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**Understanding Authoritarianism and Kleptocracy in Russia**

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*Written testimony*

Chairman Keating, ranking member Fitzpatrick, Distinguished Members

It is an honor to be able to share my thoughts with the committee on this vitally important topic. But I have to tell you: we are losing.

I say this as someone who has been dealing with this subject since the 1980s. I lived behind the Iron Curtain and experienced the corruption integral to the communist system. I witnessed how funds from the dying Soviet regime were transferred abroad and how they returned, freshly laundered, from foreign financial centers, to undermine and profit from nascent democracies. I observed the fusion of organized crime, business, government and the KGB in a system of power that brought Vladimir Putin to the Kremlin. I have seen the tentacles of kleptocracy reach deep into Western democracies, corroding our institutions, damaging our reputation, distorting our decision-making and demoralizing our fellow-citizens.

I have published books and made films on these topics, and lectured at universities including Brown, Harvard, SAIS and Stanford. After many years as a journalist at the *Economist* writing about these and other issues, I am now a non-resident fellow at CEPA, a DC-based thinktank specializing in transatlantic security. Disclosures about our US government and other funding have been provided as requested.<sup>1</sup>

Russia's authoritarian kleptocracy is resilient at home and effective abroad. The Kremlin uses repression and propaganda to prevent effective challenge within Russia's rigged political system. And as I outline in the pages that follow, it:

- undermines, forestalls and muzzles outside criticism.
- weaponizes trade and investment in pursuit of its geopolitical goals.

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<sup>1</sup> This testimony draws on research from publications and/or advice from staff at the Alliance for Securing Democracy, the FACT Coalition, Global Witness, the Hudson Institute, the OECD, Transparency International and others. But the interpretations are mine alone.



- leverages its position as an energy supplier to extort diplomatic favors and to build political bridgeheads.

This is exemplified by the Nord Stream 2 natural gas pipeline to Germany, now nearing completion amid the failure of US sanctions policy.

### **How it works**

Russian kleptocrats use and abuse our democratic societies' rules, rights and freedoms, and the opportunities provided by our legal systems.

- They launder their money;
- They buy influence;
- They use Strategic Lawsuits Against Public Participation (SLAPP) to bully detractors into silence, citing defamation or supposed breaches of privacy and confidentiality; and when challenged
- They feign outraged innocence and demand to be treated fairly.

These people are not just rich. They have access to state resources.

- They run disinformation campaigns to demoralize and distract Western societies.
- They use cyber and other intelligence means to snoop on and harass whistle-blowers, anti-corruption campaigners and investigative journalists.
- They apply diplomatic pressure to protect their wealth.
- They conduct physical intimidation campaigns, including abductions, assaults and assassinations — and then deny brazenly what they have done.

Few democracies have yet realized the scale of the threat. In many countries the temptation is to accommodate the Kremlin's dirty money and mischief-making in the hope that economic engagement will eventually change things for the better. Such self-interested complacency underpins Germany's attitude to Russia. Others argue that the threat from China is so much greater that Russia can be deprioritized.

That approach is mistaken. Russia is indeed far less important than China when it comes to global economic governance. But the Kremlin is the biggest source of instability on Europe's borders, and the biggest source of interference inside democratic societies. It funds extremist parties, spreads disinformation, sows divisions and peddles influence. Russian pipelines, for example, do not just export natural gas. They export corruption. Germany is a weaker country because of its energy dependence on Russia. It is also a weaker member of NATO. The United States, as the security guarantor for Europe, must do more as a result. In short: cheap natural gas for Germany means higher costs and greater risks for the United States.

Russia is also forging ties with kleptocracies in Africa and Latin America. It offers them political, military and technological help in exchange for natural-resource concessions, for help in evading sanctions, and for diplomatic backing on issues such as Ukraine and Syria. That



means a more dangerous world for everyone, and — again — a greater burden on the United States.

How treat Russia’s kleptocracy also sends an important signal to China’s leaders. If we cannot deal with a stagnant country with an Italy-sized economy, there is little chance that we can deal with the biggest country in the world. I increasingly see China taking advantage of the economic, legal, political and social vulnerabilities that have long been created and exploited by the Kremlin. As my colleague Josh Rudolph notes, “Chinese state companies, party elites, and criminal organizations use shell companies to facilitate sanctions evasion, fentanyl trade, exploitation of forced labor, and corruption throughout the Belt and Road Initiative.”<sup>2</sup>

Not all kleptocracies are direct geopolitical threats to the US and its allies. But dirty money, regardless of its origin, both impoverishes its source and taints its destination. The means employed to ease its path harm our democracies and weaken our alliances. The same combinations of sleaze and secrecy, and the compliance of supposedly respectable enablers, benefits organized crime, sex-traffickers, people-smugglers, counterfeiters, drug cartels and child-abusers.

Kleptocracy starts with domestic corruption. The Putin regime sits on a pyramid of theft: of tax revenues, of natural-resource rents and of bribes. The anti-corruption campaigner Alexei Navalny has produced excoriating videos depicting the grotesque luxury in which Russia’s rulers live.

We cannot do much to stop Vladimir Putin and his cronies stealing money from the people of Russia. We cannot stop them disporting themselves in the miserable, poverty-stricken countries that Russia counts allies: the Central African Republic, Syria, Tajikistan and Venezuela spring to mind.

But as Navalny told me on his last visit to London, the Kremlin system works only thanks to Western accomplices. It is through the West that Russia’s kleptocrats launder their money. It is from the West that they buy their luxury goods. It is in the West that they buy real estate. It is at Western marinas that they moor their yachts. It is in Western leagues their sports teams play. It is at Western universities that they educate their children.

Nobody made us allow this. No Russian tanks crunched down Wall Street or the City of London, forcing us to open our financial system to our enemies. All this works only because we permit it. And that can change.

Here’s how.

### **Counter-measures**

The problem is broad, but our response is fragmented. Our government departments and agencies too often operate in silos. Our efforts should involve all of government, but also the

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<sup>2</sup> <https://securingdemocracy.gmfus.org/regulating-beneficial-ownership-for-national-security/>



private sector and civil society. Given the urgency and importance of the task, it needs high-level leadership, for example, by a senior director at the White House, coordinating efforts across the areas of democracy and human rights (DHR), international economics (Intecon), the Domestic Policy Council (DPC), and other White House offices, to energize the Treasury, State Department, USAID, DOJ, and other departments and agencies.

We also need to deal with the enablers: the bankers, lawyers, accountants, PR people, real-estate agents, advisers, luxury goods dealers, celebrity agents, and educational and cultural institutions who launder the kleptocrats' money and reputations. These are powerful lobbies and big political donors. They will protect their business models. But we need to be clear. If they take on kleptocrats as clients, they are aiding and abetting the enemies of this country and its allies. They should expect unforgiving regulatory scrutiny and normative pressure if they choose to do so. The climate of impunity must end for perpetrators and accomplices alike.

National approaches, even in a country as powerful as the United States, will always be insufficient. Kleptocracy's tentacles are global. So too must be our response.

I applaud efforts such the proposed Summit for Democracy, whether this year or next, the Global Kleptocracy Initiative and the International Anti-Corruption Court. We need to work towards:

- an international agreement to end offshore financial secrecy, with public registries listing the owners of assets and companies, and the beneficiaries of trusts;
- automatic exchange of tax information; and
- a cross-border payments database.

All this should be backed by sanctions: the penalty for providing false or misleading information about ownership, or the source of funds, should be confiscation of the asset concerned.

But we can start straightaway by better sharing of the data we already have, with

- harmonizing procedures between criminal justice systems;
- replicating sanctions across jurisdictions; and
- building greater resilience to kleptocratic attacks on our political system, by protecting whistleblowers, using aid money to fund anti-corruption campaigns, and countering SLAPP lawsuits.

This process has started. I commend the American lawmakers who pushed through the first Magnitsky sanctions in 2012 in the teeth of resistance from the then administration. Many other legislatures have now followed suit. That is a tribute to the determination of Bill Browder and his team in overcoming what now seems like inexplicable timidity and reluctance.



But these visa bans and sanctions on individuals are just pinpricks. Far more important, and more difficult, is to tackle the way that Russian and other kleptocrats exert real economic and political power in Western countries.<sup>3</sup>

A central element in the counter-offensive against kleptocracy must be to lift the veil of corporate anonymity. It is hard to see why this should be contentious. Indeed, it is hard to see why corporate anonymity exists at all. When the modern limited liability company was developed in the 19<sup>th</sup> century, it was a way of managing risk and raising capital. Nobody then conceived of it as a means of disguising or concealing ownership. Such an idea was never debated or passed into law. It is a historical accident — but one with baleful consequences. Undisclosed beneficial ownership allows criminals, terrorists and kleptocrats to conceal their identities, and enjoy the rights and privileges intended for honest shareholders.

A publicly accessible register of beneficial ownership allows businesses, customers, employees, and other interested parties to know whom they are dealing with, which is a precondition for fair dealing in business in general, and a deterrent to those whose competitive advantage relies on deceit.

Regulating the smithies that turn out shell companies is just the start. We have to deal with the millions that already exist.

For this, we need to say that if a company cannot show who really owns it, then it should not be allowed to do business: no contracts, no assets, no access to finance, and no recourse to the courts. This is kryptonite for kleptocrats.

It is therefore shocking that though law enforcement, anti-money laundering authorities, anti-corruption watchdogs and investigative journalists have been highlighting the pernicious effects of undisclosed beneficial ownership for more than two decades, it is only in very recent years that the national security community in the US and (at least some) allied countries has begun to appreciate its own stake in this struggle. It is also a matter of regret that powerful industries have lobbied so effectively to water down proposed reforms.

The Patriot Act of 2001 for example includes powerful anti-money-laundering (AML) rules. But these are not evenly applied. Many enablers have wiggled out of these requirements with supposedly temporary exemptions. Lawmakers might wish to ask the US Treasury leadership to display more energy and determination in applying these provisions more effectively. Why are banks obliged to check the identity of their customers and the source of their funds, but investment funds and non-banking financial institutions such as money services businesses are not? A Senate investigations committee report highlights how kleptocrats abuse the international art market. But AML provisions apply only to antiquities dealers, not those who trade in big-ticket art.

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<sup>3</sup> This report by Ben Judah and Nate Sibley has 70 recommendations. <https://www.hudson.org/research/16608-countering-global-kleptocracy-a-new-us-strategy-for-fighting-authoritarian-corruption>



The most obvious low-hanging fruit is funds and other financial conduits administered by investment advisers. A stroke of a pen would bring \$13 trillion — including substantial funds held by kleptocrats — within FinCEN’s scrutiny. A leaked FBI Intelligence Bulletin from May 2020 stated that “threat actors [or money launderers,] likely use the private placement of funds, including investments offered by hedge funds and private equity firms, to launder money, circumventing [AML protections in place elsewhere, such as with broker-dealers].”<sup>4</sup>

This rule change was proposed in 2015. One of your committee members, Tom Malinowski, has just urged its implementation, along with Senator Whitehouse.<sup>5</sup> It is hard to imagine why this should not happen at once.

Under the 2004 Intelligence Reform and Terrorism Prevention Act, FinCEN was tasked with establishing a database of financial institutions’ reports on cross-border payments. It hasn’t. Why?

The Corporate Transparency Act (CTA), enacted on January 1, 2021, drives a stake through the heart of the legal monstrosity of anonymously owned “shell” companies. It is therefore a matter of vital importance, not only for the future of the United States, but for democracies everywhere, that the CTA is interpreted and implemented broadly and effectively, with minimal or nil exemptions to the new beneficial ownership registry when it takes effect on January 1 next year.

The following points, highlighted by Josh Rudolph, deserve intense Congressional scrutiny.<sup>6</sup>

- 1) The law’s broad definition of “beneficial owner” should mean listing activities that indicate control and define broadly the duty to report to include: partnerships, trusts, foundations, sole proprietorships, special purpose vehicles, and business associations.
- 2) Exemptions should be narrowly interpreted and limited to entities that are already required to report beneficial ownership elsewhere (such as to the SEC).
- 3) Minimize exemptions as follows.
  - Pooled investment vehicles should disclose their full legal names (not just SEC codes) and file detailed certifications. They should be exempt only if operated or advised by regulated financial institutions;
  - Unregistered private equity and hedge fund advisors should be exempt only if they already disclose their beneficial ownership to the SEC;
  - Subsidiaries should be exempt only if wholly owned;

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<sup>4</sup> <https://www.moneylaunderingnews.com/2021/02/investment-advisers-may-be-subject-to-aml-regulations-under-revival-of-proposed-rule/>

<sup>5</sup> <https://malinowski.house.gov/media/press-releases/representative-malinowski-and-senator-whitehouse-urge-biden-administration-take>

<sup>6</sup> <https://securingdemocracy.gmfus.org/regulating-beneficial-ownership-for-national-security/>



- Dormant/unused companies should be exempt only if they already existed at least one year before CTA enactment and continue to not conduct any activity; and
  - Money transfer companies should list a beneficial owner (not a legal entity) on their Treasury registration forms and link to that information in exemption notification forms.
- 4) Companies should provide usable, verified information about their parent companies, subsidiaries, and affiliates. Complex webs of related entities spanning many jurisdictions obscure ownership and risk frustrating the point of the register.
- 5) Verify the accuracy of data immediately at the point of entry, for example by requiring the same standard of authentication and fraud-protection tools used for a credit card payment, checking passport information against the State Department's Consular Consolidated Database and comparing driver's license information to databases maintained by the National Law Enforcement Telecommunications System. Addresses should be checked to ensure they exist and comply with U.S. Postal Service standards.
- 6) Ensure broad, timely, and easy access to the database. Malign actors act speedily and stealthily over a period of days and are long gone by the time their pursuers are on the trail.

Other legislation also has the potential to damage kleptocracy and protect American and other democracies. The Geographic Targeting Orders introduced in 2016, for example, require title insurers involved in certain residential real estate transactions to identify the natural persons involved. Under the presidency of Donald Trump, these expanded to include counties in 12 metropolitan areas: Boston; Chicago; Dallas-Fort Worth; Honolulu; Las Vegas; Los Angeles; Miami; New York City; San Antonio; San Diego; San Francisco; and Seattle. The rules now cover transactions carried out by wire transfers (not just cash deals), above a \$300,000 threshold. Absent a nationwide ban on such deals, however, these rules simply encourage kleptocrats to range more widely. The latest renewal notice from FinCEN, disappointingly, does not expand this useful measure. Lawmakers should pressure the executive branch to make this scheme permanent and nationwide, to include commercial real estate; and then pressure allies/partners to implement similar rules.

The weakest point in the kleptocrats' business model is where they try to acquire respectability. They invest their way to visas and even citizenship, they donate to universities and thinktanks, sponsor cultural institutions and even buy news organizations, hoping in every case to evade inspection and distance themselves from their past. This works only because we allow it. Access to these points of entry can be tightened, and those who try to pass through them scrutinized. The commendable Foreign Agents Registration Act requires updating for the modern age, with sharper teeth and wider scope. The US should encourage allies and partners to adopt similar FARA-style measures to constrain and highlight kleptocrats' influence-peddling and reputation-laundering.



Speaking from outside the United States, I would like to underline how much your allies appreciate the bipartisan efforts in Congress in ensuring that this administration makes good on its promises. We note the new Caucus Against Foreign Corruption and Kleptocracy which launches formally on June 10<sup>th</sup>. We are studying intently proposed legislation such as the:

- CROOK (Countering Russian and Other Overseas Kleptocracy)
- Foreign Extortion Prevention,
- REPEL (Rejecting Enemy Payments through Enforcement and Leadership); and
- TRAP (Transnational Repression Accountability and Prevention) acts.

I would like to thank Representatives Keating and Fitzpatrick for their role in promoting the CROOK act.

Finally, we should not forget te people directly languishing under the rule of the kleptocrats. Our freedom is merely endangered; theirs is crushed. The Russian people overthrew the Soviet Union, under which they had suffered more than anyone else. But they have had the fruits of victory snatched away by the kleptocratic ex-KGB regime. The bread and circuses it offers are little consolation for the loss of a once-glittering prospect: a country governed by law, freed from the shadows of empire and totalitarianism, and at peace with itself and its neighbours.

The United States as the world’s foremost democracy has a vital role to play in championing its values globally. We may be an era of geopolitical competition but that does not mean that should see foreign policy solely through the lens of *Realpolitik*.

Furthermore, promoting democracy undermines kleptocracy. The regimes in Moscow, Beijing and elsewhere are focus so hard on crushing independent media and autonomous social organization because they know that these will, left unchecked, become deadly threats to their rule.

For this reason it is vitally important that the United States continues to support independent media and civil society in any way it can. The traditional model of giving grants to organizations in Russia and China no longer works: indeed, being tarred as a “foreign agent” now carries serious risks and penalties. But that is no reason to give up. I would particularly highlight the possibility of boosting efforts outside Russia and China that may filter back into these closed societies. We should support independent universities, media outlets and civil society groups in Estonia, Latvia, Lithuania, Poland, Czechia, Slovakia and Ukraine that can train, inspire and inform Russians and Belarusians. We should promote similar efforts in Taiwan, and in any country with a significant Chinese diaspora.

These legislative and other efforts contrast sharply with the dismally ineffective approach of my own country, the United Kingdom. I hope that US officials and elected representatives will underline forcefully their dissatisfaction with Britain’s progress. It should be a source of national shame that London remains the money-laundering capital of the world. It certainly is to me. I look forward to your questions.