

# Russian Federation

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RISK & COMPLIANCE REPORT

DATE: January 2017

## Executive Summary - Russia

<b>Sanctions:</b>	US and EU Sanctions
<b>FAFT list of AML Deficient Countries</b>	No
<b>Higher Risk Areas:</b>	US Dept of State Money Laundering assessment Corruption Index (Transparency International & W.G.I.) World Governance Indicators (Average score) Failed States Index (Political)(Average score)
<b>Medium Risk Areas:</b>	Compliance with FATF 40 + 9 Recommendations
<p><b>Major Investment Areas:</b></p> <p><b>Agriculture - products:</b></p> <p>grain, sugar beets, sunflower seed, vegetables, fruits; beef, milk</p> <p><b>Industries:</b></p> <p>complete range of mining and extractive industries producing coal, oil, gas, chemicals, and metals; all forms of machine building from rolling mills to high-performance aircraft and space vehicles; defense industries including radar, missile production, and advanced electronic components, shipbuilding; road and rail transportation equipment; communications equipment; agricultural machinery, tractors, and construction equipment; electric power generating and transmitting equipment; medical and scientific instruments; consumer durables, textiles, foodstuffs, handicrafts</p> <p><b>Exports - commodities:</b></p> <p>petroleum and petroleum products, natural gas, metals, wood and wood products, chemicals, and a wide variety of civilian and military manufactures</p> <p><b>Exports - partners:</b></p> <p>Netherlands 12.2%, China 6.4%, Italy 5.6%, Germany 4.6%, Poland 4.2% (2011)</p> <p><b>Imports - commodities:</b></p> <p>machinery, vehicles, pharmaceutical products, plastic, semi-finished metal products, meat, fruits and nuts, optical and medical instruments, iron, steel</p> <p><b>Imports - partners:</b></p> <p>China 15.5%, Germany 10%, Ukraine 6.6%, Italy 4.3% (2011)</p>	

**Investment Restrictions:**

Russian government officials have repeatedly stressed that foreign investment and technology transfer are critical to Russia's economic modernization. At the same time, the government continues to limit foreign investment in sectors deemed to have strategic significance for national defence, state security, energy, insurance, electricity, banking, and transportation via the Strategic Sectors Law of 2008. The law originally specified 42 activities that require government approval for foreign investment however, the Federal Anti-monopoly Service prepared several amendments, which are intended to diminish administrative barriers and simplify a number of procedures required for foreign investment in Russian strategic companies. The amendments were proposed in November 2012 and are now awaiting approval by the government.

Other sectors, such as business services, hotels and restaurants, construction, and distribution, have been opened up for foreign investment.

Foreigners can own, inherit, lease, mortgage, and sell real property, with certain restrictions, notably with respect to the ownership of farmland and areas located near federal borders.

In April 2013, the Russian Parliament adopted a new set of anti-corruption legislation that is aimed at preventing high-ranking officials from stashing illicit wealth abroad and stopping annual capital outflows of around USD 80 billion. The law prohibits all high-ranking officials, parliamentarians, judges and their immediate family members from having accounts in foreign banks.

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## Section 1 - Background

Founded in the 12th century, the Principality of Muscovy, was able to emerge from over 200 years of Mongol domination (13th-15th centuries) and to gradually conquer and absorb surrounding principalities. In the early 17th century, a new Romanov Dynasty continued this policy of expansion across Siberia to the Pacific. Under PETER I (ruled 1682-1725), hegemony was extended to the Baltic Sea and the country was renamed the Russian Empire. During the 19th century, more territorial acquisitions were made in Europe and Asia. Defeat in the Russo-Japanese War of 1904-05 contributed to the Revolution of 1905, which resulted in the formation of a parliament and other reforms. Repeated devastating defeats of the Russian army in World War I led to widespread rioting in the major cities of the Russian Empire and to the overthrow in 1917 of the imperial household. The Communists under Vladimir LENIN seized power soon after and formed the USSR. The brutal rule of Iosif STALIN (1928-53) strengthened Communist rule and Russian dominance of the Soviet Union at a cost of tens of millions of lives. The Soviet economy and society stagnated in the following decades until General Secretary Mikhail GORBACHEV (1985-91) introduced glasnost (openness) and perestroika (restructuring) in an attempt to modernize Communism, but his initiatives inadvertently released forces that by December 1991 splintered the USSR into Russia and 14 other independent republics. Since then, Russia has shifted its post-Soviet democratic ambitions in favor of a centralized semi-authoritarian state in which the leadership seeks to legitimize its rule through managed national elections, populist appeals by President PUTIN, and continued economic growth. Russia has severely disabled a Chechen rebel movement, although violence still occurs throughout the North Caucasus.



## Section 2 - Anti – Money Laundering / Terrorist Financing

### FATF Status

Russia is not currently identified by FATF as having substantial money laundering and terrorist financing (ML/TF) risks or having strategic AML/CFT deficiencies

### Compliance with FATF Recommendations

The last Mutual Evaluation Report relating to the implementation of anti-money laundering and counter-terrorist financing standards in Russia was undertaken by the Financial Action Task Force (FATF) in 2008. According to that Evaluation, Russia was deemed Compliant for 10 and Largely Compliant for 13 of the FATF 40 + 9 Recommendations. It was Partially Compliant or Non-Compliant for 2 of the 6 Core Recommendations.

### Main conclusions from Follow-Up Report – 2011

The financial threshold in respect of A.174.1 (Legalization (laundering) of monetary funds or other property acquired by a persons as a result of crime commission) should be reconsidered and it is strongly advised that it should be removed. Beyond this, on Recommendation 1, progress has been made in that the range of designated categories of predicate offence is now complete. An impressive number of cases were investigated in the period under review, though despite the threshold the large majority of convictions remains for self laundering as opposed to laundering by third parties. As at the time of the report, the Russian Federation is encouraged to make more use of the stand-alone money laundering offence, where the evidence permits, in the prosecution of serious laundering in major proceeds-generating cases.

The shortcomings in the criminalisation of TF have been partly addressed in that the theft of nuclear material is now covered. While the issue of corporate criminal liability has been revisited, as the Action Plan required, there is no progress on the issue of criminal liability of legal persons. The Russian Federation have no current plans to address this shortcoming as they consider their administrative sanctioning powers can achieve the same results in practice without the introduction of corporate criminal liability. The issue will need to be revisited in MONEYVAL's follow up evaluation. In any event, the offence as it stands appears, on a desk review, to be used effectively.

On Recommendation 5 and Customer Due Diligence generally there have been several significant and positive developments in the regulatory measures to address the shortcomings identified in the report. Several issues, while addressed in other normative documents, still have not been covered in Law or Regulation, as is required (and as those terms are interpreted by FATF). The major problem, which cannot be resolved in a desk review, is what is understood to be meant by the term "beneficiary", which is the term used

in the English translation of the legislation, rather than “beneficial owner”. The definition in the AML Law seems not to be entirely in line with the FATF definition, though the Russian Federation considers that the FATF’s definition of “beneficial owner” is how the concept is understood in practice. This will also be fully analysed in the forthcoming follow up onsite visit.

The other issue which still needs attention by the Russian Federation is to ensure that all attempted money laundering and terrorist financing STRs are reported to the FIU. Presently there is no legal basis for reporting attempts by those involved in occasional transactions. Overall, though, the STR regime under R.13 appears to be working well in practice.

In conclusion, subject to what has been said above, the Russian Federation has responded positively to most of the points on the Action Plan in the last report with respect to the Core Recommendations. Steady progress is being made overall in the implementation of the AML/CFT regime.

In conclusion, as a result of the discussions held in the context of the examination of this second progress report, the Plenary was satisfied with the information provided and the progress being undertaken and thus approved the progress report and the analysis of the progress on the core Recommendations. Pursuant to Rule 41 of the Rules of procedure, the progress report will be subject of an update in two years from the adoption of this report unless the 4th onsite visit has taken place before then.

## **Further Information extracted from IMF Reports: -**

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### **Key Findings extracted from IMF Report - Russian Federation: Targeted Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision (released November 2011)**

#### **Institutional and Market Structure—Overview**

The Central Bank of Russia (“CBR”) CBR Law and the Law on Banks and Banking Activities (BL) assign responsibility for the licensing and supervision of banks to the CBR. The law empowers the CBR to grant banking licenses, approve permissible activities, issue regulations, supervise and enforce compliance with laws and regulations.

As part of the Russian Federation’s Development Strategy for the Banking Sector through 2015, the CBR is in the process of overhauling the supervisory, legal and operational landscape to enable the implementation of supervision by risk; including an enhancement in the scope of consolidated supervision. A published strategic plan to strengthen capital requirements and strengthen banking supervision is comprehensive and candid in recognizing shortcomings in the banking supervision framework. The strategy proposes to strengthen the CBR’s legal supervisory powers, and improve transparency, asset valuation, and corporate governance in banks. Adopting the proposed agenda and pending legislation will enhance the CBR’s ability to conduct more intensive supervision, identify risks, and take timely corrective action.

Current oversight of banking activities by the CBR relies on an integrated process combining offsite reviews with on-site inspections. In the course of supervision exercised by the CBR's territorial offices, as well as by the CBR's central staff with respect to SIFs, frequent contact is maintained with bank management. Since the last FSAP, the CBR has been working on legislative changes required to enable the CBR to appoint resident inspectors at SIFs.

Legislation, granting the CBR increased professional judgment to implement international best practices without always requiring a revision of existing legislation would enhance the safety and soundness of the banking system. Currently, the CBR is unable to require banks to implement best practices in many areas of corporate governance, and risk management or to perform consolidated supervision because of a lack of regulatory authority. Authority, within an approved legislative framework, to rely on professional judgment to implement best practices as prescribed by international standard setters, adjusted to the local market, is an essential element of supervision.

The Russian banking sector is dominated by state-owned banks. As of January 1, 2011 there were 1,012 banks operating in Russia, a decline of 46 from January 1, 2010. The number of banks is expected to decline further as a result of increased minimum capital requirements. As of January 2010, minimum capital was raised to Rub 90 million and will be raised to Rub 180 million on January 2012. The 50 largest banks control 80 percent of assets and the top five (all state-owned) control 48 percent.

The level of nonperforming loans and overdue loans has declined. As of January 1, 2011 banking system assets totalled Rub 33,805 billion and the capital adequacy level was 18.1 percent. Non-performing loans (NPL), which are defined as loans classified in categories IV and V, amounted to 8.2 percent of total loans, a decline from 9.6 percent on January 1, 2010. Total loan provisions currently cover 102 percent of total NPLs but seem inadequate to cover possible losses in the remainder of the loan portfolio. Profitability has increased over the last year, with a return on equity moving from 5 percent in 2009 to 12.5 percent in 2010.

The following summarizes the main findings of the detailed assessment of compliance with the BCP

## **Objectives, independence, powers, transparency and cooperation**

### **Licensing and structure**

The CBR Law does not establish requirements for banks to seek prior CBR approval when making domestic investments in nonbank financial institutions. Foreign investments by Russian banks require prior approval by the CBR, when they lead to the establishment of a subsidiary abroad, or acquisition of the status of parent company of a non-resident entity. A domestic acquisition of shares in a bank above a 20 percent ownership requires prior CBR approval. Acquisitions of over one-percent share require ex- post notification to the CBR. There is also an aggregate 25 percent limit on investments in banks and other entities. However, bank investments in nonbank financial firms do not require prior CBR approval. The CBR relies on the 25 percent aggregate limit to control that risk. Licensing regulations should provide for an approval/notification process for bank investments in non-banking

institutions. Without such requirement the CBR is not able to measure the possible impact of acquisitions on a bank's condition or to determine whether the acquisition will affect the transparency of the bank's organizational structure and affect the ability of the CBR to supervise it.

### **Prudential Regulations and Requirements**

Capital adequacy rules generally meet Basel II, Pillar 1 guidelines but the CBR lacks a legal authority to implement the Pillar 2 component. The standardized, simplified approach is being implemented but the CBR lacks the regulatory authority to implement the supervisory review process prescribed by Pillar 2. Under Pillar 2 the CBR plans to issue recommendations in the second quarter of 2011 on minimum standards for organizing internal procedures for assessing the adequacy of internal capital to cover potential and assumed risks and to provide for future capital needs based on stress testing, strategic plans and risk evaluation. Without legislation specifically stating the authority of the CBR to stipulate standards for risks and capital management, the CBR may not oblige credit institutions to implement said recommendations, to develop internal capital adequacy assessment procedures and to implement them.

The existing risk management regulatory framework is complex and multi-faceted. However, it does not provide the foundation necessary for full implementation of supervision by risk. The CBR has issued numerous regulations, instructions and recommendations which directly or indirectly support banks' strengthening their internal risk management processes. The nature of existing regulations enable a compliance approach to supervision but limit the ability of the CBR to exercise professional judgment to rate the adequacy of risk management systems or Board of Director policies and governance. Addressing these deficiencies is an area where the CBR is focused but needs amendments to existing legislation.

The concept of related parties has been identified in the regulations and the CBR collects reports on related parties. However, the definition of related parties is narrow and based on legal relationships. Legislation is being reviewed by the Duma that would expand the definition of related parties and allow the CBR to make judgments based on economic relationships or evidence of ability to influence decisions. The regulatory framework for related party transactions is also deficient in that it does not require that lending to related parties be on same terms and conditions as those generally offered to the public. The CBR has issued recommendations to banks on related party lending, however, they lack enforcement capacity.

The CBR is considering amending Regulation 254-P to address country and transfer risk. The current system does not impose country risk limits or provisions, except for operations with residents of offshore centres. The CBR has issued recommendations to credit organizations on the management of risk country based on the approaches specified in the BCBS document "Management of Banks' International Lending (Country Risk Analysis and Country Exposure Measurement and Control)" and also includes BCP requirements.

The supervisors do not have the authority to directly share client information with other agencies and regulators, at home or abroad, which constitutes a serious deficiency.

However, it can share such information with the FIU. Also, the CBR is aggressive and very successful in closing banks that are involved in money laundering.

### **Corrective and Remedial Powers of Supervisors**

The legal regime for corrective and remedial actions is clearly addressed in the regulations. Enforcement powers are broad and clearly spelled out. The remedial powers of the CBR are deficient in some key areas, such as the inability to sanction Board members and to prevent transactions between the bank and its affiliates.

### **Consolidated supervision**

An inability to limit transactions between affiliates, and request information from holding companies limits the ability to conduct consolidated supervision. Legislation is pending with the Duma to amend the CBR Law and the BL that will extend the supervisory authority of the CBR to cover bank holding companies. The amendments will also expand enforcement authority over banking groups and bank holding companies by granting the CBR authority to limit transactions between affiliates. The CBR will be able to dictate the types of consolidated information that bank holding companies will need to provide. The CBR actively collaborates with foreign supervisors and the amendments will enable the CBR to exchange customer-specific information. Finally, the definition of direct and indirect influence is expanded. Absent such powers, the ability of the CBR to monitor transactions between affiliates is severely hampered, increasing risks that losses are hidden through affiliate operations or off-balance sheet transfers. In defining bank holding company the EU standard (to be a bank holding company, over 40 percent of the company's activities must be in banking) will be applied. However, in Russia that definition may not be adequate as a large banking group would not be included. The definition should be reviewed and adjusted to the Russian market and ensure that all SIFIs are covered.

## **Russian Federation: Detailed Assessment of Observance of IOSCO Objectives and Principles of Securities Regulation**

### **Anti-money laundering**

Regulated entities must comply with anti-money laundering provisions (FZ-115), and the implementation of FSFM ("Federal Service for Financial Markets") compliance programs are assisted by the Financial Intelligence Unit (Federal Financial Monitoring Service) and the FSFM. In 2009 and 2010 this resulted in the revocation of an unprecedented number of licenses (731) of seven different types. Anti money-laundering is reviewed pursuant to the FATF assessment methodology by FATF assessors.

### **Inspections in Practice**

In 2009 FSFM's headquarters inspection team conducted 106 inspections; 90 of which were

on-site and 16 of which were off-site. 2010's numbers were fairly similar. Most headquarters inspections are of brokers, dealers and investment fund management companies. In the territorial offices 11,195 inspections/ reviews were conducted of which 1368 were on-site and the remainder of which were off-site. Regional oversight is largely directed to issuers. Sanctions and orders/instructions flowing from the conduct of inspections/investigations are posted on the FSFM website (see also Principle 11). The FSFM aims to achieve yearly coverage of brokers.

**Assessment Partly: Implemented.**

Comments: Tremendous progress has been made by FSFM in securing the capacity to conduct effective oversight of the market and market professionals. It can conduct inspections without notice or judicial intervention. FSFM also has been granted broad authority to demand documents and information from brokers, and by brokers of their clients, and to suspend operations for failure to cooperate—a vigorous and prompt means of halting non-compliance, subject to further investigation. The FSFM's authority with respect to insider information and potentially manipulative conduct, or non-standard transactions, applies not only with respect to shares but also can be obtained with respect to commodities, financial instruments, and currency transactions.

The Russian Federation has moved forward to put in place laws and regulatory structures that provide FSFM with a robust ability to mandate maintenance of needed records, prompt access to those records and the ability to compel the production of records necessary to properly enforce its rules against market misconduct from its licensees. FSFM must clarify its ability, and process or gateways, to obtain banking records of natural persons for all regulatory purposes (see also Principle 13). To the extent possible, FSFM should clarify any remaining ambiguity as to the access to natural persons' general bank accounts either through declarative action or by furthering legislative change. For example, it could clarify the scope of Article 26 of the Banking Act, secure the adoption of pending CBR Banking Law amendments, or try to address the issue by executing a protocol with CBR as to the access to information needed for purposes of enforcing securities laws and related cooperative sharing as suggested under Principle 1.

FSFM should also explain in its procedures how it investigates the ownership of nominee accounts.

FSFM's expanded powers are new; therefore some time should be permitted to see how they are implemented in practice as provided in the assessment of Principle 10. The rating could be improved to the extent the power to access such accounts can be demonstrated.

Caveat: if further constraints are introduced by the banking laws, then this could adversely affect all the enforcement and information sharing ratings.

Russia was deemed a Jurisdiction of Primary Concern by the US Department of State 2016 International Narcotics Control Strategy Report (INCSR).

Key Findings from the report are as follows: -

**Perceived Risks:**

While Russia continues to make significant progress in improving its AML/CFT legal and enforcement framework, the prevalence of money laundering in Russia remains a major obstacle to financial sector development. Money laundering continues to cost the Russian economy billions of dollars every year. The Central Bank of Russia (CBR) estimates that \$8.6 billion in 2014, and \$936 million in the first half of 2015 left Russia through what the CBR terms "fictitious transactions." This definition, according to the CBR, includes payment for narcotics, bribes to government officials, and tax evasion. Domestic sources of laundered funds include organized crime, evasion of tax and customs duties, fraud, smuggling operations, and corruption. In particular, official corruption remains a significant problem at all levels of government, and is a major source of laundered funds, with proceeds frequently moved offshore. Cybercrime remains a significant problem. Russia's highly skilled hackers and traditional organized crime structures have followed the global trend of increasingly combining forces, resulting in an increased threat to the financial sector.

Russia is considered a significant transit and destination country for international narcotics traffickers. Criminal elements from Russia and neighboring countries continue to use Russia's financial system and foreign legal entities to launder money. Criminals invest and launder their proceeds in securities instruments, domestic and foreign real estate, and luxury consumer goods.

Gaming is only allowed in specified regions, with regulatory authority shared across multiple agencies, including the Ministries of Finance and Internal Affairs. The Federal Financial Monitoring Service (Rosfinmonitoring), Russia's financial intelligence unit, has been designated as the competent AML/CFT authority for casinos. Only licensed casinos in special gambling zones can register with Rosfinmonitoring, which has inspected the two registered casinos. Online gaming is prohibited.

There is a large migrant worker population in Russia. While the majority of workers likely use formal banking mechanisms, a considerable amount of transfers are believed to occur through informal value transfer systems that may pose a vulnerability for money laundering.

Executive Order (E.O.) 13660, dated March 6, 2014, imposes a travel ban and freezes any assets held in the United States of persons or entities who acted to undermine the democratic processes and institutions in Ukraine and contributed to the misappropriation of its assets. E.O. 13661, dated March 16, 2014, expands the scope of E.O. 13660 to cover the Government of the Russian Federation and its officials, the Central Bank, any state-controlled entities, those who operate in the arms sector in Russia, and seven specified individuals who are senior Russian government officials. The EU took parallel action and imposed similar

sanctions in March 17, 2014, followed by Council Regulation (EU) No 692/2014 of June 23, 2014, imposing restrictions on import/export activity and financial transactions.

**DO FINANCIAL INSTITUTIONS ENGAGE IN CURRENCY TRANSACTIONS RELATED TO INTERNATIONAL NARCOTICS TRAFFICKING THAT INCLUDE SIGNIFICANT AMOUNTS OF US CURRENCY; CURRENCY DERIVED FROM ILLEGAL SALES IN THE U.S.; OR ILLEGAL DRUG SALES THAT OTHERWISE SIGNIFICANTLY AFFECT THE U.S.:** YES

**CRIMINALIZATION OF MONEY LAUNDERING:**

**“All serious crimes” approach or “list” approach to predicate crimes:** All crimes approach

**Are legal persons covered: criminally:** NO **civilly:** YES

**KNOW-YOUR-CUSTOMER (KYC) RULES:**

**Enhanced due diligence procedures for PEPs: Foreign:** YES **Domestic:** YES

**KYC covered entities:** Banks and credit institutions; Russian Post; payment acceptance and money transfer services; securities, insurance, and leasing companies; investment and non-state pension funds; casinos and gaming outlets; dealers in precious metals and stones; real estate agents; pawnshops, microfinance organizations, and consumer credit cooperatives; and legal or accounting service providers

**REPORTING REQUIREMENTS:**

**Number of STRs received and time frame:** Not available

**Number of CTRs received and time frame:** Not available

**STR covered entities:** Banks and credit institutions; securities markets, investment and pension funds; Russian Post; insurance sector; leasing companies; pawnshops and dealers in precious metals and stones; casinos; real estate agents; lawyers, notaries, and legal or accounting service providers; microfinance organizations; consumer credit cooperatives; and non-commercial organizations receiving funds from certain foreign entities

**MONEY LAUNDERING CRIMINAL PROSECUTIONS/CONVICTIONS:**

**Prosecutions:** Not available

**Convictions:** 164 in 2014

**RECORDS EXCHANGE MECHANISM:**

**With U.S.: MLAT:** YES **Other mechanism:** YES

**With other governments/jurisdictions:** YES

Russia is a member of the FATF and two FATF-style regional bodies: the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL); and the Eurasian Group on Combating Money Laundering and the Financing of Terrorism (EAG).

## **ENFORCEMENT AND IMPLEMENTATION ISSUES AND COMMENTS:**

Russia continues to strengthen a number of regulatory and legal measures to combat financial crime and money laundering. During this period of economic difficulty, Russia has continued to make progress in reducing money laundering, partly as a way to lessen the amount of money that is being illegally siphoned out of the local economy. The improvement in financial legislation, while a major step forward for Russia, requires full and unbiased implementation to address Russia's reputation as a center for money laundering.

Several pieces of legislation tighten controls on the financial sector. Federal Law 110-FZ, enacted in May 2014, lowers the threshold of foreign currency transactions conducted by non-profit organizations, foreign states, and international and foreign organizations subject to mandatory controls to 100,000 rubles (approximately \$1,400). Federal Law 213-FZ, passed in July 2014, regulates the opening of banking accounts and letters of credit for defense and strategic industries. In December 2014, several additional laws were passed. Federal Law 461-FZ was amended to expand the list of entities covered under the AML/CFT law to include communications providers. Federal Law 484-FZ requires individuals trading in commodity or financial markets to provide information, upon request, to Rosfinmonitoring. Federal Law 484-FZ mandates the notification to Rosfinmonitoring of the opening, closing, or changing of details of any accounts or letters of credit by companies of strategic importance to the Russian Federation.

The CBR again stepped up enforcement within the banking sector, revoking 92 banking licenses in 2014 and 93 by November of 2015. The CBR claims dubious transactions were one of the main reasons behind the revocation of licenses. The CBR tightened the criteria for suspicious transactions by reducing the quarterly transaction volume threshold from RUB 5 billion (approximately \$68.3 million) to RUB 3 billion (approximately \$41 million) and the proportion of suspicious cash transactions from 5 percent to 4 percent of the debit turnover on customer accounts. The CBR also has tightened restrictions on cash payment terminals by forcing 95 percent of cash transactions to go directly to special accounts. The CBR Department of Financial Monitoring and Currency Control had estimated the aggregate value of illicit cash payments through terminals in 2015 was RUB 390 billion (approximately \$5.3 billion). Over 11 million suspicious transaction reports (STRs) were filed in 2014.

In November 2015, the President signed an executive order to establish an interagency commission on preventing the financing of terrorism. The Kremlin stated that this order will be used to block money and assets belonging to organizations or individuals believed to be involved in terrorist activity. The interagency commission will process requests received by Rosfinmonitoring from other countries' relevant agencies on organizations' or individuals' possible involvement in terrorist activity (including financing terrorism). The Prosecutor's Office, Central Bank, regional and local authorities, and other state agencies and organizations have been instructed to send materials in their possession on possible involvement in terrorist activity (including financing terrorism) of organizations and individuals to the Inter-Agency Commission for Preventing the Financing of Terrorism.

Rosfinmonitoring published a draft bill in October 2015 that would require administrative liability for laundering criminal proceeds for legal persons (e.g., companies). Current Russian legislation provides for criminal liability for laundering by natural persons and penalties of up

to RUB 60 million (approximately \$819,500) for legal persons but only in cases of financing terrorist attacks and similar crimes, not for ordinary criminal operations.

In March 2015, Federal Law 140-FZ, also called the Capital Amnesty Law, was passed. It allows Russian citizens and legal entities to declare their offshore assets without fear of being held accountable for criminal, administrative, or tax indiscretions that may have occurred in connection with their assets prior to January 1, 2015. The amnesty was scheduled to end on December 31, 2015, but was extended until June 2016 by Presidential decree on December 29, 2015. The Capital Amnesty Law is intended to be an incentive to return capital to Russia in conjunction with the de-offshorization law, which entered into effect, after a delay, in June 2015. This legislation requires offshore entities that are at least 50 percent Russian-owned to pay tax on unallocated profits; the ownership threshold will fall to 25 percent in 2017. Russian ownership in a controlled foreign company of more than 10 percent must be reported to the Russian authorities before April 1, 2015.

In 2014, the Russian Federation undertook additional measures centered on its tax system. The plan develops a number of items of important AML legislation. Most of these steps were completed in 2014. In 2015, there was a steady improvement in efforts to reduce illicit transactions. The Federal Tax Service and Rosfinmonitoring created new interagency working groups and exchanged information databases to increase cooperation in the prevention, detection, and suppression of illegal financial transactions. Russian authorities are also using computer models to analyze trade and financial flows, as well as to model taxpayer behavior in the home appliance/electronics and precious metal markets.

In June 2014, Federal Law 173-FZ was passed to allow Russian financial institutions to improve information exchange with foreign tax authorities generally. According to this law, Russian financial institutions may transfer information to a foreign tax authority only with the consent of the non-resident customer. If no consent is provided, the financial institution may unilaterally terminate the contract with the client. In addition, on Dec. 12, 2015, the Russian government established Decree No. 1365 requiring Russian individuals to report annually to the government on transactions on their foreign bank accounts. Russia is unable to effectively enforce foreign forfeiture orders.

There were a number of criminal prosecutions for money laundering in 2014. The most prominent was the arrest of Sergei Magin for the creation of a criminal association. The charges claimed Magin established 14 shell companies that specialized in illegal encashment transactions. It was estimated this group illegally transferred RUB 200 billion (approximately \$2.7 billion) abroad. Other cases involved the misuse of state funds awarded under government contract in the amounts of RUB 5 billion (approximately \$68.3 million) and RUB 9 billion (approximately \$122.9 million). In 2014, there were over 1,200 criminal charges filed using Rosfinmonitoring materials, and 164 convictions on charges related to money laundering.

QIWI, a large Russian digital payment system, has announced plans to issue a Russian cryptocurrency, called the BitRuble in 2016. QIWI is currently testing and finalizing the various platforms to ensure they comply with Russian law. While bitcoin is currently illegal in Russia, if BitRuble is able to launch, it would present challenges to law enforcement to prevent money laundering in Russia.

Although the U.S. and Russia are parties to a bilateral Mutual Legal Assistance Treaty (MLAT), cooperation under the MLAT is often not effective. Additionally, U.S. authorities have been unable to work with Russian counterparts to pursue criminal forfeiture under Russian law of millions of dollars in drug-trafficking proceeds that an international drug dealer, convicted in the U.S., admits went to purchase warehouses for the storage of drugs.

#### **Current Weaknesses in Government Legislation (2013 INCRS Comparative Tables):**

According to the US State Department, Russia conforms with all necessary government legislation and other identifying characteristics required to combat money laundering vulnerability.

#### **EU White list of Equivalent Jurisdictions**

Russia is on the EU White list of Equivalent Jurisdictions

#### **World Governance indicators**

[To view historic Governance Indicators Ctrl + Click here and then select country](#)

#### **Failed States Index**

[To view Failed States Index Ctrl + Click here](#)

#### **Offshore Financial Centre**

The Russian Federation is not considered to be an Offshore Financial Centre

## Key Findings from other US State Department Reports:

### Narcotics - 2016

Russia remains a major destination country for Afghan opiates, consuming approximately 75 metric tons (MT) of heroin each year, according to a UN estimate from 2011. Smuggled opiates primarily enter Russia through extensive land and rail routes through Central Asia and through the country's Baltic and Black Sea ports. Other illegal drugs, particularly cocaine, are also smuggled into Russia via the port in St. Petersburg. In the first half of 2015, Russian law enforcement seized approximately 14 MT of illegal drugs, of which 1.34 tons were opiates (approximately half the volume of opiates seized during the same period in 2014). Four federal agencies conduct drug-related investigations in Russia: Federal Drug Control Service (FSKN); Ministry of Internal Affairs (MVD); Federal Security Service (FSB); and Federal Customs Service (FTS). FSKN is also the primary agency responsible for demand reduction within Russia.

According to FSKN, the estimated population of persons suffering from substance use disorders ranges from 7.5 to 8.5 million. Even at the low end this represents a significant increase from the 2011 estimate of 670,000. According to the FSKN, youth mortality (within the age group of 15 to 34) related to drug addiction has decreased by 30 percent over the last 14 years, from 130,000 annual deaths to 92,000. Nevertheless, in 2014, the FSKN reported a 35 percent increase in usage by minors in Moscow, while the Ministry of Health claimed a 6.5 percent increase by youth across the country. Leading specialists ascribe spotty progress and metrics to poor interagency and intersectoral cooperation, as well as a lack of a cohesive national rehabilitation program.

In 2013, Russia terminated its letter of agreement with the United States that funded counternarcotic capacity building programs. FSKN Director Victor Ivanov is included on the list of Russian officials sanctioned by the United States as a result of the illegal Russian annexation of Crimea. Cooperation between the FSKN and the U.S. Drug Enforcement Administration (DEA) has diminished, though good working relationships have been maintained between DEA and the FSB, and to some degree with the MVD and FTS.

On February 3, 2015, President Putin signed into law a bill allowing the FSKN to unilaterally but temporarily impose a ban on distribution of new psychoactive substances, which the FSKN claims appear at a rate of one new chemically unique drug every two days. Adding new substances to Russia's prohibited substance list otherwise took 12 to 18 months. This initiative was prompted by a series of synthetic marijuana poisonings and deaths in several Russian regions in September 2014. In addition, Russian law enforcement officials have recently sought assistance from DEA for structure and implementation of the temporary scheduling procedure employed in the United States.

### Trafficking in Persons

Russia is classified a Tier 3 country - a country whose government does not fully comply with the minimum standards and is not making significant efforts to do so.

Russia is a source, transit, and destination country for men, women, and children subjected to forced labor and sex trafficking. Labor trafficking remains the predominant human trafficking problem within Russia, accelerating in the context of Russia's significant increase in labor migration. Official and unofficial statistics estimate that there are between five million and 12 million foreign workers in Russia. According to official statistics, in 2013, an estimated 1.1 million labor migrants were employed in the Moscow region alone. Of this number, 22,000 worked in the housing and utilities sector, 110,000 in the construction industry, and the rest worked primarily as public transport drivers, seasonal agricultural workers, tailors and garment workers in underground garment factories, and vendors at marketplaces and shops. Many of these migrant workers experienced exploitative labor conditions characteristic of trafficking cases, such as withholding of documents, nonpayment for services rendered, physical abuse, or extremely poor living conditions. During the year, workers from Russia and other countries in Europe, Central Asia, and Southeast Asia, including Vietnam and North Korea, were subjected to forced labor in Russia. Instances of labor trafficking have been reported in the construction, manufacturing, agriculture, grocery store, maritime, and domestic service industries, as well as in forced begging, waste sorting, and street sweeping; trafficking also continued to be prevalent in textile and garment factories. In factories in the Moscow suburbs, textile workers were beaten, poorly fed, refused medical care, and prohibited from leaving the factory. Human Rights Watch reports that construction of facilities for major events drew estimated tens of thousands of migrant laborers to Russia. Human Rights Watch also documented that employers of construction projects related to the 2014 Winter Olympic Games in Sochi withheld pay, disregarded contracts, and seized passports and work permits to keep workers in conditions of exploitation. Human Rights Watch and other sources reported that Russian authorities rounded up many of these migrants, many of whom were vulnerable to human trafficking, for alleged status violations and detained or deported them without any reported efforts to identify them as trafficking victims. According to official sources, there have been criminal cases involving Russian officials allegedly facilitating trafficking in the country, including by facilitating victims' entry into Russia, providing protection to traffickers, and returning trafficking victims to their exploiters, and of employers bribing Russian officials to avoid enforcement of penalties for engaging illegal workers. Organized crime syndicates from Russia were also involved in arranging trafficking. According to the Federal Migration Service, under a state-to-state agreement, approximately 20,000 North Korean citizens are imported annually by the North Korea government for work in Russia in a variety of sectors, including the logging industry in Russia's Far East, and many of these North Korean citizens reportedly are subjected to conditions of forced labor. There were also reports of Russian citizens facing forced labor abroad.

Reports of Russian women and children subjected to sex trafficking, both in Russia and abroad, continued in 2013. Also in 2013, Russian citizens were reportedly victims of sex trafficking in many countries, including in Northeast Asia, Europe, Central Asia, Africa, and the Middle East. There were also reports of children and women from European (predominantly Ukraine and Moldova), Southeast Asian (primarily Vietnam), African, and Central Asian countries being forced into prostitution in Russia. Law enforcement cases from this reporting year indicate that forced prostitution occurs in brothels, hotels, and saunas, among other locations; certain traffickers advertised the sexual services of some minors over the internet.

The Government of Russia does not fully comply with the minimum standards for the elimination of trafficking and is not making significant efforts to do so. During the reporting period, an international organization opened a trafficking shelter in space granted by a municipal government in St. Petersburg. The government also submitted to the Russian Security Council for approval a national anti-trafficking in persons action plan, which included a request for authority to appoint a trafficking rapporteur. The Security Council did not announce a decision on this request. The absence of a national action plan, to combat trafficking, non-existence of a single coordinating authority for anti-trafficking efforts, and the absence of funding in the federal and local budgets for trafficking prevention and victim protection illustrated the Government of Russia's low political will to address human trafficking. The Russian government has signed the Program of Cooperation between CIS Member States against Trafficking in Persons, but to date there have been no specific steps taken toward implementation. Previous promises of creating an interagency committee to address human trafficking were not fulfilled. During the reporting period, the government did not establish any concrete system for the identification or care of trafficking victims and lacked a victim referral mechanism, though there were reports of victims being identified and provided assistance on an *ad hoc* basis. Prosecutions remained low compared with estimates of Russia's trafficking problem. The government detained and deported hundreds of migrant workers, many of whom were vulnerable to human trafficking, without any reported efforts to identify them as trafficking victims.

### **Terrorist Financing 2015:**

**Overview:** The Russian Federation continued to make counterterrorism efforts a priority during 2015. These efforts intensified after an explosive device downed a Russian passenger jet flying over the Sinai Peninsula on October 31.

The Russian government has expressed a willingness to work with the United States and multilaterally on counterterrorism issues, although some bilateral counterterrorism joint activities were suspended in the wake of Russia's occupation and attempted annexation of Crimea in 2014. The Russian government continued to cooperate with the U.S. Federal Bureau of Investigation's (FBI) investigation of subjects associated with the Boston Marathon bombing.

Continued high profile attacks by the Islamic State of Iraq and the Levant (ISIL) in 2015 prompted increased concern among Russian officials that ISIL could affect Russian security interests by destabilizing the Middle East, Afghanistan, and Central Asia. Russia's military involvement in Syria caused increased concern among Russian authorities about retaliatory terrorist attacks in Russia. Members of both ISIL and al-Nusrah Front made numerous threats of retaliation, including publishing a video in November threatening that soon "blood will spill like an ocean" in Russia, and beheading a Russian citizen from Chechnya in December. Authorities believed the main terrorist threats were related to the activities of armed groups in the North Caucasus and were concerned about ISIL's ability to influence domestic insurgent groups; Imarat Kavkaz, the largest terrorist group in Russia, pledged allegiance to ISIL in 2015. Separatists and violent Islamist extremists calling for a pan-Islamic Caliphate in the North Caucasus continued attacks against Russian authorities, but the government did not label any as a "terrorist attack." Russian authorities avoided labeling attacks as "terrorist attacks" in

order to maintain the narrative that they are defeating terrorism, and that Russia, especially the North Caucasus, is stable.

On December 29, 2014, Russia's Supreme Court issued a ruling recognizing ISIL as a terrorist organization, and banned its domestic activity. With the ruling, participation in ISIL activities became a criminal offense under Russian legislation. In 2015, authorities convicted at least 80 and prosecuted more than 100 Russian citizens of participation in foreign terrorist activity, namely fighting with ISIL in Syria.

**2015 Terrorist Incidents:** On October 31, a Russian charter plane exploded in mid-air over Egypt due to an explosive on board. All 224 people on board died; 219 were Russian nationals. Russian authorities determined the incident was an act of terrorism, likely carried out by ISIL's Sinai branch.

On December 29, gunmen shot 11 tourists, killing one, while they visited the Citadel of Naryn-Kala in Derbent, Dagestan. Islamic State of Iraq and the Levant – Caucasus Province claimed responsibility.

The Russian Federal Security Service (FSB) reported no "terrorist attacks" within the Russian Federation in 2015. However, in the North Caucasus, authorities detained more than 770 suspected terrorists and accomplices, killed 156, and prevented 30 out of 84 "terrorism crimes," according to FSB Head Alexander Bortnikov. Most terrorist groups in the North Caucasus are allied with ISIL. On December 29, gunmen proclaiming affiliation with ISIL shot at civilians in a historical fortress in Derbent, Dagestan, killing one and injuring eleven. Russian authorities have not labeled the crime an act of "terrorism."

According to the Russian General Prosecutor's statistics portal, registered crimes of "terrorist character" throughout Russia increased over the previous year from 1,127 to 1,531 incidents. The General Prosecutor defines crimes of a "terrorist character" as crimes against public security, including acts of terrorism, planning a terrorist attack, making a public call for a terrorist act, taking hostages, and organizing or participating in an illegal armed formation. The Russian government does not maintain an open, detailed, and centralized depository of crimes, nor do its agencies share a single legal definition of what constitutes terrorism or a terrorist-related act.

**Legislation, Law Enforcement, and Border Security:** Russia has a comprehensive counterterrorism legal framework that includes the provisions of the Criminal Code and various federal laws to include, "On Countering Terrorism," "On Money Laundering and Terrorism financing," "On Countering Extremist Activity," "On Security on Transport," and "On Security in the Fuel and Energy Complex."

The Russian government adopted two decrees in 2015 that allowed security forces to create a more secure environment in crowded urban areas, including sports and transportation facilities.

The Russian government continued to use its "anti-extremism" legislation to prosecute peaceful individuals and organizations, including the political opposition, independent media, and certain religious minorities. Despite having counterterrorism as its ostensible primary purpose, the law criminalizes a broad spectrum of activities, including incitement to "religious discord" and "assistance to extremism," and does not precisely define what is

meant by “extremism.” The law includes no stipulation that threats of violence or acts of violence must accompany incitement to religious discord, for example.

The threat of prosecution under Russia's “anti-extremism” legislation has an intimidating effect that results in restriction of freedom of speech and religious freedom under the guise of countering terrorism.

The FSB remains the primary agency responsible for counterterrorism activities within Russia. To a lesser extent, the Ministry of Interior (MVD) also has a role in counterterrorism matters. The FSB International Cooperation Directorate, through a joint relationship with the National Antiterrorism Committee (NAC), has developed the “International Counterterrorism Database” (Russian acronym: MBD), which holds both an unclassified and a restricted section. The FSB exclusively maintains and controls this database, but has invited international intelligence and law enforcement agencies to contribute information on events, subjects, organizations, and methods. The FSB promotes this as the only international database that adheres to UNSCR 2178.

Immediately following the October terrorist attack that downed the Russian passenger jet flying over the Sinai Peninsula, the FSB instructed airport staff and airline agencies to screen their employees in order to prevent a similar act of terrorism.

Border guards are responsible for air, land, and sea arrivals, although with more than 12,000 miles of land border and more than 23,000 miles of coast, the extent to which they are able to patrol all land and maritime crossings is unclear. Border crossings, particularly on the frontiers between Russia and some former Soviet republics, may not be registered. Border guards have the capability of collecting biometrics at ports of entry. While they do not do so regularly, on December 10, 2014, a Presidential Executive Order went into effect requiring biometrics collection for visas issued at Russian embassies in Burma, Denmark, Namibia, and the UK, in addition to requiring passenger fingerprint scanning at Moscow's Vnukovo airport (one of three international airports in Moscow). This initial collection was reportedly a pilot program for an envisioned worldwide rollout, but collection was not done regularly in 2015, nor was the list of countries expanded by the end of 2015.

Standard operating procedures exist for information sharing within the Russian government, but it is unclear how often these procedures are followed. A traveler to Russia must receive a visa from the Ministry of Foreign Affairs (via an embassy or consulate abroad), be permitted entry by the FSB (through the Border Guard Service), and then be registered with the Federal Migration Service (until 2012 a part of the Ministry of Internal Affairs, but now an autonomous organization). Russia has visa-free travel regimes with numerous countries, which limited the amount of screening given to travelers before arriving in Russia.

Terrorism-related prosecutions concerning incidents occurring before 2015 continued, in addition to charges being brought against more than 100 persons for allegedly fighting with ISIL in Syria in 2015. Law enforcement actions/prosecutions in 2015 included:

- On July 13, the Volgograd oblast court rejected the appeal of four Dagestanis convicted of aiding and abetting the 2013 terrorist bombings of a trolley bus and railway station in Volgograd.

- On July 14, the North Caucasus District Military Court convicted six individuals of conducting a terrorist act at a police station in Stavropol Krai in 2013, killing three people. Murad Ataev and Shamil Abulazizov were sentenced to life. The other sentences were: Ramazan Halizov, 23 years; Vladimir Halizov, 18 years; Magomed Ibragimov, 19 years; and Shamil Gazimagomedov, 17 years. The terrorists used a cellphone timer to detonate an explosive-laden car parked at the Pyatigorsk police station. Three bystanders were killed.
- On November 6, the Supreme Court of the Republic of Dagestan sentenced Magomed Gadjiiev to 12 years in prison for participation in the "Balahinsk" terrorist organization.
- On August 6, the Nizhny Novgorod District Military Court convicted Ilya Romanov of an attempted terrorist attack in Nizhny Novgorod in 2013.

Russian media reported that federal and local security organs continued counterterrorism operations in the North Caucasus. These operations occurred throughout the region, but predominately were in Dagestan, Chechnya, and Kabardino-Balkaria. Operations included roadblocks and larger-scale military-style operations, especially in rural areas. On December 15, FSB-Director Bortnikov announced authorities had killed 20 of the 26 known leaders of ISIL-affiliated groups in Russia.

- On April 15, law enforcement officials killed two alleged terrorists in Kabardino-Balkaria. One of the terrorists was later identified as Zelim Shebzukhov, the leader of the local underground and a member of Imarat Kavkaz. He reportedly was recruiting and transporting young men to Syria and preparing a terrorist attack for May.
- On October 24, the FSB killed three members of a local terrorist group: Ruslan Ibragimov, Ahmed Abdurahmanov, and Shamil Shamilov. One FSB officer was killed during the operation. The terrorists belonged to a local group known for attempting to kill law enforcement officials and extort businessmen.
- On October 10, authorities in Kabardino-Balkaria killed Robert Zankishev. Authorities believed Zankishev was the head of a local ISIL cell.
- In late November in Kabardino-Balkaria, authorities killed the leader and two members of a local ISIL cell.
- On November 29, authorities killed three Russian citizens in Dagestan, all recently returned from fighting for ISIL in Syria: Mahmud Mahmudov, the leader of "Tabasaran;" Robert Melikov, leader of "Suleiman Stalski;" and Hasan Mamedyarov.
- In early December, the FSB detained the treasurer of an ISIL cell in Dagestan, Islam Hajiyev, in a Moscow mall.

At the end of 2015, the Russian government estimated 2,900 Russian citizens were fighting with ISIL in Syria and Iraq. During the year, authorities convicted at least 80 individuals for fighting with ISIL or the "opposition" against the Syrian government, according to open sources. Authorities held 41 more in detention while investigating alleged terrorist links. In August, Tural Ragimov became the first Russian sentenced for fighting with ISIL in Syria.

Ragimov was sentenced to four years under Article 208 of the Russian Criminal Code for involvement in an illegal armed unit in the territory of a foreign state.

Despite the tensions in the overall bilateral relationship with the United States, the FSB has engaged in a limited amount of cooperation on counterterrorism matters. Russia continued to disseminate threat information and responded to requests for information on counterterrorism matters, although its responses were often not substantive or timely. Both the FSB and Investigative Committee requested information from the FBI pertaining to the downing of the Russian charter plane in Egypt. The FSB requested the FBI's assistance regarding security preparations for the 2018 FIFA World Cup.

While there were no known legal constraints to effective Russian law enforcement and border security related to counterterrorism, attempts at judicial reforms have had little success due to a lack of political will and institutionalized corruption within law enforcement entities. Ethnic or clan ties in certain regions can make policing and prosecutions difficult. Important cases are often moved to Moscow or other regions to ensure a judge is not influenced by a clan.

**Countering the Financing of Terrorism:** Russia is a member of the Financial Action Task Force (FATF) and belongs to two FATF-style regional bodies: the Council of Europe's Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism, and the Eurasian Group on Combating Money Laundering and Financing of Terrorism (EAG), in which it is a leading member and primary funding source. Through the EAG, Russia provides technical assistance and other resources towards improving legislative and regulatory frameworks and operational capabilities.

The highest levels of government support anti-terrorist funding initiatives, and in November 2015, Russian President Vladimir Putin signed an executive order to establish an interagency commission on preventing the financing of terrorism. Russia's financial intelligence body, the Federal Financial Monitoring Service (Rosfinmonitoring), was moving forward on a draft bill to ratify the 2005 Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of the Proceeds from Crime and on the Financing of Terrorism (aka the "Warsaw Convention"). Rosfinmonitoring is a member of the Egmont Group whose head reports directly to the President of Russia.

The most current data on investigations and convictions of terrorism financing is from 2014. In that year, the Russian government conducted more than 6,000 counterterrorism/extremist financial investigations, resulting in the filing of 62 criminal charges, and 15 convictions. The authorities froze approximately 3,500 accounts belonging to 1,527 people for a value of around US \$475,000. In the period of 2008 to 2013, there were 80 total investigations and 21 convictions. In the same period, the government suspended 32 transactions totaling US \$106,172.

In order to reduce persistently high capital outflows and fictitious transactions, Russia has increased oversight of the financial sector, putting pressure on smaller financial institutions that are most likely to engage in money laundering and terrorism financing. The primary regulator is the Central Bank of Russia, which has revoked a large number banking licenses over the past few years, often citing the presence of dubious transactions.

**Countering Violent Extremism:** The Russian Government adopted a countering violent extremism strategy in November 2014, but there were no significant developments in 2015. Russian efforts to counter violent extremism focus on enforcement mechanisms and program administration through governmental agencies, or organizations controlled by the government. The Russian government is reluctant to work with independent NGOs, including Russian-based NGOs, in this area.

**International and Regional Cooperation:** Russia continued to work in regional and multilateral groups to address terrorism. Russia is a member of and participated in UN and Global Counterterrorism Forum activities. Russia is a member of the OSCE, the Council of Europe, and the ASEAN Regional Forum.

## International Sanctions

The U.S. and Europe are regularly expanding sanctions to include other Russian government officials and business entities in an effort to pressure President Vladimir Putin and his Ukrainian allies to cease their military activity in eastern Ukraine.

[US](#)

[Europe](#)

21 March 2014; The US President has issued a new Executive Order, Blocking Property of Additional Persons Contributing to the Situation in Ukraine; expanding the scope of the national emergency declared in Executive Order 13660 of March 6, 2014, and expanded by Executive Order of March 16, 2014

[Read Order](#)

21 March 2014; The EU has imposed sanctions on another 12 individuals over Russia's annexation of Crimea from Ukraine.

18 March 2014 - US President signed an Executive Order Blocking Property of Additional Persons Contributing to the Situation In Ukraine. This new authority expands upon E.O. 13660 by providing the ability to target officials of the Government of the Russian Federation, any individuals or entities that operate in the arms or related materiel sector in the Russian Federation, and any individual or entity that is owned or controlled by, or provides material or other support to any senior official of the Government of the Russian Federation or any person designated pursuant to this order.

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EU imposes Ukraine sanctions after deadly Kiev clashes

7 March 2014 Council Regulation (EU) No 208/2014 of 5 March 2014 concerning restrictive measures directed against certain persons, entities and bodies in view of the situation in Ukraine

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7 March 2014 OFAC: Issuance of Ukraine-related Executive Order

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## Bribery & Corruption

Index	Rating (100-Good / 0-Bad)
Transparency International Corruption Index	29
World Governance Indicator – Control of Corruption	19

### US State Department

The Russian government stepped up its campaign against corruption in 2012. In March 2012, then-Russian President Medvedev adopted the National Anti-Corruption Plan for 2012–2013. The plan contained guidance and recommendations for the government, federal executive bodies and other government agencies on counteracting corruption, including the establishment of a legal framework for lobbying and increasing the transparency of state officials' personal finances and acceptance of gifts. Additionally, in 2012, Russia adopted a law requiring individuals holding public office, state officials, municipal officials and employees of state organizations to submit information on the funds spent by them and members of their families (spouses and underage children) to acquire certain types of property, including real estate, securities, stock and vehicles. The law also required public servants to disclose the source of the funds for these purchases and to confirm the legality of the acquisitions. In addition, the State Duma adopted a law in 2013 that required state officials, deputies, senators and governors to disclose information on their foreign property holdings and to close foreign bank accounts.

Speaking at the Russian General Prosecutor's Office on the occasion of the 291<sup>st</sup> anniversary of its establishment, Sergei Ivanov, Chief of the Presidential Administration, mentioned that in 2012, over 7,000 persons charged with corruption had received prison sentences and a greater number of corruption cases were initiated. One high level case led to the firing of Defense Minister Anatoly Serdyukov, who was reportedly at the center of multiple corrupt schemes on a very large scale. However, after a year of investigation, no charges have been filed. Various reports in the media speculated that Serdyukov had been given amnesty, or alternatively, that the investigation had been limited to suspicious of negligence rather than more serious crimes. Failure to hold high government officials accountable for corruption sends a strong signal throughout the system that certain persons are untouchable and protected by the highest authorities. This phenomenon undermines the rule of law in Russia.

Indeed, a long-running dispute between the Russian Prosecutor General, Yuri Chaika, and the Chairman of the Investigative Committee, Alexander Bastrykin, flared up in the Spring 2014. Chaika publicly accused the Investigative Committee of being unwilling to handle serious corruption matters. However, even the General Procuracy has experienced public embarrassment on this issue, when Hewlett Packard Russia pleaded guilty in the United States in April 2014 to bribing Russian prosecutors ten years earlier in exchange for a computer

systems procurement contract. Media reports suggested that Russia has not been very helpful in investigating cases under the U.S. Foreign Corrupt Practices Act (FCPA).

Russia is a signatory to the UN Convention against Corruption, the Council of Europe's Criminal Law Convention on Corruption, and, as of 2012, the OECD Anti-Bribery Convention. The OECD Convention calls for the implementation of national legislation to criminalize commercial bribery and to prohibit both offering bribes to foreign government officials and accepting such bribes. It provides no exceptions for "grease payments," and includes foreign entities doing business in Russia, meaning these entities could be subject to liability under their own country's law, as well as Russia's. The convention also calls for increasing the penalties that may be imposed upon an individual or entity found in violation. Fines and terms of incarceration contemplated by the Convention vary, depending upon the type of bribe and the official involved. During 2011-2012, Russia passed national legislation to bring itself into better compliance with its commitments under the OECD Convention and UNCAC. For instance, Article 13.1 of the Federal Law on Corruption allows removal of government officials for failure to take measures to combat corruption. Article 13.3, very broadly requires all legal entities in the Russian Federation implement an ethics and compliance program to combat corruption and conflict of interest. This law also applies to Russian government budgetary entities like schools.

Some analysts have expressed concern that lack of depth in the compliance culture in Russia will render the law a formality that does not function in reality. The implementation and enforcement of the many measures required by these conventions have not yet been fully tested. In recent years, there appears to be a greater number of prosecutions and convictions of mid-level bureaucrats for corruption, but real numbers were difficult to obtain and high-ranking officials were rarely prosecuted. After the close of the 2014 Winter Olympic Games in Sochi, anti-corruption blogger and opposition political candidate Alexey Navalny released a detailed report alleging wide-spread corruption and graft from those government and private individuals involved in construction of the Olympic venues. According to reports, the Prosecutor General's Office opened over 50 criminal cases related to the Olympic Games and has imposed administrative penalties on over 100 persons and companies. It is likely that many of these cases touch only lower level bureaucrats and not high-ranking government officials or prominent businessmen close to the Kremlin who won the lucrative construction contracts for the Olympics.

It is important for U.S. companies, irrespective of size, to assess the business climate in the relevant market in which they will be operating or investing, and to have an effective compliance programs or measures to prevent and detect corruption, including foreign bribery. U.S. individuals and firms operating or investing in Russia should take the time to become familiar with the relevant anticorruption laws of both Russia and the United States in order to properly comply with them, and where appropriate, they should seek the advice of legal counsel.

## Corruption and Government Transparency - Report by Global Security

### Political Climate

Russia enacted into law new anti-corruption legislation in December 2008. The legislation imposes financial disclosure requirements on government officials, restricts post-government employment at entities with which the official had prior connections and requires reporting of corrupt activities. According to the US Department of State 2012, Russia has introduced a series of amendments to the Code of Criminal Procedure between 2008 and 2010. In February 2012, former President Dmitry Medvedev signed the OECD Anti-Bribery Convention. Before leaving office, Medvedev signed and adopted the National Anti-Corruption Plan 2012-2013 in March 2012, which focuses on increasing transparency of asset declaration and acceptance of gifts by state officials. It also includes guidance for the government, executive bodies and governmental agencies on how to counteract corruption.

Under President Vladimir Putin, improvement of Russia's investment climate has been the top priority. Several administrative barriers have been reduced and tariffs across borders decreased, according to the US Department of State 2013. In April 2013, Parliament (Duma) adopted a new set of anti-corruption legislation aimed at preventing high-ranking officials from stashing illicit wealth abroad and stopping annual capital outflows of around USD 80 billion, according to a 2013 article by Reuters. The law prohibits all high-ranking officials, parliamentarians, judges and their immediate family members from having accounts in foreign banks. Despite increased anti-corruption regulation and the adoption of the new anti-corruption strategy, the implementation and enforcement of the measures, required by the law and several international conventions signed by Russia, remain ineffective, according to the US Department of State 2013. In its 2012 Evaluation Report, GRECO specifically recommends Russia to ensure that bribery of all judges and high-ranking officials of international courts is criminalised, broaden the scope of the bribery provisions in the Criminal Code and criminalise as a separate offence trading in influence. GRECO has given a generally positive evaluation of Russia's anti-corruption efforts, and the country is expected to present a new report on the implementation of the GRECO recommendations.

Despite Russia's recent anti-corruption efforts, Transparency International's Global Corruption Barometer 2013 reveals that 57% of surveyed Russian households consider the government's fight against corruption to be ineffective, and 50% perceive the level of corruption to have increased in Russia over the past two years. The same survey also shows that the police and public officials are perceived to be the most corruption-prone public institutions in the country. More than 92% of respondents perceive public officials to be "corrupt" or "extremely corrupt". Corruption in Russia is widespread throughout the executive, legislative, and judicial branches at all levels of government. Weak institutions, weak enforcement, theft, extortion, and abuse of office are often cited as the reasons for rampant corruption, according to the US Department of State 2012. One of the most recent and prominent cases involves an ally of President Putin, Vladimir Pekhtin, who resigned from Parliament in February 2013 and faces charges after allegations of failing to declare ownership of property worth USD 2 million in the United States, according to a 2013 article by Reuters. As of November 2013 the case is still pending.

## **Business and Corruption**

Following the global financial crisis and a decline in foreign direct investment, the Russian government came forward with a massive economic stimulus package, but corruption and lack of trust in institutions continue to hamper domestic and foreign investor confidence. The World Economic Forum's Global Competitiveness Report 2013-2014 outlines that the weak institutional framework in Russia impedes business growth. According to the US Department of State 2013, despite the announced political will of Russian politicians to promote foreign investment and technology transfer, the government continues to exert control on the economy's strategic sectors and limits foreign investment in sectors that are significant for state defence and security. Nevertheless, in April 2013, Parliament initiated a step towards improving the investment climate for foreign companies and approved several amendments to the Federal Law on Foreign Investments proposed by the Federal Antimonopoly Service. The amendments have significantly simplified procedures for approval of acquisitions of shares in Russian companies operating in strategic sectors, reports a 2013 article by RussiaReport.

Large companies cite corruption as a major obstacle to doing business in Russia. Companies surveyed in the EBRD & World Bank's BEEPS Russia 2012 identify corruption as the fourth-largest obstacle for conducting business in the country. According to an April 2012 article by The Wall Street Journal, nearly 33% of top officials and leading finance professionals point to corruption as the biggest problem Russia needs to solve to realise its potential. Similarly, corruption is identified as the most problematic factor for doing business in Russia by surveyed business executives in the Global Competitiveness Report 2013-2014, who report the occurrence of irregular payments and bribes in Russia to be common. According to the World Bank & IFC's Enterprise Surveys 2012, over 20% of companies make unofficial payments to "get things done". As a result of the unattractive conditions for business, investments are far from sufficient to satisfy the modernisation needs of the Russian economy, according to the Bertelsmann Foundation 2012.

Many SMEs operate in Russia's sizeable informal sector. According to the Enterprise Surveys 2012, more than 30% of surveyed companies report that they must compete against unregistered or informal companies, and more than 14% identify the practices of competitors in the informal sector as a major constraint. An SME can expect to pay more than 2% of the contract value in bribes to secure a government contract. Given the high-risk of exposure to corruption on the Russian market, foreign companies are recommended to develop, implement, and strengthen integrity systems and to conduct extensive due diligence when planning to invest and when already doing business in Russia. View the special page on information on obtaining business licences and permits in Russia.

## **Regulatory Environment**

Corruption is institutionalised in Russia and permeates through all levels of government, including the regulatory bodies. To reduce bureaucracy and decrease the opportunities for corruption, one-stop shops have been established for citizens and companies to reduce direct interaction with public officials and reduce opportunities for extortion. In addition, several governmental internet portals have been launched to make the regulatory processes more transparent. Further, salaries of civil servants have been significantly increased in recent years. To raise awareness among public officials about corruption, the Russian government

has instituted mandatory anti-corruption training for public officials through the Academy of State Service. In January 2013, a new amendment to the Russian Federal Anti-Corruption Law came into force. Now Russian and foreign companies are required to establish effective anti-bribery compliance programmes and promote extensive anti-corruption policies internally. Companies, however, continue to report that they frequently encounter attempts at extortion. The Prosecutor General's Office has launched a special section, Prosecutorial Supervision over Observance of Rights of Business Entities and Entrepreneurs, where businesspeople can lodge complaints if their rights or legal interests have been violated.

Business regulations in Russia have improved in recent years. Figures from the World Bank & IFC's Doing Business 2014 show that the amount of time required to start a business in Russia is only slightly above the regional average, while costs associated with starting a business are lower than the OECD and the regional averages. Although Russia has increased its ownership in strategic sectors, such as energy, insurance, electricity, banking and transportation, the bias in favour of well-connected companies has decreased, while support to innovative and export-oriented firms has improved, according to the Bertelsmann Foundation 2012. However, the inconsistent and non-transparent application of laws and regulations and the weak enforcement of laws and court decisions have decreased the country's regulatory efficiency. Global Integrity 2010 reports that Russia exhibits a huge implementation gap and that many laws are poorly enforced. Companies surveyed in the World Economic Forum's Global Competitiveness Report 2013-2014 identify inefficient government bureaucracy to be among the most problematic factors for doing business in the country. According to the World Bank & IFC's Enterprise Surveys 2012, senior managers spend more than 15% of their time dealing with requirements of government regulation in Russia.

According to the US Department of State 2013, it can be difficult to obtain independent dispute resolution in Russia due to the developing judicial system, political pressure, widespread corruption within the courts and weak law enforcement. Reportedly, many attorneys refer their Western clients with investment or trade disputes in Russia to international arbitration in Stockholm or foreign courts. Russia accepts binding international arbitration and foreign arbitral awards are legally enforceable in Russia, even without a reciprocal treaty between Russia and the country where the order was issued. Russia is a member of the International Centre for the Settlement of Investment Disputes (ICSID) and a signatory to the New York Convention of 1958. Domestic arbitration avenues are available through the Supreme Arbitration Court of the Russian Federation and the International Commercial Arbitration Court at the Russian Chamber of Commerce and Industry (ICAC). The ICAC will hear claims if both parties agree to the referral. Similarly, an Arbitration Tribunal at the St. Petersburg Chamber of Commerce and Industry has been established. However, the enforcement of domestic international arbitral awards ultimately requires action from Russian courts and follow-up by bailiffs, which, according to the US Department of State 2013, has yet to consistently and effectively enforce court judgments. Access the Lexadin World Law Guide for a collection of legislation in Russia.

## Section 3 - Economy

Russia has undergone significant changes since the collapse of the Soviet Union, moving from a globally-isolated, centrally-planned economy towards a more market-based and globally-integrated economy, but stalling as a partially reformed, statist economy with a high concentration of wealth in officials' hands. Economic reforms in the 1990s privatized most industry, with notable exceptions in the energy and defense-related sectors. The protection of property rights is still weak and the private sector remains subject to heavy state interference. Russia is one of the world's leading producers of oil and natural gas and is also a top exporter of metals such as steel and primary aluminum. Russia's manufacturing sector is generally uncompetitive on world markets and is geared toward domestic consumption. Russia's reliance on commodity exports makes it vulnerable to boom and bust cycles that follow the volatile swings in global prices. The economy, which had averaged 7% growth during 1998-2008 as oil prices rose rapidly, was one of the hardest hit by the 2008-09 global economic crisis as oil prices plummeted and the foreign credits that Russian banks and firms relied on dried up. Slowly declining oil prices over the past few years and difficulty attracting foreign direct investment have contributed to a noticeable slowdown in GDP growth rates. In late 2013, the Russian Economic Development Ministry reduced its growth forecast through 2030 to an average of only 2.5% per year, down from its previous forecast of 4.0 to 4.2%. In 2014, following Russia's military intervention in Ukraine, prospects for economic growth declined further, with expectations that GDP growth could drop as low as zero.

### **Agriculture - products:**

grain, sugar beets, sunflower seed, vegetables, fruits; beef, milk

### **Industries:**

complete range of mining and extractive industries producing coal, oil, gas, chemicals, and metals; all forms of machine building from rolling mills to high-performance aircraft and space vehicles; defense industries including radar, missile production, and advanced electronic components, shipbuilding; road and rail transportation equipment; communications equipment; agricultural machinery, tractors, and construction equipment; electric power generating and transmitting equipment; medical and scientific instruments; consumer durables, textiles, foodstuffs, handicrafts

### **Exports:**

country comparison to the world: 9

### **Exports - commodities:**

petroleum and petroleum products, natural gas, metals, wood and wood products, chemicals, and a wide variety of civilian and military manufactures

### **Exports - partners:**

Netherlands 12.2%, China 6.4%, Italy 5.6%, Germany 4.6%, Poland 4.2% (2011)

**Imports:**

country comparison to the world: 16

**Imports - commodities:**

machinery, vehicles, pharmaceutical products, plastic, semi-finished metal products, meat, fruits and nuts, optical and medical instruments, iron, steel

**Imports - partners:**

China 15.5%, Germany 10%, Ukraine 6.6%, Italy 4.3% (2011)

**Banking**

Despite improvement over the last several years, the Russian banking system is still evolving in terms of being able to meet the capital and credit needs of a rapidly growing and dynamic market economy. However, while the banking services available from Russian banks is still limited compared to what is available in the U.S., a company doing business in Russia can access an expanding range of basic services offered by a larger commercial bank.

The Russian banking sector is highly segmented, with the top five banks controlling 48% of assets. There are over 1000 banks in Russia; 80 are 100% foreign-owned. The number of small banks is gradually decreasing due to insolvency and consolidation. The top two banks, Sberbank (controlled by the Central Bank) and VTB (controlled by the government), together own about one-third of the banking sector assets in Russia. The Russian government has approved a list of 11 state-controlled companies whose stakes are to be privatized in 2011-2013, which includes Sberbank and VTB. This mass privatization began with the sale of a 10% stake in VTB for \$3.3 billion in February 2011.

**Stock Exchange**

Russia's two main stock exchanges are in Moscow: (1) the [Russia Trading System \(RTS\)](#), and (2) the equity trading floor on the [Moscow Interbank Currency Exchange \(MICEX\)](#). Trading volume is largely dominated by large oil and gas companies such as Gazprom, Rosneft, and Lukoil. Trading activity at Russia's other exchanges, such as the Moscow Stock Exchange and several regional centers, is low. Some large Russian companies choose to list their stock in London and elsewhere abroad in order to obtain higher valuations.

The Law on the Securities Market includes definitions of corporate bonds, mutual funds, options, futures, and forwards. Companies offering public shares are required to disclose specific information during the placement process, as well as on a quarterly basis. In addition, the law defines the responsibilities of financial consultants who assist companies with stock offerings and holds them liable for the accuracy of the data presented to shareholders.

Russian financial authorities are attempting to deepen the ruble-denominated domestic debt market to make it more attractive to foreign investors. In December 2011, the Central Bank issued a resolution allowing, effective January 1, 2012, government bonds ("OFZ"s) to be traded outside Russian exchanges (over the counter). Currently, foreign investors wanting to trade domestic bonds must set up local brokerage and custody accounts, a lengthy process that discourages many investors from buying OFZs. Additionally, in October 2012, the Federal Financial Markets Service granted Euroclear Bank, the world's largest settlement system for securities, access to the Central Securities Depository to offer post-trade services for Russian OFZs. The Russian Deputy Finance Minister expressed hope that Russian OFZs would begin trading via Euroclear by early 2013. Hostile takeovers are common in Russia among both foreign and local firms. Private companies' defenses to prevent hostile takeovers relate to all potential hostile takeovers, not just foreign ones.

### Executive Summary

Russia's annexation of Crimea in March 2014 is not recognized by the U.S. government and led to the placement of USG sanctions on various Russian government officials and a limited number of entities, as well as the imposition of stricter licensing controls on certain products exported to Russia. Policy discussions with the Russian government regarding measures to increase bilateral trade and investment ties and in multilateral forum such as the G8 were also halted in the aftermath of Russia's illegal actions in Ukraine.

The government of Russia continues to express interest in attracting higher levels of domestic and foreign investment. Looking to domestic investment, the Russian Government has established a number of regulations which penalize Russian individuals and firms for investing abroad, in part possibly to offset lower levels of foreign direct investment in Russia during 2014. As detailed below, the Russian Government has worked actively on the technical level to improve the business and investment climate. Despite numerous new programs and initiatives, progress has been uneven and the government has yet to take action to make much needed overall structural reforms. Russian government officials have publicly and privately expressed their desire for foreign investment and technology transfer. At the same time, the government continues to limit foreign investment in "strategic" sectors and by maintaining control over half of Russia's GDP through state-owned enterprises.

American firms seeking to invest in the Russian Federation should be aware that the Russian investment climate continues to be marked by high levels of corruption and political risk, making thorough due diligence and good legal counsel essential for any potential investment. A variety of regulations also require Russian government approval for foreign firms to invest in "strategic sectors" and, in some cases, ban majority foreign ownership. The Russian legal system and jurisprudence is improving but recent changes in the structure of the Russian high court have cast doubts on its ultimate autonomy. Given Russia's continued actions in Ukraine, additional sanctions from the international community cannot be ruled out, which could have effects on potential investments. Additionally, senior Russian government officials have threatened that they could retaliate against sanctions, although they have not specified in what manner.

### 1. Openness to, and Restrictions Upon, Foreign Investment

Russia's annexation of Crimea in March 2014 is not recognized by the U.S. government and led to the placement of USG sanctions on various Russian government officials and a limited number of entities, and the postponement of key bilateral and multilateral engagement on economic reforms. The United States announced the first round of sanctions against influential Russian government officials and entities in early March and has added additional names to the sanctions list on subsequent occasions. Policy discussions with the Russian government regarding measures to increase bilateral trade and investment ties were also halted in the aftermath of Russia's illegal actions in Ukraine.

In late March, Senator Andrei Klishas of the Federation Council, the upper chamber of Russia's national legislature, said the Council plans to draft legislation which would allow the confiscation of property, assets, and accounts of American and EU companies, including

private companies, as a retaliatory measure on possible sanctions from the U.S. and EU. While no specific legislation has been proposed or passed, such an announcement clearly adds an additional element of uncertainty to any investment prospect in Russia because it would signal the willingness of the Russian government to violate national and international norms when it finds it to be politically expedient.

However, the government of Russia continues to express interest in attracting higher levels of domestic and foreign investment by private companies. Looking to domestic investment, the Russian Government has established a number of regulations which penalize Russian individuals and firms for investing abroad, possibly to offset lower foreign direct investment in Russia during 2014. It is unclear what success this policy initiative, called “de-offshorization” by President Putin, has had to date. In the first quarter of 2014, capital outflow from Russia reached approximately \$63.7 billion, the highest quarterly outflow since the last quarter of 2008 during the height of the global financial crisis.

As detailed below, the Russian Government has also worked actively on the technical level to improve the business and investment climate. Despite numerous new programs and initiatives, progress has been uneven and the government has yet to take action to make much needed structural reforms.

Russia's illegal annexation of Crimea has dampened growth prospects for the Russian economy. The International Monetary Fund predicts the Russian economy will grow by a sluggish 0.2 percent in 2014. Given the uncertainty surrounding Russia's actions in Ukraine, the World Bank provided two estimates for GDP in 2014. The low risk scenario anticipates 1.1 percent GDP growth and the high risk scenario anticipates a contraction of 1.8 percent for 2014. Russia finished 2013 with 1.3 percent growth, the lowest rate since the 2009 financial crisis and well under half of the 3.6 percent the Russian government forecasted at the beginning of the year. Russia's economy continues to be particularly vulnerable to fluctuations in global energy prices and continued weakness in the European economy, as the EU represents more than 50 percent of Russia's total trade volume. According to the United Nations Conference on Trade and Development (UNCTAD) Global Investment Trends Monitor from January 2014, FDI inflow into Russia jumped 83 percent to \$94 billion in 2013 from \$51 billion in 2012.

Russian government officials have repeatedly stressed that foreign investment and technology transfer are critical to Russia's economic modernization. At the same time, the government continues to limit foreign investment in sectors deemed to have strategic significance for national defense and state security via the Strategic Sectors Law of 2008. The law originally specified 42 activities and has since been amended on five separate occasions. As of April 2014, 45 activities require government approval for foreign investment. Foreign investors wishing to increase or gain ownership above certain thresholds need to seek prior approval from a government commission headed by Russia's Prime Minister. While the Commission has approved 129 of 137 applications for foreign investment since 2008, the number of transactions approved with conditions has been increasing significantly.

Russia continues to promote the use of high-tech parks, special economic zones and industrial clusters which offer additional tax and infrastructure incentives to attract investment. One of President Putin's stated goals, to move Russia from 120<sup>th</sup> (in 2010) to 20<sup>th</sup> on the World Bank's Doing Business Index by 2020, saw progress with Russia climbing to 92<sup>nd</sup> in

the 2014 publication. It will likely climb in the ranks again due largely to improvements in obtaining a connection to electricity for new businesses and in the ease of registering a business.

Russia's policy to foster innovation continues but the enthusiasm and funding for this policy appears to be waning. The flagship project, the Skolkovo Innovation Center, was designed to be the Russian equivalent of Silicon Valley and has been assured funding through 2015 with future funding uncertain. Roughly a dozen American firms have made sizable commitments to investment in the tech park portion of the project and the Massachusetts Institute of Technology continues to run a multi-million dollar program with Skolkovo Institute of Science and Technology (SkolTech) to design educational curricula and research programs, innovation activities, administrative policies and structures, recruiting processes, and campus operations and infrastructure. So far, tangible results from the project have been modest. On top of this, in 2013, the Skolkovo Foundation, which runs the endowment portion of the project, faced accusations of corruption though no case was ever brought to court. In early 2014 the Russian government announced a new initiative to create an innovation center on Russky Island in Vladivostok. It remains to be seen if this latest project will yield results.

While a legal structure exists to support foreign investors, the laws are not always enforced in practice. The 1991 Investment Code and 1999 Law on Foreign Investment guarantee that foreign investors enjoy rights equal to those of Russian investors, although some industries have limits on foreign ownership (see Establishment section). Russia has sought to enhance consultation mechanisms with international businesses (for example through the Foreign Investment Advisory Council whose members are CEOs of large companies) regarding the impact of the country's legislation and regulations on the business and investment climate. In June 2012, President Putin created the position of Ombudsman for Entrepreneur's Rights, which was designed to be an additional measure of protection and advocacy for entrepreneurs, and the relevant implementation legislation was signed into law by President Putin on May 7, 2013. Still, the country's investment dispute resolution mechanisms remain a work in progress, and at present can seem non-transparent and unpredictable (see Dispute Settlement section).

The government continues to hold significant blocks of shares in many privatized enterprises with state-owned enterprises (SOEs) accounting for approximately 50 percent of Russia's GDP in 2013. In June 2013, the Russian government unveiled its 2014-2016 Privatization Plan, the most recent update of Russia's original privatization plan that was drafted in 2010 and amended in 2012. However, the government has taken little action to implement additional privatizations, arguing current valuations for SOEs are too low to justify proceeding with a privatization. The new plan significantly rolled back the scope of privatizations and involves, to a large extent, the Russian government maintaining "golden shares" in some of the most prestigious SOEs. To date, treatment of foreign investment in new privatizations has been inconsistent: foreign participation has often been confined to limited positions in the companies. Subsequently, many have faced problems with inadequate protection for minority shareholders and corporate governance. Potential foreign investors are advised to work directly and closely with appropriate local, regional, and federal agencies that exercise ownership or authority over companies whose shares they may want to acquire. (See State-Owned Enterprises)

In September 2012, the United States and Russia signed a new bilateral visa agreement which extended the validity of a tourist visa to 36 months for both American and Russian travelers. This agreement also reduced the documentary requirements for Americans applying for a visa and eliminated the need for an invitation letter in some cases. The process for the approval and renewal of visas and residence permits for foreign businessmen and investors remains cumbersome with numerous documentary requirements. Additionally, there are regulations in specific industries that require a certain percentage of staff be Russian citizens, which may have a negative impact on foreign investors. The situation is improving, however. As part of Russia's efforts to encourage investment in innovative sectors, the GOR has eased the regulations on visas and residence permits for "highly-skilled" workers, and eliminated yearly quotas for foreign workers who fall into this category (defined by salary, position and education level). Potential investors are advised to consult the [State Department's Country-Specific Information on travel to Russia](#), which includes the latest information on Russian visas.

Corruption remains a major challenge for Russia. Targeted efforts in 2012 to root out corruption by public officials and within business transactions led to widely-reported investigations in the Ministry of Defense and the Ministry of Agriculture. Russia's ranking improved six spots to 127<sup>th</sup> in Transparency International's 2013 Corruption Perceptions Index (CPI). The National Anti-Corruption Plan for 2012–2013 contains guidance and recommendations for the government on counteracting corruption, including the establishment of a legal framework for lobbying and increasing the transparency of state officials' personal finances and acceptance of gifts. Specifically, the bill requires all civil servants to declare large expenditures or face termination. These officials must also present information on the expenditures of their spouses and children if the expenditures involve acquisitions of land, vehicles or securities. Expenditures that do not match the declared income will be investigated by law enforcement agencies. If an individual fails to prove that the property in question was acquired legally, the property will be confiscated and turned over to the state. Bribing a public official has been illegal in Russia since May 2011 (see Corruption section).

### **Global Benchmarks**

The following table includes the most recent data from indices measuring the investment and business climate in Russia:

<b>Measure</b>	<b>Year</b>	<b>Index/Ranking</b>
Transparency International Corruption Index	2013	127 of 175 countries
Heritage Economic Freedom	2013	140 of 184 countries, "Mostly Unfree"
World Bank Doing Business	2014	92 of 185 economies
Trade Policy	2013	74.6 out of highest score of 100

(Heritage Economic Freedom)		
Starting a Business (World Bank Doing Business)	2014	88 of 189 economies
Land Rights Access (World Bank Doing Business)	2014	Construction Permits: 178 of 189 economies
Freedom Rating (Freedom House)	2014	Registering Property: 17 of 189 economies 5.5 out of 7 (scale of 1-7, 1 being the best) Status: Not Free Political Rights: 6 Civil Liberties: 5

## 2. Conversion and Transfer Policies

While the ruble is the only legal tender in Russia, companies and individuals generally face no significant difficulty in obtaining foreign exchange. Only authorized banks may carry out foreign currency transactions but finding a licensed bank is not difficult. According to currency control laws, the Central Bank retains the right to impose restrictions on the purchase of foreign currency, including the requirement that the transaction be completed through a special account. The Central Bank does not require security deposits on foreign exchange purchases. Russia has no capital controls and there are no barriers to remitting investment returns abroad, including dividends, interest, and returns of capital. Nonetheless, investors should seek expert advice at the time of an investment.

Currency controls exist on all transactions that require customs clearance, which in Russia applies to both import and export transactions and certain loans. A business must open a "deal passport" with the authorized Russian bank through which it will receive and service the transaction or loan. A "deal passport" is a set of documents that importers and exporters provide to authorized banks which enable the bank to monitor payments with respect to the transaction or loan and to report the corporation's compliance with currency control regulations to the Central Bank. Russia's regulations regarding deal passports are prescribed under Instructions of the Central Bank of Russia number 117-I of June 15, 2004. In early 2011, the Central Bank of Russia expanded the list of grounds under which a deal passport does not have to be submitted. On June 4, 2012, the Central Bank issued Instruction number 138-I, which introduced some changes to the regulation. In particular, an authorized bank is no longer required to submit additional documentation if the authorized bank is debiting money for a currency operation from an existing bank account of a resident or non-resident. In case of multilateral agreements with multiple parties and participation of non-residents, only one resident deal participant is obligated to execute a deal passport for this agreement rather than all resident parties being required to submit documentation. The Central Bank further amended the regulation by issuing Directive number 3016-U of June 14, 2013, which came into effect in the fall of 2013. A deal passport is now needed only if the value of the underlying contract is equal to or exceeds the equivalent of \$50,000.

### **3. Expropriation and Compensation**

The 1991 Investment Code prohibits the nationalization of foreign investments, except following legislative action and where deemed to be in the national interest. Such nationalizations may be appealed to Russian courts, and the investor must be adequately and promptly compensated. At the sub-federal level, expropriation has occasionally been a problem, as has local government interference and a lack of enforcement of court rulings protecting investors. Some Russian parliamentary deputies suggested in March 2014 that Russia might expropriate Western firms in reaction to U.S. and EU sanctions but there has been no government action to that end.

### **4. Dispute Settlement**

Russia has a body of conflicting, overlapping, and frequently changing laws, decrees and regulations, which complicates the environment for dispute resolution. Independent dispute resolution in Russia can be difficult to obtain since the judicial system is still developing. Courts are sometimes subject to political pressure. According to numerous reports, corruption in the judicial system is widespread and takes many forms, ranging from bribes of judges and prosecutors to fabrication of evidence. However, corruption likely does not play a role in the vast majority of cases, most of which involve relatively low stakes.

Until mid- 2014, Russia will continue to have two parallel court structures: one, which is specialized in commercial cases and known as the Arbitrage Courts, answers to the Higher Arbitrage Court and a second criminal and civil court system that answers to the Russian Supreme Court. At the end of June 2014, the Higher Arbitrage Court will be eliminated and the lower arbitration courts will thereafter answer to the Russian Supreme Court. Many in the business community have expressed concern about this change, as the Arbitrage Courts have been known for their professionalism and reputation for judicial independence (although they were not completely free from corruption). The process of appointment to the Higher Arbitrage Court – done via regional structures and not federal structures – also was more independent from the centralization of power in the Russian government. When this change is implemented, the legal chain for the lower arbitration courts will run through to the Supreme Court, which consists of federally-appointed judges who are widely believed to pay particularly keen attention to the wishes of the Kremlin. It is too early to tell if these changes will make it more difficult for foreign investors to receive independent dispute resolution under this new system. It is also unclear how the elimination of the Higher Arbitrage Court will affect the existence of the lower arbitration courts. No indication was given if these specialized courts will also eventually be eliminated at the lower levels. However, it is clear that the level of judicial independence of the courts will have been reduced.

In an attempt to address some of these challenges facing the business community, the GOR created the Office of the Ombudsman for Entrepreneur Rights in 2012 which is headed by Boris Titov, a businessman and former Chairman of the business group Delovaya Rossiya. Titov's remit includes advocating for foreign and domestic business rights in court and requesting suspension of official actions if a business feels its rights were violated. Each Russian Federal District also has an Investment Ombudsman who reports to the national Ombudsman and oversees efforts to improve the business climate, including the protection of foreign and domestic investors. The government has also encouraged international business leaders, as part of their work in the Foreign Investment Advisory Council, to

participate in the discussion of dispute resolution mechanisms and individual commercial disputes. While these steps offer some promise, overall, the country's investment dispute mechanisms remain underdeveloped and largely non-transparent.

In 2008, then-President Medvedev carried out a series of legal reforms that aimed to reduce corruption in the courts. These measures included a law that requires judges to disclose their income and real estate assets, including those owned by their spouses and minor children. Another component included a series of amendments to the Code of Criminal Procedure – in 2008, 2009, and 2010 – to limit pre-trial detention of individuals accused of economic crimes. Implementation of these reforms has yielded mixed results. Prosecutors have sometimes avoided them by charging defendants under articles technically not covered by the amendments and judges have sometimes refused to apply them. Nevertheless, available statistics reveal a substantial decrease in the number of pre-trial detentions in cases involving economic crimes since the legislation was passed. In June 2013, President Putin announced plans for a widespread amnesty for those convicted of economic crimes. However, by year's end, only a relatively small number of persons had been released under this program.

Commercial arbitration courts are required by law to decide business disputes relatively quickly, and many cases are decided on the basis of written evidence and little or no live testimony of witnesses. The arbitration court workload is dominated by relatively simple non-contentious cases involving the collection of debts between firms and disputes with the taxation and customs authorities, pension fund, and other state organs. Tax-paying firms often prevail in their disputes with the government in court. The number of routine cases limits the time available to decide more complex cases. The court system has special procedures for the seizure of property before trial, such that it cannot be disposed of before the court has heard the claim, as well as for the enforcement of financial awards through the banks. Many observers believe that over the twenty year period that the arbitration court system has existed, its judges have grown more competent and better at writing decisions. Many lawyers nonetheless report that due to insufficient training, especially in complex business disputes, many judges often make poorly reasoned or simply incorrect decisions. As with international arbitral procedures, the weakness in the Russian arbitration system lies in the enforcement of decisions. Few firms pay judgments against them voluntarily and rumors of corruption concerning bailiffs, who are charged with enforcing decisions, are frequent, although hard evidence is scarce.

Federal Law 262, in effect since 2010, requires courts to publish their decisions online and otherwise make information about their activities publicly available. All Russian courts now have websites, which generally include a schedule of cases to be heard, the name of the judge, the location of the court, form documents that can be used by prospective litigants, and copies of decisions. Personal information is expunged before case decisions are posted online. The better of these court websites allow citizens to calculate filing fees and search for analogous decisions. The arbitration courts have played a leadership role in providing information online and using information technology. Electronic filing allows citizens to sign up to receive e-mail notifications of developments in cases of interest to them. NGOs have rated the compliance of courts with their obligations under the law and found that the information provided varies greatly in quality from one region to another, but have noted a willingness by some courts to respond to queries and criticisms by improving their sites.

Although there are gaps and failures to provide information, overall judicial transparency has increased since the law took effect in 2010.

Many attorneys refer Western clients who have investment or trade disputes in Russia to international arbitration in Stockholm or to courts abroad. A 1997 Russian law allows foreign arbitration awards to be enforced in Russia, even if there is no reciprocal treaty between Russia and the country where the order was issued. Russia is a member of the International Center for the Settlement of Investment Disputes (ICSID) and accepts binding international arbitration. Russia is also a signatory to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (UNCITRAL). However, international arbitral awards still require Russian courts to enforce awards and bailiffs to attach assets; these courts have yet to become consistently effective enforcers of court judgments, whether domestic or international.

In January 2011, a new law took effect that authorizes the use of mediation in various kinds of disputes, including commercial ones, and provides for the confidentiality of mediation proceedings and for their enforceability in court. Although there are still issues concerning implementation, this represents an important step towards further development of alternative dispute resolution in Russia.

According to a Federal Law of December 2011, a specialized court for intellectual property (IP) disputes began to function in 2013. This court, embedded in the system of arbitration (commercial) courts, will hear cases on intellectual property rights (IPR), including those challenging statutory instruments on IP, in the first instance and cassation. In September 2012 the Higher Qualification Board of Judges (a body within the Russian judicial corps responsible for nominating judges to be further appointed by the President) nominated 20 judges to form the new IPR Court, and the Chief Judge of the IPR Court was appointed by the President in December 2012. The elimination of the Higher Arbitrage Court has now raised doubts about how the decisions of the IP Court will be reviewed.

The IP Court has reportedly adjudicated around 360 cases as a trial court, and over 200 cases as the court of the 3rd instance (second level of appeal) out of over 900 suits admitted to the court since it started operation in July 2013. Several legal experts and litigation practitioners have cited the good quality of its dispute resolution, the high qualification of its judges and the good attention to detail in the court.

## **5. Performance Requirements and Incentives**

Performance requirements are not generally imposed by Russian law and are not widely included as part of private contracts in Russia. However, they have appeared in the agreements of large multinational companies investing in natural resources and in production-sharing legislation. There are no formal requirements for offsets in foreign investments. Since approval for investments in Russia frequently depends on relationships with government officials and on a firm's demonstration of its commitment to the Russian market, this may result in offsets in practice.

The Central Bank of Russia has imposed caps on foreign employees in foreign banks. The ratio of Russian employees in a subsidiary of a foreign bank is set at no less than 75 percent; if

the executive of the subsidiary is a non-resident, at least 50 percent of the bank's managing body should be Russian citizens.

In early 2014, the Russian government drafted a directive requiring all state-controlled assets including SOEs to come up with a series of key performance indicators (KPIs) to guide their development strategy going forward. In rolling out the initiative, the government made it clear that if KPIs were not met, personnel changes would be made. This measure is meant to push state corporations toward a more efficient operating strategy. The Russian government also declined to increase the size of the government budgetary subsidies to each state corporation, with a view to forcing these companies to run more efficiently.

## **6. Right to Private Ownership and Establishment**

Both foreign and domestic legal entities may establish, purchase, and dispose of businesses in Russia, except in certain sectors that are regarded as affecting national security. There is a blanket ban on purchases of property in border areas for national security reasons. Some Russian Duma deputies called for a ban on foreigners purchasing land without the permission of the Federal Management Service, but no legislative action has been taken in this regard yet.

The Russian government limits foreign investment in sectors deemed to have strategic significance for national defense and state security via the Strategic Sectors Law of 2008 (Law No. 57-FZ). The law has been amended on four occasions, most recently in February 2014. The law currently specifies 45 strategic activities that require government approval for foreign investment. Foreign investors wishing to increase or gain ownership above certain thresholds in any of the sectors listed need to seek prior approval from a government commission headed by Russia's Prime Minister. In 2012 (most recent information published), the Russian government considered 44 petitions from foreign investors of which 22 were pre-approved, 18 were returned to the petitioner for additional information, and four were withdrawn. The government denied in April 2013 a petition from the U.S. company Abbott Laboratories to purchase Russia's Petrovax in a deal that was strongly supported by Petrovax. Russia also established via Executive Order No. 1009 of August 4, 2004 a separate list of strategic companies which includes the largest and most profitable Russian companies. Companies identified on this list have some level of government ownership; the Executive Order sets forth the requirements to privatize these firms. The 2012 addition of Russian privately-held internet company Yandex to the strategic companies list highlights the broad interpretation of what is required to protect state security and national defense.

### **Real Estate**

The Constitution and a 1993 presidential decree give Russian citizens rights to own, inherit, lease, mortgage, and sell real property. Foreigners enjoy similar rights with certain restrictions, notably with respect to the ownership of farmland and areas located near federal borders. Mortgage legislation enacted in 2004 facilitates the process for lenders to evict homeowners who do not stay current in their mortgage payments. Thus far, this law has been successfully implemented and is generally effective. Mortgage lending is in its initial stages, and after a sharp contraction in 2008-09, the total value of mortgages in Russia is around three percent of GDP. In 2013, mortgage lending grew by 31 percent compared to 2012, with new issuances amounting to \$42.5 billion in 2013.

## **7. Protection of Property Rights**

In Russia, the protection of intellectual property rights (IPR) is enforced on the basis of civil, administrative, criminal or customs legislation. The Civil Code sets up the statutory damages for IPR infringement and/or incurred damages for copyright, trademarks and geographical indications. The Code of Administrative Offenses concerns IPR infractions that violate public or private interest or rights, but do not meet the criteria of the Criminal Code. An administrative investigation may be initiated at the request of an IPR owner or by law enforcement authorities (police or customs) suspecting possible IPR infringement. Administrative cases are dealt with by general jurisdiction courts or state arbitration (commercial) courts that have jurisdiction over economic disputes. The IPR provisions of the Criminal Code apply to large-scale infringements of copyright, patent and trademark rights that cause gross damages, as defined by the Criminal Code.

### **Enforcement**

The United States Government has expressed concerns that IPR enforcement continued to decrease overall in 2013, following a dramatic decline in 2012, and remained plagued by a lack of transparency and effectiveness. Stakeholders express concern about the manufacture, transshipment, and retail availability of counterfeit goods, including counterfeits of agricultural chemicals, electronics, information technology, auto parts, consumer goods, machinery and other products. Enforcement actions combatting end user piracy have sharply declined, including a decrease in raids, initiations of criminal cases and issuances of court verdicts.

Copyright violations (audiovisual and sound recordings, computer software) remain a serious problem, particularly in the online environment. Although dwarfed in volume by pirated products online, legitimate DVD sales are on the rise, thanks in part to cheaper legitimate products, a growing consumer preference for high quality goods, and law enforcement action against physical piracy. Russian police on occasion carry out end-user raids against businesses using pirated products, namely software. However, at times, police have used IPR enforcement as a tactic to elicit bribes or harass NGOs.

For additional information about treaty obligations and points of contact at local IP offices, please see WIPO's country profiles at <http://www.wipo.int/directory/en/>.

Embassy point of contact: William Muntean [moscow.office.box@mail.doc.gov](mailto:moscow.office.box@mail.doc.gov)

Local lawyers list: <http://moscow.usembassy.gov/root/pdfs/list---attorneys.pdf>

### **Bankruptcy**

Russia has had a law providing for bankruptcy of enterprises since the early 1990s. Law enforcement officials, however, tend to view bankruptcy with suspicion and reported 500 cases of financial crimes involving bankruptcy in 2011. In November 2012, the State Duma passed in its first reading (three readings are required for passage) a personal bankruptcy bill, but the bill has not been adopted. The bill states that a citizen who finds himself in financial difficulty can submit a bankruptcy statement to the court. The court may then grant the individual the right to pay the debt in installments for a term of up to five years. An individual with debts exceeding 50,000 rubles (\$1,389) and whose arrears amount to three months can

be declared bankrupt. In this case, the individual cannot apply for a bank loan without citing his bankruptcy for the five years after his bankruptcy status was declared. The individual is then given six months to come up with a debt restructuring plan subject to the approval of both the creditors and the court. Once the plan is approved, all late payment fees and penalties will be waived and assets unfrozen. Only in the case of a person who has no assets and no income may the debt be completely written off. The bill also stipulates a ban on declaring oneself bankrupt more than once in five years. The Duma is expected to consider the bill in the first half of 2014.

## **8. Transparency of the Regulatory System**

Russia's legal system remains in a state of flux, with various parts of the government continuing to implement new regulations and decrees on a broad array of topics, including the tax code and requirements related to regulatory and inspection bodies. Negotiations and contracts for commercial transactions, as well as due diligence processes, are complex and protracted. Investors must do careful research to ensure that each contract fully conforms to Russian law. In some cases, Russian law has contradictory provisions. Contracts must likewise seek to protect the foreign partner against contingencies that often arise. Keeping up with legislative changes, presidential decrees, and government resolutions is a challenging task. Uneven implementation of laws creates further complications; various officials, branches of government, and jurisdictions interpret and apply regulations inconsistently and the decisions of one may be overruled or contested by another. As a result, reaching final agreement with local political and economic authorities can be a long and burdensome process. Companies should be prepared to allocate sufficient funds to engage local legal counsel to set up their commercial operations in Russia.

### **Taxes**

Russia's tax system has recently undergone major changes. The Russian government has brought its tax legislation into line with OECD requirements, which has simplified the system and prevents double taxation on transfer prices. However, businesses continue to raise concerns regarding audits. Multiple audits, repeated requests for documentation, and technical weaknesses of some claims have been identified as serious impediments to the conduct of business. Russia's Law on Transfer Pricing entered into force on January 1, 2012, and fully phased in all provisions by the start of 2014. Some experts caution the new provisions could result in additional disputes with the tax authorities.

### **Public Comment**

All draft laws that go through the Russian Duma are published on the Duma's website. Sometimes, but not consistently, ministries and other Russian government bodies also publish proposed legislation (including draft laws, government decrees and regulations) on their websites. The scope of Russia's Open Government initiative was severely reduced after the Russian government announced in May 2013 that it would no longer be a part of the international Open Government Partnership due to unspecified differences regarding the terms of the partnership. In a statement announcing the decision, Kremlin spokesperson Dmitry Peskov said that Russia remained committed to providing more transparency in government and might reconsider joining the partnership at a later date. Russian Ministries have become more active in seeking input from industry experts and business groups,

including the Foreign Investment Advisory Council, when developing business-related laws and regulations.

### **Strategic Sectors**

Statements made by key Russian officials in November 2012 suggest the government will take additional action to roll back administrative barriers to foreign investment in Russian strategic companies. The Federal Antimonopoly Service (FAS) has prepared various amendments, still awaiting approval by the State Duma, intended to simplify the procedures for state supervision of foreign investment in Russian strategic companies and to eliminate ambiguities in the interpretation and application of existing legislative provisions. The proposed amendments include the following: (1) removal of food and beverage production from the list of strategic activities involving the use of infectious agents (e.g., cultured bacteria in yogurt production). FAS is considering similar revisions to exempt certain entities involving selected activities (e.g., foreign banks vis-a-vis distribution and servicing of encryption devices required for their operations); (2) eliminating the need for prior approval by the Government Commission for certain share increases or transactions in cases where the foreign investors hold 75 percent or more of a Russian strategic company's shares; (3) eliminating the need for prior approval for intra-group transactions by foreign investors controlled by the same entity; (4) allowance of automatic permit extensions for foreign investors already holding a permit (typically with a 2-year term) to invest in a strategic enterprise; (5) elimination of the need for government approval for acquisitions by Russian-controlled purchasers from foreign-controlled sellers (currently, only Russian-to-Russian transactions are exempt, but not acquisitions by Russian-controlled purchasers from foreign-controlled sellers); (6) clearer rules on state supervision and approval of transactions involving the placement of securities of Russian strategic companies (including depositary receipts) on stock exchanges, including foreign stock exchanges. However, it is unclear if and when such proposals would be advanced in the current economic and political climate.

### **9. Efficient Capital Markets and Portfolio Investment**

Banks continue to make up a disproportionate share of Russia's financial system. Although Russia has roughly 900 banks, the sector is dominated by state-owned banks, particularly Sberbank and VTB. The six largest banks (in terms of assets) in Russia are state-controlled, and the top five held 53.7 percent of all bank assets in Russia as of March 1, 2014. The growing role of the state in the banking sector continues to distort the competitive environment, impeding Russia's financial sector development. The successful implementation of the Deposit Insurance System in 2004 has proved a critical psychological boon to the banking sector, reflected in the overall growth of deposits. This has significantly enhanced the stability of the banking sector's deposit base. At the beginning of 2014, aggregate assets of the banking sector amounted to 86.0 percent of GDP and aggregate capital was 10.6 percent of GDP. Russia's banking sector has recovered from the global economic crisis, with corporate loan growth reaching 17.0 percent and retail loan growth 27.4 percent in the 12 months running up to March 1, 2014. The share within Russia's banking sector of non-performing and troubled loans (categories III-V), which during the 2008-2009 financial crisis increased substantially, stabilized in 2010 at around 20% and began to slowly decline in the second half of 2011, so that as of March 1, 2014, it was equal to 14.0 percent. These positive

trends notwithstanding, Russian banks reportedly still operate on short time horizons, limiting capital available for long-term investments.

On September 1, 2013, the Central Bank of Russia became the consolidated financial markets regulator (replacing the Federal Financial Markets Service) for Russia's capital markets and financial institutions. Whereas the Central Bank previously had primary responsibility for banks, the new Financial Markets Service of the Bank of Russia, the so-called mega-regulator, has responsibility for other non-bank financial institutions including pension funds, insurance companies, and asset management companies, as well as the securities markets. Consolidated supervision is expected to improve overall regulation and oversight of the capital markets.

Along these lines, the Central Bank has closed down a growing number of banks in recent months as part of a crackdown on the banking sector, as the Central Bank attempts to tighten oversight of banks and rein in shadow banking activity. The Central Bank revoked licenses for 54 banks from June 2013 through March 2014, with many banks cited for violating anti-money laundering or countering the financing of terrorism (AML/CFT) laws. This effort is succeeding in not only much needed banking sector consolidation, but also in weeding out bad banks that have been complicit in money laundering and facilitating the so-called "grey transactions" that have been part of capital outflows from Russia.

To fill the gap in capital available for long-term investments, authorities have also sought to improve the regulatory environment for non-bank institutional investors. This has had some success, though non-bank financials remain small relative to the size of the financial sector. Pension funds are viewed as the most promising source of long-term capital. Pension funds have had strong inflows, in recent years, though they have shown little risk appetite, primarily investing in sovereign debt, corporate debt, and bank deposits, thus limiting their utility as a source of long-term capital. A recent decision by the government to freeze inflows to funded pensions has increased uncertainty, undermining confidence in the industry. The government plans to allow inflows to resume to private pension funds once they have been audited and restructured. This could bolster confidence in the industry over the long term.

Russia's two main stock exchanges – the Russian Trading System (RTS) and the Moscow Interbank Currency Exchange (MICEX) – merged in December 2011. The MICEX-RTS bourse conducted an initial public offering on February 15, 2013, auctioning an 11.82% share. Russian authorities and shareholders of MICEX and RTS believe the merged entity, now branded the Moscow Exchange, has the potential to become a global player. While most large Russian companies currently choose to list their stocks in London and elsewhere abroad, the Russian government has begun a campaign to encourage state-owned companies to use the Moscow Exchange as a vehicle for privatization.

The Law on the Securities Market includes definitions of corporate bonds, mutual funds, options, futures, and forwards. Companies offering public shares are required to disclose specific information during the placement process, as well as on a quarterly basis. In addition, the law defines the responsibilities of financial consultants who assist companies with stock offerings and holds them liable for the accuracy of the data presented to shareholders.

Russian financial authorities are attempting to deepen the ruble-denominated domestic debt market to make it more attractive to foreign investors. In December 2011, the Central Bank issued a resolution allowing, effective January 1, 2012, government bonds (OFZ) to be traded outside Russian exchanges (over the counter). In February 2013, Euroclear and Clearstream, two international securities depositories, began settling transactions of OFZ bonds, Russia's primary sovereign debt security. Euroclear and Clearstream have since also begun settling transactions of Russian corporate and municipal debt, and may soon be able to settle equity transactions as well, possibly by early 2015. This has increased access to Russian securities markets for foreign investors by negating the need to have onshore brokerage and custody accounts.

## **10. Competition from State-Owned Enterprises**

State-owned enterprises (SOEs) accounted for roughly half of Russia's GDP in 2013 and the Russian government's policy is for the most part focused on maintaining the status quo, rather than supporting competition. In June 2013, the Russian government unveiled their 2014-2016 Privatization Plan, the most recent update of Russia's original privatization plan that was published in 2010 and amended in 2012. The new plan rolled back previous commitments to fully privatize oil giant Rosneft, VTB bank, energy company Zarubezhneft and hydroelectric company Rushydro. Instead of selling all stakes in those companies by 2016 the Russian government will continue to own a 50.1 percent of each company, a "golden share." Plans for Russian Railways, the Russian Agricultural Bank and Rosagroleasing were also scaled back. However, a decision was made to fully privatize Rostelecom and a total of 431 enterprises were added to the block for privatization by 2016. Most of the sales involve selling off minority share positions, privatization through dilution of shares rather than divestment and retaining golden shares to maintain government veto power. To date, treatment of foreign investment in new privatizations has been inconsistent; at times, foreign participation has often been confined to limited positions. Subsequently, many have faced problems with inadequate protection for minority shareholders and corporate governance. Potential foreign investors are advised to work directly and closely with appropriate local, regional, and federal agencies that exercise ownership or authority over SOEs whose shares they may want to acquire.

### **Corporate Governance**

Due to the significance of SOEs within Russia's economy, corporate governance within those companies is a significant factor in Russia's economic growth. A specific variant of SOE, state corporations, are 100% owned by the Russian government and operate under special legislation. The Russian economy also features thousands of other companies owned in part or whole by the Russian government that operate under different legal arrangements, such as unitary enterprises and joint stock companies. In early 2014, the Russian government drafted a directive requiring all state corporations to come up with a series of key performance indicators (KPIs) to guide their development strategy going forward. In rolling out the initiative, the government made it clear that if KPIs were not met personnel changes would be made. This measure is aimed at pushing state corporations toward more efficient operating strategies. The Russian government also declined to increase the size of the government subsidy supporting each state corporation, also with the aim of forcing these companies to run more efficiently. Private enterprises are theoretically allowed to compete

with SOEs on the same terms and conditions, and in some sectors, including where state ownership is minimal, competition is robust. But in other areas the playing field can be tilted. Issues that hamper efficient operations and fair competition with SOEs include a lack of transparency, lack of independence and unclear responsibilities of boards of directors, misalignment of managers' incentives and company performance, inadequate control mechanisms on managers' total remuneration or their use of assets transferred by the government to the SOE, and minimal disclosure requirements.

## **SWFs**

There are two sovereign wealth funds in Russia: the Reserve Fund (\$87.46 billion, or 4.3% of GDP as of April 1, 2014, up from 3.9% of GDP as of April 1, 2013) and the National Wealth Fund (\$87.5 billion, or 4.3% of GDP as of April 1, 2014, up from 4.1% of GDP as of April 1, 2013). The Ministry of Finance manages both funds' assets in accordance with established procedures; the Central Bank of Russia acts as operational manager. Both funds are audited by Russia's Chamber of Accounts and the results are reported to the Federal Assembly. The Reserve Fund, at 4.3% of GDP, remains below the target of 7% of GDP and is, under currently loosening fiscal policy policies, expected to fall. In February 2014, the Finance Ministry announced plans to spend RUB 212.2 billion on FX purchases for the Reserve Fund. Since the beginning of the year, 38 billion rubles (\$1.1 billion) have been spent on currency purchases. The Ministry said that currency purchases for the country's Reserve Fund were tied to the position of the ruble within the currency's euro-dollar trading corridor. Due to the high volatility of the markets, triggered by the tensions around the situation in Ukraine and Crimea, the Ministry suspended such purchases March 4.

## **11. Corporate Social Responsibility**

While not standard practice, Russian companies are beginning to show an increased level of interest in their reputation as good corporate citizens. When seeking to acquire companies in Western countries or raise capital on international financial markets, Russian companies face international competition and scrutiny, including on corporate social responsibility (CSR) standards. Consequently, most large Russian companies currently have a CSR policy in place, or are developing one, despite the lack of pressure from Russian consumers and shareholders. CSR policies of Russian firms are usually published on corporate websites and detailed in annual reports. However, these CSR policies and strategies --are still in an early stage relative to those of Western counterparts. Most companies choose to create their own NGO or advocacy group rather than contribute to an already existing organization. The Russian government is a powerful stakeholder in the development of certain companies' CSR agendas, predictably, some companies choose to support local health, educational and social welfare organizations favored by the government.

The Federal Service for Financial Markets established a corporate governance code in 2002 and has endorsed an OECD White Paper on ways to improve practices in Russia. International business associations such as the American Chamber of Commerce in Russia, the U.S.-Russia Business Council, the Association of European Businesses in Russia, the International Business Leaders Forum, and Russian business associations, all stress corporate governance as an important priority for their members and for Russian businesses overall. One association, the Russian Union of Industrialists and Entrepreneurs, developed a Social

Charter of Russian Business in 2004 in which over 200 Russian companies and organizations have since joined.

## **12. Political Violence**

Political freedom has been significantly curtailed during the past year, including rising hostility toward almost all opposition media outlets and increasing harassment of non-governmental organizations. In the aftermath of Ukraine's EuroMaidan protest which led to the ouster of Kremlin-friendly Ukrainian President Viktor Yanukovich, the Russian government and Russian society as a whole has been gripped by nationalist rhetoric. Soviet-era phrases such as "national traitors" and the "fifth column," which for the Government refers to persons and groups within Russia which they regard as fomenting revolution on behalf of outside forces but in reality may include those opposed to government policy, have reappeared. It remains difficult to predict the next actions of the Russian government, ruled with increasing authoritarianism by President Putin. Political risk is arguably the biggest drag on the Russian economy through the end of 2014.

On the media front, in December 2013, RIA Novosti, the only remaining semi-independent Russian wire service, was abruptly dissolved and reorganized into a new organization to be called "Rossiya Segodnya." The new organization will take marching orders directly from the Kremlin and is charged with producing a specifically Russian view on world events. In early 2014, popular opposition-minded cable channel Dozhd was cut from every major cable and satellite network due to an internet poll that was deemed to be "unpatriotic." The channel continues to produce online content but retains only 20 percent of its original audience, and little advertising revenue without access to cable networks. In a call-in show in April, President Putin indicated a reprieve for the embattled channel but it is still unclear how much longer Dozhd will be able to continue to operate in its limited state.

Public protests continue to occur sporadically in Moscow though they are often disrupted by spur of the moment construction work at the protest site and heavy police presence. The most recent large-scale protest was in February 2014 when 30,000 persons took to the street to protest the illegal Russian annexation of Crimea. There have been smaller protests regarding media freedom and eCommerce issues in 2014 that drew a few thousand participants as well as protests in support of opposition politician Alexey Navalny, who has faced a variety of legal charges due to his activism. The Russian government has also been more inclined to use government-sponsored counter-protests to gain support for their actions. Counter protests in support of Russia's illegal annexation of Crimea drew less than 5,000, although the Russian media erroneously reported the participation figure as much higher.

Some individuals who took part in Moscow's Bolotnaya Ploshchad protest in May 2012 are currently serving jail sentences of up to 4 years for offenses including violence against police officers and participating in an unsanctioned rally. Opposition leaders insist that the individuals were arrested at random and their prosecution was meant to intimidate Russians and prevent future protest actions. Aleksey Navalny, anticorruption whistleblower and member of the opposition Coordination Council, was convicted in October 2013 of stealing \$500,000 worth of state-owned timber in a trial that was maligned by opposition leaders and international organizations as little more than a show trial. However, he was released and his five-year sentence was suspended so he could run in the Moscow mayoral elections. His

conviction and release resulted in large rallies in Moscow. He has since spent ten days in jail for participation in an unsanctioned rally and is currently under house arrest on a new set of trumped up fraud charges. Although the use of strong-arm tactics is not unknown in Russian commercial disputes, the U.S. Embassy is not aware of cases where foreign investments have been attacked or damaged for purely political reasons. Russia continues to struggle with an ongoing insurgency in Chechnya, Ingushetiya and Dagestan. These republics and neighboring regions in the northern Caucasus have a high risk of violence and kidnapping.

In yet another sign of the worsening civil rights situation in Russia, prominent economist and Rector of the New Economic School Sergei Guriev fled Russia in April 2013. He currently lives in exile in Paris. He has written extensively in the Western press regarding his decision, which was motivated primarily by increasing harassment by the Russian government for support of opposition politicians. He is only one of many examples of high-profile people who have fled Russia because they fear repercussions for holding opinions different from the government's.

The remaining two imprisoned members of the Russian punk rock group "Pussy Riot" were released on December 12, 2013 as a part of a Presidential amnesty to celebrate the 20<sup>th</sup> anniversary of the Russian constitution. Since their release they have been arrested and subsequently released for their participation in additional protest actions in Moscow and in Sochi, on the margins of the 2014 Winter Olympic Games. They have also been physically abused in public multiple times, with authorities refusing to press charges against their assailants despite video evidence of the crimes. Also released as a part of the amnesty was Russian oligarch Mikhail Khordorkovsky, who was convicted in 2005 of fraud in the controversial Yukos case and sentenced to nine years in prison. He was convicted on secondary charges in 2010 which extended his term to 2014 and a third case was in the process of being brought before the courts. Upon release, Khordorkovsky departed Russia for Germany and currently resides in Switzerland.

### **13. Corruption**

The Russian government stepped up its campaign against corruption in 2012. In March 2012, then-Russian President Medvedev adopted the National Anti-Corruption Plan for 2012–2013. The plan contained guidance and recommendations for the government, federal executive bodies and other government agencies on counteracting corruption, including the establishment of a legal framework for lobbying and increasing the transparency of state officials' personal finances and acceptance of gifts. Additionally, in 2012, Russia adopted a law requiring individuals holding public office, state officials, municipal officials and employees of state organizations to submit information on the funds spent by them and members of their families (spouses and underage children) to acquire certain types of property, including real estate, securities, stock and vehicles. The law also required public servants to disclose the source of the funds for these purchases and to confirm the legality of the acquisitions. In addition, the State Duma adopted a law in 2013 that required state officials, deputies, senators and governors to disclose information on their foreign property holdings and to close foreign bank accounts.

Speaking at the Russian General Prosecutor's Office on the occasion of the 291<sup>st</sup> anniversary of its establishment, Sergei Ivanov, Chief of the Presidential Administration, mentioned that in 2012, over 7,000 persons charged with corruption had received prison sentences and a greater number of corruption cases were initiated. One high level case led to the firing of

Defense Minister Anatoly Serdyukov, who was reportedly at the center of multiple corrupt schemes on a very large scale. However, after a year of investigation, no charges have been filed. Various reports in the media speculated that Serdyukov had been given amnesty, or alternatively, that the investigation had been limited to suspicious of negligence rather than more serious crimes. Failure to hold high government officials accountable for corruption sends a strong signal throughout the system that certain persons are untouchable and protected by the highest authorities. This phenomenon undermines the rule of law in Russia.

Indeed, a long-running dispute between the Russian Prosecutor General, Yuri Chaika, and the Chairman of the Investigative Committee, Alexander Bastrykin, flared up in the Spring 2014. Chaika publicly accused the Investigative Committee of being unwilling to handle serious corruption matters. However, even the General Procuracy has experienced public embarrassment on this issue, when Hewlett Packard Russia pleaded guilty in the United States in April 2014 to bribing Russian prosecutors ten years earlier in exchange for a computer systems procurement contract. Media reports suggested that Russia has not been very helpful in investigating cases under the U.S. Foreign Corrupt Practices Act (FCPA).

Russia is a signatory to the UN Convention against Corruption, the Council of Europe's Criminal Law Convention on Corruption, and, as of 2012, the OECD Anti-Bribery Convention. The OECD Convention calls for the implementation of national legislation to criminalize commercial bribery and to prohibit both offering bribes to foreign government officials and accepting such bribes. It provides no exceptions for "grease payments," and includes foreign entities doing business in Russia, meaning these entities could be subject to liability under their own country's law, as well as Russia's. The convention also calls for increasing the penalties that may be imposed upon an individual or entity found in violation. Fines and terms of incarceration contemplated by the Convention vary, depending upon the type of bribe and the official involved. During 2011-2012, Russia passed national legislation to bring itself into better compliance with its commitments under the OECD Convention and UNCAC. For instance, Article 13.1 of the Federal Law on Corruption allows removal of government officials for failure to take measures to combat corruption. Article 13.3, very broadly requires all legal entities in the Russian Federation implement an ethics and compliance program to combat corruption and conflict of interest. This law also applies to Russian government budgetary entities like schools.

Some analysts have expressed concern that lack of depth in the compliance culture in Russia will render the law a formality that does not function in reality. The implementation and enforcement of the many measures required by these conventions have not yet been fully tested. In recent years, there appears to be a greater number of prosecutions and convictions of mid-level bureaucrats for corruption, but real numbers were difficult to obtain and high-ranking officials were rarely prosecuted. After the close of the 2014 Winter Olympic Games in Sochi, anti-corruption blogger and opposition political candidate Alexey Navalny released a detailed report alleging wide-spread corruption and graft from those government and private individuals involved in construction of the Olympic venues. According to reports, the Prosecutor General's Office opened over 50 criminal cases related to the Olympic Games and has imposed administrative penalties on over 100 persons and companies. It is likely that many of these cases touch only lower level bureaucrats and not high-ranking

government officials or prominent businessmen close to the Kremlin who won the lucrative construction contracts for the Olympics.

It is important for U.S. companies, irrespective of size, to assess the business climate in the relevant market in which they will be operating or investing, and to have an effective compliance programs or measures to prevent and detect corruption, including foreign bribery. U.S. individuals and firms operating or investing in Russia should take the time to become familiar with the relevant anticorruption laws of both Russia and the United States in order to properly comply with them, and where appropriate, they should seek the advice of legal counsel.

Additional country information related to corruption can be found in the U.S. State Department's annual Human Rights Report available at <http://www.state.gov/g/drl/rls/hrrpt/>.

### **Assistance for U.S. Businesses**

The U.S. Department of Commerce offers several services to aid U.S. businesses seeking to address business-related corruption issues. For example, the U.S. Commercial Service can provide services that may assist U.S. companies in conducting their due diligence as part of a company's overarching compliance program when choosing business partners or agents overseas. The U.S. Commercial Service can be reached directly through its offices in major U.S. and foreign cities, or through its Website at: [www.trade.gov/cs](http://www.trade.gov/cs).

The Departments of Commerce and State provide worldwide support for qualified U.S. companies bidding on foreign government contracts through the Commerce Department's Advocacy Center and State's Office of Commercial and Business Affairs. Problems, including alleged corruption by foreign governments or competitors, encountered by U.S. companies in seeking such foreign business opportunities can be brought to the attention of appropriate U.S. government officials, including local embassy personnel and through the Department of Commerce Trade Compliance Center "Report A Trade Barrier" Website at: [tcc.export.gov/Report\\_a\\_Barrier/index.asp](http://tcc.export.gov/Report_a_Barrier/index.asp).

The U.S. Government seeks to level the global playing field for U.S. businesses by encouraging other countries to take steps to criminalize their own companies' acts of corruption, including bribery of foreign public officials, by requiring them to uphold their obligations under relevant international conventions. A U.S. firm that believes a competitor is seeking to use bribery of a foreign public official to secure a contract should bring this to the attention of appropriate U.S. agencies, as noted below.

### **U.S. Foreign Corrupt Practices Act (FCPA)**

In 1977, the United States enacted the FCPA, which makes it unlawful for a U.S. person, and certain foreign issuers of securities, to make a corrupt payment to foreign public officials for the purpose of obtaining or retaining business for or with, or directing business to, any person. The FCPA also applies to foreign firms and persons who take any act in furtherance of such a corrupt payment while in the United States. For more detailed information on the FCPA, see the FCPA Lay-Person's Guide at: [www.justice.gov/criminal/fraud/fcpa/docs/lay-persons-guide.pdf](http://www.justice.gov/criminal/fraud/fcpa/docs/lay-persons-guide.pdf).

The Department of Justice (DOJ) FCPA Opinion Procedure enables U.S. firms and individuals to request a statement of DOJ's present enforcement intentions under the anti-bribery provisions of the FCPA regarding any proposed business conduct. The details of the opinion procedure are available on DOJ's Fraud Section Website at: [www.justice.gov/criminal/fraud/fcpa](http://www.justice.gov/criminal/fraud/fcpa).

Although the Department of Commerce has no enforcement role with respect to the FCPA, it supplies general guidance to U.S. exporters who have questions about the FCPA and about international developments concerning the FCPA. For further information, see the Office of the Chief Counsel for International Counsel's website, at: [http://www.ogc.doc.gov/trans\\_anti\\_bribery.html](http://www.ogc.doc.gov/trans_anti_bribery.html).

### **Other Instruments**

It is U.S. Government policy to promote good governance, including host country implementation and enforcement of anti-corruption laws and policies pursuant to their obligations under international agreements. Since enactment of the FCPA, the United States has been instrumental to the expansion of the international framework to fight corruption. Several significant components of this framework are the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Anti-Bribery Convention), the United Nations Convention against Corruption (UN Convention), the Inter-American Convention against Corruption (OAS Convention), the Council of Europe Criminal and Civil Law Conventions, and a growing list of U.S. free trade agreements.

### **OECD Anti-Bribery Convention**

The OECD Anti-Bribery Convention entered into force in February 1999. There are 38 parties to the Convention including the United States (see <http://www.oecd.org/dataoecd/59/13/40272933.pdf>). The Convention obligates the Parties to criminalize bribery of foreign public officials in the conduct of international business. The United States meets its international obligations under the OECD Anti-Bribery Convention through the FCPA. In 2011, Russia passed anti-corruption legislation that clearly criminalized foreign bribery and acceded to the Anti-Bribery Convention in 2012.

### **Local Laws**

U.S. firms should familiarize themselves with local anticorruption laws, and, where appropriate, seek legal counsel. While the U.S. Department of Commerce cannot provide legal advice on local laws, the Department's U.S. Commercial Service can provide assistance with navigating the host country's legal system and obtaining a list of local legal counsel.

Transparency International (TI) publishes an annual Corruption Perceptions Index (CPI). The CPI measures the perceived level of public-sector corruption in 183 countries and territories around the world. The CPI is available at: <http://cpi.transparency.org/cpi2011/>. TI also publishes an annual Global Corruption Report which provides a systematic evaluation of the state of corruption around the world. It includes an in-depth analysis of a focal theme, a series of country reports that document major corruption related events and developments from all continents and an overview of the latest research findings on anti-corruption diagnostics and tools. See <http://www.transparency.org/publications/gcr>. Transparency

International-Russia also posts corruption-related research materials and findings on the following sites, all specific to Russia: [www.transparency.org.ru/INTER/index.asp](http://www.transparency.org.ru/INTER/index.asp) and [www.askjournal.ru](http://www.askjournal.ru).

The World Bank Institute publishes Worldwide Governance Indicators (WGI). These indicators assess six dimensions of governance in 213 economies, including Voice and Accountability, Political Stability and Absence of Violence, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption. See [http://info.worldbank.org/governance/wgi/sc\\_country.asp](http://info.worldbank.org/governance/wgi/sc_country.asp). World Bank Business Environment and Enterprise Performance Surveys may also be of interest.

The World Economic Forum publishes the Global Enabling Trade Report, which presents the rankings of the Enabling Trade Index, and includes an assessment of the transparency of border administration (focused on bribe payments and corruption) and a separate segment on corruption and the regulatory environment. See <http://www.weforum.org/reports/global-enabling-trade-report-2012>.

Global Integrity, a nonprofit organization, publishes its annual Global Integrity Report, which provides indicators with respect to governance and anti-corruption. The report highlights the strengths and weaknesses of national level anti-corruption systems. The report is available at: <http://www.globalintegrity.org/report>.

#### **14. Bilateral Investment Agreements**

While the United States and Russia signed a bilateral investment treaty (BIT) in 1992, it is not in force due to lack of ratification by the Russian Duma. In January 2014, Russia and the United States began talks on ways to improve the bilateral investment relationship. Those talks were suspended after Russia's illegal invasion of Crimea in February 2014. Russia has BITs with 75 countries, 54 of which are currently in force.

The United States and Russia have shared an income tax treaty since 1992, which is designed to address the issue of double taxation and fiscal evasion with respect to taxes on income and capital. Full text of the treaty: <http://www.irs.gov/pub/irs-trty/russia.pdf>. There is some concern that taxation requirements have sometimes been used in Russia as a way to "raid" or illegally take possession of foreign companies, particularly small and medium enterprises.

#### **15. OPIC and Other Investment Insurance Programs**

Since 1992, the U.S. Overseas Private Investment Corporation (OPIC) has been authorized to provide loans, loan guarantees (financing), and investment insurance against political risks to U.S. companies investing in Russia. OPIC's political risk insurance and financing help U.S. companies of all sizes invest in Russia. OPIC insures against three political risks: expropriation; political violence; and currency inconvertibility. OPIC recently announced that political risk insurance now covers private equity fund investments. To meet the demands of larger projects in Russia and worldwide, OPIC can insure up to \$250 million per project and up to \$300 million for projects in the oil and gas sector with offshore, hard currency revenues. Projects in the oil and gas sector with offshore, hard currency revenues may be approved for an exposure limit up to \$400 million if the project receives a credit evaluation (shadow rating) of investment grade or higher. The individual per project exposure limit for financing is \$250 million. The maximum combined (insurance and financing) exposure limit to OPIC on a single

project is \$400 million. OPIC has no minimum investment size requirements. OPIC also makes equity capital available for investments in Russia by guaranteeing long-term loans to private equity investment funds. Detailed information about OPIC's programs can be accessed at [www.opic.gov](http://www.opic.gov). Russia is also a member of the World Bank's Multilateral Investment Guarantee Agency.

## **16. Labor**

The Russian labor market remains fragmented, characterized by limited labor mobility across regions and consequent wage and employment differentials. Earnings inequalities are substantial, enforcement of labor standards is relatively weak, and collective bargaining is underdeveloped. Employers regularly complain about shortages of qualified skilled labor. This is due in part to weak linkages between the education system and the labor market. In addition, the economy suffers from a general shortage of highly skilled labor. Businesses face increasing labor costs as competition over a limited pool of workers intensifies. On the other hand, private business must compete with SOEs, where Russians have indicated in recent surveys they would prefer to work due to salaries and benefits. The public sector, which maintains inefficient and unproductive positions, accounts for about 25 percent the workforce. The 2002 Labor Code governs labor standards in Russia. The enforcement of worker safety rules continues to be a major issue, as enterprises are often unable or unwilling to invest in safer equipment or to enforce safety standards.

The rate of actual unemployment (calculated according to ILO methodology) in 2013 was low at 5.5 percent. Average unemployment in urban districts (4.7 percent as of December) was much lower than in rural districts (8.3 percent). In 2013, two regions in the North Caucasus had the highest unemployment rates in the country: Ingushetia (43.7 percent) and Chechnya (26.9 percent). In stark contrast, the unemployment rate was 1.5 percent in St. Petersburg and 1.7 percent in Moscow.

## **17. Foreign Trade Zones/Free Ports**

Russia has 26 Special Economic Zones (SEZs), which fall in one of four categories: industrial and production zones; technology and innovation zones; tourist and recreation zones; and port zones. Enterprises operating within SEZs enjoy a range of benefits that the Ministry of Economic Development (MED) – which manages the SEZ program – estimates can save investors up to 30% of the cost of doing business. Specifically, investors enjoy streamlined administrative requirements and procedures, a more favorable customs regime (including the waiver of import duties and refunds of the value-added-tax), and reduced tax rates on income, property, land, and transport. SEZ investors also receive discounts on infrastructure expenses, including facilities and utilities costs. Such benefits are extended for an agreed introductory period, often lasting five years.

Progress in attracting foreign investors to SEZs is uneven. The majority of SEZ investments are still listed as “planned,” meaning investors are still able to back out of commitments. The lack of interest from foreign investors in addition to environmental concerns led to the closure of the proposed Kaliningrad tourist and recreational zone SEZ in late 2012. The Russian government has been hesitant to go forward with major SEZ infrastructure projects. Detailed information about the benefits and results of Russia's SEZs can be found at the MED's SEZ website: <http://www.economy.gov.ru/minec/activity/sections/sez/main/>.

Independent of the SEZs, in 2010 then-President Medvedev launched an initiative to establish the Skolkovo Innovation Center in the Moscow suburbs to promote investment in high-technology startup businesses, research, and commercialization of technological innovation. Inspired by the model of Silicon Valley, Skolkovo "resident companies" can receive a broad range of benefits, including exemption from profit tax, value-added tax, property taxes, and import duties, and partial exemption from social fund payments. Applicants for residency are evaluated and selected by an international admission board; company performance is monitored to ensure continued qualification for benefits. According to the Skolkovo Foundation, over 1,000 startups have been selected as residents thus far, although very few are physical present at Skolkovo now. The infrastructure for Skolkovo is still being built.

## 18. Foreign Direct Investment and Foreign Portfolio Investment Statistics

Table 1 shows flows of foreign investment into Russia by country for the first nine months of 2013, compared to the same period in 2012. Total foreign investment increased by 15 % year-on-year. According to Russian statistical practice, total foreign investment numbers include direct investment (FDI), portfolio investment, and other investment (largely trade credits). FDI flows into Russia also increased in 2013, rising by 52%; the largest share came from Cyprus according to available data. FDI from the Netherlands and Cyprus is consistently high, reflecting the fact that most FDI coming from these countries is likely either returning or reinvested Russian capital through subsidiaries or off-shore "shell" vehicles. The data in the table below is from the Central Bank of Russia. While official statistics for 2014 are not yet available, anecdotal evidence suggests that uncertainty spawned by the crisis in Ukraine as well as market fluctuations in Russia will drive FDI numbers down for this year.

**Table 1: Top Investors - By Year (in \$ million)**

Country	Jan-Sep 2013		Jan-Sep 2012		Jan-Sep 2011	
	Total	FDI	Total	FDI	Total	FDI
Switzerland		754	43,252	88	69,115	70.1
Netherlands	12,812	2,655	15,676	909	13,218	3,023
Cyprus	17,612	7,772	11,788	3,842	12,972	2,758
Germany	6,338	2,411	3,799	1,119	8,169	1,480
UK	12,158		10,618	500	6,336	176
All Others			29,330	5,819	23,976	4,228
<b>Total</b>	<b>132,385</b>	<b>18,610</b>	<b>114,463</b>	<b>12,277</b>	<b>133,784</b>	<b>11,736</b>

The numbers in Table 2 represent the accumulated stock of total foreign investment in Russia by originating country, including FDI, portfolio, and "other" investment as of September 30, 2013, compared to the amount accumulated a year prior. Source: Central Bank of Russia.

**Table 2: Top Investors - Accumulated Basis (in \$ million)**

Country	As of Sep 30, 2013		As of Sep 30, 2012		As of Sep 30, 2011	
	Total	FDI	Total	FDI	Total	FDI
Cyprus	67,635	44,160	78,566	53,357	69,057	47,290
Netherlands	67,113	23,385	59,223	21,723	46,295	23,328
Luxembourg	47,197	1,319	39,808	1,191	35,051	643
Germany	21,969	12,119	24,757	11,393	29,779	11,386
China	32,383	1,492	27,792	1,346	27,356	1,238
All Others			123,198	46,298	115,650	42,529
<b>Total</b>	<b>379254</b>	<b>122500</b>	<b>353,344</b>	<b>135,308</b>	<b>323,178</b>	<b>126,415</b>

Table 3 shows total foreign investment by region over the first nine months of 2013, compared to the same period in 2012. Moscow continues to attract the lion's share of investments, mainly due to the concentration of companies' headquarters and consumers with high purchasing power. Source: Central Bank of Russia, including direct, portfolio and "other" investments.

**Table 3 – Foreign Investment – Top Regions (in \$ million)**

	Jan-Sep 2013			Jan-Sep 2012			Jan-Sep 2011		
	Amount	%	Rank	Amount	%	Rank	Amount	%	Rank
Moscow (city)	78,383	59.20%		63,211	55.20%		84,878	63.40%	1
Tyumen Region	4,669	3.50%		6,975	6.10%		9,821	7.30%	2
Sakhalin Region	1,908	1.50%		8,541	7.50%		6,570	4.90%	3

St. Petersburg	8,974	6.80%		6,580	5.70%		3,972	3.00%	4
Belgorod Region	1,433	1.10%		465	0.10%		3,171	2.40%	5
Others							25,371	19.00%	
<b>Total</b>	<b>132,385</b>	<b>100%</b>		<b>114,463</b>	<b>100%</b>		<b>133,784</b>	<b>100%</b>	

Table 4 shows investment by sector over the first nine months of 2013, compared to the same period in 2012. Total investment increased in six of the ten top sectors. Data for investment into the financial sector was not available. Source: Central Bank of Russia

**Table 4: Foreign Investment: Top Sectors (in \$ million)**

Industry/Sector	Jan-Sep 2013		Jan-Sep 2012		Jan-Sep 2011	
	%	Amount	%	Amount	%	Amount
Finance	11.77%	15,579	33.46%	38,300	49.10%	65,711
Extraction of Fuel	5.06%	6,702	10.60%	12,136	9.60%	12,850
Wholesale and Retail Trade	16.97%	22,463	15.79%	18,074	9.20%	12,363
Production of coke and oil products	34.42%	45,563	10.78%	12,338	7.50%	9,997
Metallurgy	7.50%	9,932	6.05%	6,927	4.40%	5,902
Transport and Communications	2.41%	3,190	2.95%	3,377	4.10%	5,494
Real Estate and Related Services	4.79%	6,337	6.25%	7,150	3.60%	4,782
Chemical Industry	3.67%	4,858	2.09%	2,387	2.70%	3,636
Food Industry	2.08%	2,755	1.38%	1,583	1.50%	1,964
Production of vehicles	3.90%	5,164	2.45%	2,802	1.40%	1,845

All Others	7.43%	9,842	9.20%	9,389	6.90%	9,240
<b>Total</b>	<b>100.00%</b>	<b>132,385</b>	<b>100.00%</b>	<b>114,463</b>	<b>100.00%</b>	<b>133,784</b>

Table 5 shows stocks of Russian FDI abroad as of September 30, 2013 and September 30, 2012, as well as flows of Russian FDI abroad for the first nine months of 2013, compared to the same period in 2012. Russian FDI stocks decreased in the Netherlands and the United States but increased in Cyprus, the United Kingdom and Luxembourg (data from 2011 was unavailable for Luxembourg and the United Kingdom). Source: Central Bank of Russia.

**Table 5: Top Destinations of Russian FDI - By Year (in \$ million)**

Country	as of Sep 30, 2013		as of Sep 30, 2012		as of Sep 30, 2011	
	Stock	Flow	Stock	Flow	Stock	Flow
Netherlands	22,284	6,388	31,049	6,848	25,067	8,427
Cyprus	33,595	14,974	25,686	10,834	14,280	842
Switzerland	8,190	36,446	8,115	38,641	2,814	328
United States	4,004	545	7,880	642	6,663	439
United Kingdom	9,157	3,550	6,270	7,528	N/A	N/A
Luxembourg	6,846	7,873	6,206	213	N/A	N/A
Belarus	5,501	2,831	5,820	5,877	2,685	629

## Section 5 - Government

### Chiefs of State and Cabinet Members:

For the current list of Chief of State and Cabinet Members, please access the following - [Central Intelligence Agency online directory of Chiefs of State and Cabinet Members of Foreign Governments](#)

### International organization participation:

APEC, Arctic Council, ARF, ASEAN (dialogue partner), BIS, BRICS, BSEC, CBSS, CD, CE, CERN (observer), CICA, CIS, CSTO, EAEC, EAPC, EAS, EBRD, FAO, FATF, G-20, G-8, GCTU, IAEA, IBRD, ICAO, ICC (national committees), ICRM, IDA, IFC, IFRCs, IHO, ILO, IMF, IMO, IMSO, Interpol, IOC, IOM (observer), IPU, ISO, ITS0, ITU, ITUC (NGOs), LAIA (observer), MIGA, MINURSO, MONUSCO, NSG, OAS (observer), OIC (observer), OPCW, OSCE, Paris Club, PCA, PFP, SCO, UN, UNCTAD, UNESCO, UNHCR, UNIDO, UNISFA, UNMIL, UNMISS, UNOCI, UNSC (permanent), UNTSO, UNWTO, UPU, WCO, WFTU (NGOs), WHO, WIPO, WMO, WTO, ZC

### Legal system:

Civil law system; judicial review of legislative acts

## Section 6 - Tax

### Exchange control

Generally, hard currency transactions between Russian residents and non-residents are executed without any limitation. However, certain transactions are subject to state regulations and restrictions.

Hard currency transactions between residents are forbidden with certain exceptions.

Hard currency transactions between non-residents may be carried out without limitations.

### Treaty and non-treaty withholding tax rates

Russian Federation has exchange of information relationships with 111 jurisdictions through 89 DTCs, 0 TIEAs and 1 multilateral mechanism, Convention on Mutual Administrative Assistance in Tax Matters.

Jurisdiction	Type of EOI Arrangement	Date Signed	Date entered into Force	Meets standard	Contains paras 4 and 5	
Albania	DTC	11 Apr 1995	1 Jan 1998	Unreviewed	No	
Algeria	DTC	10 Mar 2006	1 Jan 2009	Unreviewed	No	
Argentina	DTC	10 Oct 2001	16 Oct 2012	Yes	No	
Armenia	DTC	28 Dec 1996	1 Jan 1999	Unreviewed	Yes	
Australia	DTC	7 Sep 2000	17 Dec 2003	Yes	No	
Austria	DTC	13 Apr 2000	30 Dec 2002	No	No	
Azerbaijan	DTC	3 Jul 1997	1 Jan 1999	No	Yes	
Belarus	DTC	21 Apr 1995	1 Jan 1998	Unreviewed	Yes	
Belgium	DTC	16 Jun 1995	26 Jun 2000	Yes	No	
Botswana	DTC	8 Apr 2003	1 Jan 2010	No	No	
Brazil	DTC	22 Nov 2004	19 Jan 2009	Yes	No	
Bulgaria	DTC	8 Jun 1993	1 Jan 1996	No	Yes	
Canada	DTC	5 Oct 1995	5 May 1997	Yes	No	
Chile	DTC	19 Nov 2004	28 Feb 2012	Yes	No	
China	DTC	27 May 1994	1 Jan 1998	Yes	No	
Croatia	DTC	2 Oct 1995	1 Jan 1998	Unreviewed	No	
Cuba	DTC	14 Dec 2000	15 Nov 2010	Unreviewed	No	
Cyprus	DTC	5 Dec 1998	1 Jan 2000	Yes	Yes	
Czech Republic	DTC	17 Nov 1995	18 Jul 1997	Yes	Yes	
Denmark	DTC	8 Feb 1996	27 Apr 1997	Yes	No	
Egypt	DTC	23 Sep 1997	1 Jan 2001	Unreviewed	No	
Estonia	DTC	5 Nov 2002	not yet in force	Yes	No	
Ethiopia	DTC	26 Nov 1999	not yet in force	Unreviewed	No	
Finland	DTC	4 May 1996	1 Jan 2003	Yes	No	
Former Yugoslav Republic of Macedonia	DTC	21 Oct 1997	14 Jul 2000	No	No	

Jurisdiction	Type of EOI Arrangement	Date Signed	Date entered into Force	Meets standard	Contains paras 4 and 5	
France	DTC	26 Nov 1996	9 Mar 1999	Yes	No	
Georgia	DTC	4 Aug 1999	not yet in force	Unreviewed	No	
Germany	DTC	29 May 1996	30 Dec 1996	Yes	Yes	
Greece	DTC	26 Jun 2000	20 Dec 2007	Yes	No	
Hungary	DTC	1 Apr 1994	1 Jan 1998	Yes	No	
Iceland	DTC	26 Nov 1999	1 Jan 2004	Yes	No	
India	DTC	25 Mar 1997	11 Apr 1998	No	No	
Indonesia	DTC	12 Mar 1999	17 Dec 2002	Yes	No	
Iran	DTC	6 Mar 1998	1 Jan 2003	Unreviewed	No	
Ireland	DTC	29 Apr 1994	7 Jul 1995	No	No	
Israel	DTC	25 Apr 1994	1 Jan 2001	Yes	No	
Italy	DTC	9 Apr 1996	30 Nov 1998	Yes	Yes	
Japan	DTC	18 Jan 1986	1 Jan 1987	No	No	
Kazakhstan	DTC	18 Oct 1996	1 Jan 1998	Unreviewed	Yes	
Korea, Democratic People's Republic of	DTC	26 Sep 1997	1 Jan 2001	No	No	
Korea, Republic of	DTC	19 Nov 1992	1 Jan 1996	Yes	No	
Kuwait	DTC	9 Feb 1999	1 Jan 2004	No	No	
Kyrgyzstan	DTC	13 Jan 1999	1 Jan 2001	Unreviewed	Yes	
Lao People's Democratic Republic	DTC	15 May 1999	not yet in force	Unreviewed	No	
Latvia	DTC	20 Dec 2010	8 Nov 2012	Unreviewed	No	
Lebanon	DTC	7 Apr 1997	1 Jan 2001	No	No	
Lithuania	DTC	29 Jun 1999	1 Jan 2006	Yes	No	
Luxembourg	DTC	28 Jun 1993	7 May 1997	Yes	Yes	
Malaysia	DTC	31 Jul 1987	4 Jul 1988	No	No	
Mali	DTC	25 Jun 1996	1 Jan 2000	Unreviewed	No	
Malta	DTC	24 Apr 2013	not yet in force	Yes	Yes	
Malta	DTC	15 Dec 2000	not yet in force	Yes	No	
Mauritius	DTC	24 Aug 1995	not yet in force	Yes	No	
Mexico	DTC	7 Jun 2004	2 Apr 2008	Yes	No	
Moldova, Republic of	DTC	12 Apr 1996	1 Jan 1998	No	Yes	
Mongolia	DTC	5 Apr 1995	1 Jan 1998	No	Yes	
Montenegro	DTC	12 Oct 1995	1 Jan 1998	Unreviewed	No	
Morocco	DTC	4 Sep 1997	31 Aug 1999	Unreviewed	No	
Namibia	DTC	31 Mar 1998	1 Jan 2001	Unreviewed	No	
Netherlands	DTC	16 Dec 1996	27 Aug 1998	Yes	No	
New Zealand	DTC	5 Sep 2000	4 Jul 2003	Yes	No	
Norway	DTC	26 Mar 1996	20 Dec 2002	Yes	No	
Oman	DTC	26 Nov 2001	not yet in force	Unreviewed	No	
Philippines	DTC	26 Apr 1995	12 Sep 1997	Yes	No	
Poland	DTC	22 May 1992	1 Jan 1994	No	No	
Portugal	DTC	29 May 2000	1 Jan 2003	Yes	No	

Jurisdiction	Type of EOI Arrangement	Date Signed	Date entered into Force	Meets standard	Contains paras 4 and 5	
Qatar	DTC	20 Apr 1998	19 Jan 2000	No	No	
Romania	DTC	27 Sep 1993	1 Jan 1996	No	No	
Saudi Arabia	DTC	11 Feb 2007	1 Feb 2010	Yes	No	
Serbia	DTC	12 Oct 1995	1 Jan 1998	Unreviewed	No	
Singapore	DTC	9 Sep 2002	16 Jan 2009	No	No	
Slovakia	DTC	24 Jun 1994	1 May 1997	Yes	No	
Slovenia	DTC	29 Sep 1995	1 Jan 1998	No	No	
South Africa	DTC	27 Nov 1995	1 Jan 2001	No	No	
Spain	DTC	16 Dec 1998	13 Jun 2000	Yes	No	
Sri Lanka	DTC	2 Mar 1999	1 Jan 2003	Unreviewed	No	
Sweden	DTC	15 Jun 1993	1 Jan 1996	Yes	No	
Switzerland	DTC	15 Nov 1995	18 Apr 1997	No	Yes	
Syrian Arab Republic	DTC	17 Sep 2000	1 Jan 2004	No	No	
Tajikistan	DTC	31 Mar 1997	1 Jan 2004	Unreviewed	Yes	
Thailand	DTC	23 Sep 1999	1 Jan 2010	No	No	
Turkey	DTC	15 Dec 1997	1 Jan 2000	No	No	
Turkmenistan	DTC	14 Jan 1998	1 Jan 2000	No	Yes	
Ukraine	DTC	8 Feb 1995	1 Jan 2000	No	Yes	
United Kingdom	DTC	15 Feb 1994	1 Jan 1998	No	No	
United States	DTC	17 Jun 1992	1 Jan 1994	Yes	No	
Uzbekistan	DTC	2 Mar 1994	1 Jan 1996	No	Yes	
Venezuela	DTC	22 Dec 2003	1 Jan 2010	Unreviewed	No	
Viet nam	DTC	27 May 1993	1 Jan 1997	No	No	

## Methodology and Sources

### Section 1 - General Background Report and Map

(Source: [CIA World Factbook](#))

### Section 2 - Anti – Money Laundering / Terrorist Financing

	Lower Risk	Medium Risk	Higher Risk
<a href="#">FATF List of Countries identified with strategic AML deficiencies</a>	Not Listed	AML Deficient but Committed	High Risk
<a href="#">Compliance with FATF 40 + 9 recommendations</a>	>69% Compliant or Fully Compliant	35 – 69% Compliant or Fully Compliant	<35% Compliant or Fully Compliant
<a href="#">US Dept of State Money Laundering assessment (INCSR)</a>	Monitored	Concern	Primary Concern
<a href="#">INCSR - Weakness in Government Legislation</a>	<2	2-4	5-20
<a href="#">US Sec of State supporter of / Safe Haven for International Terrorism</a>	No	Safe Haven for Terrorism	State Supporter of Terrorism
<a href="#">EU White list equivalent jurisdictions</a>	Yes		No
<a href="#">International Sanctions</a> <a href="#">UN Sanctions</a> / <a href="#">US Sanctions</a> / <a href="#">EU Sanctions</a>	None	Arab League / Other	UN , EU or US
<a href="#">Corruption Index (Transparency International)</a> <a href="#">Control of corruption (WGI)</a> <a href="#">Global Advice Network</a>	>69%	35 – 69%	<35%
<a href="#">World government Indicators (Average)</a>	>69%	35 – 69%	<35%
<a href="#">Failed States Index (Average)</a>	>69%	35 – 69%	<35%
<a href="#">Offshore Finance Centre</a>	No		Yes

### **Section 3 - Economy**

General Information on the current economic climate in the country and information on imports, exports, main industries and trading partners.

(Source: [CIA World Factbook](#))

### **Section 4 - Foreign Investment**

Information on the openness of foreign investment into the country and the foreign investment markets.

(Source: [US State Department](#))

### **Section 5 - Government**

Names of Government Ministers and general information on political matters.

(Source: [CIA World Factbook](#) / <https://www.cia.gov/library/publications/world-leaders-1/index.html>)

### **Section 6 - Tax**

Information on Tax Information Exchange Agreements entered into, Double Tax Agreements and Exchange Controls.

(Sources: [OECD Global Forum on Transparency and Exchange of Information for Tax Purposes](#) [PKF International](#))

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