

FinCEN Report Holds Key Russia-Linked Risk Considerations

By **Siana Danch and Peter Hardy** (February 6, 2023)

The Financial Crimes Enforcement Network released a financial trend analysis[1] on Dec. 22, 2022, focusing on Russian oligarchs.

The report discusses FinCEN's findings of movement of Russian oligarch-related funds and assets with a nexus to the United States around the time of Russia's military invasion of Ukraine. FinCEN's trend analysis considered Bank Secrecy Act, or BSA, filings filed during the period of March to October 2022.

FinCEN published the report pursuant to the Anti-Money Laundering Act of 2020's requirement that FinCEN periodically publish threat pattern and trend information derived from BSA filings. This requirement seeks to improve information-sharing between law enforcement, regulators and industry, and make industry better informed about what sort of suspicious activity reports, or SARs, are actually useful to the government.[2]

According to the report, the BSA data filed on financial transactions of Russian oligarchs, high-ranking officials, sanctioned individuals and their family members in 2022 revealed transactional patterns indicative of corruption and sanctions evasion, including: (1) the movement or transfer of funds or ownership of assets and trusts, (2) the purchase of high-value goods or property, and (3) changes in financial flows with links to property or companies in the U.S.

Financial institutions covered by the BSA are subject to several filing obligations triggered by certain transactions, including the filing of SARs. Additionally, every U.S. person, including businesses and financial institutions must ensure that they do not engage in transactions with persons listed by the Office of Foreign Assets Control on the Specially Designated Nationals And Blocked Persons List, or engage in transactions with certain jurisdictions sanctioned by OFAC.

The report reminds financial institutions to review recent guidance issued by FinCEN on reporting suspicious activity related to Russia-linked actors — specifically, three FinCEN alerts published since Russia's military invasion of Ukraine, all of which provide red flags on Russian oligarchs, high-ranking officials, and sanctioned individuals as well as key terms to use in specified filing fields or narratives of SARs.[3]

Thus, financial institutions need to continue to review their anti-money laundering and OFAC sanctions monitoring programs and processes to ensure they are risk-based and adaptive to swiftly moving global developments.

The report takes seriously the goal of information-sharing: It sets forth remarkably detailed information regarding reported suspicious activity that FinCEN views as notable. This level of detail is potentially helpful to financial institutions going forward as they review their AML programs and assess whether specific transactions should be reported on a SAR.

These specific details reveal what FinCEN regards as actually useful and arguably can be more helpful to financial institutions than the general lists of red flags in the alerts. Red



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flags can be easy to articulate but sometimes difficult to implement successfully and pragmatically.

The report is also realistic about the challenges facing financial institutions trying to detect and report suspicious activity by Russian oligarchs and their proxies, noting that determining the source of funds in cross-border transactions can be particularly difficult.

The Report's Conclusions Based on the BSA Filings

First, FinCEN found that in late February 2022 — around the time of Russia's invasion — there was an increase in funds and asset transfers by Russian oligarchs.

Among other things, the BSA filings revealed that several Russian oligarchs transferred beneficial ownership of their companies, trusts or accounts to their children, other family members or close business associates. Further, the report notes that several Russian oligarchs sent large wire transfers to their children, and points out that these wires frequently went to children studying in the U.S.

Second, FinCEN found that several oligarchs purchased high-value goods, including jewelry, art, and property or real estate in other countries leading up to the invasion in February 2022.

FinCEN's March 16, 2022, alert on real estate, luxury goods and other high-value assets by Russian oligarchs advised financial institutions of the importance of identifying and quickly reporting this behavior.[4]

That particular alert explained — and the report noted — that the sudden purchase of high-value goods using funds derived from unknown sources could indicate that the transacting individuals were attempting to use the purchase of these goods to shield or launder portions of their wealth from the possibility of future sanctions.

According to the report, residential and commercial real estate has "become a safe haven for Russian wealth, both legitimate and illicit real estate, since the beginning of the Russian invasion at the end of February 2022." The report frequently drew attention to real estate transactions in the United Arab Emirates.

For example, a Russian oligarch transferred assets to a family member before being sanctioned, and the family member used these funds and accounts to make payments for luxury goods and real estate potentially located in the United Arab Emirates. The report's emphasis on real estate is consistent with the advanced notice of proposed rulemaking issued by FinCEN in December 2021 regarding potential BSA/AML regulations for the real estate industry, which are still pending.[5]

Third, FinCEN found that several oligarchs moved funds from accounts in Russia to accounts in other countries usually right before or around the time of the Russian invasion. Some of the accounts were located in the United States.

FinCEN recognized that some of these oligarchs have been transferring funds for years — this time, however, the BSA data showed that the frequency and value of the transfers increased around the time of the invasion.

The report surmises that these oligarchs were motivated "potentially for fear of not being able to use or transfer funds once hostilities commenced" and opines that some of the

transfers "may be disguised by using accounts linked to shell companies, family members, or associates."

As noted, one of the strengths of the report is its specificity. For example, the report describes a BSA filing regarding "a Russian oligarch and his child [who] own or control several shell-like entities registered in Cyprus and the United States. The accounts for these companies, with a U.S.-based individual listed as signer, received funds from apparent shell entities, mainly based in Monaco, and then used the funds to invest in companies in the movie or online gaming industry."

This example is specific to the point of where the persons described in the filing presumably could recognize themselves, if they were to read the report.

FinCEN also looked at the activity after the transfer of funds by Russian oligarchs and discovered that the funds were used to cover real property expenses. Many of the activities described in the BSA filings, such as having and transferring to a U.S.-based account, owning a U.S. company, and owning U.S. property, are not inherently illegal or suspicious. What seems to have caused the financial institutions to submit the BSA filings is that, in most cases, the financial institution could not determine the source of funds coming from Russia and had concerns the funds could be linked to corruption.

Data in the BSA Filings

The report explains that FinCEN initially reviewed 7,000 filings that had a nexus to Russia and were filed between March 1 and Oct. 31, 2022, then selected 454 out of the 7,000 filings for a detailed analysis of parties involved and transaction types, and summarized its findings of the 454 filings in the report.

While the report does not provide insight into the type and quantity of BSA filings reviewed, based on context, it is clear that SARs comprised the bulk of the BSA filings examined by FinCEN. The report notes that the 454 filings "detailed tens of billions of dollars of suspicious activity," strongly indicating that FinCEN reviewed SARs.

The report explains that (1) while the examined BSA filings were filed between March and October 2022, some BSA filings pertained to transactions that occurred as early as January 2005, and (2) some of the closely examined 454 filings were for continuing suspicious activity.

Of note is that the majority of BSA filings FinCEN considered for the report were filings by U.S.-based depository institutions: 356 of the 454 closely-reviewed filings, or about 78%. The second-largest group of financial institution filers, 85 of the filings, were other types of financial institutions, including holding companies.

In drafting the report, FinCEN closely reviewed only one BSA filing by a money services business — a type of financial institution that includes cryptocurrency exchanges. The report does not touch on cryptocurrency.

The report also explains that only some of the 454 closely reviewed filings included location information for the subject fields. According to the report, Europe was the top region, with Russia, the United Kingdom and Switzerland being the top countries in that region.

The other top regions, in descending order, were the Middle East, the Caribbean, North America, and, last, Asia. Within North America, the U.S., Bermuda and Canada were the top

countries.

Takeaways for Financial Institutions From the Closely Reviewed BSA Filings

The BSA filings revealed a significant increase in the transfer of beneficial ownership interests in companies, trusts and accounts by Russian oligarchs to their family members.

This observation is particularly relevant in the context of the new beneficial ownership information, or BOI, reporting rules under the Corporate Transparency Act, effective in 2024.[6]

The CTA requires covered U.S. and foreign entities to report their BOI to FinCEN upon incorporation. While FinCEN has promulgated a final rule to determine who must report what BOI, the agency still has work left to do before 2024, such as issuing the final BOI reporting form and issuing regulations to conform the CTA with the Customer Due Diligence Rule requiring covered financial institution customers to disclose BOI.

Financial institutions, especially those subject to the Customer Due Diligence Rule, should stay apprised of developments for CTA BOI reporting. Although the CTA BOI reporting obligations apply directly to certain small businesses, these obligations still will inform how financial institutions should review and revise their AML programs to try to align the Customer Due Diligence Rule with the CTA, with a sensitivity to the BOI disclosures by so-called shell companies that may obfuscate the true role of oligarchs.

Aside from describing the specific details of particular filings, the report sets forth some red flags for financial institutions to watch out for, such as:

- A Russian individual or entity requests a wire transfer from a non-U.S. (particularly non-Russian) bank to pay for an all-cash purchase, especially if the wired funds come from an account held by an individual or entity other than the original requestor.
- The maintenance, purchase or termination of real estate insurance by persons with a known nexus to sanctioned Russian elites and their proxies.
- Changes, without an apparent business reason, to the transaction patterns of a firm located in a country other than the United States, Russia, Belarus or Ukraine, where the new transactions involve convertible virtual currency and Russian-related investments or firms.
- The use of shell companies and trusts, and/or third-party intermediaries, including art dealers, brokers, advisers or interior designers, with a nexus to sanctioned Russian elites and their proxies, to purchase, hold or sell art on a client's behalf.

- The involvement of transportation service companies that have been owned by, or have a nexus to, sanctioned Russian elites and their proxies, and that may be used to transport luxury goods and obfuscate their movement.

With regard to large transfers of funds, as the report notes, financial institutions may struggle to identify the source of funds.

Further, as the report notes, large funds transfers "may be disguised by using accounts linked to shell companies, family members, or associates." This observation relates to the problems created by the use of so-called proxies, which the report references.

However, there is an open question regarding exactly whose conduct should trigger the reporting of suspicious transactions. In the March 7, 2022, alert, FinCEN put three categories of possible wrongdoers under the same umbrella: (1) sanctioned Russian elites, (2) their family members, and (3) persons or entities through which sanctioned Russian elites and their family may act (labeled as proxies).

Further, the alert repeatedly mentioned anyone with a nexus to sanctioned Russian elites and their proxies. As a practical matter, FinCEN has provided little guidance regarding how financial institutions should identify whether someone is a proxy, a term that appears to mean nominee.

This is another version of a constant problem in AML compliance: How much due diligence must a financial institution do in order to trace potential connections and the source of funds? If there is no publicly available and relatively accessible document that links a person with a sanctioned Russian individual, much less with the family member of a sanctioned Russian individual, the use of proxies often will be very hard to detect, if not impossible. It is possible that an AML policy discusses proxies and nominees but that the financial institution faces substantial challenges in implementing day-to-day procedures to capture that information.

Ultimately, the report underscores that financial institutions may better assist law enforcement by completing SARs in a manner that highlights the suspicious activity with particularity. For example, if a financial institution includes a Russian-oligarch key term in the BSA filing, FinCEN and law enforcement may more efficiently connect that suspicious activity to a related filing.

In addition, financial institutions can assist law enforcement with the "bigger picture" by connecting bad actors and suspicious transactions detected through their own AML programs by filing SARs that provide context regarding both timing (e.g., over years) and scope (e.g., connected bad actors). Connecting this loop will further the goal shared by FinCEN and industry of enhanced information-sharing.

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[1] FinCEN, Financial Trend Analysis – Trends in Bank Secrecy Act Data: Financial Activity by Russian Oligarchs in 2022, (Dec. 22, 2022).

[2] Section 6206 of the Anti-Money Laundering Act of 2020, Division F, §§ 6001-6511, of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, Pub. L. 116-283 (2021).

[3] FinCEN, FinCEN Advises Increased Vigilance for Potential Russian Sanctions Evasion Attempts, (March 7, 2022); FinCEN, FinCEN Alert on Real Estate, Luxury Goods, and Other High Value Assets Involving Russian Elites, Oligarchs, and their Family Members, (March 16, 2022); FinCEN, FinCEN and the U.S. Department of Commerce's Bureau of Industry and Security Urge Increased Vigilance for Potential Russian and Belarusian Export Control Evasion Attempts, (June 28, 2022).

[4] FinCEN, FinCEN Alert on Real Estate, Luxury Goods, and Other High Value Assets Involving Russian Elites, Oligarchs, and their Family Members, (March 16, 2022).

[5] FinCEN, Anti-Money Laundering Regulations for Real Estate Transactions, 86 F.R. 69589 (Dec. 8, 2021).

[6] FinCEN, Beneficial Ownership Information Reporting Requirements, 87 F.R. 59498 (Sept. 30, 2022).