stringent procedural safeguards for their important financial evidence gathering and information sharing functions, especially in countries where the FIU has investigative powers. 'Effective law enforcement rests on efficient and speedy access to financial information. But this law enforcement need pushes against the boundaries of financial privacy concerns, raising legitimate concerns about the potential for abuse.'⁵³

While the effectiveness of national AML/CTF systems should be improved, this should not happen to the detriment of data protection and privacy, especially when the information of innocent individuals is concerned, who should at all times be protected from violations of their privacy.

51 Gayane Abrahamyan Former Foreign Minister Arrested for Alleged Money Laundering, Eurasianet, 7 May 2007; Gayane Abrahamyan ,Armenia National Security Service Search Targets Opposition Members, Eurasianet, 6 May 2007.

52 *ibid.*

53 *ibid.*

Finally, to avoid the abuse of FIU powers, it is important to raise the question of how an FIU is supervised, to which institution it is accountable and how it is sanctioned, should abuse take place.

It is therefore important to strengthen the oversight of FIUs by an independent technical control body, for example the Court of Auditors, as well as the internal FIU rules on governance. This is also an issue that international standard setting bodies, like the FATF or the Egmont Group could consider improving.

6. The AML/CTF system in Russia

Overview

Russia takes on a special position in the region of Central and Eastern Europe, not just by its size – it is not only the biggest country in the world and spans two continents, but inasmuch as it qualifies as a European nation, it is also Europe's most populous country and plays an important role in the region, especially in the Commonwealth of Independent States (CIS).

In the area of AML/CTF, it takes on an equally special position. On the one hand, the country suffers from massive money laundering, estimated at up to USD 370 billion in 2008⁵⁴. As a country in transition, Russia continues to receive technical assistance in the AML/CTF sphere, for example from the Council of Europe, within the framework of the MOLI-RU projects of technical assistance provided to RosFinMonitoring.

On the other hand, as Russia's AML/CTF system is further advanced than that of most of its neighbours, Russia provides itself considerable amounts of technical assistance in the area of AML/CTF to many of its neighbours, mostly through the Eurasian Group on Combating Money Laundering and Terrorist Financing (EAG)⁵⁵, the secretariat of which is based in Moscow and its effectively run by Russia. Russia's unique position in the area of AML/CTF is further underlined by its simultaneous membership in two FSRBs (Moneyval and EAG), as well as in the FATF.

As far as Russia's AML/CTF system is concerned, it can be qualified as advanced, as the creation of the national FIU dates back to 2001, when it was established by a Presidential Decree as the Financial Monitoring Committee (FMC). The institution is now called the Federal Financial Monitoring Service or RosFinMonitoring, and is the country's central authority for combating money laundering and terrorist financing.

RosFinMonitoring – the Russian FIU

RosFinMonitoring, the Russian FIU, was originally created as an independent government authority in 2001 and has been a member of the Egmont Group since June 2002. It was integrated into the management structure of the Ministry of Finance in March 2004 and in September 2007 it was placed directly under the authority of the Prime Minister, then Victor Zubkov, who until 2007 was Head of RosFinMonitoring.⁵⁶

The Budget of Rosfinmonitoring is set by law and has been growing steadily over the

54 International Narcotics Control Strategy Report, Vol. II, Money Laundering and Financial Crimes, State Department, 2009, available at www.state.gov/documents/organization/120055.pdf.

55 Available at www.eurasiangroup.org.

56 International Narcotics Control Strategy Report, Vol. II, Money Laundering and Financial Crimes, State Department, 2009, www.state.gov/documents/organization/120055.pdf, FATF.

last few years, from RUB 470 million in 2005, to RUB 659 million in 2006 and RUB 764 million in 2007 (approx. USD 25m, latest available figure).⁵⁷

The maximum number of staff of the FIU is 350 for headquarters and 295 in total for the seven regional offices. Not all positions are currently filled.⁵⁸

Data collection

‘The amount of data collected by Rosfinmonitoring has expanded considerably over the last few years. By January 2005, the FIU had received 3 million messages (sic!) from reporting institutions (including about 1.8 million STRs). In 2006, the database volume doubled, when the FIU received another 6.1 million messages (of which 3.8 million STRs). By April 2007, the database had accumulated about 14 million messages and STRs.’⁵⁹

In 2008, the FIU received a total of 8.5m messages, bringing the total to 30m messages on 1 January 2009. The total value of suspicious transactions reports is believed to be in excess of \$900 billion.⁶⁰

Money laundering prosecutions and convictions

According to the 2009 International Narcotics Control Strategy Report of the US State Department, ‘money laundering offences are being increasingly prosecuted, with ML investigations jumping from 618 in 2003 to 7,957 in 2006, the number of money laundering cases sent to court rising from 465 in 2003 to 6,880 in 2006 and the overall number of convictions increasing from 14 in 2003 to 532 in 2006.’⁶¹

According to the FIU’s 2008 Annual Report, in 2008 the FIU sent 10,789 cases to law enforcement and prosecution. The latter initiated 610 prosecutions, which resulted in 262 convictions.⁶²

Despite the above figures, in its latest mutual evaluation report of Russia the FATF criticises the difficulty in gaining a precise picture of the country’s exact AML/CTF record, as the government does not keep full statistics on the number of STRs that result in investigation, prosecution and conviction.⁶³

It is also difficult to say precisely how many prosecutions and convictions were rendered with intelligence provided by the FIU. As far as the nature of ML prosecutions and convictions are concerned, there were indications that ‘Russia has begun to prosecute high-level money laundering cases’, yet there has been little concrete evidence of any high level convictions so far.⁶⁴

As far as the fight against TF is concerned, there have been very few TF convictions. There were 24 convictions in the years 2004-2006, which is a surprisingly low figure, given the level of terrorist activity in Russia. According to the latest US State Department’s International Narcotics Control Strategy Report, ‘the fight against

57 Moneyval Mutual Evaluation Report of Russia, available at www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Evaluation_reports_en.asp, 2008.

58 FIU Annual Report 2008, available at www.fedsfm.ru.

59 FATF mutual evaluation report, available at www.fatf-gafi.org/infobycountry.

60 International Narcotics Control Strategy Report, Vol. II, Money Laundering and Financial Crimes, State Department, 2009, available at www.state.gov/documents/organization/120055.pdf, FIU Annual Report 2008, available at www.fedsfm.ru.

61 Moneyval Mutual Evaluation Report, available at www.coe.int/t/dghl/monitoring/moneyval/Evaluations/Evaluation_reports_en.asp.

62 FIU Annual Report 2008, available at www.fedsfm.ru.

63 FATF mutual evaluation report, available at www.fatf-gafi.org/infobycountry.

64 U.S. State Department, available at www.state.gov.

terrorism in Russia focuses more on the prosecution and elimination of terrorists than on combating terrorist financing. Between 2004 and 2007, 2,677 persons were arrested for terrorism, while 774 other terrorists were eliminated.⁶⁵ According to these figures, it seems that not enough attention is given to following up on the financial aspect of combating terrorism.⁶⁵

National co-ordination

The FIU regularly co-operates with the main national law enforcement bodies involved in the fight against ML and TF, such as the Ministry of Internal Affairs and the Federal Security Service, as well as the Prosecutor's Office. Despite the apparently established mechanisms of inter-agency co-operation, the FATF points out in its latest mutual evaluation report of the country that 'it is not always clear how these bodies co-operate with each other', implying that national co-ordination in the fight against ML and TF could and should be improved.

Co-ordination appears to be particularly weak with prosecution authorities, as there seems to be a lack of awareness about ML offences by many prosecutors and a lack of co-operation between prosecutors and other law enforcement bodies. This factor, along with the existence of rampant corruption within law enforcement as acknowledged by the Russian authorities, has a negative impact on the effectiveness of the system.⁶⁶

Corruption

Studies and surveys on Russia consistently describe corruption as rampant and endemic, with little hope for improvement, despite numerous public declarations by political leaders about the intention to fight corruption. According to opinion polls, the different police forces (national, traffic and municipal police, customs, as well as other law enforcement agencies) are usually described as the most corrupt institutions in the country, followed by courts and prosecutors.⁶⁷

The high levels of corruption among law enforcement officers are also recognised by the institutions themselves, with the head of the Russian interior ministry's internal investigation department, Oleg Goncharov, calling Russian police officers 'the biggest single source of graft'.⁶⁸

Corruption levels are also high among judges and prosecutors, raising huge challenges to seriously investigate crimes such as money laundering. One of the biggest problems of the judiciary is its 'lack of independence, as the court system frequently serves the political interests of the country's leadership in key areas. Russian judges are not appointed for life, which would make the procedure for removing them more difficult.

65 International Narcotics Control Strategy Report, Vol. II, Money Laundering and Financial Crimes, State Department, 2009, available at www.state.gov/documents/organization/120055.pdf.

66 International Narcotics Control Strategy Report, Vol. II, Money Laundering and Financial Crimes, State Department, 2009, available at www.state.gov/documents/organization/120055.pdf.

67 World Bank study on 'Anti Corruption in Transition 3', Russian Analytical Digest, by University of Bremen and the Centre for Security Studies at ETH Zurich, volume 11/06; Transparency International Corruption Perception Index 2009, available at www.transparency.org; The Public Opinion Foundation available at <http://bd.english.fom.ru/report/cat/societas/corruption/etb064708>.

68 Russian victims challenge police By Rupert Wingfield-Hayes BBC News, Moscow 8 2009.

Often judges are selected less on their qualifications than for their political submissiveness.⁶⁹

Potential for political abuse

This lack of independence of Russia's judiciary has also been highlighted in a recent Council of Europe Report on 'Allegations of politically motivated abuses of the criminal justice system in Council of Europe member states', which focused in particular on the situation in Russia.⁷⁰

This raises the question as to whether the financial intelligence provided to the judiciary by the FIU is only used to investigate genuine violations of the law, or whether the vast amounts of information held by the FIU are not used for political ends, as has been observed in other CIS countries.

There are fears that the Russian authorities intend to expand the use they make of such intelligence, as it seems to have become a habit to tighten legislation after each new terrorist attack. There were fresh fears about a new tightening after the terrorist attack on Moscow on 29 March 2010. In the wake of the attack, the Russian government submitted a bill to the Duma that would allow the Federal Security Service to take 'preventive measures' against individuals suspected of engaging in 'extremist' activity. Human rights activists expressed the fear that the law would give the Security Service more powers to intimidate citizens and harass political rivals. In Russia's notoriously opaque state institutions, this could potentially also include the use of financial intelligence held by the FIU. As a result, there is a growing fear that this information could be abused for political purposes.⁷¹ According to a US Diplomat, 'You may have a great FIU, but you'll never see any money laundering convictions unless they are politically motivated.'⁷² In this context, the case of Mikhail Khodorkovski could be mentioned, who was convicted, among other things, for money laundering, in a case that was, according to *The Economist*, 'politically motivated'.⁷³

The increased control of the political process by the Secret Services is mainly the result of the growing number of former Secret Services officials, so-called 'siloviki' in high level positions in government, politics and the economy.

The siloviki were among the main beneficiaries of the collapse of the Soviet Union. According to a 2006 study by Olga Kryshchanovskaya, the head of the Centre for the Study of Elites at the Russian Academy of Sciences, in 1988 only 5.4 per cent of government positions were occupied by military and KGB men. In 1993 that percentage rose to 11 per cent; by 1999 their representation had doubled to 22 per cent; by the middle of Mr Putin's first term, the proportion was 32 per cent. In 2006, people with a security background filled 77 percent of Russia's top 1,016 governmental positions.⁷⁴

According to Victor Yasmann, 'Never in Russian or Soviet history has the political

69 Robert W. Orttung, *Nations in Transition 2009*, Freedom House, available at www.freedomhouse.org.

70 Council of Europe Report on Allegations of politically motivated abuses of the criminal justice system in Council of Europe member states, Doc. 12038, 29 September 2009.

71 RFE, *New Russian Legislation Would Increase FSB's Authority*, April 27, 2010; Vasily Davydov, Legal and Tax Consulting Department, *Problems of investigation of crimes relating to money laundering in Russia*.

72 Matt Squire, *Russian FIU making little headway in combating endemic corruption*, available at www.moneylaundering.com, News 25 July 2008.

73 Mikhail Khodorkovsky's case, available at www.economist.com, 22 April 2010.

74 Charles Clover, *Russia: Shift to the shadows*, *Financial Times*, 16 December 2009.

and economic influence of the security organs been as widespread as it is now.⁷⁵

The siloviki control law enforcement, the intelligence services, as well as the armed forces. For them, ‘stability’ is a much higher priority than democratic process or an active civil society.⁷⁶

One example of such a ‘silovik’ is the former Head of RosFinMonitoring, Viktor Zubkov. ‘Although Zubkov is not an intelligence officer by background, he has become one de facto during his years at the Financial Monitoring Service, as he has intimate knowledge of where the country’s legal and illegal financial assets are to be found.’⁷⁷ He headed RosFinMonitoring until 2007, when he was appointed Prime Minister and became Deputy Prime Minister in 2008, when Vladimir Putin assumed the Premiership.

The siloviki today effectively control much of the Russian state and its economy. Given the secret service background of most of Russia’s siloviki, ‘enforcement in today’s Russia it does not necessarily mean enforcement of law, but enforcement of power and force, regardless of the law and quite often against the law. [...] The real power in Russia today belongs to a de facto corporation of secret-police operatives.’⁷⁸

Given the control of key state institutions by former and current secret service officers, there is a growing fear that ‘siloviki’ hold control over many of the country’s financial transactions and that they could be used for political purposes.

In order to avoid such abuse, Russia’s international partners, especially within the FATF and the regional FSRBs, in which Russia is a member, should keep a close eye on the progress of Russia’s AML/CTF system, in particular during mutual evaluations of the country.

Similar observations as those about Russia above can be made about other countries of the region. The Head of the Ukrainian FIU, a politician from former Prime Minister Yulia Tymoshenko’s party, was removed shortly after the appointment of a new Government led by Mr Azarov from the Party of the Regions. The new Head of the FIU had previously been in charge of the same function when Mr Azarov was Minister of Finance under the Prime Minister Yanukovich, now President of Ukraine.

75 Victor Yasmann, *Siloviki Take The Reins In Post-Oligarchy Era*, RFE, September 17, 2007

76 Ian Bremer, *The Siloviki in Putin’s Russia, 2006-07* by The Centre for Strategic and International Studies and the Massachusetts Institute of Technology, *The Washington Quarterly* 30:1 pp. 83–92.

77 Victor Yasmann, *Siloviki Take The Reins In Post-Oligarchy Era*, RFE, September 17, 2007.

78 Andrei Illarionov, *The siloviki in charge*, *Journal of Democracy*, April 2009.

7. Recommendations for improving the effectiveness of FIUs

As has been discussed on the previous pages, despite considerable progress over the last few years in creating functioning AML/CTF systems, FIUs in the transition countries of CEE/FSU still suffer from a number of significant shortcomings that hamper the effective operation of these systems and with it the effort to combat money laundering and terrorist financing.

In order to make both national and international AML/CTF efforts more effective in Central and Eastern Europe, a number of improvements can be made to the existing national mechanisms. Based on recommendations put forward in the mutual evaluation reports of the countries of the region, as well as advice provided by AML/CTF experts at the Egmont Group, the IMF, UNODC and the World Bank, this paper suggests to take the following measures:

Strengthen FIU independence and governance

As has been discussed above, most FIUs are not sufficiently independent from national authorities, especially the executive branch. It is therefore suggested to strengthen the independence and governance of FIUs by enshrining their autonomy in their terms of reference. As appointments of FIU Heads across the region are mostly political, which carries a high risk of leaving the institution open to political influence and political patronage, it is suggested to strengthen the independence of FIUs by setting clear legislative guidelines on senior FIU appointments. Finally, it is suggested to strengthen independent oversight of FIUs by an independent technical control body, for example the Court of Auditors.

Improve the FIU's analytical and technical capacity

Many FIUs suffer from weak capacity to perform meaningful analysis at either the strategic, operational or tactical levels due to lack of expertise and comprehensive and effective information and data collection/processing systems. Some FIUs also suffer from weak technical capacity due to outdated or ineffective IT systems, which limits them in their effort to analyse big amounts of data and create meaningful typologies. It is suggested to strengthen the analytical capacity of FIUs by improving the analytical skills of existing staff through training and either introducing or upgrading the institutions' information technology systems. As this is cost and labour intensive, the countries should draw on existing and request additional technical assistance from international organisations such as the European Union, the IMF, UNODC and the World Bank.

Improve national co-ordination and international co-operation

Many AML/CTF systems in the region suffer from weak coordination among their various national institutions involved in the fight against money laundering and terrorist financing. This is partly due to a lack of awareness, but also a lack of experience and lack of means. Co-ordination should in particular be improved with national financial oversight bodies as well as with the relevant law enforcement bodies. In this context, it is important for FIUs to have access to national databases containing relevant information for their activities, while safeguarding the rights of individuals to data protection.

It is also important for FIUs to co-operate with their counterparts in other countries. Those FIUs that are not yet members of the Egmont Group should therefore make joining the Egmont Group a priority.

Strengthen the STR follow-up

One important weakness observed in most countries of the region is a weak legal follow-up of reported suspicious transactions and a very low number of convictions. It is therefore important to strengthen law enforcement authorities by increasing their capacity to deal with an increasing number of money laundering cases, for example through training. In this context, it is particularly important to reduce political influence on law enforcement and the judiciary and to combat corruption in these areas, as this is one of the most important obstacles to successful money laundering prosecutions in CEE/FSU.

Strengthen data protection

Financial Intelligence Units daily handle highly confidential financial and other data. It is therefore of the utmost importance to protect the rights of individuals that their data is handled in the most confidential way possible and that it is not abused for political or other purposes. Each country must therefore carefully balance the need for effective action against the privacy concerns of its citizens. This is particularly important when allowing the use of data that is not in the public domain (tax, customs, police etc.).

Reinforce mutual evaluations

All countries of the region are members (except Turkmenistan) of one of the regional FSRBs, i.e. Moneyval or the EAG. This means that the AML/CTF systems of all countries of the region are assessed on a regular basis by independent international evaluators. As a result, the respective FSRBs have an important role to play in highlighting deficiencies in the system. They should insist on full transparency when assessing FIUs and should not hesitate to point out their weaknesses. They should in particular monitor instances of political abuse of the system and bring these to the attention of the FSRB plenary meetings. One way of achieving this could be to strengthen the current FATF Recommendation 26 on FIUs.

8. Conclusion

Over the past few years, the countries of Central and Eastern Europe have made considerable progress towards setting up a functioning national AML/CTF system. Almost all countries of the region have adopted legislation in line with their international commitments towards fighting money laundering and terrorist financing and all countries have also set up the required national institutions, notably a financial intelligence unit (FIU). However, the mere existence of AML/CTF legislation and an FIU is not sufficient to effectively fight money laundering and terrorist financing.

On the preceding pages we have seen that many FIUs in the region have been considered as weak and not always fully effective by independent evaluators. An important reason for the observed weakness is the lack of experience, qualified staff and financial means, but also a lack of political independence, as many Heads of FIUs in the region are political appointees.

The lack of effectiveness of many national AML/CTF systems in the region is further highlighted by a low number of money laundering cases brought to prosecution and an even lower number of convictions.

Efforts are also hindered by political clientelism in many countries of the region and high levels of corruption, in particular in law enforcement bodies and the judiciary, which is not always free from political influence.

There seems to be only limited political will at present in the countries of the region to effectively fight corruption and there is a risk that the same applies to the fight against money laundering and terrorist financing, especially when officials close to the ruling regime are implicated.

What is particularly worrying is that the efforts of some countries to combat money laundering seem to be subordinate to political considerations, highlighted by instances when money laundering investigations were abused for political purposes by investigating political opponents or individuals, who had fallen out of favour with the regime in place.

It is therefore important that the international community continue to closely monitor the progress made by the countries in Central and Eastern Europe towards the establishment of fully functioning national AML/CTF systems, including the effectiveness of FIUs.

An important role accrues to FATF-style regional bodies, which should insist on full transparency when assessing countries of the region and not hesitate to point out weaknesses in the systems. They should in particular monitor instances of political abuse of the system and highlight these in their reports.

Annexe I - Glossary

AML	Anti Money Laundering
AML/CTF	Anti Money Laundering/Counter-Terrorist Financing
CEE/FSU	Central and Eastern Europe
CTF	Counter-Terrorist Financing
CIS	Commonwealth of Independent States
EAG	Eurasian Group on Combating Money Laundering and Terrorist Financing
EU	European Union
FATF	Financial Action Task Force
FSRBs	FATF Style Regional Bodies
FIU	Financial Intelligence Unit
FSU	Former Soviet Union
IMF	International Monetary Fund
IT/ITC	Information/Communication Technology
Moneyval	Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism, Council of Europe
ML	Money Laundering
Min Fin	Ministry of Finance
OECD	Organisation on Economic Co-operation and Development
STR	Suspicious Transaction Report
TF	Terrorist Financing
UNODC	UN Office on Drugs and Crime

Annexe II - Key facts on Financial Intelligence Units in Central and Eastern Europe

Country	FIU Type	Location	Appointment of FIU Head	Convictions*	Compliance with FATF Recommendation 26
Estonia	Law enforcement	Police	National Police Commissioner	1	Compliant
Latvia	Judicial	Prosecutor	Prosecutor General	5	Largely Compliant
Lithuania	Law enforcement, police	Min. Interior	Min Interior	1	Largely Compliant
Poland	Administrative	Min Fin	Prime Minister	40	Compliant
Czech Rep.	Administrative	Min Fin	(Government)	7	Compliant
Slovakia	Law enforcement	Min Interior	Min Interior?, Frequent changes	10	Partially compliant
Hungary	Law enforcement	Customs and Finance Guard Central Criminal Investigation Bureau	(Customs and Finance Guard Central Criminal Investigation Bureau)	19	Largely Compliant
Slovenia	Administrative	Min Fin	Government	4	Largely Compliant
Croatia	Administrative	Min Fin	(Government)		Largely Compliant
Serbia	Administrative	Min Fin	Government	1	Largely Compliant
Montenegro	Administrative	under Min Fin	(Government)	0	Largely Compliant
Albania	Administrative	Min Fin	Min Fin	11	Partially compliant
Bosnia-Herzegovina	Law enforcement, hybrid	State information and protection Agency	(Government)	1	Partially compliant
Macedonia	Administrative	Min Fin	(Government)	0	Partially Compliant
Bulgaria	Administrative	Secret Service	Min Fin, approved by Prime Minister	23	Compliant
Romania	Administrative	Independent, under government	Government	4	Partially Compliant?
Belarus	Administrative	Control Committee	Committee Chair, approved by President		Largely Compliant
Ukraine	Administrative	Independent	Government	25***	Compliant
Moldova	Law enforcement, police	CCCEC	Director CCCEC?	0	Partially Compliant
Russia	Administrative	Government	Prime Minister	262	Compliant
Armenia	Administrative	National Bank	National Bank	1	Largely Compliant
Azerbaijan	Administrative	National Bank	President	0	Non Compliant
Georgia	Administrative	National Bank	President	10	Largely Compliant
Kazakhstan	Administrative	Min Fin	President	--	

Kyrgyzstan	Administrative	Independent	President	3	
Tajikistan**	Administrative	National Bank	(President)	--	Non Compliant
Turkmenistan**	(Administrative)	Min Fin	--	--	--
Uzbekistan	Prosecutorial	Prosecutor's Office	President		

* latest available annual figures on personal convictions for money laundering, drawn from mutual evaluation reports and national statistics

** not yet fully functional

*** estimate, based on national statistics

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