Reporting and compliance

UNIVERSITY OF WINCHESTER

Reconceptualising regulatory bank compliance, set within a given regulatory regime (e.g. Russia), in the context of global and multi-institutional interests.

Maria Shalimova

ORCID ID 0000-0002-6505-2990

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This Thesis has been completed as a requirement for the postgraduate research degree of the University of Winchester

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ABSTRACT

Reconceptualising regulatory bank compliance, set within a given regulatory regime (e.g Russia), in the context of global and multi-institutional interests.

Maria Shalimova

ORCID N 140 99 70

Doctor of Philosophy

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This thesis is an eight-year journey into the nature of compliance. The term 'compliance' is used widely in the legislative environment and corporate world, yet remarkable under-developed in academic literature. The examination of compliance phenomenon was made through the concept of policy development and implementation. The content-process-context framework of Pettigrew (1987) framed my objectives and shaped the overall presentation and analysis made in this thesis. This chosen framework is aimed to show the complexities of the compliance phenomenon and variations of compliance approaches.

The far-reaching aim of my study is to offer new insights to the nature of bank compliance, set within a given regulatory regime (e.g. Russia), in the context of global and multi-institutional interests. The study is intended to be multi-purposeful and was supposed to develop a subtler understanding of the three above mentioned inter-connected elements (content-process-context). This thesis is also aimed to raise an awareness about compliance phenomenon in both the academic and practitioner's world to further improve and develop compliance.

Several theories used in this thesis were very valuable for the examination of the set aims and objectives, such as gradual change theory, institutional theory, goal framing theory, theories of regulation and compliance, state-building theory and others. The research formally began by posing a set of open-ended research questions. While they were not hypotheses, they did carry assumptions about the nature of compliance. These assumptions were based on the experience of the author as a compliance practitioner, alongside the selective study of the literature in and around the research topic. This research approach is based on case studies of seven financial institutions with an established history of operations in Russia.

The thesis concludes by outlining several contributions to knowledge concerning both practice and theory. The study advocates a deconstruction of compliance phenomenon into three central elements. The examination of the nature of change is the central element of this thesis. It also makes contributions to the existing knowledge by proposing a new view on policy development with enhanced focus on policy implementation, explaining the nature of change as the core concept for understanding the development of compliance. The proposed re-contextualisation of gradual change theory and institutional theory in a new context by applying both theoretical perspectives to the context of daily compliance practices is also contributed to the knowledge. This study will be considered as one of the first thesis focusing on compliance within the Russian financial environment, which has a significant influence on the conducted trainings organized by the author for the regulated financial institutions and the regulator.

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List of Acronyms

AML/CFT - Anti-Money Laundering and Countering of Financing of Terrorism

BCBS - Basel Committee of Banking Supervision

CBR - Central Bank of Russia

DODD-FRANK - Wall Street Reform and Consumer Protection Act

ECB – European Central Bank

FINRA - Financial Industry Regulatory Authority

KYC - Know Your Client

KYCC – Know Your Client's Customer

EMIR - European Markets and Infrastructure Regulation

FATCA - Foreign Account Tax Compliance Act

FATF - Financial Action Task Force

ICA - International Compliance Association

IMF - International Monetary Fund

MiFID - The Markets in Financial Instruments Directive

OECD - Organisation for Economic Co-operation and Development

Chapter 1

Introduction

In this chapter, I outline my rationale for undertaking this research project, research aim and objectives, the background to the topic, including international and domestic factors influencing on regulatory compliance and provide a sketch of the component chapters of my thesis.

With a view to pursuing the far-reaching research aim and subordinating objectives, an empirical study of compliance with reference to AML/CFT initiatives by drawing together several theories. For example: gradual change theory, institutional theory, goal framing theory, theories of regulation and compliance and state building theory, with relational dialectics and others that have been made. These afore-mentioned theories, as well as evidence obtained during the qualitative surveys, semi-structured interviews, together with analysis of documents, have significantly helped me to develop a more subtle understanding of the compliance phenomenon by using a proposed conceptual framework. This framework also assists policy development and implementation to enhance and further develop compliance.

Rationale

For some time, I have observed the apparent failures and breaches in financial regulation within Russian financial services and in other countries. My experience as a compliance officer leads me to observe that compliance officers in domestic and international banks in Moscow seem to have very different approaches to how they conduct compliance work, even though they all now operate under the same guidelines (FATF, Basel, Egmont Group, G20). What leads compliance officers to take such different approaches? Provided that there is different understanding of the same rules, how do such variations in meaning arise? Why is there a difference between an individual responsibility for any failures made by public chartered accountants, doctors, lawyers and compliance officers within the corporate financial institutions?

For some years, compliance has been globally viewed as 'cost of doing business' Mainelli (2009). Moreover, after 2008 credit crunch, there was a call for more regulation, 'never mind the quality, feel the width', rather than better regulation, which had an impact on significant raise of compliance costs. This can be highlighted by the sheer volume of compliance and corporate governance prescriptions that businesses need to incorporate within their business processes (Financial Reporting Council, 2012). In the UK, following *the* Cadbury Report (1992), a number of further reports were issued. While in Germany, *the KonTraG* corporate governance reforms were introduced as a result of concerns surrounding transparency, management accountability and minority shareholder protection (La Porta et.al., 1999). These were later influenced by *the Corporate Sector Supervision and Transparency Act*

*(*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, KonTraG) (1998); by *the* Raising of Capital Act (Kapitalaufnahmeerleichterungsgesetz, KapAEG) (1998) and by the Corporate Sector Transparency and Publicity Act (Gesetz zur Transparenz und Publizität im Unternehmensbereich, TransPuG) (2002). Among the core aims of the abovementioned laws were the liberalization of the German capital markets and increase of the transparency of listed companies (Höpner, 2003). The introduction of the Organisation for Economic Cooperation and Development (OECD, 2004) and Principles of Corporate Governance, also had a significant impact on German corporate governance as well as corporations globally.

In relation to European compliance: *Basel Committee on Banking Supervision (2004), the Markets in Financial Instruments Directive 2004/39/EC (MiFID)*, European Parliament and the Council of the European Union (2015) *Directive (EU) 2015/849 (2015*, effective since 26 June 2015 and transposed into the national law of member states by 26 June 2017, and the Financial Groups Directive are particularly worthwhile outlining. Policy statements, discussion and consultation papers, guidelines issued by financial services regulatory bodies include those issued by the Financial Conduct Authority (FCA) in Britain (formerly the Financial Services Authority until March 2013), the Securities and Exchange Commission (SEC) in the United States, the Office of the Comptroller of the Currency (OCC) in the U.S. Treasury, and the German Federal Financial Supervisory Authority (BaFiN), among others. In addition, independent audit certification, including SAS 70 or ISO 9000 or other frameworks for voluntary compliance reinforce the scope of compliance, as well as the complexities involved for businesses as they conduct their activities. Overall, compliance within the financial sector involves a wide range of national and international regulations that may impose various complicated and sometime contradictory requirements on financial institutions. Moreover, the expectations of the various regulators may differ substantially from country to country and this complicates the overall compliance position of financial institutions active in the international arena.

Agarwal and Agarwal (2006) presented an estimation made from forecasts, regression analyses and studies undertaken by economic intelligence units, that global money laundering amounted to somewhere in the region of $2 to $2.5 trillion annually, equivalent to between five and six percent of global GDP in 2006. This can be compared to a figure of between $500 billion to $1 trillion in 2004 (Agarwal and Agarwal, 2004) in the banking sector alone. The World Bank (2016) estimated that developing countries lose almost $1 trillion per year (Global Financial Integrity, 2014). The United Nations Office on Drugs and Crime (2016) conducted a study to determine the magnitude of illicit funds generated by drug trafficking and organised crime. The report estimates that in 2016, criminal proceeds amounted to 3.6% of global GDP, with 2.7% (or $1.6 trillion) being laundered. Further to a World Bank (2016) report 'while these estimates are difficult to verify, they indicate that the amounts involved are

significant and pose widespread problems, particularly in resource-rich countries and fragile, conflict-affected states' (p.1).

My research seeks to elevate such concerns to a conceptual level by providing a theoretical framework of Pettigrew (1987) to examine the compliance phenomenon through policy development, in particular policy implementation. It also seeks to offer better understanding of variations and different interpretations of compliance and improve the dialogue between the regulator and the regulated to enhance and improve compliance.

Based on the above statements, I consider that my thesis is important and able to improve and develop compliance, as it raises awareness about the compliance phenomenon in both the academic and practitioner's world, and provides a variety of different interpretations and complexities of compliance that eventually help to foster a comprehensive dialogue between both the regulator and the regulated.

Aim and objectives

Regulatory compliance also covers a broad spectrum, including money laundering and terrorism financing, economic sanctions, anti-bribery and corruption, fraud and cybercrime. Conceptual framework of my research can be considered as an organising device supporting the research aim and subordinate objectives, and directs the collection and analysis of data.

My thesis is multi-purposeful, as it aims to raise awareness of different interpretations of compliance regulation for the purpose of helping develop practical trainings to both the regulator and the regulated, with the specific aim of improving and further developing compliance. It also has ambitions to better enable meaningful dialogue to take place between the regulator and regulated to develop compliance.

The overall aim of my study is to offer new insights into the nature of bank compliance, set within a given regulatory regime (e.g: Russia), in the context of global and multi-institutional interests. The research aims for component objectives, and comprises of three elements: the 'what' question (the content), i.e the meaning of compliance; the 'how' question (the process), i.e the implementation of compliance, and the 'where' question (the context) - i.e Russia. The relationship between these three components, e.g context gives meaning to content and process, so there is no meaning without context, and the process similarly varies with context and particular attributes of content which invoke particular processes, so all these iterations between the three components make a conceptual framework of my thesis. This content-process-context of Pettigrew (1987) framed my objectives and shaped the overall presentation and analysis made in this thesis. The theoretical framework is used to assist policy development and implementation which in turn enhances and develops compliance. The chosen

framework is able to show the complexities of the compliance phenomenon and variations of compliance approaches.

Aiming better understanding of the nature and specifics of regulatory compliance, I deconstructed it into three objectives provided below:

Objectives

(i) To examine the meaning of compliance, including its meaning in principle and in practice, its interpretive flexibility, and its efficacy.

(ii) To contribute new understanding of compliance processes with financial regulation in terms of bank policy implementation responses/strategies to regulatory change; and regulatory strategies and institutional changes as responses.

(iii) To examine the influence of the domestic and international political context on Russian regulatory compliance, in terms of evolving political, policy, and legal positions.

These three objectives are interconnected and afford a broad examination of the aims of this research. It appears that very little research has been undertaken on the dynamics of compliance in the financial sector in Russia. The focus of this thesis is to develop compliance by making a sense of compliance issues around financial regulation within the Russian regulatory framework. The nature of these objectives, coupled with their respective inter-relationships as well as relationships with the aims, suggests a conceptual framework introduced by Pettigrew (1987) and still in use (Stockdale and Standing, 2006).

In order to develop deeper insights in this area of interest, this study will draw on ideas from diverse policy and business contexts beyond financial services, including international trade as suggested by Burgemeestre, Hulsijin and Tan (2009), drugs policy as suggested by Kubler and Walt (2001) and environmental policy treaty development provided by Mitchell (2005). The regulator may apply a variety of strategies in order to regulate compliance, just as regulated entities are likely to deploy a variety of strategies in order to manage the regulator's expectations, negotiate terms or, perhaps even attempt to conceal issues from the regulator. It was proposed by Shalimova (2014e) that managing various regulatory issues within different contexts, may offer novel insights to compliance issues within the Russian financial services.

Background to regulatory compliance in Russian financial services

This section starts with the examination of Pettigrew's (1985 and 1987) ideas on strategic change and regulatory compliance, then it provides an examination of key international and domestic influences, shaping compliance in financial institutions from a Russian perspective. The insight into money-laundering initiatives affords a deep understanding of inter-related international and domestic factors behind compliance in the Russian financial services.

There are five sections, namely

(i) Pettigrew's ideas of strategic change (1987) and its relevance to regulatory compliance;

(ii) International factors;

(iii) Influence of international events and laws on compliance development in Russia;

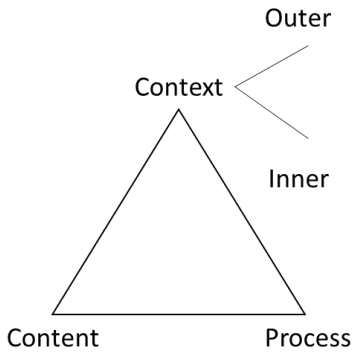
(iv) The local laws influenced on compliance development in Russia;

(v) Key Challenges facing Russian regulatory regime in relation to AML/CFT that constitute this Background section.

1.1. Ideas on strategic change and regulatory compliance

Building on Pettigrew's (1987) ideas on strategic change, an examination of the regulatory compliance phenomenon shall start with formulation of the content of any regulator's and regulated strategies, which is applied by managing its context and examination of internal processes. The outer context means political, economic, social and competitive conditions where the organization operates. The inner context means internal culture and internal context applied in the country/financial/environment/firm in which aspects of regulatory compliance have to be implemented. Therefore, applying an idea of Pettigrew (1987), the 'what' of regulatory compliance is concentrated within the notion of content, and the 'why' of regulatory compliance is provided from an examination of inner and outer context, and the 'how' of regulatory compliance shall be taken after examination of the process. Figure 1 provides a visual representation of this idea.

Figure 1. The broad framework guiding the research (Pettigrew, 1987)



The first objective of this study, as indicated earlier is to examine the meaning and idea of compliance within the banking regulatory environment. It is not feasible to discuss Russia's perspective on compliance without looking at the international context. Global practices will be explored and examined to provide the necessary tools for understanding the meaning of compliance. These practices are interpreted by Russian practitioners in the Russian context, and those recommendations made by

international bodies and organisations can be considered as a relatively new element within the Russian financial environment.

An examination of compliance as a variable leads to the question of change, for the following reasons. From a historical perspective, the introduction of rules and regulations in Russia might accurately be described as a gradual process.

Compliance is indeed a much more dynamic concept. New requirements are constantly evolving, with new regulations being established as a result of international standards and best practice around the world. The whole idea of compliance constitutes a brave new world for Russia, and there is considerable scope for tension compared to the traditional, static approach to change. The Russian way of conducting business has always been bureaucratic, bound by rules and regulations. In many spheres of life, social behaviour is standardised or controlled through a regulator or officially appointed body to implement law, and compliance can be considered as 'behaviour fitting the behavioural expectations' (Etienne, 2010). In a broader sense, there is a growing body of regulation, which encompasses environmental, ethical, economic and social issues. An examination of the meaning of compliance and how it is understood in practice within the banking regulatory environment will allow an assessment of all aspects of compliance.

1.2. International factors

Aiming to offer new insights into the nature of banking compliance in the context of global and multi-institutional interests, is an overview of the international factors and influences of international events, laws and regulations on compliance development in Russia is provided.

As was evidenced by the Russian accession to the WTO and the accompanying need to incorporate global rules into domestic regulations and procedures, there is a number of domestic and international factors influence compliance development. One of the major factors that influences compliance development is the re-identification and targeting of financial wrong-doing, perhaps due to the many money-laundering scandals, which can be viewed from a purely economic perspective in terms of the cost to the economy, but also from a corporate social responsibility or ethical perspective. The establishment of global treaties and agreements is an attempt to prevent financial wrong-doing and market conduct failures by regulating banking practices. As a result of a number of financial scandals and the ensuing plethora of new regulatory mandates, companies are under pressure to develop strong codes of ethics to guide the behaviour of board directors, managers and employees. In particular, further to *Survey conducted by the* Institute of Leadership and Management (2015) 'there are significant grey areas in the running of a business and managers need to feel empowered and entrusted to make their own judgments – but, crucially, within the framework of the organisation's underlying ethical code

of practice' (p.8). Although concern with ethics has always been viewed as an important element of doing business, the areas of corporate governance and business ethics have now become key factors influencing investment decisions and determining the flows of capital worldwide, rather than being considered as nothing more than a set of rules which companies may or may not choose to follow (Rangan, Chase and Sohel, 2012).

Starting from 1992 the Committee of Sponsoring Organisations of the Treadway Commission (COSO) continues to issue its 'Internal Control – Integrated Framework' (1992). The overarching aim of this document to promote and foster further development of internal control systems helping business environment to understand, assess and implement their internal control systems. Further to these guidelines 'that framework has since been incorporated into policy, rule, and regulation, and used by thousands of enterprises to better control their activities in moving toward achievement of their established objectives' (COSO Enterprise Risk Management (ERM) Executive Summary, 2014).

The COSO Executive Summary (2004:2) defining the scope of ERM purposefully stated it in a broader context to provide the basis for tailor-made tuning and application across organisations and industries. Depending on the structure, corporate standards and the mandate of the financial institution's compliance function, their reach may include operational risk management, internal control and financial investigations such as fraud prevention, global sanctions, prevention of bribery and corruption, and conflicts of interest, among other areas. From the reflective practitioner's perspectives while looking at money-laundering aspects we can see a gradual escalation of financial crime.

Further to the International Compliance Association (ICA) (2019), the definition of financial crime provided on its website '...financial crime can be divided into two essentially different, although closely related, types of conduct. First, there are those activities that dishonestly generate wealth for those engaged in the conduct in question. For example, the exploitation of insider information or the acquisition of another person's property by deceit will invariably be done with the intention of securing a material benefit. Second, there are also financial crimes that do not involve the dishonest taking of a benefit, but that protect a benefit that has already been obtained, or to facilitate the taking of such a benefit. An example of such conduct is where someone attempts to launder the criminal proceeds of another offence in order to place the proceeds beyond the reach of the law'.

The phenomenon 'money laundering' originated in the United States to describe 'the underworld activities of the Mafia and their attempts to 'clean' illegally gained funds via cash-intensive washing salons in the 1930s (Schneider, 2004), making the proceeds appear as legitimate business income' (Ertl, 2004; Schneider, 2004; Schneider, Dreer and Riegler, *et al.*, 2006). More information on the current US AML laws is provided in Appendix 6. Subsequently, this area of financial crime became an international concern due to the globalised nature of business and terrorism.

There are many international regulatory efforts taken toward strengthening compliance requirements for client information (Know Your Client). Among others the following examples can be suggested:

(i) The Financial Services Authority (FSA) (2007) in the U.K. introduced a compliance programme called *Treating Customers Fairly*;

(ii) The Wolfsberg Group (2007) set the global Anti-Money-Laundering rules for banks and requires that all payments between banks have to be rewired to carry full customer information;

(iii) The requirements imposed on every bank to hold client contract information, which clearly demonstrates the suitability and appropriateness of their policies to meet the client's needs (MIFID).

Being a thoughtful practitioner, it becomes apparent that the demand for compliance work seems to be flourishing now more than ever. This section outlines a number of factors that reinforce the emergence of compliance as a major facet of corporate life.

1.2.1. International agreements, treaties and laws

Compliance and financial crime phenomena are usually a transnational organised crime, which involves 'a number of different jurisdictions with differing legal status' (Rider *et al.,* 2009). Further to Karstedt and Nelken (2012) 'the link between globalisation and crime often lacks clarity, nor is internationalisation of trade or crime as new as is sometimes claimed'. It is likely that the most significant financial threats will emanate from illegal transactions, cross-border criminal activity, and risks

to overall stability of the international financial system (Davidson, 2007). International agreements and institutions, more than any other factor, have the most significant role in the evolution of compliance in Russia.

Zagaris (2010) stated that 'the United Nations pioneered international AML cooperation with the 1988 United Nations Convention against illicit Traffic in Narcotic Drugs and Psychotropic Substances, which requires signatories to criminalise money laundering and immobilise the assets of persons involved in illegal narcotics trafficking' (p. 63).

Another UN treaty with important AML/counter-terrorism financial enforcement (CTFE) provisions is the United Nations Convention against Transnational Organized Crime (2000) (Palermo Convention). Russia, as a signatory of the Palermo Convention, is obliged to establish national regulatory regimes to counter all forms of money laundering, as well as client identification, monitoring transactions and reporting them, along with case and records management.

In 1989 during the meeting of G7 Summit in Paris it was established the Financial Action Task Force on Money Laundering (FATF) aiming to address mounting issues related to raise of money laundering. FATF since its establishment continues to assess different methods of money laundering of criminal proceeds and undertakes rounds of mutual evaluations of countries and jurisdictions. The FATF in 2004, 2012, 2013, 2015-2019 further revised their 40 Recommendations, which are publicly available at FATF website.

Russia became a member of FATF in 2003 and is now a member of its steering group that advises the president of FATF on strategic issues. Russia is also a member of the Eurasian Group on Combating Money Laundering and Financing of Terrorism (EAG), as well as of the Egmont Group of Financial Intelligence and the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism, known as Moneyval.

When Russia in 2002 signed up to *the Wolfsberg Principles*, the Russian Government had raised attention to the AML/CFT areas throughout contact with financial institutions and has started to abolish practices deemed noncompliant with CBR rules and expectations among financial institutions with some degree of success (European Union, 2005).

From the practitioner's experience which was proved by series of semi-structured interviews since the official implementation of AML/CFT laws in Russia, there have been numerous formal, national and international activities undertaken by the Central Bank of Russia and the Federal Financial Monitoring Service (Rosfinmonitoring), including information letters, Decrees of the Central Bank and Rosfinmonitoring, and orders on particular issues, totalling no fewer than 5000 documents. Russian

financial institutions have to submit daily reports on obligatory transactions, which fall under certain criteria. The number of such reports could vary from 100 to 10,000 obligatory transactions per day. Thus, it becomes apparent that every financial organisation in Russia has to maintain an adequate level of staff to oversee AML compliance activities to make sure that all obligatory transactions are timely and properly reported. Thus, it is quite fair to observe that substantial amount of measures and processes have been implemented since 2001. These measures enabled to bring current AML/CFT regime in line with international AML/CFT standards.

The most strongest requirements of international compliance regulation include *the Foreign Corrupt Practices Act* (1977) (FCPA), the Sarbanes-Oxley Act (2002) (SOX), and the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (2010), (Appendix 3). Within the financial sector, industry best practices include requirements and guidance for European regulatory bodies and world financial organisations such as FATF, World Bank, OECD, covering mostly the management of those risks not otherwise managed by legal agreements.

1.3. Influence of international events and laws on compliance development in Russia

Amongst the most important international influences on the development of compliance in Russia, the following five stand out: (i) Accession to the WTO, (ii) Money laundering prevention (FATF Status), (iii) International Organisation of Securities Commissions (IOSCO), (iv) Foreign Account Tax Compliance Act (FATCA) and (v) Practice of International firms operating in Russia.

1.3.1. Accession to the WTO

In July 2012, Russian lawmakers ratified the country's entry to the World Trade Organisation. Many discussions about the 'various advantages and disadvantages of participation in the WTO had already been voiced about Russia's potential accession' (Kiselev, 2013). Ivanov (2007) analysed and evaluated the possible economic consequences of Russian WTO accession. Grinberg and Tatarkina (2007) also assessed the socioeconomic consequences of Russian WTO accession and exposure to international trade. They proposed in their work on WTO accession that 'Russia's weak legislation and regulatory framework shall be also highlighted as an area of concern should Russia proceed with membership, as well as the continuing nihilism apparent in Russian society' (p.17).

As stated by Bergsten and Åslund, (2010) 'WTO accession should enlarge Russia's GDP by 3.3% every year, which indicates great beneficial gains of becoming a member'. WTO accession shall be considered together with a broader economic reform package, if it is to result in any serious improvement in Russia's investment climate. In this respect, investor sentiment would ultimately be determined by the extent to which institutional structural changes are implemented, rather than mere

accession or non-accession to the WTO. However, WTO membership does provide an important catalyst for a more resolute approach to creating economic reform and industry efficiency in Russia. It also reflects that the government is more serious about reform and wishes to send a clear signal to investors. WTO membership would foster greater economic integration with the rest of the world and provide a boost for the investment climate. Russian business would benefit from an access to the WTOs arbitration mechanisms.

It is important that membership also provides an improved regulatory backdrop for foreign investors and creates a long-term initiative for Russian companies to become more efficient in the face of increased foreign competition. In this context, WTO accession is a significant step and cultivates hope that the next Russian government will prioritise improving the economic and legal framework and, more importantly, addressing the international perception of high country risk associated with Russia. Therefore, the interviews carried out with the majority of respondents during the research suggest that an influence on compliance would primarily depend on the regulator's political will to introduce the structural changes required. In particular, the respondents reiterated that a number of business processes and functions need to be reassessed to ensure transparency and eliminate practices which might arbitrarily or unfairly prejudice the interests of either regulator or the regulated.

The research carried out suggests that development of compliance in Russia has the potential to act as a bridge between Western standards and Russian traditions and could play a key role in the development of Russian financial sector and moderating established Russian practices. *This research does aspire to contribute toward compliance policy development in Russia and the strategies adopted by Russian regulated entities in responding to these policies.*

In terms of compliance within the financial institutions themselves it was noted that 'Russia's accession to the WTO requires the introduction of modern reporting standards and control procedures which should increase levels of transparency' (Cooper, 2012:1). Further to the WTO accession terms and conditions, a quota may be established which will limit the proportion of foreign capital held by Russian banks to 50%. Another important aspect is the ban on foreign banks opening affiliate offices in Russia. This means that establishment of local subsidiaries or representative office are only legitimately possible in Russia. In particular, further to Baker and McKenzie (2015) legal review 'non-residents have to apply to Bank of Russia's prior approval if they acquire 10% or more of the shares in a Russian bank or non-banking credit organization' (Baker and McKenzie, 2015). The regulator's position is quite clear in its desire to treat subsidiary companies of foreign banks in the same way as Russian legal entities. Whether this approach will be different in practice to that adopted in the regulator's dealings with 100% Russian banks remains unclear.

1.3.2. Money laundering prevention (FATF Status)

In accordance with Renner's KYC blog (2014) 'as a member of FATF, Russia is not currently specified as having substantial money laundering and terrorist financing (ML/TF) risks or having strategic AML/CFT deficiencies'. This conclusion is based on outcomes of *Mutual Evaluation of the Russian Federation: 6th Follow-up Report* (2013) in relation to implementation of FATF recommendation. FATF recognized in 2013 that Russia made a significant progress to mitigate deficiencies identified earlier in the 2008 Mutual Evaluation Report.

Further to FATF (2013) *Mutual Evaluation of the Russian Federation: 6th Follow-up Report* made in 2013, the Russian Federation has taken a number of actions to follow key Recommendations outlined in the above mentioned Report. Among these actions were the prohibition of opening accounts for anonymous holders, enhancing requirements for disclosure of beneficial ownership, introducing amendments in legislation to restrain criminals from holding major shareholding in the banks operating in Russia. There are certain areas that still need to be improved, such as broadening and enhancement of customer due diligence requirements, e.g. identification of PEP's.

Domestic peculiarities

Russian-related money laundering is often mentioned in the international press and reports of government agencies as a series problem in international financial and banking security (Fituni, 1998). From the domestic perspectives, corruption in Russia is a major source of laundered funds, with proceeds frequently moved offshore, as in the Daimler and Ikea cases. A former audit employee at DaimlerChrysler, claimed he was fired for raising concerns over the company's corrupt practices abroad. This was the first U.S. Foreign Corrupt Practices Act (FCPA) case in which a Russian subsidiary (US Department of Justice Statement of 01 April 2010), in this case Daimler Chrysler Automotive Russia SAO, pleaded guilty in U.S. court (2010). And with that, a previously little-known U.S. law took on a whole new significance for executives and managers in Russian subsidiaries of U.S. companies.

In the case of Ikea, the company faced a number of challenges while trying to enter the Russian market in 2000, and its operations continue to struggle mainly due to the local specifics of the business environment. The case with rented generators and kickbacks from the rental company was lead to reputational and financial loss for Ikea in the beginning of 2000s (Kramer, 2009).

1.3.3. International Organisation of Securities Commissions (IOSCO)

The International Organisation of Securities Commissions (IOSCO) takes part in drafting financial market regulation recommendations for the Financial Stability Board and G20. Some of IOSCO's key

initiatives involve regulators taking control of short sales of securities, the regulation of hedge funds, and over-the-counter (OTC) clearing implementation, including trades in derivatives. IOSCO has agreed to sign a Memorandum of Understanding with Russia allowing the CBR to request information for financial market crime investigation from other regulators. Further to the National Settlement Depository Report (2016) 'for Russia's central securities depository, this recognition simplifies the procedure of building bilateral links with the infrastructures of the IOSCO regions, in particular, with Asian central securities depositories from Hong Kong and Singapore' (p.2). Russia was originally scheduled to join IOSCO back in October 2014. Further to the Survey on Implementation of G20/FSB financial reforms in other areas conducted by the Financial Stability Board (2014) it was concluded that 'based on the analysis of recommendations that pertain to securities markets carried out by the IOSCO, the CBR has issued a number of ordinances relating to the regulation and supervision of credit rating agencies (CRAs) covering procedures, methodology, personnel and registration. All CRA activities adhered to the standards outlined with effect from January 14, 2017 for Russian legal entities and July 12, 2017 for foreign legal entities' (2017:32). It was also indicated that, 'while the legislation doesn't set any restrictions on dark liquidity (liquidity on private forums for trading securities), there is currently no in Russia 'dark pool' trading system, where trades remain confidential and outside the purview of the general investing public' (2017:45).

To sum up it can be proposed that the most challenging implication for compliance by Russian banks would be the expanded scope of regulatory queries from various jurisdictions on the activities of IOSCO member financial institutions, as it provides a legal platform for sharing information on market participants, details of the transactions between the regulators of different members of IOSCO.

1.3.4. Foreign Account Tax Compliance Act (FATCA)

The application of the U.S. government's *Foreign Account Tax Compliance Act (FATCA),* has significant implications for compliance around the world, including Russia. FATCA requires financial institutions to identify U.S. persons who have invested outside of the US either in financial accounts or entities. Therefore, in accordance with Accenture overview (2014 [on-line]) 'complying with FATCA may require significant efforts in terms of implementation, and investments and resources in 2013 and 2014 in operational processes, information systems, training and communication, and customer relationship management, as well as the compliance and tax functions'.

1.3.5. Practice of International firms operating in Russia

International companies operating in Russia have considerable capacity to influence the adoption of international standards among Russian businesses (Cooper, 2013). Although one of the

biggest internal influences continues to be political actors that propose different ideas which may later become a legislation or impact a change in existing legislation, the practices of international firms have a significant influence not only on the attitudes of the regulated entities, but also on the regulator's approaches. During a series of interviews with representatives of foreign banks and organisation it become apparent that there is a desire among some executives of foreign companies to improve the internal regulatory framework of their companies operating in Russia to comply with the ever-changing regulatory environment, known as the inside compliance process. This drives the creation of internal compliance policies, codes of best practice, compliance regulations and manuals.

Many activities carried out by foreign European banks, international companies and associations in Russia, as well as the research carried out in this study suggests that the practice of the biggest international firms, banks and organizations has a major impact on domestic compliance development in Russia. This can be seen by the strong desire among many Russian companies to attract well-paid compliance managers with experience working in big international companies to help build and deliver compliance frameworks in Russia. Their experience in the areas of corruption prevention and supporting anti-money-laundering and ethics initiatives is highly valued by Russian companies wishing to strengthen business practices in these areas and support the local business environment.

It is worth mentioning that the practices of international financial institutions are different due to their banking status and role, whether they are universal or commercial/investment financial institutions. Universal banks are engaged in a number of financial services, e.g. lending, foreign exchange, underwriting securities, deposit taking, portfolio management and so on. Commercial or investment banks are engaged in one core activity, namely commercial or investment banking. It might be concluded that compliance procedures and requirements in universal banks are likely to be more complicated due to the various business activities undertaken. However, after the 2008 financial crisis, governments across the world were empowered to push for financial reforms designed to provide greater transparency of transactions and reduce risk in order to make financial systems more stable and better regulated. Thus the legal requirements imposed on investment banks became equally challenging and increasingly complex, as seen in the U.S. through *the Dodd–Frank Wall Street Reform and Consumer Protection Act*, and the E.U. through *the European markets and Infrastructure Regulation (EMIR)*. As the majority of financial institutions in Russia are universal banks with a very a few number of investment banks, the critique of commercial universal banks can be applied to Russian financial institutions. Rich and Walter (1993) criticized the universal banks by outlining 'four kinds of concerns:

(i) Commercial banks engaged in the securities business are liable to incur greater risk than institutions undertaking traditional deposit taking and lending activities. Therefore, universal banks are prone to increase the likelihood of losses by their depositors;

(ii) Because of the increase in risk, universal banks complicate the tasks of the central banks in their capacity as lenders of last resort;
(iii) Universal banks are likely to face various conflicts of interest vis-à-vis their creditors and debtors;
(iv) Universal banks, due to their size, may further concentrate power and inhibit competition' (1993:305-306).

The difference in practices is also based on the legal system applied (i) Continental European legal system or (ii) Anglo-Saxon legal system. The Anglo-Saxon legal system is a system of law based on jurisprudence, whereby the decisions of previous judges ultimately inform subsequent legal decisions. The Anglo-Saxon legal system is used in Ireland, Britain, Australia, New Zealand, South Africa, Canada, except Quebec Province and the United States, except the State of Louisiana. By contrast, the continental European legal system is a legal system with the characteristics of the various provisions of codified law, compiled systematically and open to interpretation by judges in its application (Mousoukaris, 2015). In Russia, financial institutions historically operate within the parameters of the continental European legal system, thus the banking practices of the European financial institutions have greater influence on compliance development.

In essence, two different kinds of banking system generate different regulatory and compliance challenges for both the regulator and the regulated financial institutions. A key argument in favour of universal banks is that they are usually better equipped to diversify their risk than the commercial or investment banks. Clearly, if an institution runs into solvency problems, the regulator may be confronted by the 'too big to fail' dilemma, which does not refer to the scope of an institution's activities, but to its actual size. Moreover, the recent financial crisis demonstrated that the Anglo-Saxon model was flawed and will require a significant overhaul as the public sector has clearly become the guarantor of all systemic financial institutions, providing both liquidity and solvency insurance. The U.K. Independent Commission on Banking (ICB) was created for advising on how to improve U.K. financial security without damaging the banking industry or the economy. It had another, tacit brief: to find ways to avoid future government bank bailouts. Further to Ambler and Miles (2011) 'the ICB made two substantive recommendations: (1) ring-fencing High Street banks, which would retain government guarantees; and (2) raising capital ratios above those being considered by the E.U. and globally by Basel III' (p.5).

1.4. The local laws influenced on compliance development in Russia

One of the conclusion made in the World Bank (2016) report was about the Russian challenges 'while Russia has embraced the transition to a market economy, this has brought particular challenges. These challenges include: (i) economic crime which leads to possible loss of tax revenue and the loss of

trust and confidence in the Russian financial markets; (ii) strained political-business relations due to the current political and economic landscape; (iii) meeting the institutional requirements stipulated by the international trading community and international organisations; (iv) the need to repair reputational damage. All of these challenges exist due to weak legislative institutions and the developing nature of the Russian regulatory framework'.

Although evaluation is not well developed in the Russian policy development process, policy evaluation has a profound impact on compliance development, as no new policies can be introduced without a thorough evaluation of those previously existing. Societal and, by extension, regulatory behaviour is influenced by the socioeconomic environment and Russian culture with its particular traditions is very different from that of Western countries. Traditional Western modes of banking regulation are inappropriate for conditions in Russia because they begin with two false premises. The first assumes that Russian banking methods compare with Western banking methods and that banks can be successfully regulated irrespective of cultural and historical peculiarities.

The regulations in relation to money-laundering and other areas of financial compliance risk, have forced companies to rapidly develop internal systems, technologies and resources to enhance compliance monitoring with these laws and regulations. The strategies of both actors towards compliance will be provided in a more detailed assessment in the subsequent chapter 3 and chapter 5.

1.4.1. Money laundering and financing terrorism

The notion of regulatory compliance is multifaceted. In the context of regulating the behaviour of any sector of society, we need to recognise that regulatory compliance is a complex phenomenon involving interdependent relationships between the regulator and the regulated. To draw on metaphors, regulatory compliance involves what might be described as partners in a never-ending dance, the purpose of which is to maintain a delicate balance of interests between several stakeholders; it is to some extent a game of strategy between gamekeeper and poacher. This research proposes to investigate regulatory compliance within Russian financial services, drawing on the perspectives of several primary stakeholders, namely the Central Bank of Russia in its role as the regulating agency and the regulated corporations operating within Russia, and secondary stakeholders, including law firms, and international financial and economic institutions. The analysis will be set within the context of Russian social, political and economic institutions as well as wider international influences.

Rosfinmonitoring (RFM) acts as the special designated state body for all ML/FT issues and deals with other state authorities in relation to ML/FT issues, including the Financial Antimonopoly Service

(FAS). The Russian government has introduced a number of initiatives aimed at preventing money laundering across different state bodies.

On 13 July 2001, the State Duma adopted Federal Law 115-FZ *On Countering the Legalisation of Illegal Earning (Money Laundering) and the Financing of Terrorism 2001* (the Federal Law 115-FZ). The Federal Law 115-FZ evidenced the efforts of the Russian Government to comply with international treaties created for 'preventing, detecting and minimizing money laundering of illegal assets and financing of terrorism' (2001:2).

Thus, the Federal Law 115-FZ reinforced the provisions related to monitoring cash transactions (both depositing and withdrawing cash funds) 'in case the amount is equal to or exceeds 600,000 roubles, it is subject to such monitoring.' In addition, further to the above-mentioned law, 'organisations carrying out financial operations should take appropriate measures to prevent the legalization (laundering) of illegal earnings or the financing of terrorism by reporting: ...an odd or extraordinary nature of a deal which does not have an obvious economic sense; certain discrepancies between the purpose of the transaction and the core aims of the firm's activities specified in the incorporation document; certain repeated transactions that in substance could be considered as suspicious as their goal is an attempt to overcome the compulsory control procedures'. (2001:7.2).

Important amendments were adopted in July 2010 when Russia extended legislation on AML/CFT (Federal Law No.176-FZ *On Amendments to the Federal Law on Combating Money Laundering and Terrorist Financing and to the Code of Administrative Offences of the Russian Federation 2010* and the Federal Law No.197-FZ *On Amendments to Certain Legislative Acts of the Russian Federation Related to Combating Money Laundering and Terrorist Financing 2010.* The main focus of these amendments were made on expanding AML/CFT regulations and improving enforcement of AML/CFT regulations by enhancing administrative burden on the financial institutions.

The amendments were also introduced to the *Regulations on Submission of Information to the Federal Financial Monitoring Service by Institutions Engaged in Transactions with Monetary Funds or other Assets* approved by Russian Federation Government Resolution No.245 (2002), aiming to extend and update number of institutions involved in processing money or other assets and to *the Procedure for Designating and Publishing the List of Countries (Territories) that do not participate in the International AML/CFT Cooperation* established by the Government Resolution No. 173, (2003).

With the adoption of the Federal Law 134-FZ *On Amendments to Certain Legal Acts of the Russian Federation on Counteracting Illicit Financial Transactions* 2013 (the 134-FZ law) some measures have been taken to remedy the identified deficiency. It is states that 'credit organisations are prohibited

to open and hold accounts (deposits) in the name of anonymous owners, i.e. without submission by the individual or legal entity opening the account (deposit) of any documents necessary for identification thereof, as well as opening and holding accounts (deposits) in the name of owners using fictitious names (assumed names)' (2013:6) This provision is applicable only to Credit organisations and is not extended to other financial institutions. As stated by the Russian authorities, bank accounts are maintained only by credit institutions, however on a desk based review it is not clear whether the prohibition on maintaining accounts under fictitious names is applied by other financial institutions (e.g. stockbrokers) holding accounts or not and if not what the impact of this is.

According to the 134-FZ law a new notion of 'beneficial owner' has been incorporated in the Russian legislation, which became consistent with the FATF standards on beneficial ownership. From the local regulatory perspective (134-FZ) any natural person who directly or indirectly has 25% and more controlled shares (2013:3) shall considered to be a beneficiary owner. As for the sanctions imposed on financial institutions (and DNFBPs) for not identifying beneficial owners and establishing business relationships without identifying beneficial owners, an Article 15.27 of the Code of Administrative Offences has been further amended. The Code of Administrative Offences now specifies five types of "ML safety" violations, instead of grouping all violations under one general offence. The amended article 15.27 of the Code of Administrative Offences establishes liability of institutions/ entities involved in transactions with funds or other assets for failure to provide information on transactions of their customers and beneficial owners of customers or information on customer account (deposit) activity requested to the designated AML/CFT authority. It is however not clear whether the sanctions for violations mentioned above have been applied by the competent authorities in respect of failure to identify beneficial owners. Further to the Article 15.27 of the Code of Administrative Offences 'failure to provide such information is punishable by administrative fine imposed on legal entities in an amount of three hundred thousand up to five hundred thousand rubles'. These amendments and modifications cover all possible types of AML/CFT Law violations in terms of both organization and implementation of AML/CFT internal controls including implementation of the internal control programs and procedures, fulfillment of the customer and beneficiary identification requirements, documenting and filing information with the designated authority as well as personnel training and education.

Federal Law No.176-FZ *On Amendments to the Federal Law on Combating Legalization (Laundering) of Proceeds from Crime and Financing of Terrorism and to the Russian Federation Code on Administrative Offences 2010* (the 176-FZ) was adopted in address recommendations provided by the First Mutual Evaluation of the Russian Federation, EAG Second Follow-up Report (2010). This law was intended to further enhance the standards for identification and verification procedures. The 176-FZ also addresses the issue of liabilities while carrying out transactions with monetary funds or other

property and/or their executive officers for failure to comply with the AML/CFT legislation. As a result of such amendments the administrative liability of executive officers was enlarged by increasing the penalties and by introduction of institute of disqualification for Money Laundering Reporting Officers (MLROs).

In accordance with the results of the first mutual evaluation report on Russia carried out by the European Committee on Crime Problems (2001), it was revealed that a 'critical deficiency' existed in Russia's laws and regulations aimed at supporting international standards on money laundering. The Russian authorities were frank in their admission that KYC requirements 'do not meet the international standards'. Although Russia had confiscation procedures in place, they were not utilised in such a way as to correspond with multilateral treaties. On law enforcement in general, Russia was described as having a long way to go before it can be said to have a real operational system in place to fight money laundering'. Significant progress was made during the last 10-15 years, primarily the introduction of legislation to combat money laundering, the level of money laundering investigations, prosecutions and convictions were also increasing.

Some of the obligatory requirements of the AML/CFT compliance regime in Russia may be considered as very formal and rigid. For instance, it is mandatory to report all payments exceeding 600,000 roubles within one working day after the date of the transaction (the Provision 375-P). The research carried out suggests that given resource constraints and the sheer volume of information involved, it seems highly unlikely that such information is receiving due attention by the Russian regulator Rosfinmonitoring on a regular basis. Such traditional, formal and ineffective approaches are less business-centred than the risk-oriented approaches used by the European and U.K. financial authorities, which focus less on obligatory state procedures by placing more responsibility on the banks themselves.

As the Russian Federation is a member of 3 AML/CFT assessment bodies, it was the subject of a joint evaluation by the FATF, MONEYVAL and the Eurasian Group (EAG) in the 3rd round of MONEYVAL evaluations. Previously the Russian Federation had been evaluated by MONEYVAL alone in MONEYVAL's 1st and 2nd rounds. Recent changes in 2014-2017 to one of the oldest Russian compliance requirements which was introduced in 1991 came in the form of Federal Law 115-FZ as a reflection of the CBR's desire to align the Russian regulatory regime with international standards in relation to terrorism and global sanctions. For these 18 years of AML compliance requirements, Russia has established a solid and efficient framework for dealing with ML/TF risks.

1.5. Key Challenges facing Russian regulatory regime in relation to AML/CFT

One of the key challenges is the very, strict, obligatory nature of AML requirements and the overwhelmingly formal approach taken by the CBR toward financial institutions. In many ways, this presents an administrative burden to the authorities which limits their capacity to take the practical steps needed to pay attention to genuinely suspicious cases and undertake the level of money laundering prevention and monitoring activities demanded by international standards.

Based on the recommendations offered by the FATF, Moneyval and EAG experts, being a member of all above-mentioned groups, Russia was forced to implement an action plan to improve existing laws and enforcement measures, as well as to address the issues of beneficial ownership highlighted in the earlier sub-section. In accordance with the FATF Mutual Evaluation of the Russian Federation: 6th Follow-up Report (2013), it was scrutinized that '…with the removal of the threshold for criminalising self-laundering, Russia has sufficiently addressed the deficiencies to Recommendation 1 and brought its compliance with Recommendation 1 back to a level of largely compliant or higher. In line with FATF Recommendation 5 of the Mutual Evaluation of the Russian Federation: 6th Follow-up Report (2013) and Moneyval Progress Report (2014), Russia has addressed all deficiencies relating to this Recommendation by introducing beneficial ownership relating to the nature and intended purpose of business relationships and the timing of verification.

It can be further summarized that issues of money laundering and terrorist financing are still major challenges for Russia. However, from the Russian perspectives, a remarkable progress was made. For example, several critical laws in relation to new technology and remote financial transactions, i.e. State Duma of the Russian Federation (2011) Federal Law 161-FZ on *National Payment System* and State Duma of the Russian Federation (2011) Federal Law 162-FZ *On amendments to the National Payment system* were adopted, which, establish the regulations for new technologies applied by the banks. Transactions below 15,000 rubles become no longer subject to client identification requirements. Based on the Order of Rosfinmonitoring No.103 (2009), a new basis for submission Suspicious Activities Reports (SARs) to the Financial Intelligence Unit (FIU) based on the monetary transactions made by the client remotely via payment service providers was initiated.

It was acknowledged in 2011 by the Report of the Bureau of International Narcotics and Law Enforcement Affairs (2011) that application of AML/CFT requirements has been extended to foreign branches, representative offices and affiliates of the Russian banks located outside of Russia. Overall, the amendments made to the Code of Administrative Offences improved regulatory oversight related to ML legislation and broadened the authority of Rosfinmonitoring, the (FIU), and the CBR to conduct investigations of ML violations.

However, further to PricewaterhouseCoopers report made in 2017 '…sometimes, the challenges are considerable. Russia still has significant bureaucracy, and corruption has yet to be eradicated. Almost everybody in the government seems to realise the necessity of structural economic reforms, but progress in this direction has been rather sluggish so far'

Conclusions

Finally it shall be concluded that compliance is a socially constructed variable phenomenon with a variety of definitions and interpretations. There are two core principles of regulation, namely rules-based and principles-based, which make further complications for compliance, as the rules and regulations in Russia are invariably static, while compliance is actually a more dynamic concept. Further layers of complications shall be added in applying formal and informal approaches towards compliance by the regulator and the regulated, depending on many factors well as contextual influences that are specified in this thesis. One of the core findings suggests that there is a considerable support for the practice of compliance as a constantly developing dynamic phenomenon. Thus, the understanding of the meaning of compliance is getting more and more sophisticated. The regulated banks currently find themselves in a very challenging position to design their own compliance strategies and implement compliance frameworks based on a subjective interpretation of compliance and a somewhat limited experience of the regulatory authorities' expectations. As well as the regulator, who also has limited experience in regulating banks in a broader international context, in line with various international agreements and policies (not only ML/FT related). The main contribution of this thesis is developing a more subtle understanding of compliance by adopting a new, helical theoretical framework of three inter-connected concepts (content, process and context).

Provided that there are two types of change, namely an incremental and a radical one, this study examines compliance through the relevant notions, e.g gradual change theory. In this respect, gradual change theory, outlined by Mahoney and Thelen (2010) describes policy-making as a slowly evolving process applicable to a number of situations. Therefore, the research views compliance's gradual change during time periods of stability in contrast to the views on institutional change based on a result of radical change. Another contribution of this thesis is adding a missing fifth element initiation into the Mahoney and Thelen work (2010), which is an additional element to the existing traditional gradual change theory. All these findings and contributions are provided in more detail in chapter 6, which contribute to developing a more sophisticated understanding of the overall meaning of compliance.

As a navigational point, this thesis consists of 6 chapters. Chapter 2 is a literature review, comprising of an examination of ideas directly relevant to the aim and objectives of the research. Chapter 3 presents the methodology, covering philosophical issues affecting compliance, the research

design strategy and supporting methods of data collection and analysis. Ethics in research is also discussed here. Chapter 4 outlines the findings of this research and provides an account of the variation in meaning and ideas behind compliance in seven financial institutions, and the strategies of both regulator (Central Bank of Russia) and those seven regulated entities. This chapter includes an identification of the influence of the domestic political context in Russia, and the role of international treaties and agreements on the conduct of financial institutions. Chapter 5 employs a mix of conceptual tools and frameworks to help analyse the range of policies used by the Russian financial regulator in order to effect compliance in the area of money laundering and the strategies employed by banks for managing compliance. A discussion of how context shapes compliance ends this chapter. Chapter 6 provides conclusions, offering a synthesis of the study's main findings and insights, reflections on the achievement of the aim and objectives, and a discussion of the contribution made by this study.

Chapter 2 - Literature Review

Introduction

The overarching research aim of this thesis, is to offer new insights into the nature of bank compliance, set within a given regulatory regime (Russia), in the context of global and multi-institutional interests. These new insights of the nature of banking compliance are based on a fundamental understanding of variations and different interpretations of compliance. This understanding will raise an awareness about compliance and will improve the meaningful dialogue between the regulator and the regulated and overall enhance compliance. A provided theoretical framework for examining compliance phenomenon will assist policy development and implementation to develop and enhance compliance.

The conceptual framework used in this chapter mirrors the research aim components comprising of three elements: the what question (the Content), e.g. meaning of compliance; the how question (the Process), e.g. implementation of compliance; and the where question (the Context), e.g. Russia. The relationship between these three components, e.g. context gives meaning to content and process, so there is no meaning without context, and process similarly varies with context and particular content invokes particular processes, all these iterations between three components make a conceptual framework of my thesis.

The aim of this Ccapter is to give an overview of theories, concepts and ideas that are relevant to the above mentioned research aim and could provide answers on my objectives specified in chapter 1. This chapter consists of three main parts, such as examination of theories and views on Compliance as Content; secondly examination of theories and views on regulatory strategies and institutional changes, and thirdly examination on theories regarding influences both international and political context on Russian regulatory context is provided.

The theory by Streeck and Thelen (2005) has been very powerful and has been applied within a broad number of literature on institutional and policy change. This theory enables to distinguish between different types of change, and their impacts on the system. For the purpose of this thesis, the theory of institutional change applies mainly to institutions, even though policies can be institutions in some instances. In practical terms unfortunately, it is not always clear when this is the case. Streeck and Thelen (2005) proposed that a main issue in traditional institutional analysis is that it ‘always emphasized structural constraints and continuity’; considering institutions as ‘frozen residues' had appeared theoretically inadequate and did not match empirical reality. Greif and Latin (2004) proposed that institutions themselves should be viewed at different stages of aggregation. The meaning of institutions as regimes keeps also gradual change provided that institutions are multilayered and occasionally overlap, more institutions can be ambiguous, inconsistent and contain contradictory logic (Lieberman, 2002); Streeck and Thelen, 2005). Further to Berger and Luckman (1967) ‘self-reproducing properties of

institutions are cognitive in nature, and may be so routine and 'taken for granted' that they are beyond conscious scrutiny'

Part 2.1. Compliance as Content: its meaning in principle and in practice.

Further to Pettigrew (1987) 'there are many ways of putting contextual and processual research into the practice'. There is a direct connection between transformation of the firm and an institutional idea of gradual change. In fact, Pettigrew (1987) was referred to the institutional change, as the central theory of his paper is the link between action (behaviour of actors) and structure (institutional structure). They interact with each other and this is a kind of institutional behaviour. It will be seen that compliance is encompassed within a framework that can be explained in terms of substance, process and context. Although this framework has been widely documented in the literature relating to strategy described in the work of Boje, Burnes, Hassard (2012), it has been very limited knowledge about how this can be applied to compliance specifically. In the following section, the meaning of compliance will be considered, followed by an analysis of how it overlaps with other concepts, including concordance and conformance. An examination of the meaning of compliance, its interpretive flexibility and efficacy will be provided by considering compliance as a component within a system.

2.1.1. The Meaning of Compliance

Compliance has a long history with many definitions and interpretations, and is by no means restricted to the workings of the financial markets. Compliance means different to different stakeholders. The understanding of variations and different interpretations of compliance is provided in this chapter. This understanding will raise an awareness about compliance and will improve the meaningful dialog between the regulator and the regulated and overall enhance compliance. A provided theoretical framework for examining compliance phenomenon will assist policy development and implementation to develop and enhance compliance.

Traditionally, compliance was understood in terms of conformity or obedience to laws and regulations (Youndt and Snell, 2004). However, the recent concepts defined by legal and organisational scholars have expanded the scope of compliance space. As Parker (2002) suggests, 'not only regulators require organisations to meet their legal and regulatory obligations, stakeholders require that organisations operate in accordance with expected norms and values' (p.249-250). From behaviouristic perspectives, compliance can be defined as the actual behaviour of a subject conforming to specified and expected behavior. In this context, Simmons (1998) claims that 'even when compliance can be necessary for effectiveness, it shall not be considered that compliance is always fitted' (p.4). The meaning of compliance is influenced by the particular context, which will be analysed in more detail in

objective 3. The peculiarities of implications for regulatory policy implementation in the Russian financial landscape are provided in subsequent chapters 4 and 5.

For my thesis the role of language is considered as 'fundamental' as it allows to make certain methods of thinking and acting possible (Phillips, Lawrence & Hardy, 2004). Implementation of any policy, requirement in the bank is impossible without understanding its written language. The language can be considered as a vital element for 'desirability and appropriateness of institutional deviance' (Suddaby R. & Greenwood R., 2005, p.37). The language is a social tool through which the world is represented, e.g. compliance world, therefore it is also of a particular relevance to understanding the meaning of compliance considering Fairclough's point that 'language is a particular type of social semiotic structure (1989). For example, the meaning of compliance is varied depending on attitudes of people work in domestic banks, where local language used and a foreign banks, where internal language is English. Moreover, the meaning affects the context and vice versa. Detailed explanations of these variables and effects made by meaning to the context and vice versa is provided in further chapter 5 (Analysis).

Compliance can also be considered as the regulatory behaviour of individual entities or as the behaviour of interacting agencies in the sense of increased frequency and complexity of interactions between the various regulatory bodies (Cagaggi, 2014). The behaviouristic patterns and strategies of both actors (regulator and regulated) in ensuring compliance will be provided in more details in the objective 2.

Interpretive flexibility is a relevant term frequently used to outline such complexities. In the context of this thesis interpretive flexibility can be viewed as the capacity of a specific approach to sustain different views about the subject matter. It plays an important role in explaining how the meaning of regulatory compliance can be socially constructed. A detailed illustration of interpretative flexibility is demonstrated by the severe AML deficiencies witnessed in the U.S. subsidiary of HSBC, which will be considered more broadly in chapters 4 and 5.

The of efficacy of compliance is another notion to consider in discussing meaning of compliance. Moreover, evolution of efficacy of compliance will be further provided in chapter 4. While compliance is a defined concept, it is replete with its ambiguities and anomalies applicable beyond the living banking environment. These will be highlighted in more detail in the subsequent chapters (chapters 4 and 5).

2.1.2. Theories of regulation and compliance and its inter-dependence

Compliance and regulation are two closely inter-connected and interrelation notions, thus it is almost impossible to apply one without affecting the other. The term 'regulation' has been used to encompass a variety of different conceptions (Moran, 2002). Regulation can be considered as the

artefact or as the process. There are two kinds of process relevant to the theory of regulation, which are a rational linear and helical process. The process is 'a focused, sustained attempt by the state to alter the types of behaviour valued by society' (Morris et al., 2012). The above definition draws from an amalgam of ideas, strongly influenced, but not identical to, the definition adopted by Jones (2002) and Black (2002b). This concept requires further elaboration. Firstly, Jones (2002) emphasises regulation as a process of 'systemic control,' not only embracing rules that restrict behaviour but also including commands and mechanisms for monitoring and compliance (pp.611-628). Secondly, the types of behaviour that are subject to regulation are thought to be of value to society, with the primary aim of regulation being to modify that behaviour rather than to ultimately punish or censure those engaging in regulatory activities (Baldwin, Scott and Hood, 1998; Black 2002b). Black (2002b) claims that the 'real heart' of the regulatory function is 'how to alter behaviour so that people act in a way that they would not otherwise do, and in such a way as to ensure that regulatory objectives are met' (69). Thirdly, 'regulation has an orientation purpose in that it seeks to implement particular goals that are considered by society to be valuable and worthy' (Dainith, 1998). Jones (2002) observes that 'in regulating economic and social activity, the state is a "purposeful actor" pursuing economic and social objectives through linking state law with power resources of instruments, force, wealth, information and persuasion' (Jones, 2002). Van den Bergh and Faure (1991) observed a while ago that 'organisations can be forced, e.g., to keep certain prices, to stay out of certain markets, to apply particularly techniques in the productions or to pay the legal minimum wage. Sanctions can include fines, the publicizing of violations, imprisonment, an order to make specific arrangements, an injunction against withholding certain sanctions, or closing down the business' (165). The considerations of Baldwin et al. (1998) about the three different notions of regulation are provided in Appendix 1.

Further to Hertog (1999) 'regulation will be taken to mean the employment of legal instruments for the implementation of social-economic policy objectives'. Hertog (1999) provided a distinction between three types of theories of regulation: (i) pubic interest theories, (ii) the Chicago theory of regulation; and (iii) the private interest theory, which is aimed to explain economic regulation. Further to Hertog (2010) 'public interest theories, described as the best possible allocation of scarce resources for individual and collective goods and private interest assumes that in the course of time, regulation will come to serve the interest of the branch of industry involved' (p.5). There have been numerous researchers that have studied other theories of regulation (e.g. theory of self-regulation proposed by Bandura (1991), Baumeister (1998) and Muraven and Baumeister (2000), which were focused on behaviour and cognitive component of individuum. As my thesis is about firm behaviour rather than about individual behaviour within the regulatory environment, the primary focus shall be made on theories that implied firm behaviours only.

Further to Braithwaite (2002), Ayres and Braithwaite (1992) it has been already developed for 40 years a better understanding of the importance of 'responsive regulation', in which regulators should be responsive to the conduct of those they seek to regulate, or to how effectively citizens or corporations are regulating themselves before 'deciding on whether to escalate intervention. It become apparent for regulators that application of only informal measures can 'easily degenerate into intolerable laxity and a failure to deter those who have no intention to comply voluntarily' (Gunningham and Johnstone, 1999). For resolution of the old discussion, the regulatory theorists Ayres and Braithwaite (1992) originally devised as a combination of two methods, in the form of the 'enforcement pyramid', or alternatively 'an interactive compliance' (p.2) by Sigler and Murphy (1988).

Part 2.2. Compliance as Process in terms of bank policy implementation responses/strategies to regulatory change; and regulatory strategies and institutional changes as responses

This section will address the second objective of this research by providing an examination of the regulatory practices of the regulator and the regulated in the area of money laundering. Firstly, discussion on various theories of regulation and theories compliance is provided that allow to look at the compliance and regulation as two inter-related and closely inter-dependent phenomena. Secondly, a variety of approaches and principal strategies taken by regulator and regulated in enforcing compliances as well as institutional changes as responses will be further identified followed by an analysis of how these impact on compliance in positive and negative ways. Thirdly, transparency and accountability will be further examined.

2.2.1 Institutional context

Aiming to put the institutional context establishment of global treaties and agreements is an attempt to prevent financial wrong-doing and market conduct failures by regulating banking practices. Financial crime became an international concern due to the globalised nature of business and terrorism. The attacks on September 11 destabilized the payment's processing for a week. The closure of New York Stock Exchange, and a temporary suspension of flights within the United States. U.S. stock prices fell, and the implied volatility of equities rose and remained high for several months (Neely, 2004).

Particular schools of institutional theory could be taken as indicating that regulatory compliance can take differing forms specified further, while some theories of compliance (Mitchell, 2007) highlight that compliance is about behaviour. Czarniawska (2008) proposed that 'institutional theory shall not be viewed as a theory, but as a translation, a method of looking into social life'. Presented by Powell and DiMaggio (1991) new institutionalism prioritized the logic of appropriateness in organizational action, and emphasized the rules, as well as understanding of a meaning that is used in institutions. Further to

Czarniawska (2008), it has been suggested by many critics, however, that the notion of change was not properly explained by the new institutionalists.

The behaviour of banks reflect all elements of neo-institutional theory, such as normative, rational, sociological/cultural, historical and institutional theory, three dimensions of which will be further explained in more detailed. Scott (1995) has identified three kind of elements associated with organizational change (regulative, normative and cognitive social systems). Table 1 illustrates key dimensions where these elements have the difference.

Table 1. Regulative, Normal and Cognitive Elements Associated with Organizational Change

	Regulative	**Normative**	**Cognitive**
Legitimacy	Legal systems	Moral and ethical systems	Cultural systems
Central Rudiments	Policies and rules	Work roles, habits and norms	Values, believes
Systems Change Drivers	Legal obligations	Moral obligations	Change values are internalized
System Change Sustainers	Fear and coercion	Duty and responsibility	Social identity and desire
Behavioural reasoning	Have to	Ought to	Want to

Source: Scott (1995)

Powel and DiMaggio (1991) provided that the cognitive theorists are likely to focus on changes in the conceptual beliefs, mental models and interpretations of shared meaning when organizations go through significant change. Compliance brings legitimacy, which can be seen in the varieties of dimensions, antecedents, process and outcomes that relate to legitimacy. Scott (1995) believed these theories concerned (regulative, normative and cognitive) can be considered as the basis for legitimacy, where there is a reflection of congruence with rules or laws, normative support or cultural alignment. The conditions where the regulative elements emphasize the conformity with the legal systems itself, forming the basis of legitimacy (Palthe, 2014).

It is proposed that over time many institutional responsibilities have been migrated to machine technology. If the majority of organisational actions are currently automated by machines, and taking into consideration that these machines are getting more complex, institutions became literally 'black-boxed' (Whitley, 1972). Therefore, further to Joerges and Czarniawska (1998), the world of social scientists remains focused on social norms; provided that technical norms remain within the remit of engineers.

In this context, looking at theories of compliance, goal framing theory provides a prescriptive model of compliance. Further to Lindenberg (2009) 'from an evolutionary point of view, the most

inclusive goal modules will have evolved around the most important fault lines for adaptive behavior of humans living in groups'. Three such high-level goals have been identified and described in some detail (Lindenberg, 2001a, 2006). Lindenberg (2009) described them as he *hedonic* goal 'to feel better right now', as the *gain* goal 'to guard and improve one's resources', and as the *normative* goal 'to act appropriately'. In reference to compliance notion, which is pursued a normative goal-frame, if people interpret a situation as one in which appropriateness is the most important purpose, a normative goal is likely to be automatically made focal (Lindenberg, 2009). This is the gist of goal-framing theory (Lindenberg, 2001a; 2001b; 2006), which is relevant and helpful in understanding compliance phenomenon.

Some elements of critique and practicability of this theory will be discussed in more details in the Ch.5 (Analysis). It is apparent that they are not limited to the bank's behaviour in relation to a national regulator, but include a state behaviour in relation to the international community. While a number of individual theories provide a suitable basis for analyzing compliance with international law, this thesis aims to look at a combination of the institutionalist and realist theories to ultimately produce a cohesive paradigm to evaluate compliance phenomenon. Further to Powell (2002) the institutionalist theory of state compliance with international law views states as rational actors that behave on the basis of self-interest. The institutionalists help us to recognize that 'membership in a regional human rights system, which states join with the aim of setting a common standard of behaviour, positively impacts a state's perception of its self-interest by creating significant incentives to comply with the international rules and norms established by the regional human rights system' (Elvy, 2012).

In contrast, 'the realists assume international anarchy and purports that a state will comply with international law only when compliance is in the state's self-interest' (Burgstaller, 2005). His views are based on political, economical and military power or human rights regime of the state that are pre-requisite of the state's behaviour towards norms of international law' (p.96). Both theories provide a tool for analysing compliance phenomenon, but as they are not immune from critique and therefore, shall be considered in combination to allow a wider range of factors affecting compliance strategies of both actors.

2.2.2 Theories of regulation and compliance and its inter-dependence

The organization of my second objective, which is a discussion on regulatory practices of both actors, acknowledging this relationship starts with overview of theories that used for better understanding strategies of both actors towards compliance.

As the theories of regulation apply public interests policies, that needs to be maintained by the regulator and the regulated in the context of theories of compliance, Etienne (2010) proposed one of the

preferred enforcement strategy that called 'target analytic approach' (Baldwin and Black, 2008). Further to Etienne (2010), there are five categories of regulator-regulatee relationships, which are namely: (i) Relationships of self-interest are built around a shared focus on resources (gains and costs). Social theorists have considered such relationships as fragile because self-interest is an unstable motivation; (ii) Legality relationships are built by contrast around a common focus on legal rules. Regulatee and regulator hold different positions in a legality relationship, as it is the latter's role to control that laws are complied with; (iii) Authority relationships are built on status, and put regulator and regulatee in positions of superior and inferior; (iv) Judgment relationships are built on a shared attention to facts and values. Parties to such a relationship are motivated to act on the basis of right/wrong or true/false considerations. Judgment may be a central motivation for cooperation, especially when the activity regulated is strongly linked with moral issues or scientific–technical issues; and finally (v) solidarity relationships are built on trust, itself emerging from repeated positive interactions (Blau, 1964). It shall be emphasized that the real trust might be quite unlikely possible within the hierarchical regulator–regulatee relationships, especially if we consider Granovetter's view (2002) that 'the concepts of trust and distrust refer to horizontal relations in which neither party can dictate to the others what she must do' (Granovetter, 2002)'.

It shall be taken into account that Etienne (2010) in his work specified that 'these five profiles of regulator-regulatee relationships can be considered as ideal, but not realistic examples of the relationships (pp.7-9). It is fair to note that real example may present only one characteristics of such types. The further analysis of relevance of each type and its implication in the context of the Russian AML/CFT regime will be specified in the chapter 5 (Analysis).

It is worth noting that, the interdependence of theories of regulatory compliance and theories of regulation is apparent by considering a gradual change theory (Lindenberg 2001a, 2006, 2008; Lindenberg and Steg 2007), which is about the evolution of policy (i.e. regulation). Both works of Mahoney and Thelen (2010) on theory of gradual institutional change are quite helpful model in trying to understand the compliance phenomenon as variable. Theories of institutional change can be theories of policy change, when 'policies stipulate rules that assign normatively backed rights and responsibilities to actors and provide for their public, that is third party enforcement' (Streeck and Thelen, 2005, p.12). Policies are institutions in the sense that 'they constitute rules for actors other than for policy-makers themselves, rules that can and need to be implemented and that are legitimate in that they will if necessary be enforced by agents acting on behalf of society as a whole' (Streeck and Thelen, 2005, p.12).

Practice of compliance can be considered as a dialectical relationship between the regulator and the regulated institutions. Ayres and Braithwaite (1992:33) popularized the notion of compliance suggesting that 'regulatory encounter are fluid, situated in the specific contexts that vary and change over time'. Etienne (2011) suggests that 'respective behaviours of regulators and regulated cannot be

viewed only as a stand-alone preposition, but have to be assessed by a more complicated and dynamic consideration of compliance motivations' (p.1). This kind of relationship generates subsequent changes, which are gradual and uneven across global financial services. There is a relationship between gradual institutional change and dialectical change, as they are both focused on the same issue, namely, the nature of change itself. While both describe evolutionary change, gradual institutional change is focused on institutions and dialectical change is focused on theoretical explanations underlying this.

In addition, Mahoney and Thelen (2010) proposed that 'a growing body of work suggests that important changes often take place incrementally and through seemingly small adjustments that can, however, cumulate into significant institutional transformation. Once created, institutions often change in subtle and gradual ways over time' (p.12). The gradual change theory acknowledges that regulatory change affects the behaviour of the regulated entity as was mentioned earlier regulation and regulatory compliance are interdependent phenomena, like birth and death. That is, compliance by the regulated entity will mirror but lag the evolving regulation. Regulation in turn gradually evolves in response to firm/bank behaviour, as well as to other wider national and international influences. This inter-dependent relationship can be considered further in this chapter as a dialectical relationship. Within this regulatory environment the regulated financial institutions also develop their own sense of good practice, and copy each other, with some taking a rules-based approach while others take a principles based approach, along a spectrum between a moral calculated risk taking and those possessing a strong moral compass and little appetite for risk.

In summary, based on the above discussion on theories, it becomes apparently clear that regulatory compliance and regulation are two inter-dependent phenomena and the former exist because of regulation and regulation in its turn infers the need for compliance.

2.2.3 Policy development process

Making sense of compliance within a regulatory environment involves an analysis of the policy development process that was suggested by Easton (1957). This is a closed cycle model, which begins with clear policy objectives based on an understanding of the demands of citizens, followed by the translation of policy into implementation, which in turn changes the environment and satisfies the demand of citizens, thereby closing the cycle. Hill (1993) provides a definition of the policy as 'the product of political influence, determining and setting limits to what the state does'. It shall be noted that some political scientists do argue that policy is best understood in terms of process (Jenkins, 1978, Rose, 1976, Anderson, 2003). It can be suggested that this is due to t 'decisions are not something confined to one level of organisation at the top, or at one stage at the outset, but rather something fluid and ever changing' (Gillat, 1984). It can be concluded that this process involves negotiation, bargaining and accommodation of many diverse and competing interests.

We live in a regulated world. Most fields of endeavour, especially those involving any kind of commercial transaction, are governed through policies (rules of conduct) established by government bodies, often in combination with other bodies, including professional and industry associations, trade unions and consumer advocacy groups. Of interest here is the need to better understand this regulated environment, in terms of the interactions between regulator and regulated commercial entities (banks). More particularly, this study is concerned with how banks operating within Russian engage with this evolving regulatory environment, especially how they meet the challenge of money laundering, in the context increasingly complex and sophisticated extra-Russian requirements.

There are some elements of resonance between transformation of the firm and gradual institutional change. Further to Pettigrew (1987) 'these elements required comprehensive understanding of the structure, cultural and political processes of the organization'. These refer to the small and slow but purposeful gradual changes. Gradual institutional change is mostly concerned at macro-level regulatory change landscape. The resonance here is that financial regulator represents a kind of institution and the CEOs of the banks represent the actors and there is an on-going interaction between the banks and regulator. There are a lot of small movements that make banks transformation happening. At the firm's change level, CEOs usually orchestrate and manage inter-organizational matters. The CEOs are in charge have the power of final decision taking. Differently, at the institutional change level, CEOs of the banks trying to understand the regulator's requirements and the regulators trying to guide the banks and sometimes to adjust as some banks cannot follow the requirements. The regulators are in charge here and power of decision's taking always lies within the regulator.

Both the regulator and the regulated banks can be considered as 'producers and products' (Pettigrew, 1987). Later Pettigrew (2012) noted that 'legacy of the past is always shaping the emerging

future' (p.340). Strategies adopted by the regulator and the regulated in response to compliance requirements can be considered through the policy development components highlighted below, and ultimately afford a fresh understanding of regulatory strategies toward compliance. Policy development models can be used by both the regulator and the regulated, but are applied differently by virtue of their differing positions relative to the regulation. In addition, focusing on the strategies of both actors facilitates a broader consideration of compliance as a systemic component. Related areas such as corporate governance, culture and compliance interrelations will also be considered in terms of regulated firms' interpretation of compliance requirements.

Making sense of compliance within a regulatory environment involves an analysis of each stage within policy development process. One of the most substantial impact on the stages model is Brewer and DeLeon's (1983) theory. They divided policy development process into 6 stages:

1) Initiation;
2) Estimation;
3) Selection;
4) Implementation;
5) Evaluation;
6) Termination.

This foundation of policy analysis proposed core elements of the policy development process, which had deep and significant implications after 1980s. The above approach is useful, as it is a framework for understanding the key elements of policy development, however this view suffers from the assumption that policy formation and execution is a linear top down process. In reality, it is too simplistic and quite narrow, and cannot reflect current framework when the policy maker creates a regulatory regime provides ambiguous guidance and instruction to the regulated firms, who in turn should create appropriate departments and procedures, and train staff, so as to ensure the firm complies with said ambiguous regulations. This model may be appropriate for explaining the process of introducing and implementing new policy into hitherto unregulated fields.

As can be seen from above, the notion of a policy cycle usually goes beyond this simple linearity, and reflects that in the real world there is a feedback loop after policy implementation, through evaluation and back to problem definition. The proposed stages of the Foundations of the Policy analysis is important as the first vital stage, which is the Initiation is the central concept of the subsequent analysis made. The Initiation model is utmost import for considering a gradual institutional change, as it provides an additional element for consideration in creating a completely new requirements, laws, phenomenon.

In addition, these policy frameworks fail to take account of two important elements. First, that in order to better understand the regulatory environment, it is not enough to focus on the policy maker

and policy making process; policy development does not take place in a vacuum. As noted above, complex channels of communications develop between the affected parties, some of which influences policy direction. Therefore, we also need the practice of compliance, that is, how the regulated firm engages with policy development. Second, these models fail to accommodate the dynamic and evolving nature of the regulated space. Even where this space is long established, such as in banking, there continues to be changed, often gradual and occasionally revolutionary. Importantly, one might regard the regulated environment as essentially one where policy is in continuous implementation, with revisions and new policies adding further complexity. This section reflects the idea that we need to understand the regulated environment through the combined effects of both regulator and regulated firms, and that such environment is in constant change.

Referring to my thesis and for the interests of better consideration of my overarching research question, the models of policy development will be considered in three main stages: (i) policy making, (ii) policy implementation, and (iii) policy evaluation.

For the purpose of this thesis, the main focus will rest with policy implementation. Policy implementation is the stage of policy-making between the establishment of a policy, and the evaluation of a policy's impact on the people it affects. Implementation involves translating the goals and objectives of a policy into a functional and continual programme. The policy implementation strategies of both regulator and the regulated will now be analysed in detail.

Policy implementation is the key element of policy development analysis in this chapter. Mazmanian and Sabatier (1983) viewed policy implementation as 'carrying out of a basic policy decision, usually incorporated in a statute but which can also take the form of important executive orders or court decisions' (p.20). Policy implementation rests solely with regulated banks and reference to the behaviour of banks in relation to their need to interpret and implement compliance requirements is largely missing in the current literature. As the majority of respondents contributing to this study were representatives of professional and business organisations, an analysis of policy implementation is further considered through the different perspectives and the strategies of the key stakeholders in policy development, which has a direct implications on development of compliance activities. More details on literature on policy implementation is provided in Appendix 9.

Howlett and Ramesh (2003) proposed that effective policy implementation involves three key elements broadly categorised as (i) agenda-setting, (ii) formulation and (iii) implementation. They observed that the strategies adopted by the regulator and regulated firms are reflected in regulatory processes, in particular in policy development, through which these processes can be identified as three abovementioned stages, that are crucial to understanding policy cycles. These three elements (i) agenda-setting, (ii) formulation and (iii) implementation also constitute another way of looking at the

interrelationship between both the regulator and the regulated organisation, and can arguably apply equally to both. The strategies of regulator and the regulated entities will be further examined for each element.

(i) **Agenda-setting**

The first element specified above, which is agenda-setting can be considered from both the perspective of the regulator and that of the regulated entities. The behaviour of the regulator can be considered as a gradually evolving process. Organisation is pertinent to the target for introducing a new policy inside the regulated entity. This feature typically delegates the responsibility of implementation to a specific group. Often, on the regulator's side, the government agency is given a programme specified by legislation. The regulated entity, whether public or private, that is responsible for implementation is not likely to be involved in the decision-making process, so the actual implementation is undertaken at the local level. This poses a serious social distance dilemma as those making the policy are not actually implementing the programme.

a. **Strategies of the Regulator**

Contemporary literature on regulatory compliance provides a lot of evidence that compliance is a constantly evolving, expanding in scope and quite complex process. Researchers (Hutter, 1997; Di Mento, 1986 and Parker, 2002) have observed that, from a regulator's perspective, it is clear that it is overly simplistic to think that compliance is simply about regulators comparing the way that actual behaviour conforms with, or measures up to, the requirements of published rules or standards (Johstone, Sarre, 2004). The works of Di Mento (1986), Hutter (1988, 1989, 1997) and others (Hawkins, 1984, 2002 and Black 2001a) help us to understand that compliance is a complicated, on-going, evolving and open-ended social process of negotiation.

Variety of distinctive 'intervention strategies' applied by regulators used for compliance and enforcement (Gunningham, 2011) can be also considered, available in the Appendix 2. There is no consensus about the ideal criteria, which an excellent intervention strategy should satisfy. Thus, Gunningham (2011) proposed that the core criteria for considering an intervention strategy shall be effectiveness and efficiency. One of the most interesting formulation of the flexible approach to achieve compliance is encapsulated in a pyramid associated with a concept entitled 'responsive regulation' proposed by Ayres and Braithwaite (1992) (see Appendix 4). In contrast, the sanctioning/deterrence style is a more rules-based, arm's length approach, and should be considered less flexible.

For the purpose of my study deterrence strategy is the most relevant strategy for the Russian regulatory regime in contrast to responsive, smart and meta-regulation, which are not very helpful in the context of the study. This is based on historical, social and political differences, which are the root cause

of deterrence strategy in Russia. As outlined by Arndorfer and Minto (2015) the four lines of defence model for financial institutions are taken a step further, advising that the use of the three LoD model in understanding systems of internal control and risk management should not be regarded as an automatic guarantee of success. All three lines need to work effectively with each other and with the audit committee in order to create the right conditions. The three LoD model might prove to be not suitable for accurate dealing with an organisation's operational specifics which depend not only from the nature of the business itself (De Haan and Vlahu, 2013; Mehran, Morrison and Shapiro, 2011). The four root causes of its problems and weaknesses is specified in the Appendix 9.

A representative from the Central Bank of Russia said 'the primary aim of the regulator is to make sure that all banks in Russia are conducting proper risk assessment activities applying stringent KYC frameworks to business relations incorporating information on the source of wealth and funds, expected business transactions, high-risk jurisdictions, high-risk counterparties, which involves a much wider analysis than standard due diligence and continues to be deepened'.

There is no excellent regulator approach to intervention that can be applied to each financial institutions, as each has its strengths and weaknesses. According to the OECD (2000), 'regulators can face a failure of deterrence because so many kinds of business rule breaking have high rewards and low probabilities of detection' (p.20). However, where punishments are commensurate with or exceed potential rewards, there is the possibility of a cascaded benefit, as potential wrongdoers note the level of punishment and are suitably deterred from committing a similar offence. As such, the deterrence literature overwhelmingly indicates that countries and organisations learn from the experiences of their neighbours, and that this learning impacts compliance behaviour in others. However, Shimshack and Ward (2005, 2008), also show that countries regularly update their beliefs about regulatory stringency.

The Russian approach to regulation gradually aligns its processes with international norms and standards as 'the most interesting aspect of Russian and CIS developments is the gradual "opening" of the domestic legal systems of countries of this region to international law' (Danilenko, 1999). Due to the regulators' strategies continue evolving, it can be difficult to keep up with the speed of change in the policy environment.

b. **Strategies of the Regulated Firms**

Regulated firms have an element of choice in determining how best to organise their strategies in order to achieve compliance. They can opt to comply with the letter of the law, or comply with the spirit of existing and forthcoming regulatory requirements. Regulated banks interpret regulations and

codify strategies in response. This does not automatically mean they will comply with either the letter or the spirit of the law and may involve the following:

(i) A literal interpretation of the rules requires compliance officers to make their understanding of a situation on both a strict reading of the details of a case, as well as an exact reading of the wording of similar rules in order to adopt what might be referred to as a black-and-white approach in interpreting what the regulation requires. From such a stance, an action can be designated as compliant or as a violation via a precise reference to the regulation wording. It is similar to Dworkin's (1986) arguments against the phenomenon of legal conventionalism. Further to Dworkin (1985 and 1986) argues 'an individual can never really possess a 'true' rule-book conception of the law, as all rules require interpretation and deliberation in making a judgment'.

(ii) Operating within the spirit of the law is the alternative approach adopted by regulated firms in assessing how best to fulfil their regulatory requirements. Newton (1998) illustrates this by stating 'regulators would like to oversee organisations that can not only demonstrate compliance with the rules, but indeed internal culture, with its values, attitudes and beliefs, which supports the broad goals of regulation' (p.58).

This approach reflects a further aspect of Dworkin's (1986) interpretivist approach to the law, where the rule interpretations should reflect the overall legislative system, the intent of those framing a particular piece of regulation, and also how the concept relates to contemporary and future understanding of the meaning related to an activity in question.

The concept of reasonableness is also relevant to the practices of regulated banks. Reasonability is a legal term and has become embedded in a number of international conventions. The scale of reasonability represents a quintessential element of modern judicial systems and can be used in the context of policy implementation and disputes between the regulator and regulated firms. The concept is founded on the notion that all parties should be held to a reasonable standard of conduct, therefore the regulator and the regulated firms are expected to be reasonable in their actions. The reasonableness test is set out under the Unfair Contract Terms Act (1977) (UCTA) and asks about fairness and reasonableness regarding the circumstances were or to have been taken by the parties at the time when contract was made. The reasonableness test is used by global banks to ensure that the treatment of a client in one country is the same in others. However, the reasonableness test fails to capture differences in, say, varying levels of risk across geographical jurisdictions. As such, it does not provide a one-size-fits-all approach.

The OECD (2000) summarises the case for a cooperative rather than punitive compliance approach, stating that 'although cooperative and persuasive strategies are not always appropriate, when they are successful they are superior to punitive sanctions in effectively and efficiently accomplishing long-term compliance' (p.43). There are certain sociological and psychological research claim that non-coercive and informal alternatives are likely to be more effective than coercive law in achieving long-term compliance with norms, whereas coercive law is most effective when it is reserved as a last resort. The overall conclusion made by the OECD (2000) was that 'minimal sufficiency principle', which is in fact simply means, the less powerful the technique used to secure compliance, the more likely it is to produce a long-term desire to comply' (p.45).

Turning once more to the peculiarities of the Russian system, which is considered to be a developing country, the main state authority for the evaluation of regulatory policies relating to financial markets is the CBR (Article 75 of the Russian Constitution, State Duma of the Russian Federation (2002) Federal Law No 86-FZ 'On Central Bank of the Russian Federation'). As of September 1, 2013, further to the State Duma of the Russian Federation Federal law No. 251-FZ 'On amendments to Certain Legislative Acts of the Russian Federation connected with Transfer of Authorities to Exercise Regulation, Control and Supervision of Financial Markets to the Central Bank of the Russian Federation' dated 23 July 2013, the CBR took on the role of 'mega-regulator,' assuming oversight responsibility for all aspects the Russian financial system, alongside expanded responsibility to support 'sustainable and balanced economic growth'. On this basis, the CBR becomes 'the ultimate regulator of the financial system,' taking over its new powers from the Federal Financial Markets Service (FFMS). In addition to the CBR's conventional responsibilities, as the new regulator, it is now involved in insurance activities, loan cooperatives, microfinance, ratings agencies, investment of pension savings and other spheres of financial activity. However, the CBR is not entitled to legislate initiatives, although it may at some future point be expected to significantly improve the quality of monitoring systemic risks, including compliance risks.

(ii) Formulation

One of the aims of formulation is to translate legislative intent into operating rules and guidelines. This is a very complex and ambiguous process. Ultimately, the judiciary may become involved and legislators may need to later clarify their ends and means. In discussing the formulation mechanisms of regulated firms, certain interrelated aspects such as culture, corporate governance and compliance will be mentioned.

a. Strategies of the Regulator

One important component in policy implementation with respect to formulation of the procedures between the regulated and regulators can be outlined in terms of negotiation. Furthermore, 'negotiations are likely to be based on unequal access to information between the regulator and the regulated' (Weale, 1992; Ogus, 1994). Gouldson and Murphy (1998) reasoned that 'the rationality of negotiated decision-making during formulation may therefore be far from comprehensive, particularly if an adversarial relationship between the regulator and the regulated encourages he latter to withhold information or only to present information that leads towards what the regulated would perceive to be a favorable outcome' (p.16). Historically, the AML legislative is principally driven by U.S. rules and regulations from other parts of the world and, as such regulated entities are typically keen to establish the limits of their accountability. Having diversified financial institutions in various countries, bankers will usually seek to negotiate and interpret the applicability and accountability of particular laws relevant to their various territorial branches and subdivisions as documented by local regulators.

b. **Strategies of the Regulated Firms**

Compliance can also be considered as a variable concept whereby its definition and parameters are in a constant state of flux. In approaching compliance regulation, institutions stabilise expectations by providing information about the probable behaviour of others. Like institutional change, compliance evolves slowly and does not occur globally at the same speed. Some countries are more developed that the others, but compliance continues to evolve everywhere to some extent. Further to Thony (2000) 'the strength and quality of the AML/CFT system lies within its effective institutional set up, the combination of soft and hard laws and professional assessment mechanisms carrying a real threat of sanctions for noncompliance, all of which are characteristics of established legal systems (FATF 40 Recommendations). Combined, these elements have made the AML/CFT framework a robust and effective international regime to control evolving financial crime'.

The theory of gradual change can be applied to demonstrate these changes that occur worldwide. Mahoney and Thelen (2010) suggest that little attention is paid to gradual institutional change in social sciences more broadly. Thelen (2000) stated that 'it is not so useful to draw a sharp line of institutional stability versus change' (p.106). She suggested that periods of institutional stability are often characterised by incremental change. Therefore, the change occurs within the periods of stability questions the more traditional view of institutional change as a result of exogenous shocks. As a result of these discussions, some scholars have developed a multitude of labels to explain the variety of channels through which institutions may gradually change.

(iii) **Implementation**

The reality of compliance for banks on a day-to-day basis is far from straightforward and multiple areas need to be considered, including global and local competing demands, regulatory uncertainty, internal systemic problems, institutional problems and industry issues. The strategies adopted by the regulator and the regulated institutions in relation to the implementation of policy may vary, and include top-down, bottom-up and multi-stakeholder approaches. These are constantly evolving, as does the relationship between the regulator and the regulated entities.

a. **Strategies of the Regulator**

Regulators draw on a range of approaches as they seek to gain and maintain compliance. It is important to acknowledge the distinction between failure in regulation and failure in compliance, despite the fact that failure is frequently attributed erroneously to regulation when the actual issue is poor compliance. As it was specified in the OECD (2000) paper '…dramatic regulatory failures tend to produce calls for more regulation with little assessment of the underlying reasons for failure. Though there is little hard evidence, a growing body of anecdotes and studies from OECD countries suggests that inadequate regulation underlies many such failures. This is a common but little understood form of regulatory failure' (p.7).

Further to the U.K. regulator called FCA, acted under the Financial Services and Markets Act 2000, the FCA's strategic objective is: ensuring that the relevant markets (see section 1F) function well (available at www.legislation.gov.uk). In the immediate aftermath of the financial crisis, the UK regulator was given increased powers for supervision of the U.K. banks, following the introduction of the new Banking Bill announced in October 2008.

Overall, there is substantial cooperation and interdependence between state-based regulators and non-state regulators at various levels, such as transnational, regional, and local levels (Braithwaite and Drahos, 2000). There are a number of different layers of organisation that seek to influence regulations in various ways, including state-based regulatory agencies. At the supranational level, for example in the E.U., there are the E.U. institutions and relevant committees of financial regulators. At the transnational level there are organisations of regulators or central banks, such as IOSCO and the Basel Committee on Banking Supervision (BCBS). In addition, there are private actors, such as the International Securities and Derivatives Association (ISDA). There are also international financial institutions, such as the World Bank and the International Monetary Fund. Each of these bodies is a constituent component of the regulatory regime for financial services and each performs a different, and occasionally overlapping, role within it.

b. **Strategies of the Regulated Firms**

In discussing the strategies and practices of regulated firms, a comparative review of strategies for managing compliance as applied by private versus publicly listed companies will be provided. Furthermore, certain formal and informal strategies in managing compliance, as well as underlying behaviours, will be explained.

i. Strategies of Public Banks Versus Non-public Banks

Certain challenges faced by the regulator reviewing various approaches in applying banking regulation are apparent, as it hardly possible to uniformly regulated different countries and each country has its own approach to ensure AML/CFT compliance. Rider et al (2009) argued that 'detection of money laundering may be closely monitored by domestically, as criminals typically 'hide behind corporate nominees and obscure the ownership and control of business' (p.145). Therefore, both regulators and regulated banks may review compliance by 'monitoring, assessing, filing suspicious transactions over the bank accounts.

The business strategies of non-public companies and publicly listed companies toward compliance are very different in the world of financial services. The key areas of concern for publicly listed banks include overall business conduct and compliance with regulation, maintenance of high standards of business reputation and public trust, establishing and maintaining a robust system of compliance, and coherent, efficient corporate governance mechanisms, among others.

Internationally accepted concepts are not always legally adopted in Russia and, therefore, cannot be legally implemented. The reporting requirements for public companies are greater than for non-public companies, and every publicly traded company has to build compliance strategies based not only on its own perception of what is important, but also taking into account accepted best practices and international standards. For this purpose, compliance professionals usually run an analysis benchmarking the requirements of Russian standards with those contained in foreign legislation to ensure compliance among Russian organisations with typically more stringent requirements elsewhere. However, benchmarking exercises between non-public and publicly listed companies in Russia are deemed largely ineffective, as the regulator's requirements do not vary substantially in their application between these two types of companies, despite the divergence in strategy adopted by each.

The strategies of private banks are quite limited by their own perception of what compliance should cover and, by extension, which areas shall be emphasised. Sometimes they do not have a clear vision of the value of compliance. Their strategies in addressing ML/FT regulations may be limited with respect to compliance in relation to some elements of international best practice.

ii. Formal and Informal Strategies of Regulated Firms

Formal practices tend to be matters of corporate governance, constituted by creating written policies and procedures, which are ratified by the Board of directors. Formal practices also provide internal guidelines, educational compliance training and auxiliary compliance materials, a log of ML/FT alerts, regular management information to senior management, and seeking formal advice from the regulator on important regulatory issues. Adopting a policy, for instance, whereby a direct reporting line exists for the head of compliance into the board and C.E.O., would be a positive formal practice. Likewise, defining the role of chief compliance officer as equal to general counsel would also be an example of formal practice.

Informal practices, imply certain specific, yet unwritten, internal activities that, taken collectively, can denote the existence of a highly developed compliance culture. In general, the most significant informal practice that must be established is a high level of open, two-way communication between the compliance team and other employees. Further to for maximum benefit to the organisation and in line with internal informal practices, compliance units or officers should be consulted at the earliest possible point in the process of considering any new initiative. In Russia, long-term informal relationships between government officials and business executives frequently replace the transactional approach more common in other countries. Informal practices become more and more sophisticated to reflect the increasing sophistication of the Russian economy and its legal and administrative structures. Ledeneva's and Schekshnia's (2011) main argument that 'the reason why it has proved so challenging to eliminate these informal practices is because they are invariably viewed as somewhat functional for the overall economy. They perform a 'shock-absorber' function for a system perpetually in flux. In addition, past-oriented informal codes are constantly adjusted and integrated with future-oriented formal rules'. As it was concluded by Ledeneva and Schekshnia (2011) 'informal practices are functional for solving problems posed by defects of the legal system, and they compensate for the imperfections of Russian corporate culture' (p.5).

Further to the Russian FIU 'the informal outcomes-based approach intends to prevent violations and secure long-term cooperative compliance by persuasion, negotiation, bargaining and education. The objective is to achieve compliance, with penal sanctions used only as a last resort because penalties are often viewed as a symbol of failure to achieve compliance through other means'. This approach tends to rely on constructive and active engagement between regulating authorities and regulated entities.

Corporate Governance and Compliance

Some financial organisations approach compliance in an ad hoc, erratic fashion, with little consistency in process. This can frequently result in organisations focusing on compliance efforts only as deadlines loom, approaching them with a fire-fighting mentality. Using this reactionary approach, organisations may find themselves focusing their efforts on compliance purely to stay ahead of the next round of fresh regulatory requirements. However, once organisations understand the negative consequences that may be imposed for violations, including fines and warnings, compliance becomes a top priority. This may lead to poor and expensive decision-making in order to meet imposed deadlines. To establish an effective culture of compliance, a pioneering top-down strategy is required.

Culture and Compliance

The primary responsibility for encouraging a suitable business culture within any organisation lies with senior management. Culture is one of the most important element in making compliance with regulation in the organisation. Where the culture of an organisation is generally ignorant to moral and ethical concerns, or where any immediate profits tend to override all other interests, the issues of compliance will not be effectively managed and even the most rule-based provisions, systmes and controls will struggle to minimise the probability of regulatory sanctions. Even a solid compliance culture offers no guarantee that an organisation will not fall foul of the principles of regulation. Only in an organisational culture whereby the ethical values underpinning regulation are enshrined in the organisation's daily business activities, can the threat of regulatory sanctions be minimised.

There is much debate about how best to achieve financial regulation objectives, with some commentators even going so far as to dispute the need for regulation at all. Newton (1998) states that ‘financial services regulation is nothing less than a field of ethics’. Moreover, from a compliance standpoint, it may lead to dilemma, such as that outlined by Badaracco (1997), who couched the controversy in terms of choosing between right and right (Badaracco, 1997).

Campbell (2007) suggested that ‘the increased focus on principles-based regulation, self-regulation, and changing community expectations toward corporate social responsibility has reinforced the role of organisational culture in compliance’. It shall be emphasised that there is a number of issues related to the understanding a culture of compliance. Firstly, a generic approach fails to take into account the level and nature of regulation or industry-specific characteristics, as well as organisational variables such as size, maturity, strategy and leadership, all of which are likely to impact and differentiate cultures that encourage compliance behaviours. Secondly, further to Haines and Gurney (2004), ‘the notion of a compliance culture is overly simplistic on the basis that is does not explain how organisations balance multiple – sometimes competing – demands, or conflicting regulatory goals’ (p.353). Therefore,

it is often that organizational and contextual specifics will impact on the way in which organisations prioritise the depth and scope of a compliance culture to ensure its successful undertaking.

2.2.4 Gradual change metaphors

Janssens and Wildemeersch (2003) assert that 'policy-making is a dynamic interactive process involving the active participation of all stakeholders', including relevant for my thesis regulated organisations. The current literature focuses on strategies adopted by the regulator in relation to policy implementation, and largely fails to acknowledge the strategies of the regulated entities themselves. Likewise, given that the literature on gradual change variables in relation to policy-making does not concern itself with the behaviour of the subject, this thesis will endeavour to explore how the subject responds in relation to policy initiatives. This will be analysed in more detail in chapters 4 and 5.

The research carried out in this study suggests that strategies of the regulated firms toward compliance can be considered as the variable elements while doing analysis of institutional change. Further to Mahoney and Thelen (2010) 'if institutions involve cognitive templates that individuals unconsciously enact, then actors presumably do not think about noncompliance (p.10). Ostrom (1990) proposed that '…in rationalist accounts, sanctions and monitoring act as a mechanism to prevent free riding and promote collective actions'.

Further to Streeck and Thelen (2005), who proposed a typology of results and processes of change, there are two types of change: (i) incremental or (ii) abrupt process of change. The results of change can be either (i) continuity or (ii) discontinuity. Thus, with incremental change and continuity, reproduction by adaptation can be expected. But when change is abrupt and there is discontinuity, breakdown and replacement of the institutions can be expected. Table 2 illustrates the proposed by Streeck and Thelen (2005) options.

Table 2. Typology of results and processes of change

		Result of change	
		Continuity	**Discontinuity**
Process of change	Incremental	Reproduction by adaptation	Gradual transformation
	Abrupt	Survival and return	Breakdown and replacement

Adopted from Streeck and Thelen (2005)

Streeck and Thelen (2005) further explained the occurrence of gradual institutional change in terms of four modes of incremental change, also known as gradual change metaphors:

(i) Layering occurs in the situation in case of new elements are added to the current ones. This can be seen with reference to Federal Law 115-FZ on 'Counter of Money Laundering and Terrorist Financing', which has been amended and revised over 100 times since it was introduced in 1991. Layering has been identified as most common and most effective in contemporary literature, which is also evidenced in the Findings (chapter 4);

(ii) Drifting occurs in the situation of changed impact on existing institutions because of shifts in the institution's environment and a lack of adjustment to them (Streeck and Thelen, 2005; Thelen, 2004). In the latest studies about policy change, as well as in the Findings (chapter 4) drifting is less applied than layering or conversion. Moreover, like conversion, 'it is often studied alongside layering' (Thatcher and Coen, 2008).

(iii) Conversion is the radical change in enactment due to their strategic deployment to serve new aims. Further to (Streeck and Thelen, 2005) conversion applies when old institutions are reformatted to new purposes, provided that institutions remain in place;

(iv) Displacement occurs in the situation of the complete replacement of existing rules by new ones. This modes is the most radical one, as here the existing institutions are completely replaced.

The above-mentioned broadly framed metaphors can be helpful to explain processes of change in multiple contexts, including compliance with AML/CFT legislation. As Schickler (2001) observed 'gradual change metaphors can be invoked to characterise the development of both legislatures through the layering of multiple institutional designs over time'. The literature about gradual change focuses almost entirely on the effectiveness of policy development, but this research is equally concerned with how the subject responds, as it is important to analyse gradual change in terms of the willingness of the regulated to engage in new regulatory initiatives.

The underlying approach to exploring this objective focuses on process and, in particular, the three above mentioned aspects of policy development: (i) policy making; (ii) policy implementation; and (iii) policy evaluation. A different school of thought, supported by Hudson and Lowe (2004), suggests that the idea of a policy cycle is not useful because policy development is interdisciplinary and iterative. Furthermore, it does not necessarily reflect what happens in reality but rather 'implies a top-down view of policy making in which there is a high degree of rationality' (2004:6).

In agreement with Etienne (2011), it is assumed though this thesis that the banks will pick the options that best meets their strongest goals. More details are provided in the Appendixes 10-11.

The literature overwhelmingly ignores the fact that policy-making does not occur in a vacuum and fails to mention attempts made by regulated entities to respond to events in their regulatory environment. In practice, the literature does not provide insight into how regulated entities behave. However, there is increasingly greater interaction between the regulator and the regulated, which unfortunately current literature does not adequately capture. Moreover, in the current literature, discussions on policy-making are not applied to the regulated, when in fact, this could be equally applied to both the regulated and the regulator.

Mahoney and Thelen (2010) observed that 'the emphasis on compliance also opens up new avenues for theorising about the actors and the coalitions that drive institutional change. The institutional 'winners' and 'losers' have different interests when it comes to interpreting rules or dedicating resources to their enforcement. More importantly, the analysis of institutional change compliance problems can blur the lines between those winners and losers' (p.15). They concluded that 'putting issues of compliance centre stage will mean thinking about the distributional effects of institutions in a more sophisticated way than simply as winners and losers.

Political context and institutional form shape the type of dominant change agents and therefore have a direct impact on the type and speed of institutional change.

Mahoney and Thelen (2010) theorise four different kinds of change agents, in terms of symbionts, opportunists, subversives and insurrectionaries, that we might expect to observe in the processes of layering, drifting, conversion or displacement. However, these change agents have little explanatory power in themselves since they are conceptualised as mediators or as an 'intervening step through which the character of institutional rules and political context do their causal work' (Mahoney and Thelen 2010, p.28). Hence, while the authors claim to ascribe a crucial explanatory role in change processes to change agents that 'drive' such change, the explanatory leverage resides at the structural level. Consequently, the actor typology has barely found repercussion in the literature (with the exception of the five empirical contributions to the volume).

It can be proposed that Mahoney and Thelen's (2010) approach provides an understanding of institutionalised structures on one hand and institutional agents on the other hand. Change agents, from such a perspective, are 'squeezed' between the causal structural factors, namely the level of veto

barriers and the level of institutional discretion, that explain why we see different modes of change, and the outcome of interest.

One of the key missing element in the current regulatory framework can be identified comparing the U.K. risk-based supervisory best practice called ARROW, and the Conduct of Business Sourcebook (COBS) of the FCA, which contains risk-based guidelines in assessing the whole AML/CFT compliance framework to mitigate general and specific market threats. The four modes of incremental change, namely, drifting, layering, conversion, and displacement outlined by Mahoney and Thelen (2010) that have been mentioned throughout this thesis with a focus on the regulator's approach, can be equally appropriate when discussing the strategies of the regulated banks toward their money laundering compliance obligations. Again, they are a useful tool for considering the compliance framework through the use of gradual change metaphors.

Key Aspects of Policy Development

This section provides an overview of various theories about policy implementation as a systems component of policy development, while focusing on the political systems model and an advocacy coalition approach. Subsequently, regulation as a process and an element of the policy cycle framework will be examined. Policy development has a direct impact on compliance, as it shapes compliance by introducing new standards, policies and practices in line with external policies and regulator expectations.

The term 'policy' refers to a broad statement reflecting future goals and aspirations, providing guidelines on how to achieve those goals. Policy-making is a process of successive approximation to some desired objectives in which the desired objectives continue to change under reconsideration. Lindblom (1959) concluded that there are two methods of policy development, namely the rational-comprehensive method, and successive limited comparisons, which is not relevant to this thesis. He further provided an explanation applied for rational-comprehensive theory that 'policy' formulation is approached through means-end analysis, whereby the ends are isolated, and then the means to achieve them are sought' (1959:79). He argued that this continually advances from the current situation in a step-by-step fashion and by small degrees. As the name suggests, the rational-comprehensive analysis includes everything deemed to be important. However, the idea is significantly more complex and contains a variety of political, national, economical, and social interests. As such, it seems unfeasible to take everything into consideration unless what is deemed to be 'important' is so narrowly defined, that the analysis is rendered quite limited. Therefore, using the rational-comprehensive method for particularly complex problems needs to involve mechanisms to drastically simplify the issues. As such, this approach may not be suitable for complex areas like financial regulatory legislation development.

Moreover, in the contemporary literature, policy-making has been considered from a range of approaches, including rational, incremental, mixed scanning model, group and elite theories and political system model (Lindblom, 1959; Hogwood and Gunn, 1984; Walker, 2000). One of the most relevant lenses through which to view the policy-making process in a developing economy such as Russia, is Easton's (1965) political system model. This model views the policy process as a 'political system' that provides responses to the demands of its environment. It should be noted that Easton's (1965) model originated from studies of a developed country, the United States. Therefore, the nature of influence of demands, support and resources that generate policy as argued by Easton (1965) is likely to vary between the U.S. and other developed countries, and those of developing countries. Walt and Gilson (1994) rightly observes that 'there are a number of examples of governments in developing countries retaining power without widespread popular support. At the same time, influence and activities of social groups is given considerable importance in developing countries' (p.103). Consequently, in case of no reference to a specific policy context, it is difficult to argue that the policy-making process always follows the stages supported by Easton (1965), particularly in developing countries like Russia. For a general understanding of the dynamics of the policy process in Russia, the existing theories provide useful guidance. They are, however, far from adequate where an in-depth analysis is required as each policy has its own policy network that is likely to vary according to the specific policy context. Russian social, economic and political factors also play a key role in shaping the network of a particular policy. For this reason, theories originating beyond Russia cannot sufficiently explain Russian policies in general, including those specifically relating to AML/CFT.

Sabatier (1991) offers a somewhat heuristic approach in the study of European Community (E.C.) environmental policy. Utilising a conceptual framework referred to as 'the advocacy coalition approach' (Sabatier, 1991) he combines various aspects of political science in order to encompass the diverse but relevant variables involved in the regulatory policy process. According to Sabatier (1991), three sets of factors are involved in policy change over time:

(i) The policy subsystem, which includes competing advocacy coalitions, policy brokers and decision-makers.

(ii) Changes external to the subsystem such as impacts from other subsystems, changing socioeconomic conditions, and changing systemic governing coalition factors which affect or restrain the policy subsystem.

(iii) The stable system parameters that also affect or restrain the policy subsystem. The parameters are set by the basic legal structure, the basic elements of the problem area and fundamental cultural principles.

Two coalitions are relevant to the policy subsystem. Coalition A is composed of groups that advocate a vigorous, Western-oriented approach to money laundering policy-making. The core belief of this group is that governmental intervention in the market is necessary to protect the banking system. The actor may be the Russian government and its associated regulatory authorities. Coalition B is composed of orthodox groups that believe that Russia needs to be more independent and continue to make its own anti-money laundering policies without Western influence.

It should be noted that the Sabatier (1991) model makes four important contributions. Firstly, it provides a simple visual diagram illustrating the relevant variables and their relationship to the policy process. Secondly, it focuses attention on socio-cultural values that are instrumental in shaping policy formation but would have potentially gone unmentioned in a traditional study. Thirdly, the model emphasises the importance of impacts from global and national subsystems. Finally, the evolution of policy-making as a consequence of policy-related learning is highlighted.

According to Sabatier (1991), the policy tended to increase in complexity and scope as the relevant actors brought together relevant information. Their belief systems, though different in many respects in the cases of coalitions A and B, allowed all of them to accept, for example, the actions by the Russian government. However, the main weakness of the model is that it is a U.S. model designed for the U.S. system and, ultimately, is based on assumptions relevant to the U.S. It is also a model focusing on advocacy coalitions. It is not certain from this study that coalitions dominate the policy process or whether the different coalitions are competing in a style more typical to the U.S. The study presented here is not an adequate test of the usefulness of the Sabatier (1991) model for analysing the policy process.

Conteh (2011) commented in his publication that ‘despite the existence of three generations of policy implementation research, efforts to distill the large number of variables into a manageable framework continues to prove too ambitious, because very few scholars have so far been willing to undertake such enquiries’ (p.3). This view of Conteh (2011) is similar to the opinion expressed by Kettl (2000) and O’Toole (2000), who proposed that ‘further transformation toward decentralisation, devolution of responsibilities and restructuring of accountability resulted that public policies have been increasingly converted together with non-state actors into collaborating arrangements’.

Historically, policy implementation in Russian financial services regulation was a rigid process initiated by the government adopting a top-down approach. The top-down approach is also known as the rational or systems model. More recently, the Russian policy landscape has become more dynamic due to the presence of foreign banks. As a result, the bottom-up approach, which is critique of top-

down approach, has taken precedence in view of the influence of foreign banks complying with group and global standards. International entities might be regarded as more confident than their Russian counterparts in their dealings with the local regulator, which has also served to alter the regulatory environment. Some commentators argue that policy implementation is currently organised as a multi-stakeholder process, with various stakeholders, including N.G.O.s and international bodies, pursuing different interests and goals and ultimately influencing the policy development process. To a certain extent, this renders the process messy, but at the same time, a more adhocratic approach might be considered flexible and adaptable in meeting policy development objectives.

Overall, compliance is a very complex notion, as it consists of actions and rules components. If one component fails, a superseding component may also fail as a result. How best to comply with the evolving rules, either by enforcement or management, is of pronounced importance. Further to Tallberg's (2002) observation 'based on the case of the E.U. and a comparison with other international regimes, it may be considered that enforcement and management mechanisms are most effective when combined' (p. 610).

If to consider compliance as context-determined phenomenon, than a consideration of regimes in different contexts may provide an additional support to the proposition that compliance systems combining both management and enforcement mechanisms. In this context two contending perspectives on how best to comply with the rules will be considered. Whereas enforcement theorists stress a coercive strategy of monitoring and sanctions, management theorists embrace a problem-solving approach based on rule interpretation and transparency. As Young notes (1994) 'a new understanding of the bases of compliance - one that treats compliance as a management problem rather than an enforcement problem and that has profound practical as well as theoretical implications – is making itself felt among students of international relations' (p.279).

2.2.5 Transparency and Accountability

Regulatory compliance may be understood variously as a process, a condition, a system, even a force, and an age. When viewed as a process, regulatory compliance invokes a need for on-going performance evaluation and thereby a need for transparency and accountability. In this respect, two prerequisites – transparency and accountability are always required by the regulator in terms of communicating its policies and pursuing compliance procedures. The regulated banks are also expected to demonstrate transparency and regulatory commitments to compliance with them. In the context of this thesis, it is important to examine the transparency and accountability, as these two notions are very closely interconnected with the fundamental notion of compliance.

Transparency and Accountability

There is a vital inter-connection between transparency and accountability and its implications towards compliance that will be provided in this sub-section. Transparency is generally considered a main prerequisite of good governance and an essential element for accountability and vice versa. Transparency can be considered as the attempts made by governments, companies, organizations and individuals of being open in the clear disclosure of information rules, business plans, weak enforcement of rules and actions. In this respect, transparency applies equally to both the regulator and the entities it regulates, as it is anticipated that all regulated entities have equal access to information and decisions taken by the regulator and both have relevant accountabilities for non-compliance and mistakes made. Fox (2007) proposed that 'distinctions between different kind of transparency (clear and unclear) and accountability (soft and hard) shall be made' (p.664). In other words, for example, opaque transparency will not lead to any answerability and eventually to possibility of sanctions towards an institution.

Transparency reflects free access to information on the activities and decisions taken by an institution, which provides stakeholders with a means to challenge decision-makers. In short, transparency supports accountability and significantly decreases the scope for wrongdoing and noncompliant practices. As an example, the Basel Committee on Banking Supervision issued a paper related to transparency in cross-border cover payment messages (Bank for International Settlements (BIS), 2009)). The paper specifies inherent risks in cover payment arrangements where an originating bank does not send full transaction information to an intermediary bank, known as the cover intermediary, that cover intermediary being unable to effectively monitor these transactions. In result of such cases, the cover intermediary's risk management and compliance is getting weaken, particularly in the case of cross-border transactions. The development of appropriate mechanisms to enhance transparency is clearly a vital element for effective compliance. On this basis, the formulation of initiatives striving to increase transparency and deriving effective mechanisms to monitor and enforce its implementation, are key areas for regulatory bodies and considerable time and attention are dedicated to them.

As a practical example of transparency in relation to AML/CFT, the U.K. The 2013 United Kingdom G8 Presidency Report entitled "Trade, Tax and Transparency" (the UK G8 Report) provides an assessment of objectives identified in the beginning of the U.K. tenure and acknowledges some of the challenges encountered along the way, as well as highlighting future challenges on the transparency of company ownership and legal arrangements in respect of anti-money laundering. A number of barriers to implementation were also specified in the UK G8 Report. For instance, various arguments emerged throughout the year, mostly focusing on the right to privacy, customer confidentiality and existing legal constraints, which might also be considered privileges, depending on the point of view adopted. Particularly active in these debates have been the so-called 'offshore centres'. In this context,

Transparency International (2009) has published widely in defense of a robust AML stance, and highlighted the role played by opaque corporate structures in facilitating financial crime.

In relation to the accountability, Tisné (2010) considered that 'accountability makes the actors responsible for their actions. Furthermore, accountability allows the individuals and institutions become responsible for their actions taken according to a certain standard' (p.2).

To maintain public confidence, each bank hires responsible persons in control functions and senior management, who are accountable for the bank's compliance programmes and processes. In this respect, there are designated people within departments, who initiate compliance programmes and maintain regular audits of each compliance process and who are responsible for evaluating the quality of these processes. Accountability is of pronounced importance at every level across banking divisions. At the same time, the regulator is considered to be also accountable for any failures and mistakes made in delivering and maintaining adequate supervision of banks and their activities. Further to Transparency International (2009) 'the transparency, accountability and participation mechanisms of anti-money laundering institutions require significant improvement, both at the global level (FATF and its regional-style bodies) and at the national level (anti-money laundering institutions)'.

Different models of regulation are implied at different levels of transparency and accountability. Conventional models of regulation, such as command-and-control, which is operated under the deterrence approach to regulation (Malloy, 2003) are largely deemed to be adversarial and punitive (Ruhnka and Boersler, 1998) and, therefore, ineffective. Although this traditional approach has arguably provided many benefits to society, its limitations cannot be ignored. In some cases, the deterrence approach has even been charged with occasioning unintended consequences with the end result being a reduction in social welfare (Aalders and Wilthagen, 1997). Some commentators argue that a strict and inflexible regulatory approach may cause some organisations to adopt an adversarial approach toward regulators, instead of attempting to follow the law in good faith (Malloy, 2003). Alternatively, supporters of social reporting consider it a crucial mechanism enabling stakeholder democracy in corporate governance, which is consistent with the collaborative, participatory and decentralised approach. However, there is growing consensus that firms have been able to engage in the strategic disclosure of social and environmental information solely to protect their own interests when faced with some type of crisis that threatens their legitimacy (Deegan, 2002; O'Donovan, 2002).

It shall be emphasized that the relationship between transparency and accountability is that of a necessary but insufficient condition. Besides this instrumental value, transparency often has an inherent value. Lodge (2004) observed 'Accountability and transparency have also become prominent features in discussions on governance, as promoted by the World Bank, the IMF, OECD and nongovernmental organisations, including Transparency International. At the domestic level, the perception of limited

accountability and the transparency of the regulatory regime have been at the forefront of criticism by the media, the wider public, businesses and so-called public interest groups' (p.1).

Traditional discussion around accountability and transparency are largely considered too limited in their focus on the input of parliamentary channels in holding regulators to account, while ignoring the bigger picture in which regulations ought to be judged not only by their effectiveness, but also by their transparency. In this respect, one of the pitfall is the possibility of disagreement on whether the owner or main shareholders of a bank should be accountable for its bankruptcy or for the revocation of its banking license. In the event of bankruptcy, deposit holders are invariably subject to a protection limit, while the owner or shareholders will lose the whole business.

The underlying assumption provides that transparency produces accountability. However, distinctions between different types of accountability and transparency shall be made, as both notions do overlap with each other and one does not necessary lead to another one. The main point here lies within efficiency of transparency, in particular how access to information impacts on accountability and improve governance, which remains under researched (Bellver and Kaufmann, 2005). Further to Prat, (2005) the recent developments in citizens' legal right to information and participatory budgeting and community development processes have tested the extent to which transparency on decisions goes hand in hand with transparency on consequences. It shall be emphasized that the relationship between transparency and accountability is that of a necessary but insufficient condition. Besides this instrumental value, transparency often has an inherent value. In addition to reducing any risks of undue influence within these institutions, greater transparency and accountability would increase institutional effectiveness in the prevention and detection of money laundering' (G20 Position Paper, 2017).

This research suggests that the extent to which the regulator is ultimately responsible for poor or inefficient supervision of such a bank where a timely identification of problems could have prevented such an outcome remains unclear. Therefore, the above claims stated for the transparency and accountability shall be considered much far beyond a simple enquiry about their effective implementation. Their features extend further, to impacts involving strategies of both the regulated and the regulators toward money laundering compliance, as outlined in the next section.

Part 2.3. Compliance as Context: influence of the domestic and international political context on Russian regulatory compliance, in terms of evolving political, policy, and legal positions.

This section constitutes the third objective of this research and provides an examination of the influence of the domestic and international political context, alongside economic and legal perspectives, in relation to Russian regulatory compliance. Firstly, the context of compliance as a set of interlocking and overlapping spheres of influence from global to local institutional levels will be examined. Secondly, as governments support institutions in determining the scope of subsequent law, customs and

institutions of governance, various state actors as well as sub-state influences, will be analysed. Finally, the theories of individualism and collectivism will be considered within the cultural context of compliance.

2.3.1. The Significance of Context

Context is not a homogenous backdrop, as it is shaped by diverse groups of stakeholders with different levels of power who are driven by specific interests. For the purpose of this thesis, the context is considered through the influences of international and extraterritorial banking initiatives on emerging economies, including treaties, agreements, laws, customs and practice. Globalisation is the principle factor shaping the context of compliance, as compliance with U.S. money laundering rules has resulted in AML/CFT becoming an increasingly global issue, and all efforts taken at the national level are closely interrelated with intergovernmental and global agreements.

According to Glanzberg (2002) 'current theories of context see context as composed of information that is localizable to individual utterances. Current theories grant that discourses have important global properties that are not so localizable. The notion of context, as it appears in everyday practice, is plastic'. Although originally formulated in relation to linguistic theory, Glanzberg's (2002) comments can equally apply to the regulatory environment. In this respect, all laws have to be interpreted, appropriate for local requirements, and comprehensible to the global financial services community.

Pettigrew (1985) suggested a form of research which is context and process in character. In more detail Pettigrew (1987) proposed 'any contextual analysis of a process such as leadership and change should be considered at vertical and horizontal layers of analysis and the inter-connections among those layers over time'. Twenty five years later in other analytical paper Pettigrew (2012) accepted 'the failure to link context to process to outcome in those studies and in process scholarship more generally and the limited treatment of the method of process analysis offered earlier in 1985 and 1987' (p.1306).

As mentioned in previous sections, the concept of compliance is subject to many interpretations and meanings. Compliance is an international, multidimensional phenomenon that must be considered in a sense much broader than its significance in one country alone. In this respect, an examination of compliance cannot ignore the significance and impact of globalisation. Holm and Sorensen (1995) defined globalisation as 'the intensification of economic, political, social and cultural relations across borders.' Globalisation has arguably augmented the power of non-state actors, particularly multinational corporations. In addition, advances in information and communication technologies, innovations in financial markets, and the deregulation and liberalisation of economic activities, have enabled

companies to operate globally and create cross-border relationship networks. Further to Kern et al. (2007) 'the formation of new financial instruments and new political and regulatory arrangements has resulted in their interrelation, extended and deepened international financial market activities'.

Globalisation produced rapid economic growth that has positively impacted both developed and emerging economies (Kose et al., 2009) and established patterns in global governance. New challenges in controlling activities have been reflected in a number of international documents. Examples of these can be seen in IOSCO, the International Association of Insurance Supervisors (IAIS), the Basel Committee on Banking Supervision and its Capital Accord, known as Basel II and Basel III, among many others. Globalisation influences compliance in several ways. The rapid increase in vast international capital flows created significant threats, and also opportunities.

Firstly, globalisation established a sense of global awareness regarding the common links between financial institutions and other organisations in facing problems related to AML/CFT. In this respect, banks are now substantially more focused on reducing AML/CFT risks and are carrying out enhanced due diligence more regularly. They are also transitioning away from a rule-based approach to a risk-based approach in implementing KYC/KYCC procedures for dealing with any financial institutions and monitoring of all transactions for AML/CFT compliance. This is an evidence of flexible and adaptable AML/CFT normative system and of facilitation of effective compliance guided by AML/CFT risk assessments.

Secondly, international institutions, nongovernmental organisations, professional bodies, governmental fora such as the G8, FATF, EAG, Moneyval, the Egmont Group, the Basel Committee on Banking Supervision and many other initiatives actively collaborate on a global scale to strengthen AML/CFT standards and seek the application of these standards across all financial institutions. This can be seen by the Methodology for assessing technical compliance with the FATF Recommendations and the Effectiveness of AML/CFT systems (2013) provided the basis for a robust analysis of the extent to which countries are deemed compliant with the international AML/CFT standards and the level of their AML/CFT systems effectiveness.

Thirdly, a globalised civil society is driving corporate accountability by penalising financial institutions with poor AML/CFT systems and weak compliance controls. Globalisation can make a positive impact by reinforcing and strengthening the system of global governance to render it more effective and legitimate. At the same time, however, globalisation is creating a system that stands accused of perpetually weakening the operational sovereignty of many governments. As such, governments may struggle to independently undertake their public AML/CFT duties internally, and are therefore unable to adequately direct their policies and enforce their laws (Shelton, 2003).

For the purpose of this research, context is a set of agreements, treaties, traditions, shared values, discourses and practices that are localisable. They are the product of social action and commitments which then crystalize to inform future action. These commitments do not mean context is homogenous across the banking community. Regional and national differences remain, alongside variation born of historical forces and the particularities of contemporary interests and priorities. It is important to acknowledge that all socially devised phenomena derive meaning from a given context. As such, there is little value in discussing financial compliance in Russia unless it is grounded in the wider context of international agreements and laws, Russian political and economic priorities, and traditions and practices in the Russian financial services industry. An example might be given in relation to money laundering which, for the last two decades, has been receiving an increasing level of attention around the globe. The extent to which billions of dollars in financial transactions of unknown origin are taking place provides the context for increasing concern and the accompanying focus of many countries in attempting to address money laundering as a significant issue. Accordingly, the discussion about context will be formed of three different levels from global to national and then organisational. All of these three layers are firmly interconnected with one another.

2.3.2. The Context of Culturally Situated Compliance

The context of compliance can be further explored by looking at the various dimensions of the state governance framework, as previously mentioned. However, as rules and norms do not allow for a complete overview of the context of compliance, a further dimension, the sociocultural factors, will be also examined.

Different countries have different cultural, economic and legal traditions. The works of Paine (1994) and others (Laufer and Roberson, 1997; Trevino, Hartman and Brown, 2000; Jackman, 2001; Weber and Fortune, 2005) help us to recognize that a compliance culture geared toward mere respect of the rules should not be the aim, but instead the pursuit of a sense of common values that can facilitate in defining of an ethical role for individuals. To this extent Weber and Fortune (2005) propose 'a combination of compliance and values approaches is ideal'. Further to Edwards and Wolfe (2005:48) such combination can be also considered as 'the development of ethical values and of a compliance culture both in organisations, and in support of the activities of the supervisory authority, as a means of recognising the importance of change that involves the entire financial system'.

The cultural concepts of individualism and collectivism suggest the core differences in terms of how representatives of particular cultures think and behave. The works on individualism and collectivism (Hui and Triandis, 1986; Kagitçibasi, 1997; Triandis, 2001) provide a framework for examining the phenomena of culture and compliance attitudes.

A number of other theories have been advanced to explain cultural variability (Hall, 1976; Hofstede, 1980). In this context, Triandis (1990) suggests that the individualism-collectivism distinctions are the most important dimension of cultural difference determining behaviour overall. Triandis (1990) also argues that a person from an individualistic culture depends more on guilt than on shame, which is reflected in contractual agreements in such countries. In his findings, Triandis (1990) commented that 'there is a greater level of consistency exists in individualistic cultures than in collectivistic cultures', and he also proposed that 'the stronger the cultural or personal orientation towards individualism, the stronger the effect of past personal commitments on future compliance is likely to be'.

As suggested by Cialdini et al. (1999), collectivistically oriented individuals may be much more sensitive to information about compliance histories of other group members (the social proof principle, Cialdini, 2001) rather than their own compliance history (the commitment/consistency principle). In this context, Cialdini et al., (1999) agreed that 'consequently, in collectivistic cultures, gaining compliance is likely to be more successful by presenting information that similar members have complied with in the past'. Therefore, Cialdini, Trost, and Newsom (1995) confirm that when compared on a general view in relation to consistency, 'collectivists may not appear markedly different from individualists'. In this context, Iyengar and Lepper (1999:273) reasoned that 'collectivists consider themselves as similar to members of their ingroup and make a strong boundary between ingroup and outgroup'.

In the United States, the concept of compliance is treated as a long-established, vital requirement that is highly technologically processed and efficiently managed and controlled. In Australia, compliance is treated as a legal requirement which is clearly written and which everybody has to follow, thus ensuring that all regulated entities have an efficient system of monitoring and control. Compliance in Russia is treated quite differently, as the concept of compliance is quite a new phenomenon, which can be considered an outcome of purely Western influence and something of a prestigious function to have within an organisation, as only those organisations with sufficient foreign capital or those that aspire to trade their shares on foreign stock exchanges introduce compliance into their everyday business processes.

On the whole, Russian culture treats compliance as an artificial, modern and Western-oriented concept. Russian society is inherently more collectivistic than individualistic and ultimately, unless a compliance initiative is cascaded from the most senior echelons of an organisation or institution, any notion of adherence is unlikely to be taken seriously. This can be also understood in terms of the sociocultural roots enforced by 'Soviet' regimes on individual behaviour and practices, a system of command and control and discouragement of individual initiative where that might involve questioning the status quo.

The International Compliance Association (ICA), which has its primary aim the development of compliance around the world, arrived in Russia only as recently as 2009. Further to the Russian arm of ICA, International Compliance Training (ICT) survey held in 2014 'the majority of students and teachers of compliance in Russia are from big international and publicly traded Russian companies'. Furthermore, there are still no official professional standards or certifications relating to the role of compliance officer as applicable in Russia.

2.3.3. The Three Levels of Context

(i) International Level

On an international level, Russia is member of what is commonly referred to as the BRICS (Brazil, Russia, India, China, South Africa) major emerging economies, as well as a permanent member of the G20 leading and emerging economies. Russia also became a member of FATF in 2003. According to FATF Annual Report of 2002-2003 (2003) Russia's membership was agreed as a result of significant progress since the enactment of the legislative framework for its anti-money laundering regime. It was noted that although the Russian system has some weaknesses that must be addressed, a solid foundation is in place. Moreover, all authorities involved in implementing and overseeing the AML/CFT system seem firmly committed to making it work effectively. The report also commented that the progress made so far is due to the political will and leadership of senior government officials, especially the exemplary work of Rosfinmonitoring and the CBR.

Russia is deemed to substantially comply with the essential FATF recommendations concerning the minimum requirements for membership, including establishing money laundering as an offence punishable as a serious crime, implementing basic identification requirements for customers and beneficial owners, and establishing and implementing a mandatory suspicious transaction reporting system. As a FATF member, Russia is subject to regular assessment and monitoring processes to evaluate its adherence to FATF guidelines and recommendations. These recommendations are aimed to assess each country's behaviour in relation to their international commitments. The increased proactive participation of the countries in global AML/CFT initiatives can be considered as a good indication of country's behaviour towards improvement of AML/CFT regime. A contested element of the FATF peer review mechanism can, however, be outlined in terms of the support provided by other countries with opposing or incompatible constitutions or legal frameworks. Some degree of constitutional harmony is required for mutual evaluation initiatives among FATF members to be effective.

Raustiala and Slaughter (2002 stated that 'most theories of compliance with international law (IL) are based on the behavioural influence of legal rules. Most IL scholars treat compliance with treaties and compliance with non-legally binding commitments as driven by quite different processes' (p.553).

(ii) **National Level**

State regulators and regulated institutions are the key stakeholders in compliance initiatives at the national level. The compliance framework in any country is based primarily on its legal system, which consists of various national laws and regulations, as well as local legal requirements. With specific reference to money laundering in Russia, a number of national laws and legal requirements, including orders and instructions from the CBR, constitute the regulatory framework in which regulated firms and banks must operate.

An Overview of the Russian State

In this section, an examination of domestic factors influencing the context of compliance development in Russia, as an emerging economy at a transitional political stage, will be provided. A state's historical traditions, its legal frameworks and supporting institutions must be considered as having the most significant implications for the development of a robust AML/CFT regulatory compliance framework:

a. **Historical State Development**

Socio-cultural factors, which are examined in chapter 3, have considerable influence on compliance and an analysis of Russian history in particular, affords a deeper understanding of how compliance is understood and has evolved.

Further to Ziegler (1999) '…according to the Primary Chronicle, a 12th-century account of early Russian history mixing fact and legend, the rise of Kiev began with the city's occupation by the shadowy Oleg, a Varangian, from 882 until his death in 913. Oleg came to Kiev from Novgorod, the ancient northern city where, according to the Primary Chronicle, warring tribes agreed to invite princes from Scandinavia to rule over them. Of the three princes who accepted their offer, only Riurik survived to establish the first Russian dynasty. Prince Vladimir's forcible conversion of Kievan Russia to Orthodox Christianity and his marriage to the Byzantine emperor's sister strengthened Kiev's links to Constantinople' (pp.9-11). The approach ceremony over substance is broadly applied in the contemporarily state governance and in the context of this thesis - relationship between the regulator and the regulated.

As Ziegler (1999) summarized 'historically Russia is a huge, complex, and extraordinarily interesting place. Straddling Europe and Asia, it is neither European nor Asian in its outlook and culture. Psychologically, the Russian people were struggling with their sense of identity, a conflict that has characterised the past three centuries of Russian history. Russia is no longer an imperial power, as it had been since the time of Peter the Great, though some have described Putin's Russia as neo-imperialist. Russia is no longer communist, as it was from 1918 to 1991. Russia is no longer an absolutist dictatorship, as it was under the tsars and the communists, but it is not yet fully democratic, either' (1999:5).

In examining the influence of the domestic political context on compliance, a comprehensive set of historical comparisons that concern the concepts of stateless and statelessness can be found in Vladimir Schlapentokh's and Woods's (2007) 'feudal model' (p.22). In these works (2007) further to Cappelli (1998) 'an explanation of types of social organisation and patterns of political behaviour that persist over the centuries and which might be found in any society, but cannot be satisfactorily explained by other models, including authoritarian and liberal-democratic ones' (2008).

Ortung proposed in 2005 that 'many international corporations and conglomerates have a significant influence around the world, often over informal personal connections with local authorities rather than formal institutional arrangements'. (2005) He also found that there are different types of business-politics relations, which include: (a) corporate regions, where a single corporate ruler effectively captures the local state; (b) pluralist regions, where several powerful industrial interests exist and local government officials play the broker role; and (c) state-controlled regions, dominated by highly centralised corporations of the military-industrial complex or by governors who personally own or control essential industrial or commercial assets.

b. **Legal frameworks and Supporting Institutions**

It can be proposed that there is a tight line between the law and compliance. Raustiala and Slaughter (2002) proposed that compliance with international laws can be considered as an interesting notion, providing analytical policy navigation in the course of designing new institutions and agreements. Legal frameworks and supporting institutions shape the scope and direction of subsequent law and customs, as well as institutions of governance. The influences on compliance development depend not only on socio-political conditions, but also on legal frameworks. In a series of papers, La Porta *et al.* (1997, 1998, 1999) argued the importance of legal traditions while considering about development of financial markets.

Turning to the rules-based regulatory system in Russia, strictly legal and cultural elements can be identified. The rules-based regulatory approach in Russia is partially explained in a detailed analysis of the formal Russian approaches to legislative and governmental administrative functions, alongside a number of other historical cultural elements. At the same time, Russian society as a whole, including government functionaries, are known for exploiting the legal and regulatory system for personal benefit. Referring to the mis-adopted and mis-implemented Prussian system of governmental administration, the Russian approach to the legislative and sub-sovereign executive functions, namely law enforcement and administration, is very formal. Conversely, Russian society as a whole, including the very functionaries who implement and maintain the legislative and sub-sovereign executive functions, arguably reflects an unfortunate tendency toward identifying and aggressively exploring any lacunae, ambiguities and inconsistencies in the legal and regulatory system for personal benefit.

(iii) **Institutional or Sub-state level**

Making conceptualising of institutions as concepts of rules that are not always consistent there is a number of schools that proposed their views for explaining change. Lewis and Steinmo (2012) suggested that gradual institutional change can be understood as an evolutionary process with an example of 'generalized Darwinism' (Aldrich *et al*, 2008). They argued that the evolutionary approach used in biology can also be applied to social institutions. As Zilber (2008) argued that institutionalization is an ongoing process rather than an endpoint. Moreover, depending on type of institutional change, some changes could be brought in swiftly having an impact on the regulatory elements of change, while normative and cognitive elements would be associated with a long-term perspectives.

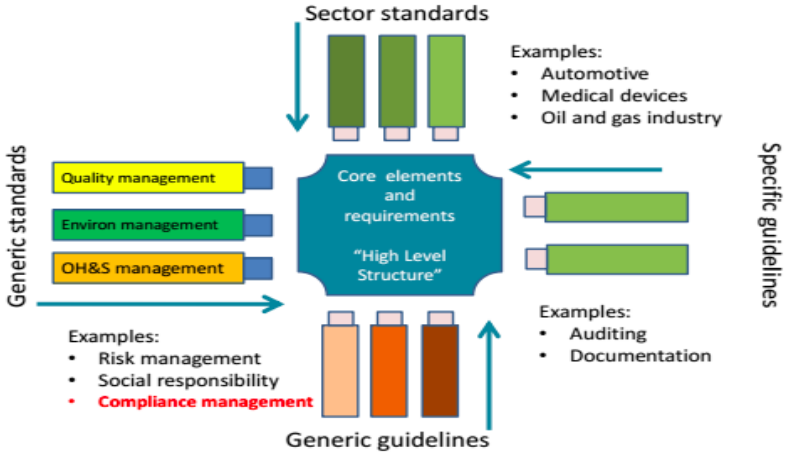
Darwin (1874) believed that his evolutionary theory can be applied much wider and beyond biology to explain the evolution of human culture, behaviour and language. The Institutional change theory can be also considered as the product of a theoretical algorithm of generalised Darwinism. Further to Lewis and Steinmo (2012) 'a simple one-off deviation in an agent's behaviour will not cause 'institutional evolution', unless that policy idea is both 'selected' by decision-makers and 'replicated' across other individuals, organisations and institutions' (p.314).

Turning to influences at the firm's level, institutional frameworks are of pronounced importance in formalising restrictions for business activities. As a relatively new phenomenon that has burgeoned globally over the past two decades, compliance has only been discussed in relation to the activities of Russian financial institutions within the last five to seven years. Every financial institution has to generate profits legally and ethically, yet there have been myriad public scandals in the financial services industry and other high-profile corporate enterprises over the course of the last decade. As a result, companies have been forced to acknowledge that the basis for social responsibility and the elimination

of regulatory failures is well-organised, well-managed compliance initiatives in line with legislation, as well as the organisation's own ethical codes and corporate directives.

The international context, Basel II, Basel III and the political pressure from US, in particular on ML and FT might be set against the Russian political and economical context, then the actions of banks or the modes of thinking of individuals. Thus, Compliance management at the institutional level includes not only meeting the requirements of laws and regulation, but also managing the requirements of a variety of stakeholders, such as customers, the banking sector, and wider international stakeholders. In accordance with ISO standard 19600 on compliance management systems (Figure 2) compliance management can easily be integrated with other management systems that are based on ISO standards, for instance, environmental management ISO 14001 and quality management ISO 90001.

Figure 2. ISO 19600 compliance standards specified in the plug-in model



As Barnett and Finnemore (2004) put it 'international relations (IR) papers have not undertaken any systematic examination to how international organisations do really operate. Most of our theories are theories of states and state behaviour' (5). In this context Andreev stated that 'as realism suggests, these organisations are set up by states, are dependent on them and act for their interests, and are typically associated with the national security paradigm' (2007:1).

Within the sphere of AML, the United States is particularly proactive and has demonstrated firm leadership on this crucial issue. However, it might be argued that perhaps it is simply exercising an imperialistic approach and ensuring that other countries conform to U.S. requirements irrespective of their own national interests.

2.3.4. Governance and Compliance at the Institutional Level

There are two main theories of governance, namely the traditional theory and the new theory of governance. From the traditional standpoint, it is possible to consider the hypothesis that good governance means to what was formerly referred to as the so-called strong state. Further to Badie and Birnbaum (1979) proposal, the level of bureaucratisation and centralisation in a country was considered as the main factor for assessing the degree of autonomy of the state in question. In contrast to traditional theory, the new theory, provides that good governance exists when the state becomes less powerful and operates in collaboration with private individuals and groups as partners. Koiman (1993) proposed that 'a low-profile state represents the only possible future for government, the future being taken here in the dual sense of what is actually going to happen and what is desirable, namely, good governance'. Thus, Merrien (1998) viewed 'a new theory of governance can be characterised by a shift from supervision to contracting out, from centralisation to decentralisation, from the state that redistributes to the state that regulates, from public services management to management following market participants, and from state 'guidance' to cooperation between the state and the private sector'. This, however, is not yet the case in respect of the current Russian political status quo, as will be shown below.

Compliance is embedded into the corporate governance activities. Stoker (1995) claims that 'the notion of governance has tended to be seen as part of a wider issue related to the efficiency and effectiveness of state action (p.101). The substantial segment in the theory of governance is now regarded to the most efficient ways of managing society, rather than focusing exclusively on the traditional realms of domination.

As compliance and governance are interconnected, different models of governance reflect the causes and outcomes of different models of compliance.

2.3.5. The Influence of Other States

One of the most significant influences on compliance is provided in Koh's (1996) theory of obedience with international law, termed transnational legal process, where 'obedience is compliance motivated not by anticipation of enforcement but via the incorporation of rules and norms into domestic legal systems'. A core implication of Koh's (1996) argument is that compliance is driven by the efficacy of domestic law; what creates compliance with an international rule is its transformation into a domestic rule. Guzman (2002) reasoned that Koh's (1996) theory gives no understanding about how these legal requirements are practically implemented. As an element of further critique, Koh (1996) did

not compare compliance and noncompliance in his studies and, therefore, he did not clarify what might be considered an appropriate response in cases of noncompliance.

States are influenced by the behaviour and actions of other states through communication, trade and investment, alongside the creation of common institutions to regulate trade and investment, including treaties, agreements, international law, FATF, WTO, WB, IMF, and others. According to Raustiala (2000) compliance theory is often defined as one of the pathways to international law, which entails seeking effectiveness through international instruments and institutions addressing specific concerns. Bradford (2004) suggested that many theories offer various explanations about states' compliance and the complexities are captured in the literature known as 'International Legal Compliance'. One of the theory proposed by Bradford (2004) was 'an alternative theory of compliance based on personality theory, analysing how individual decision-makers decide to comply with or violate treaties' (2004). However, this literature remains largely disputed in relation to motivations of states among different scholars.

Further to Nilesen and Parker 'we see two main approaches towards empirical compliance research generating theoretical development within this field: The first is objectivist research aimed at building and testing theories identifying internal organizational characteristics that are associated with compliance and non-compliance. The second is approach aimed at interpretive understanding of organizational responses to regulation and of the processes by which compliance is socially constructed' (2009:2).

In relation to the Russia, it is best described as reactive due to the fact that all significant compliance developments are overwhelmingly based on the influence of other states, including the FATF Evaluation Report published in 2008. In the context of AML/CFT, hierarchy may be used as an organising principle based on the fact that all Russian AML/CFT legislation is based on international treaties and initiatives, including the principles of international organisations, such as the aforementioned FATF report based on the Wolfsberg Principles, the Eurasian Group principles on combating money laundering and the financing of terrorism, as well as subsequent Russian federal laws and CBR regulations. Both hierarchy and networking can work in tandem or in opposition. For example, the CBR relies on hierarchy for managing domestic financial institutions and networking in its involvement with global initiatives like FATCA, EMIR, Transparency International analysis, dealings with the WB, and so on. Moreover, the U.S. governmental organisations, such as the Office of Foreign Assets Control of the U.S. Treasury (OFAC) and the SEC frequently apply extraterritorial acts, orders and guidelines which entail compliance by all financial institutions doing business with the U.S., irrespective of their jurisdiction. On this basis, the Russian government is not the ultimate decision-maker in respect of money laundering, counter

terrorism, or any global compliance initiatives for that matter. The entire process reflects the principles of hierarchy and networking.

Another example of the influence of other states is state-building theory. State-building essentially describes the construction of a functioning state. This concept was first used by Tilly (1975) when he viewed advantages of state-building as follows: 'state-building theory provided for the emergence of specialized personnel, control over consolidated territory, loyalty, and durability, permanent institutions with a centralized and autonomous state that held the monopoly of violence over a given population' (1975:70). It has offered some views that view state-building as national process driven by state-society relations. In this context, Brinkerhoff (2007) summarised 'the key goals of state-building can be considered as provision of security, establishment of the rule of law, effective delivery of basic goods and services through functional formal state institutions, and generation of political legitimacy for the (new) set of state institutions being built'.

The stronger the state, the greater its ability to pursue autonomous policies for regulated firms and banks. Weber and Tilly both proposed definitions of the state. Weber (1918) defined the state as 'a human community that (successfully) claims the monopoly of the legitimate use of physical force within a given territory […] If the state is to exist, the dominated must obey the authority claimed by the powers that be'. Tilly (1975) argues that '[a]n organization which controls the population occupying a defined territory is a state in so far as (1) it is differentiated from other organizations operating in the same territory; (2) it is autonomous; (3) it is centralized; and (4) its divisions are formally coordinated with one another' (1975:70).

During the 1990s, significant changes in state-building and overall governance began to take place in Russia. Not only has Russia moved from communism to democracy and from centralised economic planning to a market economy, it has also undergone considerable change in terms of being a federated political, military and economical network to being a smaller country, albeit continuing to exercise tremendous power. Russia has had greater difficulty in consolidating regime and state as it has not been able to neglect the various aspects of state formation in the same way as many of its fellow post-Soviet states. At the same time, Russia has arguably not benefited from the advantages that independence has brought to other Eastern European countries.

It can be concluded that most of the contemporary literature addresses the impact of financial system organisation and its growth, a smaller volume of literature addresses the underlying cause for interrelation between financial development and banking compliance development. Gerschenkron (1962, 1970) argued that banks played an important role in the industrialisation of much of Western continental Europe. However, in situations of extreme Russian underdevelopment, financial institutions

were not sufficiently adequate to support the shift to more modernised industrial activities due to a lack of strong support from the government. Government intervention has the power to hamper development of certain institutions at the cost of others. Regulation of non-banking institutions may further influence on the condition of the whole financial system. In addition, current laws that protect rights of the financial institutions may encourage further promotion of all types of financial institutions.

2.3.6. The Evolution of States

In an increasingly complex world, it is frequently argued that the state has substantially weakened its capacity for action. States have difficulty foreseeing the consequences of actions taken and struggle to avoid the creation of harmful outcomes. States evolve, but regulatory mechanisms tend to trail behind ideological ambitions. As the now prevailing neoliberal paradigm spread from West to East, the Eastern European economies and Russia experienced convulsions during the 1990s as a gap opened up between their new political-economic ambitions and the inadequacies of their existing regulatory frameworks, and they struggled to reorganise.

As detailed in chapter 1, Russia joined the WTO in 2012 after 18 years of negotiation, signalling its integration into the world economy. WTO membership involves implementing international trading rules and standards in all trading areas, including its monitoring and enforcement mechanisms. However, in accordance with the European Commission (2012) Press-Release certain inadequacies of the Russian legal regulatory framework led to the E.U's comments that certain requirements appear to be 'at odds with Russia's commitments and would stand in the way of other WTO members fully realising the benefits expected from Russia's WTO accession' (2012:1).

An evolution of compliance at the global level can be further illustrated by the introduction of the U.S.-originated FATCA law, under which overseas banks are obliged to disclose information about the accounts of U.S. taxpayers to the U.S. tax authorities. The U.S. government seeks to ensure that all financial institutions around the world comply with U.S. rules by making information more transparent. One of the main issues facing Russian financial institutions is the fact that existing domestic legal barriers prevent them from entering into direct agreements with the Internal IRS and, therefore, they are unable to fully comply with FATCA. Due to the restrictions imposed under Russian civil legislation, Russian banks were unable to register on the U.S. Treasury portal and comply with the obligations as enshrined in FATCA in terms of directly sharing account information of U.S. citizens who have assets in Russia, specifically those intentionally avoiding their tax obligations. An amendment to Russian legislation allowing banks to legally comply with the U.S. international tax information reporting law was adopted under the State Duma of the Russian Federation (2014) Federal Law No. 173-FZ. However, it should be noted that the same law also introduced an obligation for non-Russian financial institutions to report on

the accounts opened for Russian nationals or companies controlled by Russian nationals, which is similar to FATCA requirements. This obligation was provided for by Article 6 of the above federal law and is typically referred to as 'Russian FATCA.' The Russian Federal Tax Service published forms for reporting under the new legislation in December 2015, yet it is still not entirely clear how the disclosure process will work or what the sanctions for noncompliance might entail.

Conclusions

The above review serves to examine the various ideas directly relevant to the aim of this research and is organised to reflect the overall objectives. This research will conclude that the area of compliance in financial institutions remains ripe for further investigation. In relation to the first objective of this research, there appears to be scope to test the view emerging in the literature that a unitary, legalistic approach in itself is unlikely to be successful without empirical evidence supported by the opinions and experiences of financial institutions operating in Russia, alongside executives of relevant international organisations and state authorities responsible for legislation. In relation to the second objective, there is the potential to examine whether the ethical climate and corporate culture might now be considered the key drivers for compliance initiatives in organisations and how the notion of compliance differs depending on cultural differences. There are also considerable opportunities for interesting research around the third objective.

Chapter 3 - Methodology

Introduction

This chapter consists of six sections. The first section outlines the epistemological perspective and various schools of law and their implications for compliance. The second section describes the consequent research approach involving seven case studies full details of which are provided in Appendices 1-3. The third section presents methods of data collection, while the fourth section contains methods of data analysis. The assessment of research quality (issues of reliability, validity, generalisability) is provided in the fifth section, and the final section covers ethical research questions. A short conclusion follows.

3.1. Epistemology and Jurisprudence

3.1.1. Epistemology

The study of epistemology focuses on what counts as knowledge, leading to an understanding that then guides our methods for acquiring that knowledge, in this case on the nature of regulatory compliance.

The dominant epistemological debate is between positivism and interpretivism (Lee, 1991). Lee (1991) proposed that 'the positivism claims that its approach and all approaches of natural science, are the only scientific ones, while the interpretivism claims that the research about people and their institutions calls for the approaches that are altogether foreign to those of natural science. Therefore, the positivist and interpretive methods are opposed to each other' (p.350).

Positivism is the dominant paradigm in most corners of society, whereby knowledge is regarded as objective, measurable, comprising law-like relationships. This is a predetermined world, where all human action is conditioned by environmental providence. In his assessment of the relationship between knowledge and political interests, Habermas (1972) criticised positivism's hold over society, manifested as the inequality of power whereby dominant groups retain the status quo through 'instrumental reasoning'. Among the critical points of positivism is the point of separation between the researcher him/herself from what is being researched by them. From an interpretivist perspective the possibility that a researcher can consider the phenomenon without allowing values or interests to interfere is mostly impossible (Hustler, 2005).

In contrast to the positivist tradition, the interpretive view of reality regards knowledge as subjective and socially constructed. That means that each phenomenon becomes understandable in the

context of existing social groups, such as the financial institutions, stakeholders, other groups and is being subject for a constant gradual change during its construction by the social groups. For example, further to Czarniawska (2008) 'research on science and technology, such as those made by Latour and Woolgar (1979, 1986). Czarniawska (2008) proposed that 'the term 'social' as in 'social constructivism' is actually unnecessary and moreover the reality is under constant construction' (p.773).

In the context of regulatory compliance, the knowledge can be also considered as a socially constructed. For example, the same Global KYC Policy has its own understanding in each country of the Bank's presence, which is based not on the various legal deviations and requirements only on a country level, but as well on own understanding and further interpretation of its provision by particular compliance officers to their stakeholders. Thus, the concept of Ultimate Beneficiary Owners has a different layers of understanding in each country/organization/compliance unit in question. Therefore, the ambiguities arisen through layering of understanding of the meaning of compliance, e.g. language, translation between languages, using different modes of understanding, such as mediation and construction or as encounter with full embeddedness, all these factors do affect the meaning of phenomenon. Another example of layering of understanding of compliance is different treatment of basic compliance narratives, as different jurisdiction put different emphasis on the same things. For example, the local laws in Poland do not allow to transfer any AML related information to any third party, except to the branches located in Poland. In practical terms that means that the headquarter of any bank located outside of Poland is not able to receive any management information statistics in relation to AML compliance from Poland. The Polish regulatory authorities treat this compliance requirement in their own way.

The further discussion on various layering of understanding of compliance by different social groups and its ambiguities is provided in more details in chapters 2, 4 and 5 through the layering of understanding by these social groups. It shall be emphasised that where the positivist world is determined, the interpretivist world is voluntary. Humans are free to shape their environment as they wish. From within this tradition, the role of the researcher is to seek out the meanings that individuals attribute to their experiences.

Czarniawska and Joerges (1996) arguments on disembedding/re-embedding movement are examined. Further to Czarniazwska and Joerges (1996) the process of ideas movement is an 'ongoing process of realization of ideas and turning ideas into objects and actions' (p.13). Czarniawska and Joerges (1996) made their arguments towards broadening of exchange of ideas, also considering aspects of globalisation and local context (Mica, 2013). In the context of my thesis, ideas on compliance phenomenon on the same language are translated differently even in the local contexts. For example, the idea on changing formats used in the obligatory control of transactions subject to ML/FT has

completely different understanding among banks, regulators and IT companies involved in the discussion about the new initiative. The understanding of the regulator, especially Russian FIU that it should not be difficult and very expensive to introduce within 45 days in the middle of the budgeted year new fields into the STP message. This understanding was completely rejected by the banking environment, as they believe that starting new unbudgeted process involving complete re-assessment of the banking processes and its potential enhancement within 45 days is not feasible. Further to Mica (2013), the theoretical strength of disembedding/re-embedding dialects is provided in the graphical depiction of travel of ideas.

Further to Czarniawska and Joerges (1996) the translation model can be helpful to agree that any texts can be considered in different ways. In the context of my thesis, the meaning of compliance is vital, as linguistic interpretation is the cornerstone of understanding compliance nature. The epistemological position adopted in this thesis is the interpretive view of reality. From this position the compliance phenomena, especially the practice if not the principle, cannot be considered as wholly determined, and is understood differently by different stakeholders in different jurisdictions and in different situations.

Saunders, Lewis and Thornhill (2007) state that the research paradigm adopted contains important assumptions about the manner in which the researcher views their surroundings. This researcher is also a compliance practitioner, and experience shows that all participants involved in compliance contribute by sharing their own unique experiences and interpretation of the world. Mindful of this, as a researcher, I have sought to remain open and responsive to the behaviours, values and believes of the participants, and attempted to 'suspend prior cultural assumptions' (Mackenzie and Knipe, 2006).

In addition to questions of what constitutes valid knowledge, questions involving what is legal/illegal invoke a need to reflect on jurisprudence and legal validity.

3.1.2. Jurisprudence and Legal Validity

Regulatory compliance is grounded in legal theory of which there are several: natural law, legal positivism, legal realism, and critical legal studies. Familiarity with these differing philosophies of law contributes to a better understanding of legal reasoning, systems and institutions that underpin regulatory compliance in a particular jurisdiction such as Russia.

The enforceability of law depends on its legal validity, and the robustness of that validity helps or hinders the capacity of government to enforce law, if necessary through legal coercion.

There are basically two types of questions legal scholars ask to answer:

(i) Problems of internal law and legal application. For example, there is no currently established practice in deciding ML/FT and labour law cases based on precedents and thus each new case can be resolved differently;

(ii) Problems of law as a particular social institution as it relates to the larger political and social situation in which it exists. Although it is stated that the legal system in Russia acts independently of the government, all significant court decisions which have a broad political and social impact appear to have been influenced by and agreed with government authorities.

Three out of four primary schools of thought in general jurisprudence are applicable for this thesis:

(i) Natural law

(ii) Legal Positivism

(iii) Legal Realism

The Critical legal studies is not applicable for this thesis, as this is a US specific movement originated in 1970s and 'class domination that this school of thought argued is at the root of liberal legal institutions in the West' (Turley, 1987).

(i) Natural Law. There are two independent understandings of natural law. The first position sees natural law as describing moral propositions that are somehow universally objective, whose truth or falsehood is self-evident. The second position sees natural law as being rooted in the nature of human behaviour, and human beings are presumed to act rationally thereby providing natural law with its rationality. In these terms natural law is grounded in social conventions that elaborate over time and so have a historical basis. While these two positions are independent, they also overlap in that there is broad agreement that while some laws derive their authority from social conventions.

There is no tradition in Russia of thinking about financial regulatory compliance, and the control of money laundering in particular, as involving immoral behaviour, whether objectively understood or a social convention. This is not surprising since these subjects emerged on the world stage as late 20th century creations, and 21st century for Russia. That is, acts that hitherto were not considered morally wrong by much of the general Russian population or its judiciary, have been criminalised and labelled money laundering only in the last decade or two.

(ii) Legal Positivism. According to Finnis (2011) legal positivism and natural law theories are opposing views about what law is and how its relations to justice and morality should be defined. Legal positivism - in the spirit of positivism noted earlier - rejects the moral or historical basis of natural law, and instead argues that decisions be made based on legal rules whose validity rests on the legitimate

authority of political rulers. Judicial decisions in Russia are based on civil law and thus, the theory of legal positivism is relevant to discussions about the Russian legal system. Confusingly, legal positivism may also refer to 'what is evil because it is prohibited' while natural law prohibits what is 'intrinsically evil'. Financial compliance is relatively fresh legal terrain in Russia, and it is constantly evolving as new precedents continually inform judicial decisions. Nevertheless, Russian judges are guided by legal positivism, rather than natural law, which is combined with the general principles of law. Therefore, compliance and ML can be viewed as a combination of natural law, namely what people think is right or wrong, and development of new conventions from a legal positivist perspective.

This legal theory informs this study as any consideration of compliance and challenges would be focused only on rules and legal obligations if analysed from the sole perspective of legal positivism. However, taking into account the undeveloped level of compliance awareness in Russia, only a small number of laws and norms would fall under the compliance umbrella in Russia, which would render the focus of this research quite narrow and rigid. Therefore, legal positivism would be too restrictive as a standalone theory to allow a thorough examination of the meaning of compliance from different perspectives. Compliance will, therefore, be considered as combination of moral principles and social conventions. It shall be highlighted that these social conventions whether regulative, normative or cognitive should be considered in conjunctions with other aspects that will influence the process of change in organisations.

(iii) Legal realism is based on facts, cases, artefacts and precedents. Position of legal realists that common-law decisions are a subjective system that produces inconsistent results that are mainly based on the moral, social and political perceptions of judges.

While the idea of WHAT doctrine, was dominant in Soviet times and continues to prevail in modern Russia, legal realism is frequently utilised, as it focuses on what works in reality and might also be said to have greater financial advantages for all financial market participants. Legal realism informs this research as a legal realist approach would involve court judgements related to compliance, but would encompass a broader view of the importance of a number of social and economical elements. Overall, legal realism is a useful frame for discussing compliance because this theory provides a practical landscape for the protection of violated rights in courts and motivating compliance with established rules and obligations. However, the compliance concept is quite new for Russia, officially appearing at the international level in 2005 in the Basel Committee paper on 'Compliance and the compliance function in banks' (April, 2005), with further developments continuing until the present day. There are no adequate civil or criminal court judgements that can establish practice of ML cases for legal entities and individuals for designated money laundering reporting officers to refer to for guidance.

Taking these ideas as a whole, the perspective adopted here is that the Russian legal consciousness has some elements of legal positivism, taking into account the French system of civil law historically adopted by Russia in 1800s that predates the transformation of Russia into a market economy. This provides the ground for Russia's adolescent financial legislative framework, where judicial decisions are developing through a mix of legal positivism, universal general principles of law (good faith, fairness, equity, reasonableness), and the influence of cases of precedent and legal debate. This suggests an epistemological position for this research that is mixed. For the purposes of this research, what counts as knowledge or truth is grounded in epistemological pragmatism (Cherryholmes, 1992) and legal positivism, where 'truth is what works'. Epistemological pragrmatism means that judicial decisions emerge from interpretations of codified law, context, cases, legal debate, political sensibility. At the same time, a developmental epistemology (Valsiner, 2007) in the sense that Russia's financial legislation is experiencing a qualitative transformation of social and psychological structures, including a re-conceptualisation of what regulatory behaviours count as right or wrong, as it develops legislation that is internally coherent and externally credible. This view of legal process seems consistent with an interpretivist view of knowledge.

3.2.Research Approach

The conceptual framework of this thesis has three core elements, namely content, process, and context, which were earlier introduced in chapter 1 and 2. For better understanding the nature of the phenomenon, such as regulatory compliance, I deconstructed it into three objectives: understanding of the meaning, examination of internal processes and understanding of the context as an influence on both processes and meaning. For this purpose the research formally began by posing a set of open-ended research questions about the nature of compliance and its areas, e.g. ML/FT and other; the product of experience as a practitioner, and a selective study of the literature in and around the research area. The high complexities of the compliance phenomenon discussed require a comprehensive understanding of its entirety and Russian peculiarities. My theoretical motivation is driven by underlining theories of regulation and theories of compliance discussed earlier in chapter 2. This was lead to the intention to collect the data, such as social compliance, evidence from firms and regulatory institutions and compliance professionals and also from the Russian regulators and international organisations located in Russia. This was enabled to find out what various compliance stakeholders think about the entire compliance phenomenon and about the challenges of achieving corporate compliance with the Russian financial regulatory and legislative environment. I was seek to capture the interdependence of regulator and regulated entity by collecting data on shifts in firm strategy and policies as responses to shifts in regulation; and to show that regulatory shifts also reflect

bank compliance behaviour, as well as the methods of collecting, e.g. semi-structured interviews and semi-structured questionnaire and direct observations.

3.2.1. Case Study

The research approach used here is the case study. Writers distinguish between different types of case study (Yin, 1989) and this research reflects a combination of two, namely: the pure description of a social phenomenon and the development of a theory.

The Case study is well suited to this research project because it permits an investigation of a contemporary, bounded human situation or system (Yin, 1984), such as compliance with financial regulation, and the more contemporary phenomenon of money laundering specifically. This approach enables a description of the regulatory environment of money laundering, and to use the collected data to make a contribution to theory regarding this behaviour. A case study comprises various sources of data, both qualitative and quantitative, including written reports, interviews, documents and other material. Choosing between a single and multiple case studies in order to study social behaviour in a particular context reflects a trade-off between generality, accuracy, and simplicity (Thorngate, 1976). The single case study allows greater accuracy in context but at the expense of generality and simplicity. Multiple case studies better support generality, but at the expense of accuracy, while simplicity could undermine generality and accuracy. For this thesis, multiple cases seem appropriate for capturing anticipated variation in compliance practices - between Russian state-owned and private banks, and foreign banks - albeit within the same (Russian) regulatory regime. While these practices have in common Russian mandated compliance behaviour, these banks are also likely to reflect differing ideological and political influences, such as exists between state-owned, private owned, and non-Russian owned banks. More justification on the choice of banks is explained below (Choice of Organisations). In addition, case study allows to see how and in what directions layers of meaning of compliance, as well as bank's strategies may develop by a comparison of people work in a domestic banks where the base language will be local and in a foreign bank, where the internal language may well be English.

3.2.2. Choice of organisations

The compliance phenomenon can be understandable in context of the social groups where this phenomenon exists. Therefore, case studies of seven financial institutions support this research: two state Russian banks (State Bank 1; State Bank 2); four foreign banks (Foreign Bank 1, Foreign Bank 2, Foreign Bank 3, and Foreign Bank 4), and one private Russian Bank (Private Bank). The choice of seven banks provides a full coverage of all types of ownership currently existing in Russia. These seven banks

were chosen because they: (i) have an established corporate history in the Russian financial market; (ii) represent differing types of ownership, corporate structures, and cross-country coverage; (iii) have established systems of internal control and established ML/FT compliance policies at different level of their development and therefore, perceived by compliance practitioners as upholding strong ML/FT compliance policies and procedures; (iv) have a significant market share in Russia. The more detailed information about these seven banks is provided in the Appendix 5. One of the purpose of decision to use such a mix of bank type is to receive various responses from various type of banks by adding list of outsiders (third party experts), and then individuals selected to represent these banks/organizations to make a representative sampling that can provide with certain objectivity for each set of questions discussed during semi-structural interviews.

3.2.3. Sources of Evidence

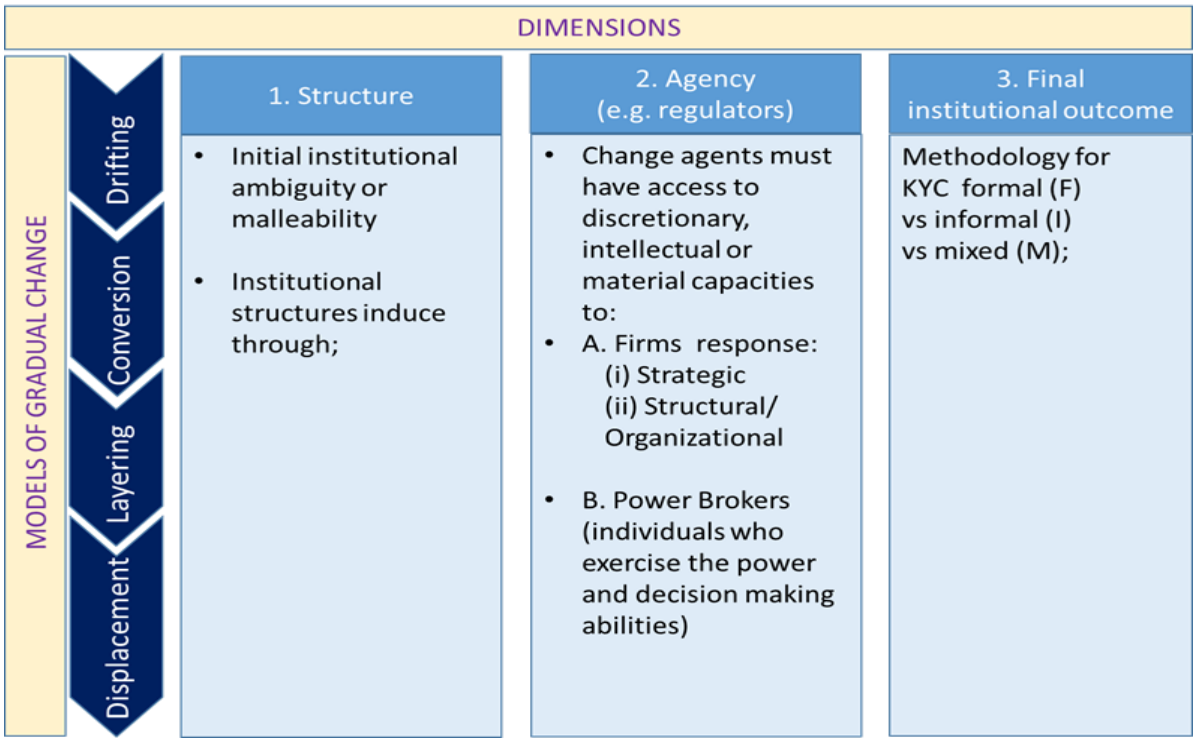
The main sources of evidence were through semi-structured interviews with Heads of Compliance, members of the Board of Directors, independent advisers, representative of the CBR, CEO of ICA in Russia, members of other international organisations. These interviews were conducted in Russian and direct observations. An average time for each interview was 120 minutes for each bank. Additional evidence was collected from internal reports and plans, public performance accounts, promotional literature and press cuttings, as well as public industry reports. Some archival evidence was also collected, going back one or two years. Despite the limitations of interviewing and observation the use of interviews is recognised as appropriate where the purpose of the research is to solicit the meanings that individuals attach to their situation, in social contexts that have not been structured in advance by the researcher (Easterby-Smith, Thorpe and Lowe, 1991). Again direct observation is still recognised as a valuable way of enriching understanding of both the material and social context, and the social phenomenon being studied (Yin, 1984). Some elements of the discussion to follow are informed by such observational evidence.

An organizing framework for collecting appropriate data regarding financial compliance priorities and practices, including anti-money laundering measures, would help focus and control the research project. Further, risk management as was highlighted by respondents in the chapter 4 is arguably the priority for all banks. With these two factors in mind data collection was therefore organized using the Enterprise Risk Management framework (ERM). Banks use the ERM to manage compliance with laws, and therefore helps organisations to minimize reputational risks and associated consequences (COSO, Executive Summary, 2004). Such key words are relevant to the ERM assessment of a financial institution's internal control system, such as governance (Board Risk Committee, Risk Management Committee, C.E.O.), and risk communication (AML risks, fraud, audit, legal, compliance). ISO 19600, which was rolled out in December 2014, is also used as an organizing framework, since it is

expected to serve as an international standard and a global benchmark for compliance management programmes. These two tools provide a comprehensive framework for capturing key risk-based words and phrases used. This approach of identifying risk-based key words and phrases from an ERM model helps eliminate the potential for subjective biases, while keeping the process of collecting the data consistent and allowing for replication across case studies.

Being a practitioner observer and looking at the compliance as evolving and many-sided notion, it seems likely that the compliance notion can be captured by combination of process (drifting, conversion, layering, displacement) and a number of particular features of environment (structure, agency and power brokers). Adapting Rocco and Thurston's (2010) categorisation of models of gradual institutional change, Figure 3 (below) shows the types of data collected. The criteria within the Figure 3 provide a useful guide for selecting both documentary sources (e.g. regulation) and for drawing on semi-structured interviews with representative of the regulators (2 persons), banking and compliance practitioners, senior managers (10 persons), and other stakeholders (ICA, World Bank) (3 persons). The results of semi-structured interviews for this Figure is provided in the chapter 4 (Findings).

Figure 3. Combination of process vs. particular features of environment



Adapted from Rocco and Thurston's (2010) categorisation of models of gradual institutional change.

3.2.4. Methods of data collection

Multiple methods of data collection were used in order to establish broad and diverse views on relating to the three research objectives, including a qualitative survey, documentation and Participant's

observations. It shall be noted that part of the way I collected the data was guided by Easterby-Smith *et al.* (1991). This had an idea with key words and association that I was looking for specified in sub-section 3.3.3. Qualitative survey.

The qualitative survey made for this analysis was based on Marsland's *et al.* (2000) idea of merging quantitative and qualitative survey methods Marsland *et al.* (2000) outlines two types of approaches: (i) the qualitative survey and (ii) the questionnaire type of survey, and recognizes that there are instances where the two used simultaneously can be mutually reinforcing, resulting in more nuanced information.

Several types of methods were used, including using both quantitative and qualitative approaches (Hacking, 2001). The idea of combining methods has been argued by Barbour (1998), further to her view 'mixing paradigms may be possible, but mixing methods within a single paradigm, such as qualitative research, is problematic as each method within 'the qualitative paradigm' has its own assumptions in 'terms of theoretical frameworks we bring to bear on our research'' (p.353).

Data was collected from observations, interviews or other research sessions. As outlined above, a combination of methods were used for gathering data were employed:

Qualitative Survey (Semi-structured Questionnaires) was sent to:

- officers of the Central Bank and Russian FUI;
- compliance officers and senior executives (professional network); and third parties, such as ICA, World Bank, Compliance Consulting firms.

The questions were in Russian and focused on compliance regulation, challenges and perspectives within the financial market in Russia. A mixture of participants from the financial markets (regulated, regulator, third party experts) gives an opportunity to provide a more flavours in understanding of compliance from the business, regulatory and international perspectives.

Semi-structured interviews

Following receipt of the completed questionnaires, semi-structured interviews were conducted in Russian with: ten representatives of the seven regulated financial organisations, two regulatory bodies and three third-party experts. More precisely, semi-structured interviews were undertaken with:

(i) One officer of the Central Bank; and one officer from the Russian FIU;

(ii) Ten current and ex-compliance officers and senior managers/members of the Board of

Directors of banks and companies (professional network); and

(iii) Three third-party experts: from World Bank, International Compliance Association (ICA), former partner of consulting firm Ernst and Young.

The duration of interviews is varied from 90 minutes to 120 minutes. The language used during the semi-structured interviews was Russian.

The rational for the individuals selected to represent these organizations was their high level seniority/responsibilities and 10+ practical experience in compliance area.

All semi-structured interviews were recorded and analysed many times while writing this thesis. Semi-structured interviews or 'qualitative research interviews' (King, 2004) were used to help to understand the reasons for the decisions respondents have taken and the reasons for their attitude and opinions (Saunders *et al*., 2007). As this research seeks to understand the meaning of compliance in practice, in-depth interviews can be very helpful to 'find out what is happening (and) to seek news insights' (Robson 2002, p.59).

3.2.5. Documentation

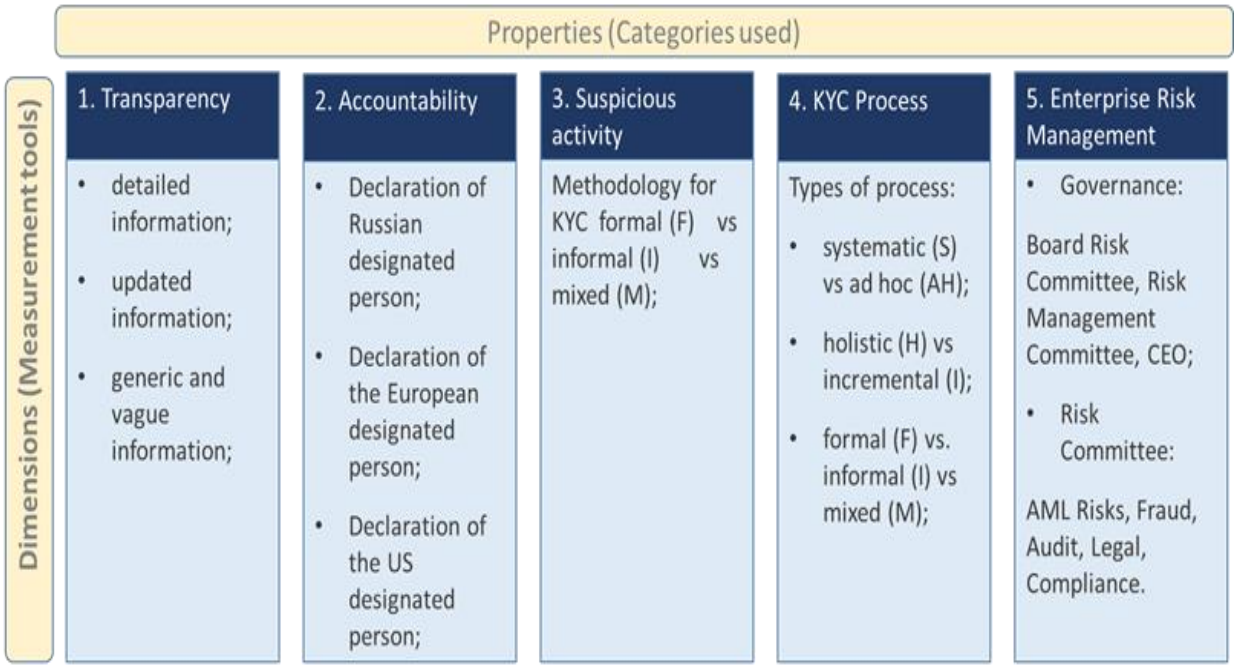
Various publicly available documents of the regulated financial organisations, such as compliance charters, policies, procedures, as well as documents of the Russian regulator and international organisations (ordinance, methodological recommendations, instructions, analytical reports) were reviewed. Collecting written documents provide a source of information for gaining a deeper understanding and description of the participants' convictions, conduct and experiences (Bogdan and Biklen, 2006). Glesne and Peshkin (1992) highlighted the value of documentation in making any observations, interviews, which generate further trustworthiness among data. These include public reports, policy documents and other public commentary, such as politicians' speeches, court records, and newspapers. Public reports and other comments are appropriate because they offer valuable insight into what is going on in the political, economical and social spheres, which leads to a deeper understanding of the various influences on compliance.

3.2.6. Participant's observations

This section explains another way of data collecting and types of data received from the mentioned earlier banks and their regulatory regime. The use of certain key words associated with compliance as used by participants from the chosen banks during the interviews are outlined in the Figure 4 below. It also can be considered as part of my sources of evidence where properties/categories/dimensions associated with compliance in the seven financial institutions, as well

as during semi-structural interviews with representatives of regulatory bodies and third-party experts. The findings for this Figure 4 is provided in the chapter 4 (Findings).

Figure 4. Key Words Association with compliance



This method for data collection allows the observation of what is being discussed by those being studied (Easterby-Smith et al. 1991). The researcher also has an ability to have in-depth and first-hand view of the actual settings. There were two different approaches of organizational research proposed by Evered and Louis (2001), namely 'external empirical research' and 'internal empirical research', whereby the first can be viewed through the researcher's separation from the organizational setting, and the second can be viewed through the personal involvement of the researcher in the research process. That means that information and knowledge about organization can be acquired through either examining data available about the organization (inquire from the outside) or by examining data available and functioning within the organization (inquiry from the inside). As a compliance practitioner this research is well prepared for being able to recognize useful data such as ideas, problems, and strategies and to be accepted by the organization.

There are however certain pitfalls from a researcher perspective. One of the main criticism towards participation observation lies within the point of potential lack of objectivity and independency in the subject of research. For the sake of objectivity of the research, it is expected a separation of personal and professional experience from the subject matter. Further to Iacono, Brown and Holtham (2009) view participant's observation provides researcher to benefit by their unique circumstances to produce research which is interesting, accessible and relevant to industry practitioners and scholars

alike. To conclude a combination of data collection methods has been employed involving differing banks, documents (both public and corporate (non-confidential), a qualitative survey, and semi-structured interviews. This provides a broad spectrum of data enabling a rich picture to be constructed of compliance, and providing a basis for its analysis (chapters 4 and 5).

3.3. Methods of data analysis

Strauss and Corbin (1990) offer a comprehensive set of procedures and techniques for analysing qualitative data. Easterby-Smith *et al.* (1991) also offer a structured approach. Both approaches recognise that analysis or interpretation is 'an iterative process' (Easterby-Smith *et. al.,* 1991, p. 108), and demands 'openness and flexibility' (Strauss and Corbin, 1990, p.26, 144). This research uses them as a guide to the spirit of analysis rather than as a formal procedure to be adhered to in moving between the main components they suggest. In my analysis, I was followed the mentioned structured approach offered by Easterby-Smith *et al.* (1991) in order to generate categories of meaningful data. Thus, all interview responses were analysed following seven main stages: familiarisation, reflection, conceptualisation, cataloguing concepts, recording, linking and re-evaluation (Easterby-Smith *et al.*, 1991), which can be also applied to discourse analysis (Alvesson and Karreman, 2000).

In following a structured approach mentioned earlier, I familiarize myself with interviews from various compliance professionals, representative of the regulator and third party experts and reflected the received answers. This can be considered as a familiarization with the content (ideas of compliance) and then I was doing reflections by asking myself whether data received do really support existing knowledge and how I can challenge an existing knowledge, what makes it different. An example of the third stage - conceptualisation is provided in the below Figure 5 and Table 7 of the chapter 4, where the most frequently used words/terms are specified. These sets of concepts are important to understand the phenomenon is provided. In cataloguing concepts I used language of the respondents and my own transcripts of each interview held. All interviews have been voice-recorded, except one interview with the regulator. In addition, I made my notes during each interview. These two types of records enable to see what actually was said vs. what I understood as a researcher, which is important taking into account different contexts existing by explaining different phenomenon. Then, having an analytical framework and responses I was focused on linking empirical data (evidences collected during the interviews and documents analysis) with more general models to have a more holistic and linked theory. Re-evaluation is a vital stage in improving quality of the work performed. On this stage my thesis was constantly required to do re-writing of some chapters and sections, putting more emphasis on one part and less on the other, omitting contradictions, considering and implementing recommendations of supervisors, reviewing the responses for making them more alive and other reasons for re-evaluation. This stage was going through a considerable period of time with numerous attempts to constantly improve the thesis.

Although, some critics argue that 'research and analysis in qualitative data is about 'feeling' and an implicit component of all research is dependent on the honesty of the person conducting the research' (Mason, 2002, p.144), qualitative data analysis is useful for analysing compliance and categorisation used by various actors to interpret and organise their responsibilities. An appreciation for use of smokescreen by respondents in answering such a sensitive topic was demonstrated by alternative methods, such as an analysis of documentation on compliance phenomenon and content analysis.

The following methods of data analysis are utilised:

i. Content analysis;
ii. Discourse analysis;
iii. Document analysis.

All these three methods of data analysis are overlapping with each other in my thesis. An explanation of how these three overlapping with each other methods of data analysis are used in my thesis and to what extent is provided below.

Content analysis is a summarising, quantitative analysis of messages that relies on the scientific method, including an observance of the standards of objectivity/inter-subjectivity, reliability and validity, as well as generalisability (Neuendorf, 2002). Content analysis is a quantitative research method and can be considered as a systematic, replicable technique for compressing many words of text into fewer content categories based on explicit rules of coding (Berelson, 1952; GAO, 1996; Krippendorff, 1980; Weber, 1990). In my thesis, the content analysis method is used as an appropriate method, as it provides a deductive approach for understanding texts, phrases used and key terms. For example, the frequency of used terms and key words during the semi-structured interviews and while doing document's analysis enabled to understand better compliance phenomenon and provided some insights for further elaboration of three objectives of my thesis. This technique provides an opportunity to examine understanding of various groups of stakeholders, e.g. individuals, groups, institutions (Weber, 1990). Further to Krippendorff (1980) 'much content analysis research is motivated by the search for techniques to infer from symbolic data what would be either too costly, no longer possible, or too obtrusive by the use of other techniques' (p.51). In applying a content analysis method to written documents, researchers sample at several levels of analysis: word count, phrases, sentences, paragraph, sections, and chapters. In this study, the deductive method has been used to analyse the frequency of key words received during interviews.

The content analysis method used here is by applying the following properties (terms and words) and dimensions (frequency) used in the seven financial institutions, as well as during semi-

structural interviews with representatives of regulatory bodies and third-party experts in relation to documentation (Figure 5). The data received is provided in the chapter 4 (Findings).

Figure 5. Frequency of use terms and words

N	Properties (terms and words used)	Dimensions
1	**Common words and phrases:**	
	(i) Money-laundering;	(Y or N)
	(ii) Compliance;	(Y or N)
2	**Specific phrases and words:**	
	Transparency	(Y or N)
	Case studies	(Y or N)
	Level of details	Minimum/Medium/Maximum
	Adequate disclosure	(Y or N): Russian banks vs European/US Banks
3	**Accountability:**	
	Declaration of designated person/body	(Y or N)

In contrast to content analysis, discourse analysis is a method for analysing social phenomena that is qualitative, interpretive and constructionist. As this research is undertaken from an interpretivist perspective discourse analysis is appropriate in qualitative research. Thus, content, document and partially conversational analysis was applied. Although, there is a certain overlapping with each methods used for data analysis, the extent of such overlapping is not critical, therefore all three methods used can be considered separately.

Discourse analysis used in this thesis to understand firstly the institutionalised meanings of compliance phenomenon and then the underlying attitudes of the regulated and regulator (strategies of regulator and regulated towards compliance). This view is based on Fairclough (1989, 1992, 1995b) observations in his various papers on critical discourse analysis (Fairclough, 1989, 1992, 1995b) and may be considered as 'a dialectical view of the relationship between structure and agency and of the relationship between discourse and other elements of social practices and social events' (1995a:2). It is important to note that further to Fairclough (1995a) 'text and context is being mediated by discourse and analysis of text includes both linguistic and semiotic analysis' (p.5).

Documentation was also subjected to discourse analysis, examining compliance policies of banks, government, international regulatory agencies and international organizations, public documents, (e.g. laws and regulations), some confidential documents (anonymised), and articles and

publications written by the interviewees were examined. Document analysis involves both qualitative and quantitative methods, examining both text and statistics.

3.4. Assessing Research Quality

There are two dominant perspectives on how the research quality can be evaluated (Saunders *et al*. 2007), reflecting either positivism or interpretivism.

Internal and external validity, reliability and generalisability are the terms used in (supposedly objective) positivist research, While credibility, transferability, dependability and confirmability, describe the equivalent criteria proposed for interpretivist research (Pretty, 1993; Lincoln and Guba, 1985). There is close correspondence between these two schemes: internal validity [credibility]; reliability [dependability]; generalisability or external validity [transferability]; objectivity [confirmability]. Perhaps for this reason the longer established trio of validity, reliability and generalisability continue to dominate both research paradigms (positivism and interpretivism).

Altheide and Johnson (1994) proposed the need for reflexive qualitative research, in order to reduce risks of bias from practitioner/researcher experiences and interpretations. They suggest the need to attend to five issues: (i) contextualisation, for example, the relationship between compliance and the context in which it takes place; (ii) interaction, whereby the researcher can change the setting and may well develop relationships with the participants; (iii) perspective, specifically the notion that some qualitative research is undertaken from a particular perspective. It should be noted that what is presented here reflects the researcher's perspective and not truth in the strict positivist sense; (iv) reader roles, namely the various roles which the reader might be expected to play should be kept in mind while conducting research, analysing the data and communicating the results; and finally, (v) style, the diverse ways in which the qualitative researcher may choose to report findings, for example a play, a painting, a novel, a short story, a multimedia document on the Internet, and an academic paper.

3.4.1. Validity

Joppe (2000) proposed the following explanation of what validity means in quantitative research. 'Validity helps us to determine, if the research truly measures that which it was intended to measure, as well as to what extent the research results are truthful' (p.1). Asking series of similar questions to different group of respondents and consider their answers in the research of others provide some basic activities in determining validity of research data. One of my research question is to understand the meaning of compliance, so the respondents had to provide their own understanding of the meaning as well as to the other two questions. Moreover, I asked different target audiences on all

three fundamental research questions. In addition, I collected documentation for all three fundamental questions. More detailed arguments would be provided in triangulation section.

The concept of validity is equally applicable in a broad range of terms in qualitative studies. Despite the fact that some qualitative researchers proposed that the term validity is not applicable to qualitative research, they have to accept the need for some kind of qualifying check or measure for their research. Further to Creswell and Miller (2000) the validity is affected by the researcher's perception of validity in the study and his/her choice of paradigm assumption. Therefore, for increasing validity of the research certain additional queries about Russian regulatory perspectives toward the broader context of money laundering were put to the representatives of foreign regulators and international organisations, independent international consultants and third-party experts.

3.4.2. Reliability

Reliability is a controversial concept which implies that other researchers should be able to draw the same conclusions by following the same procedures. Joppe (2000) defined reliability as 'the extent to which results are consistent over time'. In practical terms the reliability can be proved by a possibility to reproduce the results of the research in question using the same or similar methodology.

Further to Rayman-Bacchus (1996), reliability is problematic since, as with an experiment, it implies that other researchers should be able to replicate one's results by following the same procedures. It is questionable how far such an expectation is appropriate in a phenomenological study where the researcher has considerable scope to interpret the evidence; each researcher draws on a distinct range of knowledge and capabilities. That is why my thesis was initially focused on all formalities and then reflections on the process in reality were made.

To assure that the data I collected are reliable, I used principles of triangulation, as those in regulatory roles were less open, or completely disinclined to discussing the topic, i.e. the case with representatives of the Central Bank of Russia. This behaviour was a constant threat to the reliability of this research. For securing reliability, I asked the same questions several persons, then each person from different bank, also reviewed documents and compared this documentary evidence with what participants said to me during semi-structured interviews.

3.4.3. Triangulation

Triangulation can be considered as a method for improving the validity and reliability of research and for examining the findings. The value of using triangulation can be described as 'triangulation strengthens a study by combining methods' (Patton, 2002). There are strengths and weaknesses in

studying multiple versus single case studies (Hertog, 1999). The triangulation of studying more than one organisation (Easterby-Smith *et al.* (1991) - data triangulation) improves robustness of the research design, but does not offer a universal improvement of validity, reliability and generalisability. The variety of situations offers an opportunity to improve generalisability in theory (Yin's external validity, 1984), but this variety also makes it more difficult to support an argument that is consistent and coherent across several cases (Yin's internal validity, 1984), and which seems to echo Thorngate's (1976) proposition. The extent to which participants accept the account written from their perspective, as well as the analysis undertaken by the researcher, is perhaps another measure of the validity of the research. Nevertheless data triangulation is useful because it enables comparative analyses. It reveals the diversity of social behaviour, and provides scope for drawing similarities.

Triangulation of methods allows qualitative researchers to enhance both validity and reliability by using multiple, but independent measures. There are four categories of triangulation outlined by Esterby-Smith (1991): (i) triangulation of theories, involving using models to explain situations in other disciplines; (ii) data triangulation, where data is collected over different time frames or from different sources; (iii) triangulation by investigators, where different people collect data on the same situation and the results compared; and, (iv) methodological triangulation, using differing methods of data collection.

In this research, two triangulation methods for justifying validity and reliability of the data were used:

(i) Data Triangulation was used to confirm the same data received from many different respondents within similar or different contexts. This includes comparing data from interviews with several respondents from different organisations, such as regulators, regulated banks and third parties, all working in the Russian financial sector;

(ii) Methodological Triangulation was used by combining survey qualitative questionnaires with interview data, and building seven case studies. Comparing data from organisational documentation, for example AML/CFT policies and procedures, with the views of participants interviewed, provided helped improve the reliability of data, and also provided fresh insights.

3.4.4. Generalisability

There are two kinds of generalisation: generalisation to theory closely associated with the interpretivist perspective and statistical generalisation, identified with the positivist tradition. As Hertog (in Rayman-Bacchus, 1996) says, 'if the reality of the case does not confirm the theory, then the theory must be adjusted…the theory paves the way to generalization' (p.12). Interpreting Yin's (1984) ideas on

generalisation, the appropriate frame of reference for this research is how well the cases support theory, rather than how representative they are of a population. As the purpose of this study is to achieve theoretical generalisation rather than statistical generalisation, hypothesis testing is not applicable. Clearly, a consequence of distinguishing between statistical and theoretical generalisation is that validity must also be seen as either statistical or theoretical. Therefore, in this research an attempt to look at how well the cases support or contribute to theory has been made.

Generalisation is a central step in the qualitative research process, as Flick (2005) outlines in his qualitative process model. He underlines the necessity to define the aims of generalisation, for instance, comparisons, typologies, age, sex, area, and so on. In this research, the selection of a particular area of compliance that allows participants to understand and specify context was not a primary concern. This process of generalisation is not complete until a theory has been tested against probable negative instances and thus shown to account for all known and suspected instances of the phenomena and, therefore, contributes to the theory in question. Under this kind of generalisability, there is no hypothesis, as they are considered irrelevant.

This study aims to offer a theoretical generalisation of the relationship between Russian banks and their regulators with a focus on money laundering aspects, in the context of the Russian banking industry and wider international regulatory policies and practices. This process of generalisation is not complete until the contribution to theory developed in this thesis has been tested against probable negative instances and thus shown to account for all known and suspected instances of the phenomena. It is the task of further research to test the theoretical insights offered here.

3.5. Ethics in Research

In any research endeavour involving people, there is an innate tension between the need to learn about how society works, and the need to respect and protect human dignity. Therefore, a key consideration from an ethical standpoint is the potential conflict between the need to better understand Russian financial institutions and the regulatory compliance strategies (money laundering) of banks, and the need to be sensitive to potential harm to persons and their employing organizations that could result from this research.

In carrying out this research, respecting the rights of those participating was achieved on the basis of informed consent (Saunders *et al*., 2007). From a legal standpoint, informed consent involves three elements: capacity, information and voluntariness. All these three elements are presented in this research. All interviewees provided their consent before interviews were held, as well as those participating in the qualitative survey. Information was presented in a concise, but comprehensive way

to ensure that respondents fully understood the requirements. At no point was force, fraud, deceit, or any form of constraint or coercion applied to participants; the gathering of information for this research was carried out under the principle of free of each individual.

In order to adequately protect respondents, all data (especially participant names and their organizations), obtained during interviews or qualitative questionnaires have been anonymised.

Conclusion

This chapter provides an overall review of the epistemological perspective and various schools of law followed by research approach involving seven case studies specified in Appendices 1-3. Various methods of data collections provides elements of objectivity in research approach. The assessment of research quality (issues of reliability, validity, generalisability) was further provided. Certain ethical considerations finalise this chapter. One of the key challenge faced with the semi-structure interviews was a resistance of all participants to provide information about compliance aspects in regards to a particular bank, which they represented. Participant's observations were aimed to mitigated these effects to the certain extent.

Chapter 4 - Findings

Introduction

This chapter follows a conceptual framework of the thesis outlined in earlier chapters and has a similar structure to that of chapter 2. Part 1 outlines the findings reached by examining the idea and definition of compliance in financial institutions. Part 2 then focuses on the interpretation and practice of compliance in the Russian financial services arena by the regulator and compliance professionals. The underlying approach to exploring this objective focuses on process and regulatory strategies and institutional changes as responses to banks behaviours. Both the regulator and regulated firms develop policies, albeit for the achievement of different ends. The former does so to translate legislation into regulation, while the latter develops policies in order to comply with the required regulation. Part 3 explores the influence of the domestic political context, alongside economic and legal considerations toward compliance.

This chapter presents seven case studies: two Russian State banks: State Bank 1; Private Bank 2; four foreign banks: Foreign Bank 1; Foreign Bank 2; Foreign Bank 3; and Foreign Bank 4 and one private Russian Bank – Private Bank (please see Appendix 5). These seven banks were chosen for a number of reasons: (i) they have a relevantly long corporate history in the Russian financial market; (ii) they represent various types of ownership/ corporate structures/geography and cross-country coverage; (iii) they have established systems of internal control; (iv) their market share is significant in Russia; (v) they currently have a strong ML/FT compliance policies and procedures and are deemed to uphold strong ML/FT compliance policies and procedures in the future. The examples

Further information on each organisation, its compliance governance structure, the relationship between the compliance function with senior executives and other internal departments, and any publicly available details on regulatory breaches or violations by each institution is provided in the Appendix 6. These particular banks were selected in view of their reputation for robust AML/CFT compliance policies and procedures, and their longstanding history of operations in Russia. Each of the bank has complex internal systems and processes displaying a range of approaches and strategies in relation to their compliance obligations (please see Appendix 5). For example, State Bank 1 as a state bank has a very formal system of internal control with a substantial, well-staffed compliance function in contrast to Private and Foreign Banks. In spite of this, State Bank 1 is not immune to breaching AML/CFT legislation. In this respect, the respondent from the Private Bank commented '..it appears that that the private investment companies have considerably greater flexibility in maneuvering their internal control systems in order to comply with external regulations than state owned banks. In addition, banking regulation is considerably more stringent in Russia than that applied to investment companies, as

banking legislation has an established Soviet history. The most recent legislation applicable to new private investment companies continues to be subject to legal inconsistencies. In order to undertake this analysis, twelve compliance officers were interviewed, as well as a representative from the regulator and an external expert. A number of additional information sources and documents, such as websites and annual reports, were also consulted.

Part 4.1 The Meaning of Compliance in the Financial Regulatory Environment

Consideration of how compliance is interpreted by various representatives of financial compliance environment (regulator, regulated banks with its compliance function) is the cornerstone of this section. It is possible to outline a crucial baseline for the subsequent exploration of compliance strategies adopted by the regulator and the regulated. It can be seen that the notion of 'ideal' compliance outlined by the regulators is notably different from the subsequent compliance frameworks designed by the regulated firms in response. Such trends and subsequent alterations are often provisional and uncertain. Thus, discussion on interpretive flexibility and evolution of efficacy of compliance is further presented. Furthermore, the existing ambiguities and anomalies of compliance in Russia frequently demand 'creative interpretation' by the regulated firms in relation to the regulator's expectations and requirements. Subsequently, certain ambiguities and anomalies associated with regulatory compliance will then be presented.

4.1.1. Understandings of Compliance

This section provides discussion on key attributes of compliance, that are considered as compliance as a content. Firstly, the practice of use of interpretive flexibility approach is provided, secondly, the application of efficacy of compliance as a tool to financial regulation and its evolution of what counts as financial crime is further provided.

Interpretive flexibility

How do different stakeholders understand compliance phenomenon? What are the nuances in understanding compliance by different cultures/nationalities and its interpretive flexibility.

The punitive enforcement approach ensures that all economic actors follow particular rules or norms in their *modus operandi* in order to comply with U.S. regulation. In cases of noncompliance, various enforcement procedures, including fines, revocation of licenses, civil or criminal enforcements, loss of reputation, and so on, are deemed so severe, that noncompliance could have a significant impact on the business activities of economic actors. As the case of BNP Paribas clearly demonstrates in his breaches of US sanctions regime, it is far better to follow OFAC rules than to ignore them and potentially

place the business at risk. A respondent from Foreign bank 3 said '..Open cooperation during any ensuing investigation is encouraged and can serve to ultimately reduce the amount of any fine imposed'. Therefore, reinforcing the former EY partner's view, compliance can be regarded to some extent as a political weapon in what might be described as an economic war. By placing certain restrictions on imports and exports, for instance, regulators and courts can favour some economic players over others.

The majority of responses and documentation reviewed may provide various understanding of the meaning of regulatory compliance, thus while considering on regulatory compliance, interpretive flexibility approach shall be applied.

Certain responses on the above questions are provided below based on the semi-structured interviews with representatives of various stakeholder groups (banks with different identity, representative of the Central Bank of Russia, third party experts). A former partner at international consulting firm Ernest and Young (EY) expressed his view by saying '...compliance ought to be considered a systemic ideology, whereby the economic behaviour of actors in the market must comply with certain established rules or norms. Any deviation in the established or recommended norms and practices, or discrepancies in recommended behaviours, are strongly discouraged and subject to punishment'. A representative from a State bank 1 commented

'as there is no unified approach to compliance and very often organisations with established compliance functions that have strategic interests for the regulator tend to receive heavier and more stringent penalties for breaches compared to organisations without dedicated compliance teams in less important organisations'.

A respondent from Foreign Bank 2 continued

'practice, these attributes of compliance are an element of the decision-making process. If the compliance function of an organisation is actively involved in the offering of new products and services, for instance, and there is a coherent internal governance matrix with allocation of responsibilities for new products and services, this would demonstrate that the internal processes are transparent with robust systems of control'.

A respondent from the Foreign Bank 1 highlighted 'getting an aligned understanding among different departments within an organization sometimes is a real challenge. For example, compliance function dealing with the internal auditors has often find a compromised solution over sometimes quite obvious points using various forms of interpretations'.

Compliance as a concept is not always formally enshrined in a company's internal structure or operational ethos. Some senior executives from the state banks believe that compliance in Russia consists only of obligatory elements which specifically address AML/CFT and insider trading laws, which was re-confirmed by a representative of the State Bank 2. Thus, they do not consider other areas of the financial regulatory environment that are not subject to mandatory reporting as important. As such, these areas considered as operating beyond the scope of compliance. The respondent from a Private Bank said 'there is no distinction between good and bad, unless it is formally written that an action is good and is, therefore, permitted, and that another is bad, namely, forbidden, with the threat of applicable sanctions.'

The representatives from two Foreign Banks 1 and 3 mutually agreed that the best definition of compliance is provided by the Basel Committee on Banking Supervision (2005). In this document compliance is described as 'the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organisation standards, and codes of conduct applicable to its banking activities' (p.7). The evidence suggested by this study seems to indicate that there is no universal definition of compliance, but that interpretations of the meaning of compliance vary from company to company. All representatives agreed, however, that the 'tone starts from the top' (Basel Committee 'Compliance and the compliance function in the banks,' April, 2005). As a representative from a Foreign Bank 2 remarked: 'In my opinion, the notion of compliance significantly depends on the vision and strategy emanating from the company headquarters. If the view from the bank's global headquarters is such that compliance should be viewed as distinct from the bank's everyday business activities, then this view is likely to permeate the entire organisation, even in those countries where a separation is not common'.

A compliance officer from the State bank 1 said '…Compliance essentially concerns the proactive implementation of internal policies and procedures that are designed to protect shareholder interests and ensure adherence to applicable regulatory standards to regulations and to industry best practice, which includes requirements and guidance for European regulatory bodies and world financial organisations, such as FATF, the World Bank, and OECD'.

A representative of Foreign Bank 3 provided his view '…Reflection of industry best practice can often add value to internal compliance systems, which frequently involves ongoing improvements to existing internal systems'. Furthermore, a representative of the ICA said that compliance simply means 'to act right,' which means that the organisation and all of its employees act in a compliant manner, ensuring an ethical and fair approach with all business partners. Compliance strategies are undertaken in the spirit, as well as to the letter of the law. There remains, however, an ongoing ambiguity inherent in the understanding of compliance. This uncertainty is highlighted in the words of Christine Marshall, former U.S. state prosecutor of the SEC in her public announcement at the Compliance Conference in

Moscow held on March 1, 2013. She stated that 'there are no grey areas in compliance and, therefore, the SEC can investigate any violations made on the U.S. securities market irrespective of time, persons involved or any other limitations'. The specific U.S. laws, guidelines and recommendations that form the basis of AML initiatives currently used by the global community of banking regulators and compliance personnel include the U.S. Patriot Act, OFAC rules and guidelines, KYC guidelines and due diligence standards, and suspicious account activity, among others. Full details are outlined in Appendix 5. By contrast, a member of Russian legal firm Pepelyaev and Partners expressed that compliance exists to help their clients avoid punishment for past wrongdoings by exploiting any possible gaps in legislation and taking advantage of weak execution systems.

One British participant with over 30 years of high executive experience in compliance, said 'the power of the compliance function is determined by whether its role is deemed to have 'a big C or a small c.' She continued '…Compliance cannot be successful unless it has the commitment of the business, specifically senior management. Compliance is not just about following the letter of the law, but also the spirit of the law, which can lead to difficulties surrounding legislation which can be difficult to interpret, and even more difficult to apply in every day activities'.

This sentiment is reinforced by the example of one global European Bank, a vast institution employing around 200,000 staff globally, yet with only around 1,200 staff working in the dedicated compliance function (figures correct at March 2017). While the aim is for each employee to take responsibility for compliance, the comparatively small compliance team is understandably stretched in dealing with issues across the entire organisation. This is further compounded by the aforementioned complexities involved in interpreting compliance guidelines and frameworks, with the result that business units may avoid taking key decisions, choosing instead to move the responsibility to an already overburdened compliance team.

Another very interesting example of different understanding of the meaning of compliance by global and local actors in the big international banks can be seen by applying English language as the global language and local language as the local regulator's language. During the semi-structure interview a representative from a foreign Bank 1 said

'In practice, irrespective how well in English compliance requirements of any global policy is written, the matter is how well understand and defined local policies are in writing'. He further added 'For example, in case of internal audit they test compliance with both global and local requirements, but the level of auditor's assessment will be different. In case of local deviation to the global policy requirements, the internal audit will apply high level of deficiency, but in case of local policy/process deviation from the local requirements (e.g. not correctly or formally written certain provisions), internal audit will treat this deviation as significant'.

The other representative from a foreign Bank 4 said 'The differentiation in understanding of compliance, e.g. foreign language issue, further complicates that most of the global policies can not only be linguistically complex in understanding and further implementation, but they can be simply not feasible in the particular context due to local legal/political specifics, thus exemption from certain global requirements have to submitted'.

In summary, majority of respondents which whom semi-structured interviews have been taken agreed that the meaning and role of compliance is often formulated internally by the concrete goals, strategies and vision of key stakeholders, or, a single stakeholder in the case of state banks and the regulator. On a practical level, compliance activities and the importance attached to these activities can vary enormously across financial institutions.

The application of efficacy of compliance as a tool used in relation to financial regulation and the evolution of what counts as compliance is further provided.

Evolution of compliance's efficacy

There was no entirely agreed view on the evolution of compliance's efficacy as a tool in relation to financial regulation. The position of the respondent from the CBR was clear stated, she said 'the executives of the banks and their MLROs should be responsible for efficacy of internal control rules implemented in the regulated bank. For example, the Central Bank will reveal all deviations from the regulatory obligatory reporting and will impose relevant measures of administrative liabilities against the Bank, its senior executives and MLROs'.

In terms of evolution of compliance's efficacy, it is worth mentioning on widening of what counts as money laundering. In regards to AML/CFT, the aforementioned 'three Ts' report by the U.K. during its G8 presidency is particularly relevant. The report was categorized by country and a key theme is that of broad support for the implementation of public registries of beneficial ownership information. It appears, however, to reflect voluntary commitments rather than enforceable intentions, as demonstrated by the liberal use of phrases including 'preparing measures,' 'launching consultation,' 'committed to support,' and so on. Some barriers to implementing these measures are acknowledged, particularly those focusing on the right to privacy, customer confidentiality and existing legal constraints, or privileges.

In terms of widening responsibilities for poor compliance oversight, one respondent, who was a senior compliance executive of one international bank with an established tradition of compliance, said 'level of individual responsibility has increased in recent years'.

4.1.2. Ambiguities of Compliance

While the definition of compliance as a concept is widely understood and agreed, the extent of ambiguities on how compliance should be practised is fraught with difficulty across industries, not only in banking and financial services. Ambiguities can be defined as challenges facing regulated while considering and practising compliance within the Russian environment. They make compliance processes and work of compliance team quite challenging in Russia. Below are the main ambiguities of compliance identified by compliance professionals during their practices.

Ambiguities can be defined as challenges facing regulated while considering and practising compliance within the Russian environment.

(i) Very formal and rigid local legislation

Two respondents from Foreign Banks 2 and 4 agreed in saying that 'the main source of ambiguity associated with compliance in Russia is the very formal and rigid nature of legislation. This makes operating within what is, essentially, a rather undeveloped legal system almost impossible in an efficient and timely manner'. A respondent from Foreign Bank 1 further explained that 'this formality and rigidness can be evidenced by the Overview of the European Court of Human Rights' (1959-2012).

A respondent from the Private Bank also commented on this ambiguity 'historically, Russia is seen as a rules-oriented authoritarian country with very formal and complex legislation operating against the backdrop of a weak enforcement system. The ambiguities inherent in Russian law often result in the misinterpretation of legal provisions and court practices, which can lead to a change in the law, including the cancellation of fees and a moratorium on the early repayment of loans. Such practices have been widely documented in the Russian media during the course of the last decade. As an evidence, amendments to Articles 809 and 810 of the Russian Civil Code in November 2012 enable debtors to repay loans in their entirety, provided that the bank receive written notification of the intention to repay the loan in full with 30 days notice'.

This point actually also relates to the concept of fairness in compliance. Thus, the introduction of clear laws and regulations has the potential to reduce ambiguity and pave the way for a more coherent, consistent system.

(ii) Lack of transparency and accountability

A further aspect of ambiguity can be highlighted in terms of a lack of transparency and accountability. A former partner of EY in Russia said 'such conditions make it possible for government

officials to abuse state assets. It is possible that a system of double standards is in operation, whereby some illegal assets are fleetingly checked and due diligence is conducted very selectively'. He further continued by providing a following detailed example: 'This might be said of the sprawling office premises in the centre of London built for Mrs. Baturina, the wife of former mayor of Moscow Yuri Luzhkov. It seems unlikely that the compliance manager of these trusts, hedge funds and banks holding the assets made the appropriate checks, otherwise they would have become aware that much of her wealth was sourced through illegal activities. Compliance in this example might best be described as mere 'window dressing'. In addition, a representative from the State Bank 2 commented '…compliance might also be described as selective in its application in the case of the manual correction of SWIFT messages to and from Iranian banks, not only by Russian banks in their dealings with Iran as a major economic partner for Russia, but also by Barclays and Royal Bank of Canada (RBC) employees. The situation reveals a trade-off between the gains that these banks stood to receive and the perceived level of risk associated with the identification of such practices and eventual sanctions imposed by the U.K. regulator'.

(ii) Mis-conception of de-risking phenomenon

During the semi-structured interviews, it was confirmed by s a representative of the Foreign Bank 2 that de-risking issue is not entirely understood by the CBR. In addition, in various professional seminars conducted with the participation of the CBR representatives it was re-iterate that although risk-management is a pure internal bank's issues, CBR would never allow to accept full risk-ownership by the banks by applying their own risk models. FATF guidelines and recommendations in regards to de-risking can be considered as a vitally important document in negotiating this issue. In a statement after the October 2014 Plenary and FATF stated that '….The implementation by financial institutions should be aiming at managing (not avoiding) risks. What is not in line with the FATF standards is wholesale current loss of entire countries and classes of customers, without taking account – seriously and comprehensively – of their level of money laundering and terrorist financing risks and applicable risk mitigation measures for those countries and customers within a particular sector'. This message was further echoed in the Statement *Risk-based approach Guidance for the Banking Sector* (2014).

The representative from the Foreign Bank 1 further highlighted '...an element of prejudice about working in Russia, which constitutes a different criterion for risk assessment. As such, overseas banks operating in Russia assume a high-risk profile due to these operations. This constitutes an anomaly, as the same business would likely be treated as low risk in its European domicile'. She continued 'this anomaly impacts the practical implementation of AML compliance standards and can cause dissatisfaction among clients forced to adhere to enhanced due diligence for on-boarding'. The CBR is

not currently considering de-risking as a feasible idea for Russian banks. One of the reason for this as financial institutions could potentially avoiding but nor managing occurred risks.

There is a rather complex situation doing business in Russia, as on the one hand, all foreign banks in Russia are hierarchical and vertical structures with well-established internal frameworks and restrictions, but they have to position themselves to conduct business in other geographical locations where local compliance requirements may fluctuate. For example, Russian banking secrecy and data protection laws place restrictions on the level of client data Russian companies and banks can provide to third parties, irrespective of the subject group. Russian banks are prohibited from transferring information to third parties as such information is protected by the bank secrecy regime set forth in Article 857 of the Russian Civil Code and Article 26 of the banking law. However, personal information about the activities of a person who acts as client or counterparty can be transferred under the State Duma of the Russian Federation (2006) Federal Law 152-FZ on personal data only upon receipt of the informed and conscious consent of the relevant subject, unless certain exceptions are deemed applicable. In practice, this means that international project requirements cannot be fulfilled where such information is necessary.

(iii) Correct interpretation of the rules and regulatory expectations

A respondent from the State Bank 2 said '...we live in a very challenging and changing environment, where the rules are never precise enough, therefore a major ambiguity for compliance is the right interpretation of the rules and expectations of the regulator given that he has limited information and resources'. He continued 'Very often the Russian regulator has a position on interpretation of a particular requirement in a way that is not only written in the legal documents, but as is not provided in the guidance, thus you have either to establish an indirect contact with the regulator by attending all regulatory driven events or accept the risk of your own interpretation of the provisions of the laws'. A similar view was expressed by the respondent of the Private Bank who said 'As there is no common understanding the AML/CFT mandatory control we can realise a difference in understanding and interpretation of certain provisions only when the regulatory audit is conducted and the final enforcement report is provided'. This point was further commented by a respondent from Foreign Bank 1 'compliance is challenged by not only dealing with judging on correct interpretation of the laws, but also as an advising function, that is intended to help business to anticipate regulatory intentions. Consequently, compliance shall keep an independent judgement in order not advising only, but carrying out controlled activities as well'. One respondent from ICA commented 'sometimes the problem of non-compliance in Russia is due to the misinterpretation and misapplication of laws and regulations by different authorities. Occasionally, this can occur by the same authority across different regions as a result of inconsistencies in Russian court practices. The adoption of a unified approach by

courts in addressing compliance issues would represent a major step forward in this respect'. It shall be further clarified that the supreme Russian courts currently issue their rulings and guidelines on different areas of concern with the aim of assisting the lower courts presiding over similar cases. However, since those rulings and guidelines are only obligatory in the lower court setting, it is not always possible to apply them directly to disputes between parties in the higher courts, as there is no precedent in Russian law. She further continued 'it is not the secret that the Russian enforcement is bureaucratic, when the courts frequently seem unable to make any fair and timely decisions. Even if the court's final decision seems reasonable, the most challenging issues often start with the enforcement system, specifically implementing the court's decision or ensuring reimbursement or compensation is settled'.

A respondent from a Private Bank said 'an ambiguity in compliance can be outlined in terms of the absence of any clear guidance from government authorities, which can cause regulated firms to speculate on how to proceed with rulings in an attempt to satisfy their regulatory requirements'. This was evidenced by the comments made by the representative of the ICA, she said 'In Russia in numerous attempts to obtain tax exemptions provided by the Russian tax authorities foreign companies find it impossible to pay taxes on time and at the correct amount, due to numerous rigid requirements and obstacles presented by the ministry of taxes and levies, and the lack of access to accurate information. Foreign companies often struggle to pay taxes at the correct amount or on time due to the numerous rigid, ambiguous requirements and obstacles imposed by the Ministry of Taxes and Levies, which offers no transparent recommendations or guidance'. She continued 'this in turn has been used to hide the regulator's own uncertainty about regulation and its implementation' and further suggested 'an introduction of clear laws and regulations could potentially limit the scope for such ambiguity'.

Another example was given by representative of the Foreign Bank 1 is discrepancies between the Russian banking secrecy laws and those of their groups' policies and practical procedures. The bank can take a flexible approach toward interpretation of the Russian banking secrecy restrictions in taking these legal and regulatory risks into consideration, but their systems of controls will be at maximum standards to strengthen the control and monitoring procedures for full compliance to the accepted risks'. The representative of the Foreign Bank 3 commented '…the level of commitments towards full compliance to the local laws and regulations depends on the risk appetite of the concrete organisation and usually senior management accepts certain residual risks of non-compliance between local formal regulations and group infrastructure systems and IT solutions'.

4.1.3. Anomalies of Compliance

The anomaly in compliance is a deviation from the essential characteristics of compliance and compliance risks formally defined by Basel Committee (2005). The representatives of the three Foreign

banks 1 and 4 mutually agreed by concluding that 'there is a number of anomalies in the Russian banking compliance environment'.

(i) Contradictions between national and extra-territorial laws

An additional source of anomaly closely associated with compliance is that of contradictions arising from the overlap, or perhaps more appropriately, collision, of multiple regulatory jurisdictions, for instance, extraterritoriality as applicable to regulated cross-border activities. Extra-territoriality of regulatory restrictions is one area of conflict, while the different relationships between the regulated and regulators pose a further layer of complexity and source of conflict. The representative of Foreign Bank 1 said 'a regulated firm from an overseas country with a more established regulatory regime has the ability and the means to contact, consult and clarify any issues they may have with their regulatory authorities in a timely and efficient manner. A Russian regulated company, however, has no such scope for clarification'. An official of ICA commented 'the practice of negotiability is crystallised in the system known as tax ruling, whereby a regulated company can effectively agree tax rates and payments with the relevant tax authority. Despite the difference between levels of accessibility to regulatory bodies in different countries, the enforcement practices and punitive approaches wielded against regulated financial institutions found to be in breach of regulations are, in essence, very similar'.

A respondent from Foreign Bank 4 said 'as an example of conflicts and contradictions relating to changes in direction arising between national and extraterritorial law is FATCA'. She continued 'as one of the main challenges facing Russian financial institutions is that the fact Russia has still not signed a direct agreement with the IRS. Consequently, Russia cannot implement FATCA through the standard intergovernmental approach, and instead does it under the auspices of Federal Law 173-FZ'. The rational behind this is when FATCA was signed in 2010, the business community submitted requests to various Russian authorities asking them to clarify the country's position with respect to the application of FATCA by financial institutions. At that time, the government's position was simply that that FATCA did not apply to Russian banks and no urgent action was needed. However, on 24 April 2012, the finance ministry issued a letter confirming that it was ready to start consultations with the IRS on FATCA once implementation arrangements and the technical details of the intergovernmental approach had been clarified and agreed. Negotiations with the U.S. Treasury and the IRS commenced and acting Russian finance minister Anton Siluanov has consistently confirmed the intention of signing an intergovernmental agreement with the United States. The timetable for signing was originally envisaged for the end of 2013, but political priorities have seen the deadline move ever forward into the future.

(ii) Selective approach in enforcement

A further dimension was continued by a respondent from the Foreign Bank 1, who said: 'the process by which the regulator chooses to enforce the various laws and guidelines surrounding compliance might occasionally be deemed somewhat selective. For instance, in the event of any future military contract for arms exports to the developing world, the Russian and U.S. governing bodies will ignore any bribes or kickbacks given to the authorized representatives of the country on payment of a facilitating fee in U.S. dollars, despite the extra-territorial sanctions regime. This is permitted simply because a future contract of this nature is considered too valuable in terms of a country's external political interests'. It is worth mentioning that these practices are used worldwide, not solely in Russia or the U.S. For example, the Russian government provides assistance to North Korea for helicopters and other dual-use goods.

A representative from Foreign Bank 2 remarked '…position of tax authorities in Russia is overwhelmingly focused on punishing taxpayers, while simple tax avoidance tends to be restricted to the activities carried out by Russian state corporations improperly conducting their business through offshore jurisdictions. Moreover, the scope of the Russian de-offshorisation initiative and the extent to which it is pursued are very much a political matter, determined by the ultimate goals and objectives of the Russian state'.

As a broader recommendation to the regulator, the representative from the ICA raised an interesting regulatory point, while she said '...while some areas are potentially self-regulating and others require at least some basic form of regulatory principles and standards, a more complex and stringent style of regulation, for example in broker/dealer and investment activities is required'.

A further illustration of anomalies highlighting interpretative flexibility is demonstrated by the case of severe AML deficiencies of the U.S. subsidiary of HSBC, outlined in the staff report on "U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History", published in July 2012 (Appendix 7). The deficiencies outlined in the report accumulated over a period of time, despite the frequency of AML examinations conducted by the regulator, in this case the OCC. The AML problems at HSBC were partially related to some peculiar and ineffective aspects of the OCC's AML oversight efforts, reflecting the limits and boundaries of regulations, such is the nature of rules. To this end, there will always be exceptions and scope for interpretation.

Part 4.2. The Regulatory Landscape in Russia: Fresh Insights

Introduction

The Russian regulatory system was deemed to be slow in keeping abreast with developments in AML/CFT legislation at the global and European levels. To a considerable extent, the Russian approach to regulation remains partially isolated from recent developments in North American and European financial regulation. However, the most significant scandals related to AML/KYC deficiencies in Enron, WorldCom, Lehman Brothers came from the Unites States. Whether US regulators can be blamed for inadequate oversight over the globally operated financial market participants or it all happened due to bank's fault only? If the regulators in developed nations are perceived to be one step ahead of the latest cutting-edge market developments and innovations, for instance, high-speed and logarithmic trading, deep pools, and so on, then the Russian regulators are getting looking into development of cutting-edge technology and innovation only recently. In this respect, a renewed focus on risk-assessment is required for customers and products with a broader business exposure where some initiatives of the Russian regulators are to be focused. AML/CFT issues know no bounds, hence the perceived shortfall in matters pertaining to intellectual and geographical coverage must be addressed. A director of the CBR's department for financial regulation has since urged regulated banks to demonstrate more initiative in adopting and reinforcing the directives of the CBR. As such, the regulated banks should take responsibility for their ethical behaviour and adopt the spirit of the principles, not merely the letter of the rules. In this respect, the individual accountability and personal liability of senior managers, as outlined in objective 1, is set to increase in importance in Russia.

Any understanding of the notion of compliance and the interrelationship between the regulatory bodies and regulated organisations, as well as the strategies pursued by each, must also be considered within the wider regulatory context in which they operate.

4.2.1 Regulatory Strategies

Compliance professionals representing two Foreign banks 1 and 3 both remarked during the one to one interviews 'regulators have started to pay more attention to qualitative aspects, since rules – particularly those based on simplistic quantitative measures – have become easier to circumvent and are unlikely to be effective as the complexities of the financial sector have progressively increased'. Changes in market conditions have also modified regulatory attitudes toward the impact of portfolio structure regulations and other controls on the stability of the financial system. The representative of the Foreign Bank 2 said 'years ago, banks had a duty that only went as far as to *identify* suspicious client activity. Nowadays, however, the duties of the banks have been extended to deter money laundering, which is significantly more challenging.

Thus, the regulator's strategy can be considered through a dialectical relationship concept, which in the context of my thesis is the interactions with the regulated entities. A representative of the Central Bank of Russia further continued '…CBR uses various national and international forums, both general and specific, in applying its strategies toward the regulated entities. These forums provide opportunities for incidental engagement, such as the SWIFT Business Forum 2011-2018 held in Moscow and the International Compliance Association Annual Conferences, as well as directed engagement, such as the Russian National Association of Securities Market Participants (NAUFOR) and CBR seminars and workshops. It shall be noted that in this respect, the regulator's strategies include both formal and informal channels of communication.

Further to an OECD report on regulatory compliance published in 2000 '…most governments find it difficult to collect aggregate and systematic data on compliance trends in other policy areas where quantitative outcomes are more difficult to measure. Monitoring compliance is a relatively new activity in Member countries; there is little evidence at present that the results of compliance monitoring are used to modify ineffective policies and make enforcement more effective'.

i. **Formal Approaches**

As noted above, regulated firms and the regulatory authorities in Russia are influenced by the local socio-economic environment, as well as the particular nuances of Russian history and culture. Article 75 of the Constitution of the Russian Federation provides the special legal status of the CBR, establishing its exclusive right to issue currency, and authorising it to protect and ensure the stability of the ruble. Although the CBR is not liable for the obligations of credit institutions and noncredit financial institutions, the objectives of the CBR are addressed through the application of a variety of instruments and approaches provided throughout this chapter. The unique status of the CBR implies for having both proprietary status and financial independence. It exercises its powers to own, use and manage its property, including international reserves, in accordance with the procedures established by federal law. A key element of its legal status is its complete independence which implies, which means that the CBR is a special public institution with the exclusive right to issue currency and manage its circulation. These powers over currency are not incorporated under the mandate other financial regulators.

Further to the Guidelines for the Development of the Russian Financial Market in 2016-2018 drafted by the Central Bank of Russia (2016) '…development of the financial market of the Russian Federation is one of the priorities of the Bank of Russia activities. The efficient functioning of the financial market contributes to national economic growth and higher living standards of the population' (p.1). The Bank of Russia singles out priorities for the development of the Russian financial market, set out in the Guidelines for the Development of the Russian Financial Market in 2016-2018 drafted by the

Central Bank of Russia (2016). Among these priorities for 2016-2018 are '(i) raising the living standards and quality of life of the Russian population through the use of financial markets instruments; (ii) facilitating economic growth through competitive access of Russian economic agents to debt and equity financing and risk hedging instruments; and (iii) creating conditions for financial sector growth' (p.4).

The representative of the Central Bank of Russia said '…in pursuing its objectives, the CBR undertakes proactive and reactive approaches in its dealings with regulated entities. It carries out planned internal audits of the organisations it regulates at specific intervals, and may also engage in unplanned audits on a proactive basis. The CBR also organises various seminars and workshops to facilitate engagement with representatives of regulated banks'. In addition, she said 'representatives of the regulatory body can also be invited to participate in meetings and other events organised by the banks themselves'. The representative of the State Bank 2 said 'it is interesting to see that the Russian FUI (Rosfinmonitoring) is also trying to become more transparent by engaging market participants into an open dialog with the Russian FIU, e.g. by issuing regular magazine.

The other point made by the representative of the Central Bank of Russia was related to assessment of ML/FT risks. She said…'one of the key focus in the CBR oversight is conducting ML/FT risks assessment. This is not only related to the regular FATF visit and audit of full implementation by the banks and regulator its recommendation, but also due to evolving nature of ML/FT risks'. That means that the results of the ML/FT risk assessment should distribute to all relevant stakeholders of the AML/CFT regime. This would give an opportunity to further use of those results while various performing risk assessment projects.

In 2018 the CBR performed sectoral assessment of ML/FT risks for supervisory purposes. Drawing on the results of this assessment, the Bank of Russia prioritized the following types of supervised entities: financial institutions, securities trading and insurance companies, consumer credit cooperatives, and pawn shops. The respondent from the Russian FIU (Rosfinmonitoring) commented on an expected risk management of ML/FT risks 'it is crucial for the banks to see parallel and similar intentions of both regulators (CBR and Russian FIU) towards the same direction'. The issuance by the Rosfinmonitoring the latest report (2018) can be considered as parallel important towards increasing efficiency of ML/FT compliance activities of all market participants. The respondent from Foreign Bank 2 remarked '..there was previously a serious communication gap between the Russian regulators and the firms they regulated, compared to equivalent relationships established in the United States, Europe and Asia. It is their view that transparency and openness in exchanging information between the Russian regulator and regulated firms is still lacking. At the same time, the strategy of the CBR continues to evolve and opportunities for engagement with the regulated entities are now more frequent. However, during periods of investigation, a formal and rigid approach remains

in place'. This point was further commented by a representative of the Foreign Bank 4 '…the interaction with the Russian regulator during the regular investigation period is so specific, that it can be compared to Italian financial regulators, as they apply a very formal approach requiring a lot of paperwork, procedures and instructions. Most importantly, they require a lot of time, which might involve compliance staff working exclusively with authorised representatives of the CBR for two or three months'.

The respondent from Foreign Bank 3 mentioned that '…there are some inconsistencies in the approaches taken by the CBR, for example, further to the Federal Law 115-FZ the beneficiary owners of companies publicly traded on recognized Russian stock exchanges are exempt from being formally identified, whereas those of foreign publicly traded companies are not exempted irrespective of the highest AML/CFT compliance monitoring violations which such companies have'.

A regulatory regime is a complex system of interactions involving various players, processes, and procedures. The below specified bodies do pursue quite different strategies due to their interesting. For example, Association of European banks are mostly focused on protection of European Business in Russia in particular, sanctions exposure (e.g. potential criminalization of sanctions compliance), challenges in achieving compliance with local requirements faced by the foreign global banks, implementation of FATCA and CRS standards. The main function of the State Duma is consideration within different stages of hearing and issuance of new law and/or amendments to the current ones. Table 3 below outlines all levels of interactions between the State Duma, or Russian Parliament, the CBR, and various other bodies involved in the initiation and oversight of financial regulatory compliance in Russia.

Table 3. Levels of Interactions between regulatory bodies, associations and experts groups into regulatory compliance

N	Type of stakeholders	State Duma	Ministry of Finance	Central Bank of Russia	National Council on Financial Markets	Association of European Banks	Expert Groups	ICA
1	Internal compliance professional	Distant interaction	Distant interactions	Very close interactions	Very close interactions	Very close interactions	Very close interactions	Close interactions
2	Banking professional	Distant interaction	Close interactions	Close interactions	Very close interactions	Very close interactions	Close interactions	Close interactions
3	External stakeholders (customers, counterp/corr esp.banks)	Distant interaction	Distant interactions	Close interactions	Distant interactions	Distant interactions	Distant interactions	Distant interactions

If we further look into the models of gradual institutional change by adopting Rocco and Thurston's (2010) though the regulator's lenses we can see the level of involvement of various regulators, such as Russian in the Soviet time and in the current time and Foreign Regulators into the compliance regulation (Table 4). This table shall be considered in conjunction with the Table 6 provided

later in sub-section 4.2.3. As it can be seen from below, drifting model is relevant for the Soviet economy and the Soviet Gosbank with the focus on the strategic and structural drifting mode, which is contrasted with the layering that is more applied by the Russian regulator by using all three strategic, structural and tactical approaches. Further to the assessment of four modes of incremental change outlined above, the former partner of EY said 'although the most evident and relevant strategy adopted by the regulator appears to be layering, every strategy must be considered jointly with various factors, including the interests of the parties involved and the specific context'. The further analysis of this table provided in chapter 5 (Analysis).

Table 4. Combination of regulators approach vs. particular features of environment

N	A. Regulators Approach	Drifting	Layering	Conversion (Harmonization)	Displacement	Initiation
1	Strategic	High for planned Soviet economy and state Gosbank in 1970-1991; Medium for foreign banks in 1970-1990s; Low for current CBR	High for the current CBR Medium for current foreign regulators; Low for Soviet Gosbank	Medium for current CBR; Medium for current foreign regulators Low for Soviet Gosbank	Medium for current CBR; Low for current foreign regulators Low for Soviet Gosbank in 1970s-1991;	High for current CBR; Medium for current foreign regulators; Low for Soviet Gosbank in 1970s-1991;
2	Structural	High for planned Soviet economy and state Gosbank in 1970-1991; Medium for foreign banks in 1970-1990s; Low for current CBR	High for the current CBR Medium for current foreign regulators; Low for Soviet Gosbank	Medium for current CBR; Medium for current foreign regulators Low for Soviet Gosbank	Medium for current CBR; Medium for current foreign regulators Low for Soviet Gosbank in 1970s-1991	Medium for current CBR; Medium for current foreign regulators Low for Soviet Gosbank in 1970s-1991
3	Tactical	High for planned Soviet economy and state Gosbank in 1970-1991; Medium for foreign banks in 1970-1990s; Low for current CBR	High for current CBR Medium for current foreign regulators; Low for Soviet Gosbank	Medium for current CBR; Medium for current foreign regulators Low for Soviet Gosbank	Medium for current CBR; Medium for current foreign regulators Low for Soviet Gosbank in 1970s-1991	Medium for current CBR; Medium for current foreign regulators Low for Soviet Gosbank in 1970s-1991
4	B.Power Brokers	High for planned Soviet economy and state Gosbank in 1970-1991; Medium for foreign banks in 1970-1990s;	High for the current CBR Medium for current foreign regulators; Low for Soviet	Medium for current CBR; Medium for current foreign regulators Low for Soviet	Medium for current CBR; Medium for current foreign regulators Low for Soviet	High for current CBR; Medium for current foreign regulators Low for Soviet

		Low for current CBR	Gosbank	Gosbank	Gosbank in 1970s-1991;	Gosbank in 1970s-1991;

Adapted from Rocco and Thurston's (2010) in relation to categorisation of models of gradual institutional change.

It shall be highlighted that during the analysis, the Initiation model was overlooked. This model can be considered as the fifth element of gradual institutional change and provides quite interesting point for analysis, as it gives a new element for creation of completely new requirement, law, phenomenon. Consequently, the CBR strategic initiatives approved by the President for a framework regulating Initial Coin Offerings (ICO) and crypto-currency mining operations, approved blockchain draft legislation, new requirements on electronic digital signature for KYC purposes creation of special department for methodological support and control over cybersecurity issues.

This can be considered that the Russian authorities become more and more strategically involved in the initiation model, although structural and tactical models still remains at medium level for the CBR. Therefore, the CBR must draft regulations that bring ICOs in line with existing laws governing securities. With regard to the foreign regulators the level of involvement in Initiation models remains medium as per strategic, structural and tactical approaches. Power brokers who exercise the power and decision making abilities. They play an important role in tuning regulator's approach and level of its involvement. Their current role in keeping the drifting mode is inactive and CBR actively pursues other regulatory approaches in the layering and initiative models.

The representative of the CBR commented '…from the regulatory perspectives, the internal audit function has a key role in reviewing the corporate governance structure to ensure the effective management of risk in the banks'. Following the above discussion of internal control functions, a 'three lines of defence' model was developed by the Institute of Internal Auditors (2013). It shall be mentioned that some peculiarities of certain sectors of economics, such regulated financial institutions were not fully recognized. The three lines of defense model is illustrated in the Appendix 8.

When asked about the most developed methods of communication and interaction between the regulator ad regulated banks, a representative of the State Bank 2 reiterated 'it is all about undertaking audit reviews, whether regular thematic reviews or ad hoc reviews. Unfortunately, communication between internal auditors, regulators and external regulators is a rather weak. They are functioning in their particular ways and regime pursuing their particular different goals, that result in the facts that often an Annual Plan for internal auditors does not have any similarity and/or matching with Annual Report of the External auditors. Moreover, the goals and strategies of the regulators specified in their Audit Plans and subsequent Audit Reports are something different compared to the documents of auditors'.

Representatives from the three Foreign banks and the representative from a State Bank 1 expressed a similar view, which can be summarized by comment of the respondent of the Foreign Bank 2 who said 'in daily work activities, the borders of these three distinct lines are often blurred. As such, it can be difficult to discern where the responsibility for the first line ends and the second line starts'. Moreover, reporting requirements often contain inadequate guidance, as well as additional information unrelated to the risk elements being addressed. In addition, the internal audit often fails to incorporate all elements of organisational risk management, and does not address all categories of the organisational objectives, including strategic, operational, compliance, reporting, and ethical aims. A respondent from Foreign Bank 2 said 'the level of remuneration on the second line of defence is considerably lower irrespective of increasing level of regulatory scrutiny and accompanying pressure on those working in the compliance area'. In addition, a representative from the ICA suggested added 'the three lines of defence model is not new, and that there is a fourth line of defence which aims to address the need for greater interaction between the board and external parties, namely, external auditors and banking supervisors, in relation to the design of the internal control system'. This revised model provided below aims to mitigate the shortcomings of the former model and increase the soundness and reliability of the risk management framework. The four lines of defence model for financial institutions is illustrated in the Appendix 8.

In Russia, the best practice recommendations outlined in the above model are not yet comprehensively understood or developed. This can only be achieved with greater communication between external and internal parties. The analytical framework for both models together with accompanying critique is detailed in chapter 5.

The respondent from State bank 1 said 'another formal method of interaction with the CBR is public meetings between CBR representatives and senior management of regulated banks'. The respondent from the Russian FIU said in this regards '… the most obvious example of understanding an importance of compliance was an organization by the Russian FIU the Compliance Council (available at http://www.fedsfm.ru/en/news/3710). The further enhancement of communications with the banks is currently conducted on the platform of this Compliance Council. While such interactions are formally governed, they represent valuable opportunities for increasing communication and accessibility between both parties'. A representative from the State Bank 2 commented '…quite important venue for communication and sharing experience, challenges in the compliance universe is the Expert Council on Compliance within the Council of the Russian Federation, National Council for the Financial Markets and Association Rossia. These three bodies, among others organize formal interactive discussions between the banks society, representatives of the regulators (CBR, Russian FIU, Russian Anti-Monopoly Service,

other regulatory authorities) to share the most problematic issues, new regulatory trends and requirements.

However, a respondent from the ICA stated 'the level of disconnection between the regulator and the regulated entities can be crystallised within the tax ruling agreement. There is no negotiation, and the regulator simply confirms its final decision in writing.' The regulated firms are, therefore, unable to pick up the telephone and clarify any questions, but are required to formally acknowledge safe receipt of the written confirmation, irrespective of its value in terms of implementation. While this method might be described as lacking transparency, the regulator is able to disguise any weaknesses or shortcomings in its analysis or actions. In this way, the regulator is able to defend its position without having to justify the basis of decisions, such is the tradition of Russian culture.

ii. **Informal Approaches**

The CBR also works through professional organisations and bodies, such as the National Council for Financial Markets (NCFM), which acts as intermediary between the regulator and the regulated. As was commented by the representative of the Central Bank of Russia '…during regular meetings covering various areas, including insider dealing and AML/CFT, among others, representatives of regulated banks are able to discuss and assess potential forthcoming amendments to legislation and regulation'. The nervous formality of such so-called 'photo-op events' demonstrates that such exchanges with the Russian regulator are not always productive. The respondent from the Foreign Bank 2 mentioned 'decisions are usually made either by hierarchy, whereby orders and instructions are cascaded the top of an organisation, or by networking, for example, during open question sessions in the European Union'.

In examining the informal strategies adopted by the regulator, the respondent from the Private Bank noted '…a focus is primarily made on the state banks, for example, VTB deserves a special mention, as it is wholly owned by the Russian government and acts as its proxy. In this respect, VTB can be considered as both a regulated entity, as well as the principal recipient of financial preferences by the CBR. If VTB were a private bank, its relationship with the CBR would doubtlessly be more formal and restricted'. The aforementioned hierarchical tradition in Russia, whereby decisions taken by those at the top need not be rationalised or explained to those lower down the ranks, goes some way to explain this approach. However, the CBR prefers informal approaches to interactions with the state banks, compared to a more formal approach with non-state banks. In summary, the ongoing dialogue between the regulator and the regulated banks remains fragmented due to the CBR's continued preference for maintaining privileges for the state banks.

4.2.2 Accommodative versus Sanctioning Strategies

The different strategies applied by regulators toward the regulated banks can be outlined in terms of accommodation and sanctioning. The majority of respondents from the Foreign Banks agreed in saying that '…ideally, the regulator's strategy ought to encompass a combination of accommodation *and* sanctioning, as both approaches are indispensable, and can be proactive as well as reactive'. In terms of sanctioning strategies, more coherent and transparent measures should be taken to enable regulated entities to understand the logic and expectations of the regulator. In terms of accommodation strategies, strategic vision and reasonability tests should be used to inform regulatory oversight. The representative of ICA said 'there should be working laws and an efficient system of protection for all businesses in the event of any illegal or unethical actions on the regulator's part'. In addition, all respondents agreed that there is an underlying assumption in Russia that sanctions for mismanagement are inevitable where a company is found guilty of any wrongdoing. In spite of this, the prevailing view of enforcement strategies can be summarised as weak and, predominantly, declarative.

During the semi-structured interview with the representative of the Private Bank said 'the system of enforcement in Russia is very bureaucratic and slow and the courts frequently seem unable to make any fair and timely decisions. Even if you are lucky with the court's final decision the implementation of the court's decision can be very challenging'. The other respondent from the Foreign Bank 4 clarified that 'here is an unwritten understanding among foreign financial institutions that Russian clients, irrespective of their location, constitute a higher risk. This can also be said in cases where a foreign company operates through its Russian subsidiary'.

A question mark remains, however, over the regulator's efficiency and scope of responsibility. A respondent from State Bank 2 explained 'there is no efficient system of internal control built into the Russian regulatory apparatus. As a state authority, no individual, team or department is accountable for failed projects or inefficient regulation. There is no directors and officers (D and O) liability insurance for any state representatives, which practically means that, there is no state accountability for businesses or individuals. Overall, there seems to be little scope at present for Russia to move in the same direction as, for instance, the U.K. with its Association of Chartered Certified Accountants (ACCE) standards'.

On balance, the arguments in favour of a unified regulatory approach seem more convincing than a regulatory differentiation approach, although the need for some level of specialisation is acknowledged in relation to some areas. However, recent events appear to indicate that the consolidated approach is far more effective. Russia's Federal Service for Financial markets (FSFM) has merged to become part of the CBR, and in the U.K. the financial regulatory function is now essentially unitary. In the United States, however, the dynamic between and among the Commodity Futures Trading Commission (CFTC), Securities and Exchange Commission (SEC), Office of Foreign Assets Control (OFAC) and other regulatory actors appears to be entropic.

Commenting on the philosophy of the CBR as the new mega-regulator, which has an oversight responsibilities since September 2013 ranging from banking financial institutions to non-banking ones, respondents from Foreign Banks 1 and 4 expressed similar views, while respondent from Foreign Bank 1 said 'there was little conceptual understanding of the activities of preceding regulators, and that clarity surrounding the banking regulator's mission was also lacking. The previous regulator had a formal, rigid, very rules-based approach that did not correspond with current international practices and expectations'. The respondent from Foreign Bank 4 said '… it can be however argued that the previous regulator was simply unfit for the very purpose for which it had been created. It is hoped that the new regulator, which came into existence on September 1, 2013, will address these concerns and ultimately improve the situation'. Views of other respondents concerning whether a single regulatory body overseeing all types of organisation is better than three previous regulators with oversight of particular areas, are mixed. In defending a creation of mega-regulator a respondent from Foreign Bank 3 said 'a sole regulator is appropriate for ensuring a unified approach in financial sector dealings, and more likely to avoid the abuse of power and authority commonly associated with relations between different regulators. This is particularly important in cases where cooperation between different types of organisation is required and where problems under the previous system have occurred, for example, between banks and insurance companies'.

Respondent from the Foreign Bank 4 was opposed to the previous view and commented 'the establishment of the new mega-regulator is unlikely to alter the underlying system principles or strategy of its predecessors to any significant degree. An element of controversy exists in relation to improving financial regulatory efficiency; whether via a sole banking regulator, such as the FCA in the U.K., or via different regulatory bodies nominated to oversee legislation for particular financial spheres'. A respondent from the State Bank 1 added 'in view of globalisation and the associated blurring of boundaries of activities between commercial banks, investment banks, insurance companies, and so on, the argument for having one centralised, all-encompassing regulator for the entire financial services industry might well hold some appeal'.

Additionally, there are different regulators overseeing different sectors of financial services, the compliance issues being addressed may not be dissimilar, hence the scope for duplication of compliance tasks and associated costs is very real and potentially unnecessary. This may also involve a duplication of resources needed to supervise the same activity by different regulators. If, for example, a large financial group were to be declared bankrupt, it would make sense to address insolvency on a group level rather than by the various types of business activity. Having a single, unified regulator might also facilitate a better standard of risk assessment within financial institutions as all of the group's activities can be considered. Therefore, having a single regulator can also create problems as there might simply be too

much for a single body to focus on where industry-specific objectives require industry-specific expertise. In this respect, it might make more sense to have specialised bodies looking after consumer protection or other specific objectives. It may prove to be the case that one single regulator is forced to adopt a more rigid and bureaucratic approach than multiple, smaller, specialised regulatory agencies.

From the semi-structured interviews conducted it became apparent that the current Russian regulatory model is an example of a hierarchical, vertical system, whereby the state and its employees have no direct responsibility for errors or violations of regulatory policies and cannot be punished when they occur. A respondent from the State Bank 1 commented on 'this approach is slowly changing. At the moment, Russian regulation is predominantly rules-based and the regulator tells the regulated companies what they should do and how they should do it. However, there is some evidence to suggest that where AML/CFT regulation is concerned, the regulator may be open to adopting a more flexible approach to dealing with suspicious transactions'.

The former EY partner with 20 years of experience on the financial market remarked during an interview 'it is inaccurate to say that the CBR acts as sole arbiter, because the Russian government ultimately directs the CBR, and acts as an economic actor, albeit with preferential rights. He continued '..for example, the Russian government controls around 65% of the land and property in Russia, performing the role of asset manager. The state does not provide care for the citizen *per se*, but rather is concerned about maintaining state power. This can be seen in the ban on ordinary Russian citizens buying shares in Apple Inc. In order to be exempt from the ban, Russians must confirm that they operate an overseas bank account and undertake to provide regular statements detailing the balance of such accounts. This means that the state restrains economic activity and restricts economic freedom in order to thwart foreign investment by Russian citizens and economic actors, thus ensuring that domestic capital is maintained within state borders. This attempt to restrain the activities of economic actors might be considered counterintuitive, however, as businesses in particular will typically seek to maintain assets and capital in a safe and developed economic environment. The huge amounts of capital from pension funds and other sources of welfare funding are currently being injected into state-sponsored, yet economically dubious initiatives, such as the Gazprom/Rosneft projects. As citizens and economic actors were not given any opportunity to vote or otherwise condemn the funding methods for such projects, it can be argued that economic fairness is sorely lacking'.

Money laundering legislation in Russia began in earnest in 1991. Since then, new instruments and new bodies have been introduced, and existing instruments have been revised and reinvigorated with greater scope and additional responsibilities. The full extent of regulatory responsibility in this area is now represented by no fewer than 10,000 pages of related documentation. Compliance is a dynamic process and its significance in Russia cannot be underestimated in view of the substantial gap between

what is undertaken locally and what is required globally based on international standards. Moreover, gradual change theory can be applied to explore how Russian regulation and compliance work in practice.

4.2.3 Strategies of the Regulated Banks

As previously mentioned, both the regulator and the regulated apply various strategies in relation to regulatory requirements. The approach adopted by regulated banks also comprises of formal and informal strategies and channels of communication in their interactions with the regulator.

i. **Formal Approaches.**

As mentioned previously in chapter 3, compliance can be understood as a combination of drifting, conversion, layering, and displacement processes, alongside particular features of the environment in which it operates, namely, structure, agency and power brokers. Table 5 below summarises the findings of an analysis of documentary sources and the results of semi-structured interviews with banking practitioners, compliance officers, regulatory bodies and other stakeholders.

Table 5. Combination of features of the environment and various gradual change dimensions

N	Dimensions	Drifting	Conversion	Layering	Displacement
1.	Structure:				
	Initial institutional ambiguity or malleability	Low	High	High	High
	Institutional structures induce through:	Path dependence, creating status quo bias	Granting actors discretionary capacities to alter institutional meaning	Coupling of multiply institutions; differential growth	
2	Agency (e.g. regulators):				
	Change agents must have access to discretionary, intellectual or material capacities to:	Keep institutional updating of the policy agenda	Manipulate interpretation of institution's rules	Sponsor and carry out modest changes or propose marginal amendments	Carry out material change and propose complete new institution's rules
	A. Firms response				
	(i) Strategic	Resistance	Accommodation	Accommodation	Accommodation
	(ii) Structural/ Organizational	Resistance	Accommodation	Accommodation	Accommodation

	B. Power Brokers (individuals who exercise the power and decision making abilities)	Symbionts	Opportunists	Subversives	Insurrectionaries
3	Final institutional outcome:	Institution must not change, but institutional outcome post-drift must not be similar to institutional outcomes pre-drift	Institutional post-conversion must be functionally different than institutional pre-conversion	Initial institution must change and should become similar to the institution that was layered on top of it	Institutional outcome will completely different and replaced by new one

Adapted from Rocco and Thurston's (2010) in relation to categorisation of models of gradual institutional change.

The regulated companies tend to formally fulfill their obligations based on the theory of probability of punishment, this is due to the Russia history of hierarchical control. Compliance in Russia has traditionally adopted a formal approach based on various political, social and cultural factors. However, the respondent from the Foreign Bank 1 expressed the view by commenting that 'the very strict and formal rules are being undermined by a rather weak state enforcement system, as the Russian mentality is based on rules and orders, irrespective of the advantages and disadvantages for individuals'.

A former EY partner said 'the extent of punishment for failing to comply with regulatory policy is not commensurate with the potential profits that might be generated by choosing to ignore policies or deliberately violate them. By contrast, in cases where the punishment is severe in relation to the potential profit to be derived from a violation, for example, concerning OFAC rules, the policy is likely to be much more successful'. He further commented '…in the environmental realm, for example, if we take an example of the very small fines imposed for noncompliance with sea pollution guidelines by private ships in Russia. When we consider the potential profits that a commercial firm owning a fleet of ships might generate from whatever their business activities might be, the small fines imposed for pollution become altogether meaningless. Therefore, until the extent of civil and criminal punishment is waged at a commensurate level to the potential profits to be earned from noncompliance, breaches and violations seem set to continue unabated'.

If we further look into the models of gradual institutional change by adopting Rocco and Thurston's (2010) through the lenses of regulated, we can see the level of involvement of various regulated entities, such as the Russian financial institutions, the Soviet state banks and the foreign financial institutions into the compliance regulation (Table 6). This table shall be considered in conjunction with the Table 4 provided earlier in sub-section 4.2.1.

As it can be seen below Drifting model is apparent for the Soviet economy and the Soviet state banks with the focusing on strategic and structural the drifting model. This is echoed the regulators

approach in the similar model applicable for regulators. The layering model is more applied by the current Russian financial regulated entities with high involvement in all three strategic, structural and tactical approaches. The conversion and displacement models both provide similar measurement in regards to strategic, structural and tactical modes for all specified categories of the regulated entities, with an exception to the displacement model applicable for the foreign regulators in strategic approach where the level of their involvement is low, not medium as in the conversion model. The further analysis of this table provided in chapter 5 (Analysis).

Table 6. Combination of regulated entities approach vs. particular features of environment

N	A. Regulated Approach	Drifting	Layering	Conversion (Harmonization)	Displacement	Initiation
1	Strategic	High for planned Soviet economy and Soviet state banks in 1970-1991;	High for the current Russian regulated entities;	High for current Russian regulated entities;	Medium for current Russian regulated entities;	High for current Russian regulated entities;
		Medium for foreign institutions in 1970-1990s;	Medium for current foreign institutions;	Medium for current foreign institutions;	Low for current foreign institutions;	Medium for current foreign institutions;
		Low for current regulated entities	Low for Soviet state banks	Low for Soviet state banks	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991
2	Structural	High for planned Soviet economy and Soviet state banks in 1970-1991;	High for the current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;
		Medium for foreign institutions in 1970-1990s;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;
		Low for current Russian regulated entities	Low for Soviet state banks	Low for Soviet state banks	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991
3	Tactical	High for planned Soviet economy and Soviet state banks in 1970-1991;	High for the current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;
		Medium for foreign institutions in 1970-1990s;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;
		Low for current Russian regulated entities	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991
4.	B. Power Brokers	High for planned Soviet economy and Soviet state banks in 1970-1991;	High for the current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;	High for current Russian regulated entities;

		Medium for foreign institutions in 1970-1990s;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;
		Low for current Russian regulated entities	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991

Adapted from Rocco and Thurston's (2010) in relation to categorisation of models of gradual institutional change.

Overall, it can be seen that the Russian regulated entities compared to foreign institutions are more active in involving into the following two models (layering and conversing). In regards to strategic involvement of the Russian regulated entities in the initiation model it is high involvement compared to medium involvement for foreign banks and medium involvement in structural and tactical approach by the Russian regulated entities.

The former partner of EY by suggesting a further type of formal strategy in terms of self-regulation proposed 'formal strategy can be considered as a useful tool for altering behaviour in regulated firms. A bank with firmly established AML policies and procedures endorsed and supported by senior management has firmly laid the foundations for the creation and maintenance of a robust self-regulatory system in the organisation. He also noted that where compliance resources are inadequate, self-regulation strategies are likely to be unsuccessful and may even prove counterproductive'.

During the semi-structured interviews about financial crime compliance a special focus was made on ML/FT issues. Thus, a respondent from a Foreign Bank 2 expressed his professional view on these issues by saying 'there will be not professional to consider ML/FT issues without a holistic understanding of the basics of financial crime. Financial crime compliance covers the whole spectrum of criminal activities with a specific emphasis on various types of client/counterparty due diligence processes, including simple, standard, and enhanced due diligence. Money laundering compliance also involves a robust system of monitoring and surveillance, especially of trading activity and account movements by licensed professionals, namely, bank employees and clients/counterparties. Depending on the corporate structure, the scope of compliance activities may vary and include operational risk management and internal control issues, as well as fraud investigations, global sanctions compliance, conflicts of interest, and prevention of bribery and corruption. If we consider ML/FT compliance then one of the core elements of AML/CFT compliance is KYC process, which is mainly concerned with analysing clients and their transactions. The KYC process is closely interconnected with data protections issues'. The respondent from a Foreign Bank 2 further concluded that 'there is a great inter-connections with various countries and international laws applied doing financial investigations on money-laundering cases'.

For example, the new General Data Protection Regulation (GDPR), encompassing the twin aims of enhancing the level of personal data protection for individuals, and increasing business opportunities in the European Digital Single Market, was become a legal requirement in 2018. The Russian banks will, therefore, be required to ensure their compliance with either the required 'adequacy' assessment, or that more onerous 'appropriate safeguards' are in place. Another example is the guidelines and recommendations specified by the 4th European Money Laundering Directive became law on June 26, 2017, which is focused on KYC activities, notably the area of beneficial ownership, as well as a more risk-based approach toward AML/CFT. It shall be noted that while governments can create systems, for example, the AML/CFT subsystem, these can develop to the extent that they exist independently and ultimately become a separate system in the financial environment. Future development depends not on the government as the creator of its systems, but on the intentions and interests of the key players who will determine how this system ought to be used, and in what particular way.

Another view was expressed by a respondent of the Foreign Bank 4 '…in relation to ML/FT it is not only about spending excessive amounts of time and money on regulatory issues, it is also a better understanding of enhancing risks controls. For example, the 4th Anti-Money Laundering Directive (EU 2015/849) is important laws that will not only change risks assessment principles, but will affect the AML/CFT compliance not only within EU, but far beyond. This law enables the regulated financial institutions to establish their own risk-management procedures based on their expectation of the local regulatory requirements, as well as global standards for global financial institutions'. He further commented '….in contrast to the recommendation made by FATF regarding eliminating of de-risking practices by the banks, the CBR currently does not support this idea and encourage the banks to work with high risks clients, e.g. labour migrants '.

In terms of a single global approach to KYC procedures in all customer dealings, a respondent from Foreign Bank 2 continued 'if the global policy stipulates that disclosure of ultimate beneficial owner (UBO) ought to be carried out using a universal 10% threshold, local requirements, for example, 25% for disclosure of UBO in Russia, become irrelevant'. Moreover, the Russian regulator seems disinclined to learn from their regulatory counterparts abroad and few, if any, recommendations have been given to the regulated financial institutions themselves. The respondent from the Foreign Bank 4 noted 'when discussing risk-based regulations, it is important to understand the advantages, as well as the shortcomings, specifically the role of organisational culture, in implementing risk-based regulation, as well as cultivate a sense of awareness surrounding the reality that risk-based frameworks can, in themselves, create risks'. Therefore, there ought to be a range of approaches to compliance applicable to different sectors as determined by their appropriate context, whether environmental, medical or financial. In this respect, a uniform, if not universal, conceptual approach to addressing compliance issues across all industry sectors should be the underlying aim. However, the task of structuring and

implementing such a conceptual approach would need to take into consideration the contextually specific dimensions associated with each industry sector.

A respondent from the Foreign Bank 3 commented 'formal compliance with group standards toward the sanctions regime is very challenging in terms of its relationship with other banks operating in Russia, as well as its relationships with clients and with the local regulator. The issue of payment transfers to and from Crimea is particularly fraught in this respect. On the one hand, Russian financial regulation requires banks to screen and stop such payments, but to do so would place the banks in violation of international legal arrangements and banking law. However, many international banks operating in Russia continue to enforce certain restrictions surrounding Crimean payments. This gives rise to significant ambiguities in the strategies devised by regulated banks toward sanctions compliance, especially domestic payments to and from Crimea, which is treated differently by some European countries and the United States'.

In summary, a majority of rrespondents from Foreign banks and Private Bank admitted that many view compliance in stringent terms of black and white, namely a particular action or behaviour is either compliant or noncompliant. In this respect, it is useful to introduce the notion of compliance risk management, whereby regulated companies and financial institutions assess the potential risks of noncompliance, and establish a transparent framework in order to identify how potential risks might be accepted, and by whom. A respondent from the Foreign Bank 1 stated that '….regulated companies often find themselves in compliance with the more basic, straightforward requirements, yet continue spending excessive amounts of time and money on routine regulatory issues. In addition, while banks may appear to be investing considerable resources on implementing AML/CFT programmes, this investment is not necessarily translated into practice'.

ii. **Informal Approaches.**

The respondent of the Foreign Bank 1 said 'informal meetings of various associations, such as the Association of European Business, were useful in affording compliance committees a valuable opportunity to voice practical concerns related to AML/CFT directly to the CBR'. Other international organisations, for example, the ICA, support the development and enhancement of informal approaches to enhance AML/CFT compliance programs.

Turning to informal communications in compliance, one respondent from the ICA commented '…the Russian CBR relies on hierarchy in terms of managing domestic financial institutions and at the same time on networking with its international partners with regard to relationship with FATF, Egmont Group, OECD, Transparency International, World Bank. One of the interesting point comes when the CBR changes its attitudes to more informal in relationship with the financial institutions is the period when FATF experts start to implement Mutual Evaluation Reports. As the FATF experts run this report

directly in the premises of the financial institutions and with their direct involvement, the CBR becomes open, friendly and very helpful'. She further continued '…overall a better combination of hierarchy and networking would be beneficial for the both actors. From the regulated perspectives an introduction of informal compliance practices needs to be pioneered, supported and rolled out by senior management. This top-down approach facilitates a better understanding of compliance underlined by management commitment, enhancing not only adherence to the principles enshrined in the company Code of Conduct, for instance, but also employee support across all levels of the organisation for the development of existing and future compliance initiatives.

In regards to self-regulatory practices, a former partner of E&Y said 'self-regulatory practices are only growing in the Russian financial institutions and even now they are very diverse due to various corporate culture, risks appetite and overall strategies of the banks. Any kind of self-observation or self-assessment made by the Russia banks is at the starting but rather evolving position'. A representative of ICA further commented '…most of the proactive public banking associations do constitute the major venues for exchange of the compliance practices and approaches in compliance, including self-regulatory practices. Regulators are also quite closely interconnected in their dealings with each other'. This can be seen in Russia's decision to join IOSCO by signing the protocol agreement in February 2015. This will enable the CBR to maintain effective interaction with IOSCO, including participation in IOSCO committees and working groups, as well as contributing to information exchanges on key issues of financial market regulation and oversight. The scope of information queries can be broad and, in practice, this means that any activities of foreign companies directly or indirectly on Russian trade platforms or exchanges can be investigated and audited by the CBR simply by requesting details from foreign regulators.

In summary, this part of the thesis provides an overview of both regulators and regulated strategies with certain dimensions such as formal and informal practices. These dimensions allow to show nuances and shadows in the whole picture of discussed strategy in question. The tables 5-8 provide more information, including systems of interactions, combinations of regulators and regulated approach vs. particular feature of environment and comparison the latter with gradual change dimensions.

4.2.4 Transparency and Accountability

Whether accountability and transparency is really matter, and if yes to what extent in each bank sampled, what is the inter-connection between transparency/accountability and compliance. As

introduced in the preceding chapter, the data gathered from documentation reviewed and interview responses were collated to allow the properties, namely terms and words, and the dimension of frequency to be analysed. The results are outlined in the Table 7 below.

Table 7. Properties used/published by sampled banks

N	Properties (terms and words used)	1.Foreign Bank 1	2.State Bank 1	3.State Bank 2	4.Foreign Bank 2	5.Foreign Bank 3	6. Private Bank	7.Foreign Bank 4
1	Common words and phrases: (i) Money-laundering (ii) Compliance	 X X	 X X	 X X	 X X	 X X	 X X	 X X
2	Specific phrases and words: Transparency (Y or N) Case studies (Y or N) Level of details: Min./Med./ Max Adequate disclosure (Y or N): Russian banks vs European/US Banks	 Y Y Med. Y	 Y Y Med. Y	 N N Min. N	 Y Y Max. Y	 Y Y Med. Y	 N N Min. N	 Y Y Med. Y
3	Accountability: Declaration of designated person/body (Y or N)	Y	Y	N	Y	Y	N	Y

As can be seen from the above table that although all sampled banks used common words such as compliance and money-laundering, the level of transparency and accountability significantly varies depending on the bank sampled, which can be further explained due to different interpretation and understanding of compliance by sampled banks.

A special consideration shall be given to the ideas of a former EY partner, who remarked ’these concepts in the current Russian political-economic paradigm are rather artificial ones and shall be treated as idealistic non-vital elements, which are not the case for the Russian regulatory environment, thus they cannot be treated in Russia in the way as they treated in other countries‘. He continued ’there is a great gap between the idealistic picture of accountability and transparency of any firm or the regulator or the state and its senior officials, and how it really works. For example, pensioners in future might not receive pension payments in retirement, regardless of the amount paid into their pension funds during their working life, because the Russian government has used the funds to finance

somewhat ambiguous projects, including activities at Gazprom, Rosneft and other state giants'. That in practical aspects means that compliance in such a case is fully embedded within the organisational hierarchy with different teams of employees being responsible and accountable at different phases of the process. Moreover, the absence of any wrongdoing in the company's regulatory history is further evidence of effective compliance processes throughout the organisation. Certain Properties applied by the sampled banks vs specific measurement tools are provided in the Table 8 below.

Table 8. Properties used vs. specific dimensions applied by sampled banks

N	Properties (Categories used)	Specific Measurement tools	1. Foreign Bank 1	2. State Bank 1	3. State Bank 2	4. Foreign Bank 2	5. Foreign Bank 3	6. Private Bank	7. Foreign Bank 4
1	Transparency	Level of details: (i) detailed information; (ii) updated information; (iii) generic and vague information	 X - -	 X - X	 - - X	 X X -	 X X -	 X X X	 - - X
2	Accountability	(i) Declaration of Russian designated person; (ii) Declaration of the European designated person (iii) Declaration of the US designated person	X - X	X X -	- - -	X X X	X X X	- - -	X X X
3	Suspicious activity	Methodology for KYC formal (F) vs informal (I) vs mixed (M)	M	I	I	M	M	I	M
4	KYC Process	Types of process: (i) systematic (S) vs ad hoc (AH); (ii) holistic (H) vs incremental (I); (iii) formal (F) vs. informal (I) vs mixed (M)	S H F	AH I F	AH I F	S H F	S H M	AH I F	S H M

It might be possible to conclude, therefore, that organisations with a poor commitment to transparency are more likely to be suspected of money laundering activities. Transparency reflects free access to information on the activities and decisions taken by an institution, providing stakeholders with a means to challenge decision-makers. In short, transparency supports accountability and significantly decreases the scope for wrongdoing and noncompliant practices. As an example, the Basel Committee on Banking Supervision issued a paper addressing transparency in cross-border cover payment messages (Bank for International Settlements (BIS), 2009)).

Part. 4.3. The Context of Compliance

Introduction

Companies may feel the brunt of the international regulatory context directly, in cases where particular regulations designed and implemented in one territory must be complied with in another territory, for example, the U.S. Patriot Act against money laundering. The international context may also impact companies indirectly, such as standards of conduct spreading across borders. An example of this can be seen in the FATF recommendations that provide a comprehensive plan of actions against money laundering covering financial system, regulation, enforcement and international cooperation. At the organisational level, the principal driver is related to increased regulatory scrutiny. However, there are few, if any, companies operating in complete isolation from some form of compliance culture, for example all global international banks are operating based on their global/regional internal policies. In even the smallest of companies, some framework of rules governing conduct and controls for operating business processes is likely to exist. In this chapter, the key drivers of compliance development will be provided by respondents from different perspectives, including stakeholder interests, social and cultural aspects, domestic economic and political influences, and international considerations. This will be followed by an analysis of governance and compliance issues and consequent interrelations at the institutional level in the chapter 5 (Analysis).

4.3.1 Formal Practices

(i) **International Factors**

In the international arena, the objectives of financial services regulators are two-fold. Firstly, they aim to maintain a state of equilibrium by reinforcing existing regulatory standards and requirements, as well as introducing new regulatory mechanisms wherever necessary. Secondly, regulators endeavor to restore public faith in the financial markets as fair, reliable and transparent vehicles for ensuring capital growth. Firstly, the key international drivers for compliance development further to a former partner of EY 'the international agreements and treaties, including the requirements

stipulated by international and intra-national organisations, such as FATF, OECD, WTO and Basel 2/3'. He further continued 'for instance, FATF imposed new criteria with regard to AML and anti-corruption intended to be reflected in corresponding Russian legislation by 2014. As a result, the CBR designed appropriate regulation outlining the new requirements and will ensure that that all regulated banks adjust their AML processes and systems accordingly. All banks were required to comply before April 29, 2013 and to provide the CBR with their respective action plans'. A report was then submitted to FATF by mid-2013 confirming the steps taken. The impact of these drivers can be identified in the changes to legislation, which in turn increase the scope of responsibility for management and compliance officers across the regulated universe'. Despite the fact, that Russia was not identified as country having significant money laundering and terrorist financing risks or having substantial AML/CFT deficiencies, special measures are overwhelmingly requested for Russia, as the country does not appear on the E.U.'s white list of equivalent jurisdictions.

The respondents from Foreign Banks 1 and 2 both agreed in saying 'from a compliance practitioner's perspective, the FATF recommendations and guidance represent the global AML/CFT benchmark standards, and act as the signposts for key developments at the national level'. This can be evidenced by FATF definition of Politically Exposed Persons (PEPs), which relate to individuals performing public functions, such as heads of state, or senior government judicial or military officials. FATF guidance on international organisation PEPs indicate that all financial institutions of FATF member states must take reasonable actions to identify whether a client or its legal representatives or beneficial owner is PEP in order to adequately assess the risk component of the business relationship. The responded from Foreign Bank 1 further commented '…however, the application of this FATF recommendation in Russia remains rather selective, as it fails to incorporate the necessary legal coverage or entitlements necessary to pursue meaningful investigations'.

The FATF criteria are likely to be fully and efficiently adopted in Russia. It seems feasible that a more abstract approach was likely upon initial introduction ahead of the law's is full implementation. As the respondent from the State Bank 2 expressed his concerns by saying that 'the regulated companies perhaps chose to pursue unpredictable methods in order to demonstrate what they considered to be their adherence to the essence of the regulation, and encapsulated what they deemed to be required. However, if the regulation remains undeveloped, the spirit of the regulation will become arbitrary and the threat of misuse and potential corruption could become a real danger. The practical elements associated with the implementation of this law remain unclear for financial market participants'.

With specific reference to money laundering, many international regulatory efforts implemented at the national level have focused on strengthening compliance requirements in relation to customer information. Among them, the FSA in the U.K. introduced a compliance programme to ensure that

customers are treated fairly. In addition, the Wolfsberg Group of International Financial Institutions, consisting of Banco Santander, Bank of America, Bank of Tokyo-Mitsubishi-UFJ, Barclays, Citigroup, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan Chase, Société Générale, Standard Chartered and UBS, has prepared a system of Frequently Asked Questions (FAQs), based on their views on best practices and how the group envisage those practices should develop over time. These FAQs also reflect the contributions of American Express, Lloyds and RBS and have become global AML standards applicable to all banks during KYC and due diligence processes.

The BCBS issued a paper in 2014 that highlights the importance conducting risk assessments in the banks. The guidelines issued one year later by the BCBS in 2015 emphasized the significance of effective risk management procedures, including 'an effective independent risk management function, under the direction of a Chief Risk Officer (CRO), with sufficient stature, independence, resources and access to the board'.

In addition, MiFID requires that every bank maintain appropriate client contract information to clearly demonstrate the suitability and appropriateness of their products and policies in relation to the needs of clients. While regulators and financial professionals in many countries continue to analyse the causes of the recent financial crisis, it is clear that fears surrounding financial instability and loss of trust in the banking industry has resulted in countless new requirements pertaining to client identification and client documentation retention.

A respondent from State Bank 2 said about regulatory strategies 'in line with the all-encompassing activities of the sole financial regulatory body in the U.K., the FCA, Russia has taken similar steps toward the creation of a mega-regulator since September 2013, when the CBR became the entire country's financial market regulator, due to the transfer of a number of functions previously performed by the FFMS. That means that in addition to its supervision of commercial banks, the function of a single regulator includes monitoring non-bank financial institutions such as insurance companies, asset management companies, pension funds, brokers and exchange intermediaries, as well as microfinance institutions'. The respondent from Foreign Bank 1 further concluded 'the establishment of a mega regulator is a positive factor for the Russian economy; it fits into the general trend of regulatory changes of the leading financial markets. For example, the European Central Bank is gradually gaining more and more power'.

The supervisory function of the CBR in relation to credit organisations, namely, banks, specified in the Article 3 of the State Duma of the Russian Federation (2017) Federal Law No. 38-FZ protecting the ruble and ensuring its stability, developing and strengthening Russia's banking system, and ensuring the efficient and uninterrupted functioning of payment systems. As was earlier mentioned the powers of the CBR provide its exclusive right to issue normative acts applicable to all legal entities and private

individuals. Under the auspices of this piece of legislation, the CBR conducts ongoing supervision of credit institutions and banking groups in relation to their observance of banking legislation, normative acts and the compulsory standards set by the CBR. Although one of the principal objectives of banking regulation and banking supervision by the CBR is to protect the interests of depositors and creditors (Article 56), some respondents agreed that this might give the misleading impression that the role of the CBR is to focus on the interests of consumers. In accordance with the Banking Supervision Report 2008, the CBR (2008) issued Ordinance, which sets forth the procedure for calculating the full cost of credit as a percentage per annum using the effective interest rate formula (Central Bank of Russia, 2008) This required credit institutions to provide borrowers with credit agreements outlining the full cost of any loan agreed, as well as the number and amount of repayments. However, it appears that only a few documents were adapted and, consequently, such measures to protect consumers were not deemed adequate when considered against the impact of the financial crisis to the average borrower. In reality, most consumer protection measures were implemented by state-owned banking institutions and did not reflect a true representation of the whole banking sector.

Secondly, as further to the former EY partner 'the other principal drivers for the development of compliance are considered to be globalisation, greater competition and increased pressure from national and international peers to comply. As Russia's membership of the World Trade Organisation (WTO) was approved as recently as 2012, Russian financial services firms and regulatory bodies are relative newcomers to the global regulatory financial services scene'. The representative of the Private Bank further commented 'FATCA has considerable influence on internal compliance infrastructure, as it has generated the most significant levels of change to internal processes, as well as enhancing KYC policies and procedures and improving analytical and risk management capabilities. For higher-risk business relationships assessed under the KYC risk assessment matrix, financial institutions should obtain additional information on their clients, their source and funds and wealth, as well as the intended nature of the business relationship, obtaining senior management approval and conducting enhanced monitoring of each relationship. This also implies an increasing number of compliance managers adapting from working in a formal and reactive style, to taking a more proactive and international approach'.

The representative from the Foreign Bank 1 commented '…European banks, European Markets and Infrastructure Regulation (EMIR) and European Securities and Markets Authority (ESMA) standards are very complex and represent significant challenges in terms of the number of transactions to be reported, the terms for reporting, and subsequent ramifications for failing to report. As such, it is necessary to explore the interpretive flexibility of globally agreed statutes and practices on the ground in Russia, although it is somewhat premature to draw firm conclusions about this specific aspect of regulatory compliance'. She also added 'in Russia, the political risks can be seen as a seemingly

permanent obstacle preventing purely economic, much less market, factors from driving the domestic development of a compliance culture'. As a WTO member, the Russian economy is now deeply integrated with global markets. As such, the desire for Russia to access Western European and Asian capital markets will continue to influence decisions, specifically the Moscow financial market. Beyond Moscow, the consequences are tangential and the prospects for these drivers must be considered with a long-term view, rather than focusing on short-term gains.

(ii) **National Factors**

Majority of interviewed respondents agreed that the concept of compliance in Russia is a relatively recent phenomenon, which can be considered as the outcome of purely Western influences and something of a prestigious function to have within an organisation. As a representative of the Foreign Bank 1 clarified: 'this is primarily because only those organisations with sufficient foreign capital, or those intent on placing their shares on foreign stock markets, introduce compliance into their everyday business processes'. Historically, a tradition of compliance in Russia can be dated back over 250 years to the time of the all-encompassing codification that took place in the Russian Empire in the 1830s (Speransky, 1833). The Russian codification of the 1830s fitted into the European codification movement of the 18th and early 19th centuries, influenced by the Enlightenment. In Russia, the first codification projects were completed in 1835, when the Digest of the Laws of the Russian Empire—a set of fifteen volumes with 60,000 articles—entered into force. The civil law was codified in the tenth volume of the Digest of Laws, which was entitled Civil Laws (Zakony Grazhdanskie) and consisted of four books relating to family rights and obligations, the procedure of acquisition and preservation of real rights in general and in particular, and contractual obligations. These traditions came to a halt in 1917 when the state regime changed and the traditional legal framework was subsequently abolished in the 1920s.

A further example of compliance development due to international factors was outlined by a respondent from Private Bank who commented on the Russian response to international pressures by saying '…regarding global compliance to international security regulation demonstrated by the swift development and introduction of State Duma of the Russian Federation (2010) Federal Law 224-FZ, which concentrates on securities markets. The legislation is the first to introduce the notions of insider dealing and insider information within Russian territory. The principal reason for such prompt adoption of the law in 2008 was fierce pressure for Russia to become a member of IOSCO. In order to achieve this, Russia had to demonstrate its compliance with existing global securities regulation. The Russian approach was arguably to tick the required boxes as opposed to comprehensively applying the principles and putting them into practice. Instead of including vast amounts of substantive information in relation to insider information and without understanding of the principles of insider information, the so-called

list of inside information was introduced'. It shall be noted that with increased financial literacy, financial clients have higher expectations and demands, to the extent that only the most competitive and reputable companies can expect to succeed by demonstrating sound business practices.

While resisting pressure to cooperate with new extraterritorial regulatory regimes, such as Dodd-Frank, FATCA, and OFAC, the Russian and Chinese governments, together with a few other G20 nations, are attempting to establish alternative world organisations with other developing countries, such as the other BRICS nations. However, the most likely outcome will be passive resistance in the form of formal cooperation, but with little, if any, measurable domestic implementation measures reflecting robust policies and procedures. However, Russia may be forced to demonstrate some willingness to adapt to global requirements within a constantly changing regulatory environment. The aforementioned introduction of the U.S.-originated FATCA law, under which banks in other countries are obliged to disclose information about the accounts of U.S. taxpayers to the U.S. tax authorities, represents how Russia has been compelled to adapt to extraterritorial regulations that seek to augment financial transparency and legitimacy.

(iii) Governance and Compliance at the Institutional Level

The corporate governance can be viewed as an internal control system working very closely with the compliance function. In accordance with SOX requirements, corporate governance and internal control are both viewed as subsystems with certain procedural requirements which can be considered as just one of the many frameworks in the compliance universe. A respondent from the ICA said 'two concepts of corporate governance and compliance are interconnected, with each having ambiguities and anomalies. Corporate governance provides a framework for compliance, which is essentially an internal construction. Compliance might best be described as a facet of corporate governance. In this respect, corporate governance is a much broader concept than compliance'. Therefore, corporate governance is an instrument for ensuring that a fair internal system exists. Compliance officer from the Foreign Bank 1 further commented '…it would be almost impossible to instigate robust or even adequate compliance systems in an organization, if the required components of corporate governance were not firmly in place'.

An important point was made by a former EY partner saying that 'the key deciding factors are the presence, or absence, of tangible structural reforms in the governing structures, and also the perception of such tangible reforms. Emerging markets investors can be highly volatile and easily scared away. Therefore, the political leadership of an emerging market with a mixed global reputation, such as Russia must take extra – perhaps extraordinary – measures to demonstrate that structural reforms are receiving, or will shortly receive, due attention'. As a practitioner's observation this shall include a governmental policy of encouraging and demanding adherence to internationally accepted standards of

corporate governance and compliance. There is, however, an unavoidable and vexing paradox to be considered, in that any commitment to structural reforms, corporate governance and transparency, combined with a robust framework for compliance, can only occur in the context of a change in government. As the political institutions of most governments among the emerging markets are notoriously corrupt, such changes in ruling elites often involve social upheaval and violence, such as occurred in Russia between 1991 and 1993 and in various other former Soviet republics thereafter, as well as in the Arabic world. The influence of political factors, as discussed above, is foremost, direct and immediate.

The respondent from the State Bank 2 said on this point 'until Russia's political risk discount can be minimised, the impact of the most aggressive compliance procedures, whereby globally recognised best practices are implemented among domestic industry sectors, will have only a limited effect on the general perception of the Russian market among foreign investors'. Therefore, political factors wage considerable influence over the banking sector, and the CBR is a huge political organisation which supervises banking activities from a politically motivated platform, albeit adopting a different approach in its supervision of state banks compared to their private counterparts. Good compliance ultimately does not 'trickle up' from a nation's domestic commercial players to its governing structures. This idea was supported by the respondent of the Foreign Bank 4 saying that 'this is absolutely o appropriate for the compliance function to review and perhaps even determine the corporate governance mandate. In this context, compliance is the broader concept, as it constitutes the principles, approaches and attitudes to business as a whole. Unfortunately, the current treatment of compliance in Russia is far from adequate. Compliance is rarely reviewed as important enough to warrant a separate segment during meetings of the board of directors, but instead tends to be discussed in conjunction with the preparation of risk management reports or with the internal control investigation reports'.

Accordingly, it can be seen that domestic factors are key to defining and encouraging robust compliance systems. While Russian financial institutions may well be able to attract more experienced compliance managers, their future success will ultimately depend on the socio-economic backdrop against which governance and compliance initiatives will be framed.

4.3.2 Informal Practices

(i) Informal International Factors

Nowadays, money launderers, terrorists and drug dealers operate in a wider global environment. The serious crisis of liquidity that many global and national financial institutions faced starting from 2000s has a direct implications on demand in illicit funds to survive in times of crisis. During the last ten

years, Madoff scam, Stanford fraud, and the collapse of Bear Stearns hedge funds exemplify suspected criminal activities associated with the recent crisis.

In light of these and many other scandals in recent years, the representative from the ICA remarked that effective compliance is necessary, indeed, vital, to allow regulated organisations to respond adequately to the changes inflicted by external and internal drivers. The advent of recent broad-brush extraterritorial legislation such as FATCA, Dodd-Frank, EMIR and the U.K. Bribery Act, might also be viewed as equally significant drivers of compliance development. As a result of complying with such regulatory initiatives, Russia may come to be considered as a developed country with an enhanced role to play on the international stage.

(ii) National Socio-cultural Factors

Russia is a collectivist culture. However, collectivism is not a monolithic value system manifesting itself in a single communication pattern. In addition, indirect and group-oriented strategies are more common in Russia than in the more individualist countries like the U.S., the U.K. or Australia. Unlike most of the Anglo-American traditions, Russian culture, including the mentality of the Russian people generally, tends to be highly collective in terms of outlook.

In addition to the above, the behaviour of individuals, organisations, and regulatory authorities in Russia is influenced by the socio-economic environment, alongside the particular traditions of Russian culture and Russian history, when the Russian people are often seen as ’obedient‘ or ’doing what they are told‘, which are different from the regulatory landscape and history of Western countries. The institutions can be viewed as the sets of rules embedded within much broader institutional frameworks of a country.

The respondent from ICA said 'only where a clear and robust compliance implementation message is received from senior management can the process of transition to a highly compliant culture expect to be swiftly and efficiently achieved'. She continued that 'in some cultures, compliance is viewed as a tool of the state. In other cultures, compliance is something to be undermined, depending on attitudes toward respect for rules. In Russia, for example, written regulations do not incorporate mandatory rules or indicate guidelines in relation to timely enforcement'. In this respect, there are numerous corruption cases relating to non-enforcement of strict formal rules in collectivist countries like Russia and China. In the U.S., the concept of compliance is treated as a long-established, vital requirement that is technologically processed and efficiently managed and controlled. In Australia, compliance is treated as a legal requirement which is clearly written and which everybody has to follow, thus ensuring that all regulated entities have an efficient system of monitoring and control. Compliance in Russia is treated quite differently.

On the whole, Russian culture views compliance as an artificial, modern and Western-oriented notion. Russian society is inherently more collectivist than individualist and, ultimately, unless a compliance initiative is cascaded from the most senior echelons of an organisation or institution, the notion of adherence to compliance is unlikely to be taken seriously. According to Hofstede's 6-D Model (1980), family, friends and neighbors are extremely important in getting on with the challenges everyday life in Russia. Relationships are crucial in gathering information, introductions or successful negotiations, and they need to be personal, authentic and built on trust.

(iii) Institutional Level

Compliance practitioners contribute to the production and interpretation of financial services regulation, and are sensitive to the differences between what might be described as a universally accepted discourse, and the local or internal variations thereof.

Two respondents from Foreign Banks 1 and 2 expressed their views by saying 'the key drivers of compliance development are public scandals and cases of misconduct, which result in a regulatory reaction and, frequently, the imposition of new, tighter, stricter requirements. This in turn requires a review of internal compliance processes by the regulated companies who must ensure their compliance with the new requirements. In addition, international cooperation and some standardisation had led to regulatory development, some of which will also have an impact in Russia, specifically in areas such as AML/CFT and anti-bribery regulation'. These two respondents tended to agree that the effect of major multinationals in the Russian and CIS domestic markets has been uniformly positive. Such large-scale integrated corporate groups have extensive experience working in a variety of emerging markets and in highly contrasting cross-border contexts. Their top-down approach to relatively undeveloped emerging markets essentially involves the inadvertent imposition of globally recognised best practices on the

target region. There are, of course, instances of deviation from such high standards, but they are almost always identified and corrected within the context of group-wide compliance with promulgated compliance standards. With the arrival of the ICA in Russia in 2010, there are now more than 350 educated compliance professionals working in Russia and the CIS countries. These organisations facilitate open discussions, compliance forums and other networking events, allowing members to share ideas and best practice on compliance issues in the region.

A respondent from the State Bank 4 remarked'… entire system of beliefs, values and behaviours applied internally within the organisation constitute a unique organisational culture of the organisation and its external profile. We can see a huge difference between various financial institutions in relation to its attitude to compliance and even beyond compliance initiative'.

There was a comment from a respondent from ICA said '..although compliance management systems are virtually unknown among the majority of Russian regulators, one of the biggest Russian bank Sberbank was eager to validate its compliance programmes against an internationally recognized standards ISO 19600 (Compliance Risks Management). The validation was taken almost two years and was successfully certified in December 2016'.

All respondents interviewed basically agreed that in order to facilitate the widespread standardisation of compliance activities, there is a need for increased interaction across internal departments within an organisation and further development of a locally focused interpretation to promote a culture of compliance, as it is currently understood in North America and Western Europe. Until such an understanding has gelled sufficiently with the local Russian and CIS markets, any initiatives aimed at standardising the compliance function would likely reflect an unsuccessful cut and paste exercise by imposing irrelevant Western standards and practices in the context of a highly nuanced emerging market. In this respect, the key focus at present is not legislation, but the development of local understanding in the application of global compliance standards and practices.

Conclusions

An analysis of the evidences provided by seven financial institutions, Russian and international regulator and international organisations presented in this part demonstrates considerable support for the practice of compliance as a constantly developing, yet 'unfixed cultural phenomenon' (Bell, 2012). Representatives from the Russian financial institutions currently find themselves in unchartered territory as they struggle to design their own compliance strategies and implement compliance frameworks based on a subjective interpretation and somewhat limited experience of the regulatory authorities' expectations. The CBR, in its role as Russian mega-regulator, also has limited experience of regulating Russian banks in line with various international agreements and policies (not only ML/FT related) and must contemplate its options, perhaps undertaking analysis and deliberation, as well as

considering the longer-lasting consequences of its actions. The CBR is also uncertain about what the future holds and, therefore, the regulated firms are unclear on what is expected of them. In this respect, they often adopt ad hoc approaches to compliance.

Compliance can be viewed as a structure and agency framework with many interconnected layers. The international layer includes international organisations and governments, while the national layer comprises the political and economic conditions for compliance. Globalisation also has a pronounced impact on the direction of national and international layers of compliance.

It should be mentioned that there are invariably gaps in the information provided by respondents to a researcher in relation to the questions asked. While there is no deliberate deception on the part of respondents, they might look at a particular situation through their own internal ’mirror‘ and find themselves describing a situation as how it ought to be or how they themselves would like to see it. There are also some tensions between the thinking model of a researcher and that of a managerial compliance practitioner. In an attempt to minimise or eliminate these tensions, the author's ideas should be viewed as the ideas of a reflective practitioner. The ultimate aim of the exercise is to uncover any gaps between the views expressed by the respondents and the reality of the situation.

Chapter 5 - Analysis

Introduction

The conceptual framework of this study comprises of three core elements, namely content, process, and context. This framework is purposely rather generic in order to accommodate a wide variety of ideas and arguments. As a foundation for analysis, the questions emanating from this framework are also interconnected and permit a detailed consideration of the key objectives of the research, which is the meaning and idea of compliance (the content), the strategies of the regulator and the regulated banks (the process) and the context of domestic and international influences shaping compliance in Russia.

This chapter also provides an analysis of policy implementation by illustrating in more detail the interplay between two principal actors involved in compliance initiatives, namely, the regulators in their attempts to enforce compliance by businesses, and the regulated in their strategies for managing compliance in the Russian banking sector. An examination of theories of regulation and self-regulation, as well as policies used by the Russian financial regulator will further clarify this analytical framework. This will be followed by a comparative discussion of the context in which compliance is undertaken in Russia, as well as its influence on Russian regulation and on the development of compliance. In this analysis, the practical context of compliance is analysed, without reference to categories of established theory and technique, as the aim of this research is not to construct a new theory but to add to the existing body of theoretical compliance knowledge.

5.1. The Meaning of Compliance in the Financial Regulatory Environment

Introduction

One of the central element of this chapter is an examination of the meaning of compliance that constantly evolves and can be viewed from different perspectives. These include legal, regulatory frameworks as well as socio-cultural influences. It was also confirmed during the study that the meaning of compliance has steadily evolved within the last 10-15 years. As a dynamic concept, compliance can also be analysed through the notion of change. The two theories relevant to describing changes affecting compliance are dialectical change and gradual institutional change. What can be taken from the above discussion is that a framework for examining compliance and in particular AML/CFT regulation provides a clear example of gradual change theory, outlined earlier in sub-section 2.2.2. of the chapter 2. Thus, as previously outlined in chapters 2 and 4, the notion of compliance is subject to gradual change. In the contemporary literature, such as Strasser and Randal (1981), Luhmann (1984) there is a tendency to describe changes as periods of stability followed by major changes, known as

stages and revolutions, whereby ways of doing certain things became established as regular practice, followed by major changes in policy and practice. In the context of this study, changes were analysed as constantly going on at the lower or micro level. In this thesis the focus in made on these small changes, which are not revolutionary, but constantly evolving. Gradual change theory stems from the idea that we fail to acknowledge small institutional evolutionary changes, in regulation. Therefore, my thesis expands this focus on gradual policy and regulatory change, to include attendant compliance policies and strategies of firms. Further, international and domestic initiatives and movements have a considerable impact on the ways in which compliance evolves and develops.

5.1.1. Understandings of compliance

The definition of compliance typically describes a company-wide framework of procedures and controls as a vital aspect of business culture. The most representative and widely accepted definition of compliance is that of the Basel Committee on Banking Supervision (2005), as previously mentioned in chapter 4. The majority of respondents agree that the understanding of compliance by Russian compliance practitioners is as prescribed by published guidelines (section 1 of chapter 4), and there appears to be no underlying moral sentiment among compliance practitioners about how in practice they regard this idea, unless for example it is formally written that something is good, or permitted, while some other activity is bad, namely, forbidden. The explanation of this perception can be understood in terms of the socio-cultural roots enforced by 'Soviet' regimes on individual behaviour and practices, a system of command and control and discouragement of individual initiative where that might involve questioning the status quo. In this way, it is not uncommon for workers to appear to be waiting for a senior person to provide guidance or permission before action takes place.

Interpretive flexibility

As outlined in chapter 4 (section 4.2), Russia has an established history of hierarchical control going back hundreds of years. In attempting to make an analytical comparison, the closest approximation of a robust system of internal control, where national laws and regulations were applied by a cadre of dedicated procedure-wielding ideologues, is, ironically, that of the Communist Party's role within the Soviet state structure. The party, as a distinct organisation working within the Soviet state structure in all areas, acted as a sort of internal system for enforcing compliance with applicable legal and regulatory standards and requirements. It is not coincidental that the Soviet banking system's quasi-compliance legacy function (similar to some extent to compliance) is that of internal control. The whole history of tsarism and, later, communism can be seen as mechanisms and systems imposing top-down conformity and fairness. All authority relationships provide many elements of obedience. Further to chapter 4 (section 1) Russian people are often seen as 'obedient' or 'doing what they are told'. One

reason for this is that Russia as a whole is considered to be a rules-driven country with a collectivist nature or mentality (section 3, chapter 2).

In contrast to the above point, the overseas compliance practitioners interviewed for this study commonly referred to 'best practice', 'ethical standards' and 'basic business principles', while not always formally written, as intangible requirements in Western regulatory environments, which have a much longer history of compliance than in Russia. As such, compliance for Western compliance practitioners is not just about following the letter of the law, it is also about following the spirit of the law. In the author's view one explanation is that traditionally in the U.S., the U.K. and other Western European countries, compliance has been understood in terms of conformity or obedience to regulations and legislation for many centuries, whereas in contrast the Russian experience of compliance with financial regulation is relatively recent, as even 5 years ago compliance was considered as a purely Western phenomenon. Although, there has been some recent expansion in how Russian managers see compliance, in the view of the majority of respondents within the Russian regulatory context compliance means the formal implementation of internal policies and procedures designed to make sure full adherence to laws, regulations, requirements and expectations.

Based on the discussion set out in the previous chapters, it is worth mentioning that the background of banks and bankers greatly influences ambiguities in the 'text' arising from their context. As was mentioned earlier, the linguistic interpretation of meaning provides a great opportunity for different types of banks to interpret the meaning of compliance in their own way and thus, to construct processes relevant to their context. The compliance phenomena in reality cannot be considered as wholly determined and is understood differently by different stakeholders in different jurisdictions and in different situations.

The meaning of compliance is also varied depending on the attitudes of people working in domestic banks, where local language is used and in foreign banks where the main internal language is English. It is important to add to the section 2.1.1. of the Literature Review chapter that further to Fairclough (1995a) 'text and context is being mediated by discourse', as analysis of text includes 'interdiscursive analysis of how genres, discourses and styles are articulated together and includes linguistic and semiotic analysis' (p.5). For example, differing understanding of the meaning of compliance by global and local actors in the big international banks became apparent when applying English language as the global language and the local language as the local regulator's language. As was mentioned in the Findings chapter, irrespective of how well English compliance requirements are understood and defined, the local written policies in the local language will prevail. Moreover, in case of the deviation of the local policy from the global policy requirements, the level of criticality based on the

internal audits methodology will be considered as high, but in the case of local policy/process deviation from the local requirements, the level of criticality will be considered as significant.

The meaning of compliance also varies depending on the complexity of the bank and its institutional and market context. Taken some global banks, which provide with a complex and not always comprehensive structure, their meaning of, for example, UBO would be significantly more complex than meaning of UBO in the local Russian Bank. The rationale behind this is that global banks have to make sure that they apply global standards covering the full range of (i) any potential deviations; (ii) any potential mis-interpretations; (iii) history of audits in various countries; (iv) expectations of various regulators, and (v) concrete goals and strategies pursued by the Headquarter contrast to the local Bank, which is less ambitious in pursuing local strategies and managing the expectation of one local regulator. As a result, taking into account various contexts, the meaning of compliance and the relevant compliance processes in each bank are significantly varied.

Evolution of compliance's efficacy

Compliance can also be considered as a variable concept whereby its definition and parameters are in a constant state of flux. In approaching compliance regulation, institutions stabilise expectations by providing information about the probable behaviour of others.

Some senior Russian bank executives believe that compliance in Russia primarily involves adherence to particular federal laws and fulfillment of obligatory formal requirements, in particular anti-money laundering and terrorism financing, insider trading and market manipulation. It is suggested by the author that one reason for such beliefs is that it is only violation of these specific laws that can result in certain criminal and civil penalties being enforced and a potential banking license revocation. Moreover, information on breach of AML laws is typically announced publicly on the next working day after receipt of the warning letter on the CBR's official site. This means that for example any fraudulent actions that are not related to money laundering and terrorism financing would rarely be successfully enforced in the court's. All other legal requirements and even federal laws are considered to be beyond the scope of compliance, as violations are not penalised as heavily within the regulatory framework. Further to the analysis of opinions received and having a knowledge of the Russian financial markets it can be considered that Russian banking practitioners are mainly on the rules that permit or forbid certain actions, but not on moral principles.

Looking at AML perspectives it is worth mentioning that further to the U.S. KYC Map Rules generalised by Renner (2014) it was concluded that 'while the Russian Federation has made steady progress overall in its AML/CFT implementation, some important issues remain'. Further harmonisation

of understanding the concept of beneficiary ownership is well expected, as well as demolishment of discrepancies between standards of international and local domestic banks.

Overall, it can be seen from the semi-structured interviews and content analysis made that the banks that tend to use specific key words in their discussions of AML/CFT issues are considered more likely to be practicing an integrated approach to identifying, assessing and monitoring their compliance-risk exposure (see Findings chapter). It is worth noting that there are certain areas of development required, such as broad range of sanctions screening, system's checking more fields of transactions, transliterations, and others'. Further enhancement of compliance training and competence regime, as well as certification processes will be quire beneficial for the Russian banking sector.

5.1.2. Ambiguities

In the process of examining the meaning of compliance, it becomes apparent that although compliance is a defined concept, it is imbued with ambiguities and anomalies, as highlighted in the preceding chapters 2 and 4.

There are three main ambiguities to be highlighted here:

(i) Very formal local legislation with lack of compliance understanding, transparency and accountability

This ambiguity is based on the findings and literature review outcomes. Firstly, there is an existing ambiguity in understanding what compliance is and what it is intended to achieve with no clear concept provided from the regulator. As different Russian regulators understand the meaning of compliance in different ways, the regulated institutions lack the possibility of properly managing regulatory expectations. There is no unified standard underlying a comprehensive understanding of compliance, which is often decided in the informal meetings between non-governmental organisations and representatives of the key Russian regulators. In addressing this, ISO 19600 was rolled out in December 2014 and is expected to serve as an international standard and a global benchmark for compliance management programmes. Corporate compliance is one of management's highest-risk concerns. Implementation of a robust compliance and ethics programme based on company values and appropriate risk-based compliance has helped companies maintain integrity and avoid or minimise noncompliance issues. It is not surprising that advanced organisations are globally seeking to validate their compliance programmes against a recognised standard, although compliance management systems are virtually unknown among the majority of Russian regulators.

Moreover, there is little understanding, even between compliance professionals and representatives of the key Russian regulators, of the differences in translation between compliance requirements and compliance commitments and accountabilities, or between compliance and conformity, for example compliance with environmental requirements is treated in Russia as conformity to a particular provision of such requirements. Another example can be seen with reference to the Compliance Conference held in Moscow in March 2013. As mentioned previously, Christine Marshall from the SEC publicly announced that there are no grey areas in compliance and that the SEC is free to investigate any violation made on the U.S. securities market. Contrary to this, the approach proposed by the subsequent speaker at the conference, a representative of Russian legal firm, Pepeliyev and Partners, highlighted the firm's role in terms of assisting their clients in avoiding tax, as well as avoiding sanctions for any wrongdoings in the past by using gaps in legislation and weak execution systems. The ambiguity here lies in the fact that compliance professionals have very different opinions about the core values and spirit of compliance. In addition, as different regulators treat compliance differently (for example US regulators vs. German regulators vs. Russian regulators), they require regulated firms operating under their mandate to adopt different approaches in fulfilling their compliance requirements.

(ii) Keeping a right balance between two different mind-sets

Compliance has currently two conflicting roles, as it provides guidance to businesses on the one hand and conducts relevant monitoring, reviewing activities and control procedures on the other. This requires a careful balance between two fundamentally different mind-sets and techniques required from compliance officers by being a proactive 'trusted advisor' and the more reactive 'independent watchdog', where a controlling function is carried out. The compliance function also has a key role in conducting the necessary monitoring and oversight to ensure senior management, Board of directors and company's stakeholders of the sound operations of the business. As such, there is a need to distinguish between general compliance, compliance monitoring and compliance oversight activities. In addition, as an observation of a reflective practitioner in compliance for more than 10 years, there is always a choice to be made between following the spirits of the law and the letter of the law.

(iii) Interpretive ambiguity of the rules and regulatory expectations

As was mentioned in chapter 4 (section 1) foreign companies often struggle to pay taxes at the correct amount or on time due to the numerous rigid, ambiguous requirements and obstacles imposed by the Ministry of Taxes and Levies, which offers no transparent recommendations or guidance. The interpretive flexibility of tax law means that it can be used not only for tax mitigation, but also for tax avoidance. The Russian courts recognise the fact that no taxpayer is obliged to arrange his or her affairs

so as to maximise the tax the government receives. In this respect, individuals and business are entitled to take all lawful and ethical steps to minimise their taxes, which overwhelmingly means using the tax laws to minimise their tax liabilities.

Another example of interpretive flexibility can be seen in the different approaches used by financial institutions while conducting due diligence, which is based on the current legal requirement for Russian AML/CFT. As part of due diligence Russian compliance departments formally have to identify during the regular review all information on clients, including other financial institutions registered in Russia by undertaking enhanced due diligence over them with no exemption. However, the European compliance departments do not conduct this, as there are no such requirements established by the EU Directives. Alternatively, KYC Registry, which is considered to be a useful tool for KYC due diligence in Europe, is not considered a legitimate source for KYC purposes by the Russian regulator. These conflicting requirements produce ambiguities in practical implementation of due diligence processes.

To continue with an example of interpretive ambiguity, it shall be considered preferable that all laws are interpreted by local authorities and then by the organisations in a coherent fashion. The Foreign Affairs of Tax Compliance Act (FATCA), therefore, needs to be appropriately interpreted by local authorities in a way, and in alignment with local requirements, which will be simultaneously understood by the global community. However, FATCA law is viewed differently depending on whether its requirements are considered at the global level, at the U.S. level where the laws were originally incorporated, or at the level of particular countries. As an example of ambiguity, in Russia, FATCA is considered as a political act requiring investment in domestic infrastructure, additional compliance resources, expensive software, staff training and other costs, all for the benefit of U.S. taxpayers.

In the author's opinion there are a number of significant ambiguities. Firstly, compliance is inherently complicated by the fact that the rules can never be precise enough to cover the complexities of every possible real-world situation. These changes can involve rules creation or they may simply entail creative extensions of existing rules to address new realities. Compliance with AML/CFT is a very complex, imprecise task, where interpretation plays a significant role. Secondly, the cognitive limits of actors themselves must be considered. Even when new rules have been created, actors could be faced with information-processing limitations and find themselves unable to anticipate every possible future situation emerging from the subsequent implementation of rules written today. Thirdly, implementation by institutions is always embedded in assumptions that are often only implicit. In the absence of a shared understanding of the rules, institutions can undermine the rules by exploiting their letter while violating their spirit. Moreover, such shared understanding may exist between different designers and may shift over time. In addition, there is a different understanding of the regulatory requirements in the banks themselves. For example, audit departments are often disconnected with the meaning and

expected compliance processes with the bank and apply formal, letter based approach. There are many cases in Russia, such as reporting requirements in Russian AML/CFT mandatory controls, when formally exploiting provisions of certain CBR instructions leads to common practices that undermine the spirit of the rules. Finally, the fact that the rules are not just designed, but also have to be applied and enforced, often by actors unrelated to their creation, opens up space for change to occur in a rule's implementation. Transformation of the rules mainly depends on decisions made by the regulator on how and when the rules are to be implemented, which creates possibilities for slippage or expansive interpretations.

This is clearly evidenced by the one-sided approach of the Russian regulator in dealing with regulated firms. This in turn has been used to hide the regulator's own uncertainty about regulation and its implementation. Overall, the ambiguity of Russian law has often resulted in misinterpretation of legal provisions and court practice, which can lead to changes of the law, as seen in the example regarding the cancellation of fees and a moratorium for the early repayment of loans. The introduction of clear laws and regulations could potentially limit the scope for such ambiguity.

It shall be concluded that there is often a great deal of 'play' in the interpreted meaning of particular rules, or in the way the rules are practically implemented (chapter 4, section 1). Knight (1992) acknowledges the ambiguity of rules as a site of conflict, but assumes that such ambiguity will decline over time or be resolved through the formalisation of rules. Therefore, all the above mentioned ambiguities generate a different understanding of the compliance phenomenon, its meaning and its role, as well as different strategies applied by the regulated and regulator.

5.1.3. Anomalies

As outlined in chapter 4, various international financial institutions (global banks) with a legal presence in Russia have to deal with anomalies connected to disclosure regulation in Russia applied in their own ways. There is an existing anomaly between disclosure requirements on Russian banking secrecy laws and actual practices of foreign banks, each must decide the extent of their risk appetite. Often it can be referred to as a 'messy accommodation' between the main bank and its subsidiaries in Russia in regards to different and sometimes conflicting legal requirements e.g. sanctions restrictions over certain territorial areas, types of transactions, treatment of beneficiaries. Therefore, there is an absence of clarity regarding the strategy of the CBR and the risks that have to be taken by foreign banks operating in Russia through their subsidiaries. According to a CBR representative, the level of awareness of the current residual risks is overwhelmingly unclear to representatives of the CBR. Therefore, it is feasible to conclude that there is a difference in understanding and interests between the CBR and the regulated firms, when each bank has its own strategies, systems, processes and peculiarities.

For mitigating such risks, it is often preferable to request the approval of internal collective bodies, such as the board, executive committees or senior management, in order to shift or share the responsibility for noncompliance. Other foreign banks also take these risks providing minimal disclosure, but they maintain a strict and robust system of compliance controls for continuing to monitor and evaluate minimal disclosure. Based on the views of respondents, specified earlier in chapter 4, it can be concluded that the most succinct anomaly for foreign businesses in Russia is insufficient guidelines and recommendations provided by the regulator to the regulated firms. That means that regulated firms are invariably forced to guess the regulator's expectations of them despite the fact that regulation and legislation might be viewed as very formal and strict.

Moreover, by implying restrictions on money laundering disclosures (chapter 4, section 1), the regulator makes the business dealings of foreign banks more difficult as there are differences in regimes for dealing with money laundering in Europe and in Russia. This anomaly may lead to misinterpretation and subsequent misuse of the legal requirements by the companies, as foreign banks are formally restricted from disclosing any information on clients to the mother/sister banks, except for group audit purposes. In addition, the system of enforcement in Russia is very bureaucratic and the courts frequently seem unable to make any fair and timely decisions. Even if the court's final decision seems reasonable, the most challenging issues often start with the enforcement system, specifically implementing the court's decision or ensuring reimbursement or compensation is settled. It might also be argued that the concept of reasonability does not appear to apply to the financial environment. For instance, there is an unwritten understanding among foreign financial institutions that Russian clients, irrespective of their location, constitute a higher risk. This can also be said in cases where a foreign company operates through its Russian subsidiary. In Russia, foreign companies will be uniformly treated as high risk due to internal bank rules and procedures.

5.1.4. Competing Interests

Compliance explores the clash in purpose between the state and business. The primary purpose of the state is to protect society through the implementation of rules and regulations, namely, public policies. The primary purpose of business is to make money and to be profitable. As an example, in an attempt to balance the interests of the business and the state, the Moscow International Business Centre (IBC) was created. Currently, IBC is an ongoing project, and reflects the consolidation of efforts by businesses, government and Russian society more widely. However, the desire of one group of interests, specifically the professional financial market players, to improve the business climate and make Russia more viable on the global market, has the potential to clash with the interests of other groups. In addition, the projected cost of making the Moscow IBC a reality continues to be blighted by controversy and disagreement.

The idea that compliance practitioners construct the compliance framework can be difficult to communicate, especially to those who claim to be realists dealing only in current 'reality,' which can cause problems in attempting to envisage the bigger picture up to 10 years ahead. Compliance can, therefore, be viewed as a largely pliable construction offering more than one negotiated outcome. Some cases warrant a formal and heavy-handed approach to enforcement, while in others, most notably where considerable gains are possible, risks will continue to be taken, warnings ignored and potential consequences deemed irrelevant. It can be seen that understanding the notion of absolute compliance in practical terms is fraught with difficulty. It may, however, be possible, to talk about a 'degree of compliance.'

5.1.5. Regulatory Uncertainty

The regulator's functions are two-fold: to protect investors from fraud and grossly incompetent management, and also to protect the banking system from the effects of individual bank failures (Sir Peter Middleton, former chairman of Barclays, (Middleton, 1990). From the semi-structured interviews and participant's observations I cannot agree that the prevailing model of compliance assurance in Russia can be described as 'check and punish regardless of effectiveness and efficiency' (OECD, 2006). This means that the Russian government identifies full obedience with regulatory requirements as the overarching goal of compliance assurance. Observance of AML/CFT requirements by regulated firms is at the core of the OECD inspectorate's mission worldwide. In Russia, however, it can be concluded that focus on compliance with rules only might be counterproductive because of existing flaws in regulatory design and a declared, but selectively applied 'zero tolerance' approach, which substantially weakens the regulator's position.

In the author's opinion, the differences in zero-tolerance approaches cause great difficulties, especially for foreign and global banks wishing to operate in Russia. For example, some foreign banks have a global AML/CFT policy that has yet to be fully implemented in Russia. The local requirements outlined by the CBR can often diverge significantly from the group's global requirements, which can make compliance with all relevant regulations highly challenging and gives additional complexities and uncertainties in modus operandi of international banks. Although the CBR has improved access to laws, by-laws and online registration, other forms of compliance promotion and monitoring are not used systemically. In this respect, clear legal provisions on the parameters and frequency of monitoring of AML/CFT compliance within banks do not exist. While permitted, obligatory reporting on operations over the 600.000 rubles (app.10.000 USD) threshold remains administratively cumbersome, and this has received scant attention as a result of the one-size-fits-all approach to regulation.

A further detailed illustration of regulatory uncertainty and anomalies expressed as a result of interpretive flexibility is demonstrated by the severe AML deficiencies demonstrated by the U.S. subsidiary of HSBC outlined in chapter 4.

5.2. Compliance Strategies

Introduction

Of interest here is the need to better understand the regulated environment in relation to the interactions between the regulator and the regulator. In particular, how banks operating in Russia engage with this evolving regulatory environment, especially how they meet the challenge of money laundering regulation in the context of increasingly complex and sophisticated extraterritorial requirements.

The strategies adopted by the regulator and regulated firms are reflected in regulatory processes, in particular in policy development, through which these processes can be identified as three stages, (i) agenda-setting, (ii) formulation and (iii) implementation, which are crucial to understanding policy cycles (Howlett and Ramesh, 2003). As useful as the framework may be for understanding the key elements of policy-making, this view assumes that policy formation and execution is a linear top-down process. In such a process, the policy maker will establish a regulatory organisation to provide unambiguous guidance and instruction to the regulated firms, who in turn will create appropriate departments and procedures and train staff to ensure the firm's compliance with regulations. This model is more appropriate for explaining the process of introducing and implementing new policy into hitherto unregulated fields.

As was mentioned earlier in chapter 2, compliance and regulation are two closely interconnected and interrelation notions, thus it is almost impossible to apply one without affecting the other. Regulatory practices of both actors shall be initially considered through the applicability of theories that are used in understanding strategies of actors towards compliance. Accordingly, this section analyses the regulated environment, which is influenced by the combined effects of both the regulator and the regulated firms, and where the regulatory environment is in constant flux.

In line with Peter's (2000) view on problems and prospects of institutional theory, Selznick (1957) argued that institutionalization involves 'infusing a structure with value', so further to Verheijen (1999) 'in the case of emerging civil services it would be argued that the structures must be animated by the appropriate values, not just have formal structures than could be recognized as being like those in long-standing democracies' (p. 6).

5.2.1. The Regulator's Strategies

The regulator's strategies can be considered into two principal methods of governance:

- By the command and control method;
- By the management method.

Enforcement of policy implementation is an example of the command and control method of governance that still prevails in Russian regulatory practice. AML/CFT directives are typically implemented through enforcement mechanisms, such as disqualification of the money laundering reporting officer, administrative fines, and imprisonment.

The management method of policy implementation is a more interactive approach to policy implementation and provides some instruments which might be referred to as the 'carrot and the stick approach', by which regulated firms might be rewarded for good behaviour or granted authority to do something, or alternatively receive punishment for bad practices or the absence of required systems and controls. The CBR is attempting to use this approach, although overwhelmingly appears to favour using 'sticks' than 'carrots' at this early juncture, as evidenced by the daily publication of violations and violators on its website. Further to the variety of distinctive intervention strategies outlined in the Appendix 2, the overall regulatory environment in Russia can be fallen under the deterrence strategy. As it has sanctioning style, which tends to be laws-based and rigid in its methods. Moreover, it is oriented toward punishing violators for breaking legal rules and procedures.

It is worth mentioning that currently both methods remain underdeveloped, unclear and quite controversial in the Russian regulatory environment and the state continues to strengthen its control over regulated firms operating in the financial markets. In this respect, neither regulated entities nor regulators themselves have very much scope for maneuver.

The suggestion by some commentators that enforcement and management strategies compete against one another in a quest to achieve compliance has been challenged. According to Tallberg (2002), the combination of compliance mechanisms in the 'management-enforcement ladder' highlights that enforcement and management are most effective when combined.

(i) The Theoretical Aspects of compliance strategies

Every commercial environment is regulated to some degree. It is observable that the regulatory process is achieved through various forums. A relationship between the regulator and the regulated can be considered as a dialectical relationship, whereby the regulator establishes certain conditions and

banks respond to regulatory changes. It should be noted that dialectical theory does not highlight the gradual nature of changes.

The four modes of incremental change introduced in chapter 2 and discussed in subsequent chapters, are overlapping but discrete features and can be used to examine strategies adopted by both regulator and regulated toward money laundering compliance (Mahoney and Thelen (2010)). Although little background was provided on the origins of these features, they may have some value in considering the compliance framework in the table below through the four gradual change metaphors already introduced.

Below is Table 9, which is based on provided earlier in chapter 4 that adopts Rocco and Thurston's (2010) categorisation of models of gradual institutional change. This table illustrates the level of involvement of various regulators, such as Russian in the Soviet time and in the current time and Foreign Regulators, in relation to the compliance regulation. The drifting model is relevant for the Soviet economy and the Soviet Gosbank with the focus on the strategic and structural drifting mode. In contrast the layering model is more applied by the current Russian CBR with high involvement in strategic, structural and tactical approaches. The conversion and displacement models both allow for similar measurement in regards to the strategic, structural and tactical modes for all specified categories of the regulators, with the exception of the displacement model in strategic approach for the foreign regulators where the level of their involvement is low, not medium as in the conversion. Overall it can be seen that the Russian CBR is more active and provides higher involvement in three models (layering, conversing and displacement).

During the analysis, the initiation model was overlooked. This model can be considered as the fifth element of gradual institutional change and provides a quite interesting point for analysis, as it gives a new element for creation of completely new requirements, law, phenomena. Consequently, the CBR strategic initiatives approved by the President for a framework regulating Initial Coin Offerings (ICO) and crypto-currency mining operations, approved blockchain draft legislation, new requirements on electronic digital signature for KYC purposes and creation of a special department for methodological support and control over cybersecurity issues. It can be considered that the Russian authorities become more and more strategically involved in the initiation model, although structural and tactical models still remains at medium level for the CBR. Therefore, the CBR must draft regulations that bring ICOs in line with existing laws governing securities. With regard to the foreign regulators the level of involvement in Initiation models remains medium as per strategic, structural and tactical approaches. Power brokers exercise power and decision making abilities. They play an important role in tuning the regulator's approach and level of involvement. Their current role in maintaining the drifting mode is inactive and CBR actively pursues other regulatory approaches in the layering and initiative models.

Table 9. Combination of regulators approach vs. particular features of environment.

A. Regulators Approach	Drifting	Layering	Conversion (Harmonization)	Displacement	Initiation
1. Strategic	High for planned Soviet economy and state Gosbank in 1970-1991;	High for the current CBR	Medium for current CBR;	Medium for current CBR;	High for current CBR;
	Medium for foreign banks in 1970-1990s;	Medium for current foreign regulators;	Medium for current foreign regulators	Low for current foreign regulators	Medium for current foreign regulators;
	Low for current CBR	Low for Soviet Gosbank	Low for Soviet Gosbank	Low for Soviet Gosbank in 1970s-1991	Low for Soviet Gosbank in 1970s-1991
2. Structural	High for planned Soviet economy and state Gosbank in 1970-1991;	High for the current CBR	Medium for current CBR;	Medium for current CBR;	Medium for current CBR;
	Medium for foreign banks in 1970-1990s;	Medium for current foreign regulators;	Medium for current foreign regulators	Medium for current foreign regulators	Medium for current foreign regulators
	Low for current CBR	Low for Soviet Gosbank	Low for Soviet Gosbank	Low for Soviet Gosbank in 1970s-1991	Low for Soviet Gosbank in 1970s-1991
3. Tactical	High for planned Soviet economy and state Gosbank in 1970-1991;	High for current CBR;	Medium for current CBR;	Medium for current CBR;	Medium for current CBR;
	Medium for foreign banks in 1970-1990s;	Medium for current foreign regulators;	Medium for current foreign regulators;	Medium for current foreign regulators;	Medium for current foreign regulators;
	Low for current CBR	Low for Soviet Gosbank	Low for Soviet Gosbank	Low for Soviet Gosbank in 1970s-1991	Low for Soviet Gosbank in 1970s-1991
4. B.Power Brokers	High for planned Soviet economy and state Gosbank in 1970-1991;	High for the current CBR	Medium for current CBR;	Medium for current CBR;	High for current CBR;
	Medium for foreign banks in 1970-1990s;	Medium for current foreign regulators;	Medium for current foreign regulators;	Medium for current foreign regulators;	Medium for current foreign regulators;
	Low for current CBR	Low for Soviet Gosbank	Low for Soviet Gosbank	Low for Soviet Gosbank in 1970s-1991	Low for Soviet Gosbank in 1970s-1991

Since these metaphors are broadly framed rather than specific to each setting, they can be used in multiple contexts to help explain processes of change, including compliance with AML/CFT legislation. For example, gradual change metaphors can be used to characterise the development of both

legislatures, namely policy action and policy inaction, through the layering of multiple institutional designs over time (Schickler, 2001). They are also useful in explaining changes in the implementation of public policy regimes, such as the layering of public policy institutions that encourage the development of private markets of various industries.

However, these policy frameworks fail to take two important elements into account. Firstly, in order to better understand the regulatory environment, it is not enough to focus on the policy maker and policy-making process; policy development does not take place in a vacuum. As noted above, complex channels of communication develop between various parties, some of which influence policy direction. It is also necessary, therefore, to investigate the practice of compliance, that is, how the regulated firm engages with policy development. Secondly, these models fail to accommodate the dynamic and evolving nature of the regulated space. Even where this space is well established, such as in banking, gradual, and occasionally revolutionary change continues to unfold. Mahoney and Thelen (2010) offer a useful way of thinking about gradual change in the regulated environment as essentially one where policy is in a state of continuous implementation, with revisions and new policies adding further complexity.

The critique of the literature on gradual change offered in this research considers the response from the regulated as a part of this process. It appears that the literature on gradual changes focuses almost entirely on policy development, ignoring that compliance is not a process of straightforward one-way traffic and implementation, but is at the same time a response to the strategic or policy behaviour of the regulated entity, and so must be considered as significantly more complex. The regulator-regulatee are in a communicative relationship and it is important to note that gradual change applies to both parties in terms of their understanding and willingness to engage in new regulatory initiatives. Moreover, while implementing new regulation, banks often face practical challenges to implementation. A further critique of this approach can be seen in the fact that human beings are uniquely intentional in their behaviours.

The process of policy-making does not happen by itself, but in response to or at the same time as the regulated entities are organising their processes. Thus, the policy-making process is the most stable within the institutional framework. A wide range of actors are involved in Russian policy-making including the Russian president; the Federal Assembly or Russian parliament which is composed of two chambers, namely the State Duma and the Federal Council; the government and line ministries; and other subnational and local government actors. In addition, the Constitutional Court, the Supreme Court and the Supreme Court of Arbitration have the right to initiate laws. Other stakeholders include lawyers, researchers and practitioners, who act as experts or provide feedback on the quality of draft policies. Having this diversity of authorities and stakeholders we can conclude that their involvement plays a

positive role in balancing competing interests in policy-making, although it can potentially contribute to the fragmentation and inconsistency of the legal framework.

In the author's view, there is an evolution of policy in itself, which in turn renders implementation an equally evolving, dynamic and interrelated process. It is useful to analyse the behaviour of the regulator in the context of gradual change theory, as the regulator's behaviour also evolves. For example, it could be hardly possible to imagine 10 years ago that the Central Bank of Russia would distribute to all Russian banks in the form of Information letter N IN-014-12/49 (Central Bank of Russia, 2017). This evolution can be seen on both strategic and operational levels. Although on strategic level, the Russian Government may agree on the basic rules, but the operational models used by the regulated may incorporate or ignore certain changes due to their own interpretation of such rules. Moreover, evolution happens at all levels and it can be difficult to capture the various components succinctly. The current literature neglects the point that policy-making is an interactive, dynamic, multifaceted process involving all parties, including the target regulated entities.

Turning to the particular AML/CFT regulatory areas, further to the majority of respondents from the international banks and organisations, the international AML/CFT regulatory framework in Russia is considered as comprising soft laws with non-binding requirements. As a further consideration, legal norms can be implemented and complied with on their own merit. Compliance with the FATF AML/CFT norms is closely related to the nature and origin of these so-called soft laws, located in increasingly international financial regulation (Slaughter and Burke-White, 2007). According to Beekarry (2011) AML/CFT regulation needs to be addressed in the context of the international legal system and domestic forces (Slaughter and Burke-White, 2007).

With regards to de-risking the FATF guidelines and recommendations issued as the Statement in 2014, it was confirmed during the semi-structured interviews specified in chapter 4 that the Russian regulator is not supporting an idea of applying de-risking. One of the reason for this as financial institutions could potentially avoiding but nor managing occurred risks. What is not in line with the FATF standards is the wholesale current loss of entire countries and classes of customers, without taking account – seriously and comprehensively – of the level of money laundering and terrorist financing risks and risk mitigation measures for those countries and customers within a particular sector. Consequently this approach taken by the Russian regulator with regards to banking practices will increase ML/TF risks in the banks instead of focusing on its reduction.

Further to interviews conducted and specified in chapter 4 it can be concluded that the Russian regulator has no a conceptual understanding of its mission and is not able to provide a comprehensive strategy to the regulated firms and therefore the strategy of the latter is more akin to that of a player in

a game of charades. Ultimately, a dialogue between the regulator and the regulated is necessary in order to manage the expectations of both parties. Such efforts would be especially useful for global financial institutions operating in multiple jurisdictions.

(ii) Communication between regulators and firms

Can the regulators be blamed for AML/KYC deficiencies in Enron, WorldCom, Lehman Brothers, and the many others? Corporate scandals have brought to light the corrupt accounting practices or AML deficiencies of some of the biggest firms in the United States. Most of the blame in these instances was conveniently placed on the shoulders of the auditors and accountants responsible for overseeing the accuracy of financial statements. However, it might be argued that the delayed and politically motivated responses of the regulators to the invariably innovative and creative compliance practices within the deficient corporations actually placed the public at enormous financial risk. Can the business which chooses not to avail itself of every legal loophole offered by regulators be deemed more socially responsible?

Further to Etienne (2012), regulator and regulatee would not often communicate to each other without any expectation of how the communication is going to or should unfold. Thus, based on the results of semi-structured interviews, the reality is slightly different in the current Russian regulatory landscape. In contrast to Etienne's (2012) conception of 'a relational signaling approach', regulator–regulatee relationships may be very formal and without any signals at all, which can even lead to a deterioration of the relationship to the maximum extent. There are no precedents in the regulatory environment that such relationships can ever be rebuilt or renewed under different circumstances.

The CBR communicates behavioural expectations to the regulated firms by calling on them to choose between available options for the fulfillment of a particular task. Thus, compliance can be understood in relation to these behavioural expectations (Hutter, 1997). This one-sided approach does not include any efforts from the regulator to make sure that the regulated firms understand the regulations. One reason behind this approach is the fact that the CBR consists of almost 90 branches and is continually plagued by a shortage of personnel to supervise the activities of the banks (as of 01.01.2019 the number of CBE employees was 52,456). Most young, Western-educated graduates attracted by high salaries and the opportunity to develop and implement new banking strategies are choosing to pursue careers in private banking rather than regulation. Therefore, it is extremely difficult to educate government bureaucrats to perform judgement-laden tasks because the deeply ingrained habits formed under the old economic system are largely resistant to modification (BIS Chairman says Eastern European banking System must be re-vamped, Banking Rep., 1995). Moreover, the task before them amounts to creation rather than reformation of the banking regulatory system.

As was mentioned by the respondents in chapter 4, communication between internal auditors, regulators and external regulators is a rather weak. They are functioning in their particular ways and regime pursuing their particular different goals, that result in the facts that often an Annual Plan for internal auditors does not have any similarity and/or matching with Annual Report of the External auditors. The outcome of regulator's reviews can vary from small fines to a full revocation of the bank's license, depending on the extent of violation. CBR publicly announced in 2016 the regulator's strategy as '…to clean up the Russian financial markets and eliminate any banks suspected of engaging in money laundering activities. This requires swift evolution of the Russian regulatory landscape, as Russia's position in the international financial arena and global banking community will be determined by its commitment to improve controls, deal swiftly with violations, and ultimately bring Russia up to date'. Nevertheless, communication between a regulator and the regulated is of vital importance in enabling an analysis of these interactions in more detail. The communicator's approach allows a more involved role for the regulator in the policy-making process and provides a form of two-way limited communication between the regulator and regulated firms. This approach is now getting more focus and attention by the CBR and Russian FIU. The FCA, as well as CFTC and Financial Industry Regulatory Authority (FINRA), however, use this approach very broadly. Employees of regulated firms can send electronic queries to the responsible government department or employee and potentially receive a response the same working day. Contrarily in Russia, the CBR has been known to take years to respond to official communications from regulated firm.

The mentor's approach provides for two-way communication between the regulator and regulated firms and encourages the regulated firms to give feedback to the regulator on new regulatory initiatives. It also encourages further assessment of such initiatives and overall efforts to improve the regulatory environment. This typifies the FCA's approach to the introduction of significant regulatory changes, whereby the FCA provides the regulated banks with the opportunity to voice their comments and concerns.

Despite its new role as the financial mega-regulator, information relating to the strategies or plans of the CBR remain quite unavailable to the public. Moreover, the extent to which the regulator's strategy toward effective regulation can be qualified or measured is somewhat controversial. It is not clear who is responsible for ineffective regulations, whether compliance officers within organisations, accountants and auditors, or even regulators themselves. It might be argued that the various instances of fraud and institutional collapse that have occurred in a number of corporations and financial institutions in recent years were the direct result of inefficient and ineffective regulation.

One very important and currently evolving aspect is encouraging the regulated to go beyond compliance. These strategies of facilitating reward beyond-compliance behaviour may be grown only in

large corporate institutions that treat their reputation very sensitively. The strategy of the Russian CBR is risk based whereby the highest risks are identified and one of the ultimate goals is to deliver efficiency in regulation. Braithwaite (2011:480) proposed that 'regulators should first look at the strengths of societal actors and then look for an opportunities to explore them'. Any aspect of social license to operate that might provide reputational benefits is currently not applicable to the practice of the Russian regulators.

In summary, Russia is catching up with the gradual change of regulation more swiftly than some other developing economies. Compliance is a changing and developing phenomenon, and Russia has successfully reached a number of key milestones in its regulatory journey, including the CBR letter on unofficial translation of the Basel Committee on Banking Supervision (2005), the adoption of Basel in 2007, the publication of the CBR provision on internal control in 2012, and, the initiation of talks on ISO 19600 standards on compliance risk management in 2015. As can be seen, compliance is not a static set of rules and obligations that a country or corporation can hope to eventually achieve. Rather, the compliance universe is continually transitioning as the laws, regulations, social and political motivations, international initiatives, and so on, are constantly developing and changing.

However, the Russian economic and political situation cannot be approached from a Western analytical framework because the problems Russia faces are the product of its unique cultural and historic development (Greene, 1994). There are three major considerations. Firstly, the Russian political system staunchly resists change because the current administrative bureaucratic apparatus is widely dispersed and the representatives of only one party remain in key positions in the public and private sectors. Secondly, there remains a lack of fundamental competence in the regulation of banks, as well as in the operation of private banking. There are experienced people working in this field, but they are few and prefer to work in foreign banks and organisations. The Western regulatory regime presupposes not only regulatory competence but also strong institutions currently able to implement and enforce regulations, which is not yet the reality for Russian banking regulation. Thirdly, it is difficult to simultaneously grow and regulate a developing economy. Policy makers must grapple with the design of a regulatory framework that will limit the potential for system failure, while at the same time creating an environment conducive to the development of banking expertise.

5.2.2. Strategies of the Regulated Firms

(i) Theoretical Aspects

There are two types of institutional change to be considered, firstly internal developments of the institution itself (process of institutionalisation) and secondly change in values and/structure that characterize institutions themselves.

Huntington proposed four dimensions that allow to examine the level of institutionalization of any structure: (i) autonomy, (ii) adaptability, (iii) complexity, and (iv) coherence. Further to Peters (2000) the proposed four dimensions have been applied to several types of institutional arrangements. These dimensions also provide some understanding of the transformation that structures must make in order to survive and to influence their members and their environment (Polsby, 1968; Ragsdale and Theis, 1997).

For example, if we take autonomy, we assess to what extent the bank is capable of making and implementing its own decision and to what extent it is dependent upon its headquarters (for example a local subsidiary of global international bank). Adaptability is another important dimension which allows us to assess to what extent the bank is capable of adapting to changes in the environment, or more importantly capable of molding that environment. The third dimension enables us to assess the capacity of the bank to create internal structures to fulfil its aims and to cope with external environment. Coherence can be considered as the capacity of the institution to manage its own workload and to develop and maintain processes in a timely a reasonable manner. Conducting the whole assessment by applying these four dimensions will allow to assess the level of institutionalization of each concrete financial institution.

Below is Table 10 based on provided earlier in chapter 4 that adoptions of Rocco and Thurston's (2010) categorisation of models of gradual institutional change. This table illustrates the level of involvement of various regulators, such as Russian in the Soviet time and in the current time and foreign regulators in relation to the compliance regulation. As can be seen below in the Table 10, the Drifting model is apparent for the Soviet economy and the Soviet state banks with the focusing on the strategic and structural drifting model. This is echoed the regulators approach in the similar model applicable for regulators. The layering model is more commonly applied by the current Russian financial regulated entities with high involvement in all three strategic, structural and tactical approaches. The conversion and displacement models both provide similar measurement in regards to strategic, structural and tactical modes for all specified categories of the regulated entities, with an exception of the displacement model applicable for foreign regulators in a strategic approach where the level of their

involvement is low, not medium as in the conversion model. Overall, it can be seen that compared to foreign institutions, Russian regulated entities are more active in the following two models (layering and conversing). In regards to strategic involvement of the Russian regulated entities in the initiation model there is high involvement compared to medium involvement for foreign banks and medium involvement in the structural and tactical approach by the Russian regulated entities.

Table 10. Combination of regulated approach vs. particular features of environment

N	A. Regulated Approach	Drifting	Layering	Conversion (Harmonization)	Displacement	Initiation
1	Strategic	High for planned Soviet economy and Soviet state banks in 1970-1991;	High for the current Russian regulated entities;	High for current Russian regulated entities;	Medium for current Russian regulated entities;	High for current Russian regulated entities;
		Medium for foreign institutions in 1970-1990s;	Medium for current foreign institutions;	Medium for current foreign institutions;	Low for current foreign institutions;	Medium for current foreign institutions;
		Low for current regulated entities	Low for Soviet state banks	Low for Soviet state banks	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991
2	Structural	High for planned Soviet economy and Soviet state banks in 1970-1991;	High for the current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;
		Medium for foreign institutions in 1970-1990s;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;
		Low for current Russian regulated entities	Low for Soviet state banks	Low for Soviet state banks	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991
3	Tactical	High for planned Soviet economy and Soviet state banks in 1970-1991;	High for the current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;
		Medium for foreign institutions in 1970-1990s;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;
		Low for current Russian regulated entities	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991
4	B. Power Brokers	High for planned Soviet economy and Soviet state banks in 1970-1991;	High for the current Russian regulated entities;	Medium for current Russian regulated entities;	Medium for current Russian regulated entities;	High for current Russian regulated entities;
		Medium for foreign institutions in 1970-1990s;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;	Medium for current foreign institutions;
		Low for current Russian regulated entities	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991	Low for Soviet state banks in 1970s-1991

The Russian regulatory approach remains underdeveloped and rather isolated from recent changes in North American and European financial regulatory developments. For example, strategies, plans and key focus areas of the core governmental body formerly responsible for AML/CFT compliance,

the Federal Financial Monitoring Service, also known as FFMS or Rosfinmonitoring, were far from transparent and largely unknown to the regulated banks, as there was no practical or substantive information publicly available. A reason for this might have been the lack of fundamental competence in banking regulation as well as in the operation of private banking. Western regulatory regimes presuppose not only regulatory competence, but also strong banking institutions able to implement and enforce regulations. As previously mentioned in earlier chapters, the Russian regulator lags behind its European and North American counterparts by some considerable margin. In addition, taking into account that compliance in Russia is treated quite formally, the overall strategies of the international banks as was evidenced earlier (chapter 4 section 2) are often two sided, such as global standards and local requirements.

There is often an ambiguity in interpretation of the local laws and regulatory requirements due to the absence of further guidance and practical Q&A for the proper implementation of such laws. For example, in Russia there are no specific guidelines or recommendations issued by the CBR or other governmental authorities to regulate a number of investment banking areas vulnerable to AML/CFT risks, such as high-speed logarithmic trading and high-frequency trading. Thus, global policies and procedures applied in the international banks do fulfill such ambiguities in interpretation. It is a good regulatory practice for the foreign banks, however Russian banks are left with no methodological support. The CBR politely invites representatives of the established banks and broker-dealer institutions in Russia to participate in working sessions with the aim of explaining the peculiarities of such trades. However, existing banking legislation is incomplete and fails to regulate the banking industry sufficiently. According to information obtained by the law firm Clifford Chance, many commercial banks ignore existing legislation anyway (The Russian Banking System, supra note 34, at 5). The respondents from the foreign banks agreed that an almost impermeable communication gap remains between the Russian regulators and their Western and Asian colleagues, as well as between regulated participants in the Russian financial markets. Moreover, the law reflects the Russian attitude that law is neither uniformly applied nor internally consistent.

The analysis made by Greif and Latin (2004) provides indirect institutional outcomes, or ‘feedback effects,’ which may increase or decrease the attributes of particular situation where the institution is self-enforcing, thus ‘their solution to endogenous change is to redefine the exogenous parameters as endogenous variables’ (Greif and Latin, 2004). Viewing the institutions as the sets of rules embedded Streeck and Thelen (2005) suggested that ‘a general issue in traditional institutional analysis is that it always emphasized structural constraints and continuity.’ Furthermore, Streeck and Thelen (2005) defined institutions as ‘a ‘social regime’ consisting of set of rules that clarify accepted behaviour and define what is unacceptable’.

Turning to the AML/CFT legislation, it can be concluded that AML/CFT legislation is mostly based on international treaties and initiatives, including the principles of international organisations, such as FATF based on the Wolfsberg principles, the EAG principles, federal laws and CBR regulations. Hierarchy and networking can either work in tandem or in opposition to one another. In Russia the CBR relies on hierarchy in terms of managing domestic financial institutions and networking in its involvement with global initiatives like FATCA, EMIR, Transparency International, dealings with the World Bank, and so on. In addition, U.S. governmental departments and organisations, such as the OFAC and the SEC frequently apply extraterritorial acts, orders and guidelines, which entail compliance by all financial institutions doing business with the U.S., irrespective of their jurisdiction. On this basis, the Russian government is not the ultimate decision-maker in respect of money laundering or counterterrorism, or other such international compliance initiatives for that matter. The whole process reflects the principles of hierarchy and networking.

The 4th Anti-Money Laundering Directive (EU 2015/849) which came into force in June 2015 can be considered as hierarchy (enforcement) with substantial elements of networking (management), and is an important landmark in the gradually evolving development of AML/CFT compliance among the 28 signatory states. The effects of adopting this directive will be notable not only in Europe but beyond, as new requirements for the identification of legal and physical persons and on disclosure are introduced. A principal feature of the management element of networking can be seen in relation to Customer Due Diligence (CDD) and Enhanced Due Diligence (EDD) requirements. This enables the regulated financial institutions to establish their own risk-management procedures based on their expectation of the local regulatory requirements, as well as global standards for global financial institutions.

The FATF Report published in October 2015 on terrorist financing risks provides a clear example of the constantly evolving nature of the methods, techniques and threats and vulnerabilities used in terrorism financing. The report points out that as the size and structure of terrorist organisations have changed, financing methods are also becoming more sophisticated. In addition, the major emerging terrorist financing risks are outlined as: (i) self-funded foreign terrorist fighters (FTFs) travelling to Iraq and Syria; (ii) fundraising through social media; (iii) exploitation of natural resources; and (iv) new payment products and services. One of the major challenges in identifying FTFs is the relatively small amounts involved across many transactions and the increased use of ATMs and money value transfer services allowing funds to be accessed quickly. The report points out that online and new payment methods are particularly difficult to monitor which may lead to a substantial increase in the use of these systems in future, as these can be easily accessed globally. Identification of the actual end-user or beneficiary continues to present a major challenge to financial institutions and their regulators.

As compliance represents a risk-management discipline and, in line with majority of respondents' views outlined in the chapter 4, high-risk transactions and high-risk customers are subject to stringent customer control measures and enhanced due diligence. In practice, this means implementing robust systems and controls to identify, assess and control money-laundering risks in financial organisations. One of the most debatable aspects which gives rise to difficulties in practical implementation is the 'de-risking' issue. Some financial institutions are disinclined to take additional risks due to the additional cost of personnel for monitoring AML/CFT regulations, even to the extent that they are willing to cut off a whole industry sector or country to avoid managing the correspondent banking and money value transfer regulations (Nakao, 2015).

It is worth mentioning the inherent dilemma involved in introducing a robust system of controls to mitigate the risks of working with high-risk clients, industries and operations. There is a great deal of difficulty involved in creating strategies for risk-oriented entities, as they must be afforded a certain level of flexibility to be able to take the very risks necessary to conduct their business activities. Barclays in 2015 was forced by FCA to pay a heavy fine (GBP 72 million), arguably for treating PEP clients too flexibly. This demonstrates the need to find a balance between operating in a high-risk environment with the need for an effective compliance risk management system, as recommended by EBA, FCA and other regulators. Overall, AML laws are not intended to protect individual bank customers or indeed the bank; they safeguard the country's financial system and the nation as a whole. The regulator of nationally chartered banks plays a critical role in ensuring AML compliance. It is the regulator that is charged with ensuring that the banks are adequately safeguarded to keep risk out, rather than invite it in. To fulfil its AML obligations, the regulator needs to improve its oversight by strengthening its supervisory activities, where necessary, and apply its AML supervisory and enforcement approach to encourage closer alignment with other federal bank regulators. Therefore, regulators must firstly consider AML deficiencies as a matter of safety and soundness, not consumer protection, and ensure that ineffective AML management is taken into consideration when assigning a bank's CAMELS (Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk) score and composite ratings. The regulator should also allow its examiners to cite violations of law for individual pillar violations as well as programme-wide violations. In addition, the regulator should ensure that narrowly focused reviews are undertaken in tandem with those taking a more holistic view of a bank's AML programme.

(ii) **Communication between Regulator and Regulated**

An important aspect is the interplay between the regulator and the regulated firms. One of the fundamental theories behind this idea of interaction between the two is Hegel's laws of negotiation, or 'dialectical negation.' The negation of a thesis is a determinate negation and so results in a positive

truth. Thus, according to Hegel, we get 'Thesis-Antithesis-Synthesis.' Synthesis grasps the truth in a positive truth. In other words, any regulation first becomes negated, then returns to itself in a richer, differentiated form, through 'negation of the negation' made by both the regulator and the regulated firms.

In terms of the relationship between the regulator and the regulated firms, regulators usually impose meanings on their environment, most markedly when a financial institution is pioneering the introduction of a new product or service. The regulated firm then uses feedback received from the regulator to consider its subsequent response. For any FCA regulated firm in the U.K., feedback and any comments or preliminary thoughts can be received by telephone or by email. If a Russian regulated firm is considering introducing a new product or service and wishes to clarify certain regulatory aspects, they have to follow a very formal procedure by submitting an official letter in writing and then waiting to receive an official response. At the same time, the regulatory environment develops its own expectations regarding what the new product or service should achieve, which the innovating organisation routinely tries to make sense of. The regulator may not always have a clear idea of what the financial institution is offering, or what the most appropriate strategy for delivering the new product or service ought to be. For example, to deepen understanding of algorithmic trading, the CBR provided training facilitated by senior traders of several major investment banks.

Shareholder confidence in an organisation increases where the processes and procedures of its compliance operations are considered robust. In endeavoring to fulfil their compliance responsibilities, regulated firms see a mixture of confusing signals and possible interpretations (International Compliance Association, Annual Conference, 2015), and try to make sense of the regulator's expectations, and adjust their performance accordingly. At the same time, the environment continually tries to make sense of the regulated firm's adjusted signals, taking into consideration past selections and rejections. It is an interactive and constructive process, with both the regulator and the regulated encouraging some interpretations and ignoring or discouraging others. Slowly they become increasingly committed to thinking about a particular legal requirement or narrow range of options. They may become quiet, or pursue their beliefs more vociferously, or seek clarification. The point is that the regulated firms may begin to fragment. The interactive and constructive process is further entangled because the organisation may struggle in selecting clues against the noise of competing interpretations and requests for clarification. Further, cumulative experience among customers and competitors and other stakeholders leads to differentiated expectations and variety, which in turn can instigate yet more regulation. This is known as the multi-node dialogue between 'relevant social groups' (Bkjker's 'relevant social groups' (cited in Rayman-Bacchus, 1996).

In terms of daily practice, there is a considerable amount of complexity to navigate and negotiate. Existing policies are not always effective and may require strengthening or modification. With multiple tasks and new projects or initiatives, adequate assessment is not always a realistic option. In addition, the number of controllers, auditors and external advisers involved in compliance processes can add an extra layer of challenge in terms of duplicate reporting.

In the authors' opinions the state enforcement system is not adequately developed to reflect/provide an assessment of the real risks caused by concrete violations. For example, for making two formal mistakes in obligatory reporting within a year period, which in fact does not constitute any risks caused for the creditors, stakeholders or shareholders, the Bank may be asked to revoke the banking license. In contrast, for a legal offence that constitutes seriously insulting a person in a public domain, the fine in the court can be GBP 10. Therefore, there is a system with very strict and formal rules that is undermined by a weak state enforcement system.

This thesis challenges the conception that enforcement and management strategies compete against one another in the quest to achieve compliance. According to Tallberg (2002) 'the combination of compliance mechanisms takes the form of a highly developed 'management-enforcement ladder', a twinning of cooperative and coercive measures that, step by step, improve a state's capacity and incentives for compliance' (p.609). He identified several strategies of the European governments that aim to prevent the violation of European law and mentioned that enforcement and management mechanisms are most effective when combined. An examination of regimes in the areas of trade, environment, and human rights profoundly reinforce the belief that a combination of management and enforcement approaches are more successful in securing compliance to regulatory requirements than one or the other alone.

(iii) **Inter-institutional Lines of Defence**

As previously mentioned, practical aspects of implementation within the banks' control frameworks involve three line of defence, known as the three LoD model, namely, functions that own and manage risk, functions that oversee or specialise in risk management, and functions that provide independent assurance, above all internal audit. The borders of these lines of defence are not always clear and roles and responsibilities are not always well defined. In addition, this internal control framework is unlikely to address every context that a particular organisation may confront. More details on three/four line of defence provided in the Appendix 9.

Supervisors and external auditors are important contributors to an effective control system and are endowed with the power to challenge the system itself. Better communication and closer

interaction between internal auditors, supervisors and external auditors can result in a control system capable of capturing deficiencies and weaknesses in the first and second line, by means of information that would not be available otherwise. Besides, such an interaction has the potential to foster the creation of an environment that supports the independence, objectivity and integrity of internal and external audit work. In this respect, the reliability of external auditors' performance and output could be enhanced by the supervisor ensuring that the process for external auditor appointment was fair, objective, transparent and independent of the bank's management, as well as appropriately documented.

Self-Regulatory Practices of the regulated

Motivation is fundamental to the pursuit of goals. It shall be noted that the contemporary self-regulatory theories have probably not given sufficient attention to the role played by motivation in enabling self-regulation to be successful. Self-regulation operates through a set of psychological sub-functions that must be developed and mobilised for self-directed change (Bandura, 1986). Neither intention nor desire alone has much effect where people lack the capability for exercising influence over their own motivation and behaviour (Bandura and Simon, 1977). In light of this, policy-making would be insufficient and incomplete if the regulator or the regulated firms are deficient in the capabilities of systemic self-observation and self-motivation.

Moreover, the aforementioned framework outlines responses of regulated entity to behavioural expectations required of them by regulators, which is targeting in how public regulation affects the motives of regulated firms (goal set) and alternatives (options set). Regulators are also quite closely interconnected in their dealings with one other. This can be seen in Russia's decision to join IOSCO by signing the protocol agreement in February 2015. This will enable the CBR to maintain effective interaction with IOSCO, including participation in IOSCO committees and working groups, as well as contributing to information exchanges on key issues of financial market regulation and oversight. The scope of information queries can be broad and, in practice, this means that any activities of foreign companies directly or indirectly on Russian trade platforms or exchanges can be investigated and audited by the CBR simply by requesting details from foreign regulators.

5.2.3. Transparency and accountability

It is worth noting that such notions as transparency and accountability are essential in democratic countries and form an important element of governance and overall compliance culture. In general, money laundering violations are significantly more likely to appear in an organisation with a poor commitment to transparency. Transparency supports accountability and significantly reduces the

scope for wrongdoing and non-compliant practices. These concepts have different implications in Russia. In practice, the level of transparency and accountability demonstrated by the majority of Russian banks, including state banks, is low (Chap 4, section 2). Based on interviews with compliance practitioners, it can be concluded that information about transactions involving Russian banks varies significantly on transparency due to a number of factors, such as the shareholder/beneficiary structure of the bank, its strategy, its international presence, its credit ratings, and its international business. Where transparency is lacking, this can potentially undermine the risk management and overall compliance oversight, especially in case of cross-border payments. While this analysis does not conclude that Russian banking practices diverge significantly from more established banking practices elsewhere, there is a marked difference in the way banks approach compliance. As was evidenced in chapter 4, in contrast to foreign owned banks and/or global banks, the Russian state and private banks might be described as undertaking their compliance duties by adopting a rule-based approach ticking the relevant boxes, which is opposite to the holistic, risk-assessed, analytical approach and practices established in some global banks.

There are some inconsistencies in the approach of the CBR, for example, the beneficiary owners of companies publicly traded on recognised Russian stock exchanges are exempt from being formally identified, whereas those of foreign publicly traded companies are not exempt. This is a clear example of how rules-based, yet highly inefficient, Russian approaches can be in responding to what is required by regulation. Further to chapter 4 (section 2), this is heightened by the fact that these are the very banks that have the highest AML/CFT compliance monitoring violations, which has resulted in significant penalties, fines and reputational damage to the institutions concerned.

The call for greater accountability from managers and corporations is gaining momentum, both in academic literature and public discussions more generally. The question remains, however, on whether higher levels of accountability are always desirable from an ethical perspective. Therefore, because of these limits, it is unrealistic to expect the demands for accountability to be fully and consistently met. The limited nature of accountability has certain ramifications for its practical application. The concept of accountability refers to the legal framework, which effectively refers to compliance with legal obligations, legal liability and reporting on activities. It may also include self-audit compliance tools, as well as full-scale audits. Lodge (2004) remarked that 'the widely proclaimed rise of the regulatory state has led to a renewed emphasis on debates concerning accountability and transparency. The perceived lack of limited accountability and transparency in the regulatory regime has been at the forefront of criticism by the media, the wider public, business and public interests groups' (p.124). Evidence from the interviews conducted overwhelmingly suggests that transparency and accountability in the current Russian political-economic paradigm are rather artificial and idealistic. They

are often regarded as non-vital elements, unsuited to, and unnecessary for, the Russian regulatory environment. The absence of transparency currently allows Russian banks to obscure the projected shortfall in pension funding for those expected to retire between 2025 and 2030, irrespective of the amount paid by them during their working lives. This absence of transparency and accountability allows the Russian Government to keep financing economically dubious projects including those of Gazprom, Rosneft, and other state giants.

In addition, there is no unified approach to compliance, and organisations with established compliance functions tend to receive heavier and more stringent penalties for breaches compared to organisations without dedicated compliance teams. Moreover, based on comments received during semi-structured interviews, there is little evidence to believe that the Russian regulator encourages the development of trained compliance officers through the international compliance educational organisations. As such, the integrity of international standards in AML/CFT compliance has a long way to go before being regarded as an established strategy or behaviour in state-owned banks. As was evidence in chapter 4 (section 2), the idea of transparency is very country and region-specific and cannot be applied globally, as it does not take into account sociocultural, historical, economic and other factors affecting the notion of fairness.

As was mentioned in chapter 4 section 1, tax compliance in Russia is overwhelmingly focused on punishing taxpayers, while simple tax avoidance tends to be restricted to the activities carried out by Russian state corporations improperly conducting their business through offshore jurisdictions. In this respect the Russian Ministry of Economic Development has initiated drafting legislation that bans participation of offshore companies for bidding in state tenders. It should not apply to entities resident in jurisdictions having an adequate information exchange arrangements in place. Should the Russian authorities decide to eliminate or significantly curtail the scope for businesses to channel inbound and outbound investments and do business in Russia by establishing and using international structures, something that will also amount to a de facto, if not also a de jure, denouncement of Russia's major double tax treaties, then the long-term adverse effects on the Russian economy, such as the discouragement of inward investment, may outweigh the benefits.

Throughout Russia's history, whether monarchist or constitutional, there is little evidence that supports transparency and accountability in the development of regulatory practices. Russia's recent history from the early 20th century has been marked by significant change rather than stability. In just 100 years, the country has moved through various political systems, from feudalism to communism, to a form of unstable democracy with weak democratic institutions. This has doubtlessly resulted in a chaotic array of legacy legal statutes, alongside developmental legislative and institutional governance

arrangements. Perhaps because of this historical journey, combined with deeper cultural roots, there is ample evidence to suggest that those with access to power prioritise private interest over public service.

Russia has a long way to go before state and regime are aligned. Many issues that would advance the generation of a state with the capacity and organisational integrity to deal with transformation and the provision of security and order remain unaddressed. Russia has had greater difficulty in consolidating regime and state as it has not been able to neglect the various aspects of state formation in the same way as many of its fellow post-Soviet states. Ultimately, governance and compliance development in Russia continue to be shaped by the country's unique journey and cultural influences that are distinct from those of any other nation. These factors unavoidably hinder the potential for building a state that is legitimate (constitutionally, morally), stable (politically), secure (absence of crime and violence), non-predatory (absence of abuse of power), and durable (change incremental not revolutionary), where governance is transparent, where accountability is acknowledged, and malfeasance may be addressed. All of these observations have a broader effect on the context of compliance. For example, transparency and accountability may be deemed dangerous and rather inefficient by certain stakeholders, as the most crucial political, social and economic decisions are taken by a limited number of stakeholders in a manner that lacks transparency and consequently accountability.

Conclusions

Compliance is not only fraught with ambiguities and anomalies, there are also a number of political factors and regulatory disharmonies that regulated firms have to accommodate. The regulator may provide any statements about compliance but the reality for regulated entities is more complex than anticipated and compliance officers have to deal with the various competing demands posed by institutional, systemic, local and global AML compliance requirements.

There has always been a degree of tension between public and private interests. The strategies of companies, whether regulated or otherwise, tend to be oriented toward private interests. The strategy of a regulator can effectively be summarized as impacting the various strategies of regulated entities covered by its mandate. The deterrence strategy of the Russian regulator highlighted earlier affects the vast number of formal compliance procedures and policies created by regulated firms in order to comply with the regulator's expectations. If public humiliation is threatened or applied, then the regulated firm's strategy will be aimed at fulfilling its compliance obligations in the course of its external activities, communications and minimum obligatory reporting. If the inducement method is applied then some minimum obligatory requirements will be the focus of the regulated firm's strategy. It is worth mentioning that multiple requirements in different areas, that often need to be applied

simultaneously, require an organization to have varied and dynamic strategies to meet regulatory standards and expectations.

Unfortunately, there are currently no public cases available that underline this spirit of the law. In Russia, this approach is typically developed in foreign companies or branches operating in Russia, rather than domestic firms. One explanation for this is that the relationship between the regulator and the regulated firms is framed by the rigid, hierarchical system with one-way communication where the regulated firms must speculate as to the regulator's requirements in formulating new policies. This means that regulated firms must largely rely on their own judgment in interpreting the regulator's expectations when trying to implement internal compliance rules. A high level of skill can be required in order to ensure that the firm's interpretation does not fall foul of what the regulator is ultimately hoping to achieve.

5.3. Context and Compliance Development

Introduction

This section is structured using three deconstructed central elements of compliance, namely meaning, process and context. These elements will be examined by looking at their influences and drivers in order to understand the development of compliance initiatives aimed at detecting and curbing money laundering activities.

5.3.1. Gradual Evolution of Compliance

Compliance has many variables. Opposing a single variable approach, a framework having mixed variables potentially offers the benefits of a 'multi-causal approach', enabling to thoroughly assess compliance with AML/CFT standards, although this can present challenges in a complex environment and can be susceptible to losing weight and impact (Raustiala and Slaughter, 2002). In view of the variety of theories available to examine compliance and the different variables associated with each, divergences in the value and impact of these variables across disciplines seems inevitable (Simmons, 1998). The impact of soft power shall not be undermined, as it allows to understand compliance with international AML/CFT standards much deeper, by relying on 'the intrinsically soft law qualities of its normative and institutional structure in shaping the policies and laws of many countries forced to acknowledge the threat posed by money laundering' (Beekarry, 2011).

The whole idea of compliance is an important and new concept for Russia. This concept is much wider than pure adherence to laws and regulations. According to Glanzberg (2002), current theories 'see context as composed of information that is localizable to individual utterances. Current theories grant

that discourses have important global properties that are not so localizable.' The notion of context, as it appears in everyday practice, is extraordinarily plastic. Although originally formulated in relation to linguistic theory, Glanzberg's (2002) comments can equally apply to the regulatory environment. Accordingly, this thesis proposes that compliance is best considered as operating in complex regulatory contexts under the influence of relevant sub-contexts.

5.3.2. Contextual Influences

Of pronounced importance is the reality that compliance is a constructed and negotiated concept between parties, and its strength depends entirely on the relative powers of the parties involved. Understanding the cultural context is essential to understanding the differentiated nature of regulatory compliance, specifically its influence on the values and behaviour of compliance professionals. Institutional theory offers a useful way to understand how the wider regulatory environment influences a company's approach to business.

It shall be highlighted that these social conventions whether regulative, normative or cognitive should be considered in conjunctions with other aspects that will influence the process of change in organisations. Moreover, findings and theory suggest that not all outcomes are directly related to a gradual decision making process, as many process are just results of social construction processes. As Zilber (2008) argues, institutionalisation is an ongoing process rather than an endpoint. Moreover, depending on the type of institutional change, some changes could be brought in swiftly having an impact on the regulatory elements of change, while normative and cognitive elements would be associated with a long-term perspectives. Further to Pettigrew, Woodman and Cameron (2001) 'the explanations for organisational change cannot simply be put down to relationships between independent and dependent variables. They can however be viewed as interactions between context and action'. In an earlier study, Thelen commented that 'it is not so useful to draw a sharp line of institutional stability versus change' (Thelen, 2000). The legal positivism theory can be used to examine the regulative dimension. Positive law, which, in Austin's view is the only appropriate matter of scientific jurisprudence, is the command of a sovereign (Austine, 1968). As previously mentioned in chapter 3 (section 1), legal positivism is roughly constituted by three theoretical commitments: (i) the social fact thesis, (ii) the conventionality thesis, and (iii) the separability thesis. Hart (1994) believes the criteria of legal validity are contained in a rule of recognition that establishes the framework for creating, changing, and adjudicating law, and that this rule is authoritative by virtue of a convention among officials to regard its criteria as standards that govern their behaviour. As a contemporary legal positivist, Hart views the essence of legal positivism in the separation thesis, namely that having a legal right to do something does not entail having a moral obligation to do it, and vice versa.

Legal positivism can be a useful tool for explaining the context in which compliance operates in Russian banking. The Russian legal consciousness has a tradition of legal positivism with its system of civil law that predates the transformation of Russia into a market economy, providing the background for Russia's nascent financial legislative framework. As outlined in chapter 3, if this study were conducted purely within the tradition of legal positivism, the scope of this research would be too restrictive to allow an adequate level of reflection on the meaning of compliance from different perspectives. It would, however, continue to be useful for analysing the specifically Russian nuances in relation to money laundering compliance.

The context is full of ambiguities and anomalies with constantly evolving emphases. This context is invariably a standard model of compliance, yet one of the conclusion of this study clearly demonstrates that there is no universal understanding of compliance, as it operates within a global framework that is subject to national, supra-national and regional interpretations. To appreciate the challenges for clarity and transparency facing Russia as part of the former Soviet Union, it is necessary to look back to the Soviet system of production (Berliner, 1976). This system was built on a high level of specialisation with, where only one company producing or assembling a particular good in a particular region. The political intentions behind this were to over-specialise enterprises and particular regions with the result that any potential future separation of a particular Republic would inevitably involve a significantly high cost. At one end of this extreme specialisation, the entire economy had a disproportionately large military-industrial sector. The results of such arrangements are still visible today in many 'one-factory towns' in Russia with large populations living in economically nonviable locations. This affects compliance as many such locations are today lacking developed banking structures and relevant legal frameworks for compliance.

Further to objective 1, which is the examination of the meaning of compliance, determined by various approaches to regulation. For example, conventional models of regulation, such as command and control operated under the deterrence approach to regulation (Malloy, 2003), are largely deemed to be adversarial and punitive (Ruhnka and Boersler, 1998) and, therefore, ineffective. The constitutions and legal frameworks of emerging economies will not necessarily embody those characteristics now considered crucial, and other notions of compliance outlined earlier in this chapter in relation to international institutions such as WTO, World Bank, IMF, and others. These institutions provide access to markets in the rest of the world and are dominated by developed economies including the United States and the European Union. However, clarity as to how governmental authorities operate is lacking when the state is not stable. For example, in a fledgling state that has not yet reached a certain level of maturity, decisions made and outcomes produced may be quite unpredictable due to a failure to incorporate strategic aims based on anything beyond short-term perspectives.

The development of appropriate mechanisms to enhance transparency is clearly a vital element for effective compliance prectices. On this basis, the formulation of initiatives striving to increase transparency and derive effective mechanisms to monitor and enforce its implementation are areas which regulatory bodies dedicate considerable attention to. This argument is supported by the feedback received from a Respondent of Foreign Bank 2, who observed that, in practice, the key performance indicator for compliance is a robust structure for monitoring and analysing risk assessment and decision-making processes, which is impossible without adequate levels of organisational transparency.

5.3.3. Cultural-Cognitive Dimensions

In respect of the cultural-cognitive dimensions, Russian culture and history render the development of an efficient Western-style banking system in Russia difficult. 'Russia,' wrote Witte (1905), 'in one respect represents an exception to all the countries of the world; … the people have been systemically, over two generations, brought up without a sense of property and legality.' Since that time four subsequent generations in Russia have been brought up under a government that prohibited the ownership of private property and used the law as a weapon to enforce its political will. Democratisation requires order balanced against the demands of self-interest (Dahrendorf, 1990). The Russian concept of order is rule for cooperative purposes, not consensus, as the Russian mentality is based on rules and orders, irrespective of the advantages and disadvantages for individuals and/or companies. In this regard, three prominent cultural attributes outlined by the respondents in their interviews inhibit the adoption of a Western model of behaviour: (i) dogged respect for and allegiance to theory as opposed to practice; (ii) impatience for solutions; and (iii) decision-making by a designated person rather than adherence to objective standards (Green, 1994). Most Western regulatory models are not immediately replicable in Russia in light of cultural and historical peculiarities, as previously outlined in chapters 2 and 4.

Schein (1992) defined organisational culture as 'a pattern of shared basic assumptions that the group learned as it solved its problems of external adaptation and internal integration, that has worked well enough to be considered valid and, therefore to be taught to new member as the correct way to perceive, think, and feel in relation to those problems'. In Schein's (1992) view, organisational culture focuses on the collective behaviours in an organisation, and tends to consist of four layers (taken for granted assumptions, behaviours, beliefs and values).

However, it should be mentioned that data on Russian culture was not collected, as this would make the research too vast and complex. This study accepts the findings of Hofstede (1980) as a reasonable description of Russian culture. By analyzing the national and regional levels, the following cultural dimensions proposed by Hofstede (1980) are relevant to compliance:

1. Power Distance (high vs. low);
2. Individualism vs. Collectivism;
3. Masculinity vs. Femininity;
4. Uncertainty Avoidance (high vs. low);
5. Long-Term Orientation vs. Short-Term Orientation.

While the application of different organizational models to compliance, whether American, European, Russian, and so on, may be valuable in describing the context in which compliance may either flourish or struggle within an organisation, cultural elements do not vindicate noncompliance and regulated entities will continue to be penalized for violations irrespective of these contextual influences. In addition, cultural factors can lead to different interpretations and understandings of the rules, as well as the underlying idea behind them. Therefore, the understanding and actions of regulated institutions attempting to operate within the spirit of the rules can still potentially be challenged by the regulator. When combined with the reality that regulators can change the rules, and also change the staff employed to interpret and enforce them, this can reinforce the complexity faced by firms in approaching their compliance responsibilities.

Turning to the second element of the analysis, the process and its interrelatedness with the contextual influences, the behaviour of both the regulated and the regulator are significantly influenced by the socio-economic environment and Russian culture, as previously mentioned, is very different from that of Western countries. There is an unspoken understanding about how compliance actually works and the underlying internal and external processes involved. A deeper understanding of AML/CFT compliance requires a paradigm shift, moving away from the overemphasis on the binding-nonbinding dichotomy to an approach that captures the increasing legalisation of the normative element of soft laws, relying on content, precision, delegation, monitoring and sanctions (Kenneth *et al.*, 2000).

In terms of the contextual influences, compliance is considered by the respondents as a context-dependent notion which demonstrates the difficulty in reaching a universally accepted definition. This can impact how different nations, and individual professionals working in different sectors, comprehend and view the idea of compliance. The observations made whilst working on this thesis suggest that even having the same Policies and Guidelines, using the same compliance systems and conducting similar quality assurance procedures, cannot prevent different outcomes. One of the reasons for this is the different cultural and social-economical environment. Therefore, in practice every global/regional procedure should be modified to fit a particular regulatory landscape. Moreover, individual jurisdictions, such as Russia, may exercise regulatory oversight that makes cross-border exchange of banking principles and practices quite problematical, whereas political-economic institutions, such as European

union tend to develop multilateral agreements and arrangements that provide a common context, even as a national regulatory compliance processes and interpretation vary within the Union.

Factors shaping compliance within a state can be understood as having different layers, from the international layer to the local layer. All layers are strongly interconnected with each other. In addition, communities of influence, such as the World Bank and European agreements and treaties, also shape how compliance is undertaken. The members of a community of influence can be primary or secondary stakeholders. All stakeholders represent different interests with varying levels of power and legitimacy. The communities have complex and overlapping spheres of interest, as in, for example, the interests of the CBR, World Bank or U.S. Treasury Department. Some of these stakeholders may even be cross-stakeholders with vested interests in more than one area.

Conclusions

In conclusion, as a result of my study, I have added institutional change as a new element (or component) to Pettigrew's framework of meaning, process, context. The nature of this change is context bound, comparing a stable political context with predictable institutional behaviour (e.g. USA or European banking ecosystems) or a political context lacking appropriate institutions and needing to rapidly create them (eg Russian banking sector). Moreover, the institutional change is both gradual and radical. Gradual in the sense proposed by Mahoney and Thelen's thesis on gradual institutional change, involving overlapping layers, but also at times radical/revolutionary and driven by (conscious) political intent and design (eg WTO accession, the imposition of FATCA, sanctions on Russian economy and entities).

The institutional change in the regulatory compliance framework (meaning, process, context) is dynamic and progressive/developmental: regulatory compliance in Russia's banking sector is dynamic and developmental, being helical and dialectical, moving forward, improving, with each of the three elements shaping the other two elements. For example, taking each element in turn: on-going regulatory changes/improvements/refinements in the world banking ecosystem (international context), of which Russia is part, contributes to the development of Russia's banking sector's regulatory-compliance processes, and helps shape an on-going understanding of the process; multinational banks transport changes and improvements across jurisdictional borders; discourse (international, national, local) among regulators, policy makers, and banking practitioners, about the nature of compliance (and by implication what it means) further shapes their ecosystem.

Chapter 6 – Conclusions

Introduction

This research journey started from an idealistic yearning to acquire knowledge 10 years ago, and has grown into a pragmatic endeavor seeking to explore the very nature of knowledge. My intentions were ambitious given my work commitments in an intensive financial environment, and my lack of previous research experience. As a reflective practitioner in the compliance field, this afforded valuable opportunities to achieve a deep level of understanding of philosophical ideas that relate to compliance and how it has developed and changed, and, most importantly, a practical understanding of how compliance actually works. This represented a learning process in itself, and choices were involved when the practical diverged from the ideal. In concluding the final stages of this research, I would define my epistemological outlook as that of a pragmatic interpretive relativist.

My research experience has been characterised by various stages of making progress and then stepping back to reflect, making small, sometimes intuitive, steps to relate methodology and literature review, findings and analysis, all within the broad framework of accepted procedures as outlined in the research proposal. This was frequently challenging for a real-time practitioner simultaneously adopting the role of real-time researcher. To this end, the research provided a unique opportunity to review, examine and contribute to the existing body of compliance knowledge within the Russian financial institutional framework, which has received significant government, public and international interest in recent years. A number of fresh insights into compliance are identified in this analysis which represent a valuable contribution to the overall understanding of compliance from both a theoretical and practical perspective.

Taking the view of compliance as a variable leads to a consideration of its impact on the Russian financial landscape. Complexities abound, however, as rules and regulations in Russia are invariably static, while compliance is actually a more dynamic concept. The whole idea of compliance constitutes a new way of thinking, but tensions with the traditional static view of change are inevitable. The Russian way of conducting business has been always very bureaucratic, bound by rules and regulations. These rules and regulations present significant obstacles to the fulfilment of compliance obligations between Russia and the international business environment. Russia has undergone radical changes in recent decades from the perestroika movement and glasnost policies to blockchain technology. Yet to the outside world, Russia is still considered underdeveloped and slow to change, almost stagnant in its business development and growth.

6.1 Research Summary

This thesis presents compliance phenomena on the basis of a Western perspective explained by gradual change theory and institutional theory. Throughout the research process, various theoretical insights and compliance practices have been analysed, alongside the practical context in which compliance operates. The main aim of this study is offering new insights to the nature of bank compliance, set within a given regulatory regime (e.g. Russia), in the context of global and multi-institutional interests.

This thesis is positioned as an undertaking through which a conceptual framework is built. This is achieved by examining the complex phenomenon of compliance using a conceptual framework with three core elements, namely content, process, and context and in order to better understand the idea of strategy, which was analyzed in terms of the three elements, namely the substance of the content, the process of this phenomenon and the context within which this phenomenon occurs. From this broad conceptual framework, a number of theoretical perspectives were introduced, including gradual change theory, the theory of self-regulation, and various jurisprudence theories.

Further to the research question, which is to understand the behaviour of banks operating in the Russian financial environment set in the wider international regulatory financial policy context, this study aims to achieve the following three objectives indicated earlier on page 13:

(i) To examine the meaning of compliance, including its meaning in principle and in practice, its interpretive flexibility, and its efficacy.

(ii) To contribute new understanding of compliance processes with financial regulation in terms of bank policy implementation responses/strategies to regulatory change; and regulatory strategies and institutional changes as responses.

(iii) To examine the influence of the domestic and international political context on Russian regulatory compliance, in terms of evolving political, policy, and legal positions.

Each of the above objectives forms the basis of the conceptual framework around which this study is presented.

To maximize the potential of establishing a coherent understanding of the nature of compliance in Russian financial services, semi-structural interviews were conducted with current and former representatives of seven financial institutions, two regulatory bodies, two international organisations and a former partner of EY. Those representing the Russian financial institutions have described themselves as ‘sailing in unchartered waters’, as they have struggled to design their own compliance strategy and implement compliance frameworks. This is based on limited experience and subjective

interpretation of the regulatory authorities' expectations. The Russian mega-regulator, the CBR, also has limited experience in regulating Russian banks in line with international agreements, international regime and policies (the Ministry of Finance started to consider creating an anti-sanctions department 4 years after the anti-Russian sanctions have been initiated). The regulator must contemplate its options, perhaps undertaking analysis and deliberation, as well as considering the longer-term consequences of its actions. The CBR is also uncertain about what the future holds which adds an additional layer of uncertainty for regulated entities in their attempts to clarify what is expected from them. In this respect, the regulated banks often adopt ad hoc approaches to compliance. Understanding the views of practitioners on various concepts of compliance has ultimately guided and informed the focus of this research.

The literature review chapter provides a comprehensive analysis of the broad spectrum of compliance scholarship and thinking. Based on the conceptual framework, the concept of compliance is understood as a process, or, perhaps more usefully, as various processes working together. In the context of this study, important aspects such as transparency and accountability were also considered. These aspects are closely connected to notions of compliance and their significance is reinforced as they are often used to gauge the reliability or likely success of compliance initiatives. In order to examine regulatory practices, a number of strategies adopted by both the regulator and the regulated were identified, and analyses of their positive and negative impacts were conducted. The policy development model was examined with respect to both actors, highlighting the divergences in their respective positions and applications. By focusing on the strategies of both actors, a broader consideration of compliance highlighted interrelated areas such as corporate governance and culture. These strategies are, in turn, reflected in regulatory processes, discussed in-depth throughout this study in relation to policy development, which has three principal parts:

(i) Policy making;
(ii) Policy implementation; and
(iii) Policy evaluation.

Policy implementation was considered as a key element of this chapter, as specific reference to the behaviour of regulated banks in approaching their compliance obligations remained largely absent from contemporary literature. In addition, the majority of respondents taking part in this study were also members of professional bodies and business organisations, thereby affording an even broader base from which to consider the various strategies and perspectives surrounding policy implementation.

The most important feature of policy implementation in Russia can be outlined in terms of enforcement, namely, the strategies adopted by the regulator in enforcing policy implementation and how the regulated firms respond. The composite elements that constitute key elements for discussion

throughout the literature review chapter are: (i) agenda-setting, (ii) formulation and (iii) implementation. These three elements outlined earlier in the chapter 2 apply equally to the regulator and the regulated and afford a valuable opportunity to examine the interrelationship between both parties.

Chapter 3 presents the methodology and comprises an in-depth analysis of the principal philosophical issues affecting compliance, the research design strategy used in this study and supporting methods of data collection and analysis. The first section argues the validity of the positivist epistemological perspective for the purpose of this research and also explores various schools of law and their implications for compliance. The second section describes the mixed research approach adopted for this study. The third section presents methods of data collection and provides examples of the case study and qualitative survey used in this research. The fourth section contains methods of data analysis, followed by an assessment of research quality in the fifth section, highlighting the key issues of reliability, validity, and generalisability. The final section provides insight into ethical considerations.

Chapter 4 provides research findings based on an analysis of the meaning of compliance in financial institutions in accordance with the data collected. It also outlines findings that can be said to add new understanding to the interpretation and practice of compliance in the context of Russian financial services. This is followed by an examination of the influence of the domestic political context on compliance, in conjunction with economic and legal perspectives. Finally, an analysis of the evidence provided by the research participants presented in this section clearly demonstrates considerable support for the understanding of compliance as a constantly developing and somewhat 'unfixed cultural phenomenon' (Bell, 2012).

The underlying approach, as outlined for chapter 2, is to explore the research findings by focusing on processes and, in particular, on the three key aspects of policy development mentioned above. Both the regulator and regulated firms develop policies, albeit for the achievement of different ends. The regulator does so to translate legislation into regulation, while the regulated firms develop policies in order to comply with the required regulation. This chapter presents seven case studies: VTB Bank; Bank of Moscow, BNP Paribas, JP Morgan, Deutsche Bank, Uralsib Bank, and GE Money, providing details of the organisation and compliance structure and outlining the relationship between the compliance function with senior executives and other internal departments. Finally, any publicly available information on regulatory breaches or violations for each institution is also indicated. These particular banks were chosen in view of their reputation for robust AML/CFT compliance policies and procedures, as well as their longstanding history of operations in Russia.

Chapter 5 provides an analytical framework for understanding the meaning of compliance, an examination of a range of policies used by the Russian financial regulator in order to affect AML/CFT compliance by regulated banks, and the strategies employed for managing compliance by those banks. A discussion of the context and drivers of compliance ends this chapter.

6.2 How the Objectives Were Achieved

The first objective of this research is to provide an examination of the regulatory compliance, including its meaning in principle and in practice. In achieving this objective, the study anticipated and confirmed that the meaning of compliance is constantly evolving and is determined by a variety of perspectives. These include in-depth analyses of legal and regulatory frameworks, as well as socio-cultural influences. Consideration of how compliance is interpreted by various representatives of different stakeholder groups was the cornerstone of the first objective, thus interpretive flexibility approach was applied. The mixture of participants from financial markets (regulated, regulator, third party experts) provided more 'flavours' through which to understand compliance from the business, regulatory and international perspectives. The content of regulation was understood differently by the respondents as principles-based and rules-based regulation. It was also found that the notion of 'ideal' compliance outlined by the regulators is notably different from the subsequent compliance frameworks designed by the regulated firms in response. Thus, compliance in principle and practice can be considered through a hybrid understanding of its meaning. Moreover, the existing ambiguities and anomalies of compliance in Russia and beyond frequently demand something of a 'creative interpretation' by the regulated firms in their attempts to meet the regulator's expectations and requirements during their daily activities, as well as during the audits conducted by the regulators. Importantly, this study reveals that the regulated environment essentially involves the continuous implementation of policy, with revisions and new policies adding further complexity and adding more ambiguities.

Further to the three primary schools of thought in general jurisprudence specified earlier it shall be noted that Russia's judicial decisions are based on civil law and the theory of legal positivism. As such, legal positivism is relevant to the meaning and practice of compliance by Russian banks. Financial compliance is a relatively new legal concept in Russia, and as it is evolving under the influence of precedent cases, it seems reasonable to assume that compliance will likely become part of the judicial decision-making process. As Russian judges are guided by legal positivism, rather than natural law, which is combined with the general principles of law, compliance and AML/CFT activities can be viewed from the perspective of general jurisprudence as a combination of natural law, namely, what people think is right or wrong, and the development of legal positivist conventions. It should be noted that there is a relatively low level of awareness around compliance issues in Russia, as initially being

considered as pure Western phenomenon, thus only a small number of laws and norms would be classified as such and fall under the 'pure compliance' umbrella. Therefore, legal positivism, as a standalone theory, would be too restrictive to permit a thorough examination of the meaning of compliance from different perspectives and would involve neglecting the interplay of moral principles and social conventions in understanding what compliance means.

The second objective was achieved through an in-depth analysis of compliance processes with financial regulation in terms of bank policy implementation and responses/strategies relating to regulatory change; and regulatory strategies and institutional changes as responses. These processes are varied between the top-down and a bottom-up re-articulation of the requirements. The examination of these processes was made by analysing the three stages of policy development outlined above. The assessment performed demonstrates the value of examining the behaviour and action of both parties jointly to provide a deep understanding of the regulated environment and that such an environment is in constant flux and can remain ambiguous. This serves to further reinforce the idea of the compliance system as a dialectical and dynamic process of gradual transformation. The Russian historical and cultural context outlined in this research enhances the understanding of this transformation with reference to a number of distinctly Russian influences.

There has not been any noticeable change in policy within the last several years, however there is evidence of some change in the regulator's behavior in relation to its intention to obtain feedback from the regulated banks. Compliance only exists when both actors (regulator and regulated) are in constant dialectical relationships. The regulator's strategies are manifested in various forums, which generically exist in most regulated environments. These forums represent opportunities for the regulator to interact with the entities it regulates and, also reflect the organisational and interpretative elements of policy implementation. A consideration of the strategies adopted by the various organs of Russian compliance, specifically the FFMS and the CBR, further reinforced the view that the approach to regulatory oversight in Russia lags significantly behind that of European and U.S. regulatory approaches. Neither the CBR nor other government bodies issue specific guidelines or recommendations to regulate a number of investment banking areas vulnerable to risks. The CBR invites representatives of the regulated banks and broker-dealer institutions to participate in working sessions with the aim of explaining the peculiarities of such trades. However, existing banking regulation is still incomplete and fails to fully regulate the banking industry. Likewise, an analysis of strategies adopted by the regulated banks confirms that the Russian regulatory approach remains underdeveloped compared to the well-established compliance regimes in place in more developed countries.

The third objective was achieved by providing a thorough examination of the influence of the domestic and international political context on Russian regulatory compliance, as well as economic,

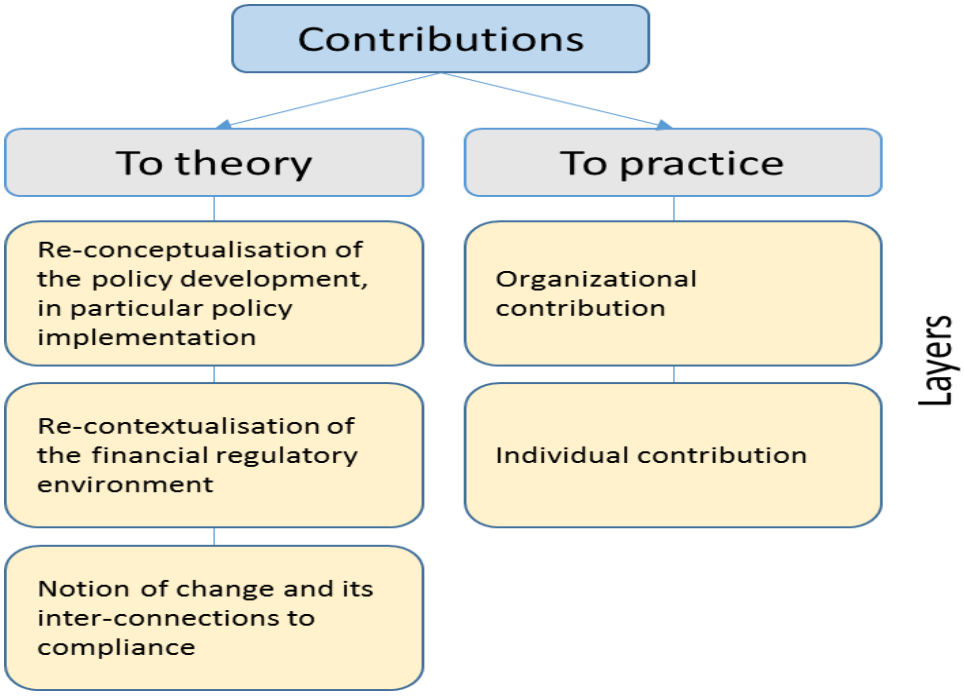
political and legal perspectives. The whole idea of compliance is an important and new concept for Russia and considerably broader than adherence to laws and regulations. This study revealed that compliance as a concept is socially constructed and negotiated between parties, and its strength depends entirely on the relative powers of the parties involved. Various international and domestic initiatives and movements have a considerable impact on the ways in which compliance evolves and develops. Therefore, the context of regulation differ in line with the content differences and in accordance with the type of ownership (state-owned/private/foreign) of financial institutions. As a dynamic concept, this study considers compliance from a structure and agency theoretical perspective involving many interconnected layers at the domestic and international levels.

6.3 Contribution to Knowledge

The study of compliance cannot be undertaken purely by focusing on the contribution of existing academic scholarship and the value of practical enquiry cannot be underestimated. As such, this thesis represents an applied research study and can be applied to any regulatory jurisdictions. This research contributes to the existing body of compliance knowledge, as it is the scope of this study to focus on compliance in the specific context of the Russian financial regulatory environment. The overall contributions of this research are two-fold, as it adds to the existing body of knowledge on both theory and practice.

The visual table of my contributions is provided in Table 11.

Table 11



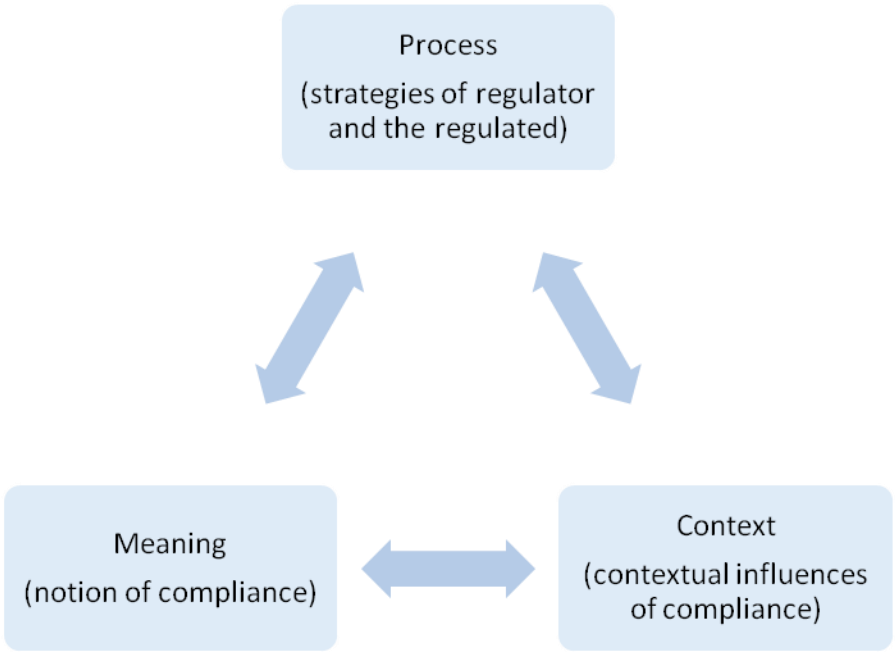
The first three contributions are related to the nature of change, i.e. institutional change, examined from various angles.

The first contribution is re-conceptualisation of the policy development, in particular, of the policy implementation. The author deconstructed compliance into the three central elements of meaning, process, and context based on Pettigrew's (1987) model. A subsequent analysis from a range of theoretical perspectives both separately and jointly focused on their interrelationships. The evidence presented reflects the helical, rather than linear nature of compliance processes, influenced at various stages by the strategies of the regulator and the regulated, the context in which compliance operates, and the evolutionary aspect of meaning and interpretation attached to compliance activities. All compliance processes have a helical nature, largely inter-connected to each other, reflecting both dynamism and developmental change (or evolution). Any emphasis that makes a change in the meaning of compliance has a direct impact on compliance processes and both these elements influence the context. Therefore, a more subtle understanding of compliance phenomenon was gained by considering it through three inter-connected conceptual elements. The rate of change of the helical process might be slow in jurisdictions where there has been (and continues to have) dialog about the meaning of compliance; where regulatory processes are fine tuned and there is a long established regulatory tradition. In places without a long tradition of regulatory compliance, the change is probably more uneven, unpredictable, and there is less discussion and agreement about the meaning.

Accordingly, this thesis proposes that the close interrelation of these three conceptual components in determining compliance outcomes is more adequately understood and supported by the adoption of a new helical theoretical framework, which the author refers to as the compliance development cycle (CDC) (author's own acronym). The CDC is explained in the diagram below.

Accordingly, this thesis proposes that the close interrelation of these three conceptual components in determining compliance outcomes is more adequately understood and supported by the adoption of a new, helical theoretical framework, which the author refers to as the compliance development cycle (CDC) (author's own acronym). The CDC is explained in the diagram below.

Compliance Development Cycle Diagram



In relation to the meaning of compliance, it is necessary to recognise that the law is open to interpretation, thus taking interpretive flexibility approach is vital for understanding compliance notion. As such, in the event that a regulator struggles to clearly interpret the intended outcome of a given compliance initiative, compliance undertakings at the local level in the banks themselves will take ultimate responsibility for judging – perhaps even guessing – how to meet the expectations of the regulators. Moreover, it follows that the different parties interpret the law differently in accordance with their own interests. This means that compliance in principle and practice can be considered through a hybrid understanding of its meaning with various ambiguities and anomalies colouring this. As compliance is not a predetermined phenomenon, but more usefully considered as a complex, dynamic, system with many layers comprising the varying interpretations of different stakeholder groups in different jurisdictions and different situations, an interpretive rather than positivist epistemological approach is adopted throughout this research, specifically an interpretive flexibility approach. Therefore, an interpretive flexibility is a pre-requisite in dealing with compliance phenomenon.

In relation to the process, the research emphases the significant level of confusion that exists about compliance. This study outlines a range of factors that contribute to this, including conflicting legislative and regulatory frameworks, the organisational complexity of global banks, and the operational complexity of the compliance function within these banks. This research explores the interdependent, dialectical relationship between the regulator and the regulated firms. Through its policies, actions and audits, the regulator requires that regulated firms respond by fulfilling their regulatory obligations. The firms will comply either by fulfilling the minimum compliance standards, namely complying with the

letter of the regulations, or by fulfilling a high level of compliance standards, namely, compliance with the spirit of the regulation. This thesis reflects that, in implementing its policies, the regulator uses many devices, such as KYC/KYCC policies, due diligence procedures. In their compliance initiatives, the regulated financial institutions utilise a number of tools across business units such as corporate governance and internal control functions, all of which originate from their need to comply with the regulator's requirements. Moreover, the study revealed that there are a number of internal intra-organizational relations, e.g. between compliance and internal audits that complicates the overall processes. These elements can be considered as sub-policies within the banking regulatory process.

The context of compliance appears somewhat under-researched in the current literature. In relation to how compliance works in global banks, this thesis demonstrates how the dual contexts of global and local can be seen to collide and overlap in terms of global regulatory requirements and local restrictions. In spite of the importance of international determinants on Russian compliance that this study has analysed in considerable detail, it is reasonable to suggest that the compliance universe operates with common language and symbols, regardless of national or even regional context.

The research proposes a new view on policy development with enhanced focus on policy implementation, with the aim of explaining the nature of institutional change as the core concept for understanding the development of compliance. This thesis reconceptualises compliance, encouraging us to consider a purely Western phenomenon in the Russian context, offering an explanation of regulatory behaviour in the Russian financial environment. In order to better understand the regulatory environment, it is not enough to focus solely on the policy maker and policy-making process, as policy development does not exist in a vacuum. As noted above, complex channels of communication have developed between the regulator and the regulated entities, some of which can have a direct impact on policy direction. Therefore, this study examines the practice of compliance, that is, how the regulated firm engages with the process of policy development.

The existing conceptual framework used to understand compliance activities seemed to reflect a very linear and straightforward process within which the development and execution of a policy stem directly from the policy objectives. However, Sabatier (2007) has discredited the linear model, as the policy development is rarely as uncomplicated as the literature might suggest. A lengthy process of constant adjustment occurs at the policy implementation level, which is not adequately documented. There are helical processes of compliance evolution. Therefore, this study seeks to fill the gap between the linearity proposed by theoretical compliance frameworks and the complex reality of compliance in practice.

The second contribution is a proposed re-contextualisation of the financial regulatory environment by applying both gradual change theory and institutional theory to the new context of daily compliance practices. By looking into policy development as a gradual change process, the institutional theory supports gradual change theory as the most relevant framework for analysing the policy-making process to allow a deeper understanding of compliance. Gradual change theory as outlined by Mahoney and Thelen (2010) describes policy-making as a slowly evolving process applicable to a number of situations. This research is supportive to her view on institutional stability and its qualification by incremental change. The gradual change theory is used in this study to explain the layering of international standards with common practices in formulating Russia's experience of compliance development. The focus on gradual change during time periods of stability challenges the traditional view of institutional change resulted due to radical shocks. However, contextual influences of regulatory compliance were not considered in their entirety in the original work, which this thesis aims to address. The authors project a high-level idea of change, whereas this study focuses on the idea of gradual change within the Russian regulatory context, specifically within the Russian financial regulatory environment. While it is assumed that gradual change theory provides an established regulatory framework in its entirety, the analysis revealed by this thesis that it does not take into account compliance as a concept of change.

Gradual change theory as outlined by Mahoney and Thelen (2010) describes policy-making as a slowly evolving process applicable to a number of situations. In an earlier study, Thelen (2000) proposed that there is no obvious border between institutional stability versus change. This research is supportive to her view on institutional stability and its qualification by incremental change. The gradual change theory is used in this study to explain the layering of international standards with common practices in formulating Russia's experience of compliance development. The focus on gradual change during time periods of stability challenges the traditional view of institutional change resulted due to radical shocks. However, contextual influences were not considered in their entirety in the original work, which this thesis aims to address. The authors project a high-level idea change, whereas this study focuses on the idea of gradual change in the Russian regulatory context, specifically within the Russian financial regulatory environment. While it is assumed that gradual change theory provides an established regulatory framework in its entirety, the analysis revealed that it does not take into account compliance as a concept of change. Absence of recognition that a policy has to be created from scratch and can be triggered by a new trend or new products/services in certain cases, leads to the third contribution.

My third contribution to theory is considering compliance though the notion of change. The nature of change has been considered throughout this study by looking at the meaning and its change, at change of processes and change of context. The thesis conceives an institution as a process not as a

structure and therefore focuses on four overlapping but discrete modes of incremental change to examine the strategies adopted by both the regulator and regulated toward money laundering compliance namely: layering, conversion, drift, and displacement (Mahoney and Thelen, 2010). Moreover, the author adds an important fifth element previously absent in Mahoney and Thelen's (2010) work. It was revealed that there is a dimension between incremental and radical change, that is proposed to be claimed as Initiation. It also can be considered as the fifth, additional dimension to existing thinking behind traditional gradual change theory. This element is reflected in cases where new regulation is initiated from scratch and where the proposed framework for new regulation could not be applied without it. When completely new regulation comes into force, for instance new regulation on Blockchain and Cryptocurrencies, initiation provides a deeper and broader understanding of why these topics are of utmost importance for financial regulation nowadays. This cannot be explained from a regulatory perspective in terms of traditional gradual change theory.

Financial regulations, regulatory requirements, compliance notion and processes are in constant flux, which are constantly evolving. The policy development models fail to accommodate the dynamic and evolving nature of the regulated space. Even where this space is long established, change is inevitable. While change is invariably gradual, it can occur occasionally in a faster, more revolutionary manner. Accordingly, this thesis proposes that no single unifying theory is capable of encompassing the vast universe of factors that can lead to compliance changes and the speed at which this takes place. This is further compounded by the utilisation of interpretive flexibility of the meaning of compliance in different jurisdictions and situations. In addition, family relations and good connections continue to play a very important role as means to achieve specific ends. Business and government remain inseparable in Russia and thus, the relationship between the two may be found in the fine detail of gradual change. Moreover, a dialectical relationship is not limited to that between regulator and regulated entity (bank), but also applies to the relationship between meaning, process, and context. Any new regulatory initiative or change in regulation (context) is bound to presage change in process (gradual or radical) and induce change in understanding/meaning.

In relation to the contribution to practice, this is the first thesis that offers analytical insight to regulatory compliance in Russia's banking sector and the first thesis using the conceptual framework of meaning, process, and context in relation to regulatory compliance. This contribution can be considered as two-fold. The first type is organizational contribution, which means the contribution to organizations made by this study and the second type is individual contribution, meaning how I was affected by this study and changed the way I personally act. My practice is not randomly applied but conscious and well organized.

The study demonstrates its potential value by addressing a number of practical considerations interesting for financial organisations, compliance professionals, policy makers, compliance associations and other stakeholders. The aims and objectives of the study enabled me to look into the nature of bank compliance and achieve a deeper and more fundamental analysis, in contrast to any management studies conducted before about compliance, its efficiency and efficacy. As the research was focused on bank compliance set within a Russian regulatory regime, I raised an awareness among compliance and banking practitioners by conducting educational trainings that were interesting for the regulated financial institutions and organisations, as well as for the regulator operating within the Russian regulatory environment. As one of the objectives was to examine the influence of the domestic and international political context on Russian regulatory compliance, the trainings conducted were interesting not only from the perspective of compliance practitioners, but also for the regulators, as the dialectical relationship between both actors keeps constantly evolving. The audience for these training sessions has received not only in-depth analytical information focusing on the Russian financial environment, but has also been exposed to contextual influences, practices and examples from other jurisdictions, by applying the interpretive flexibility approach, including the UK and US. These training sessions were also intended to provide an assessment of the participants' critical awareness of compliance practices since practitioners would be thinking in a slightly different way upon completion of the training sessions.

Therefore, the aims and conceptual framework of this study had a profound influence on practical training sessions conducted by the author in professional education centres. From the individual perspectives, educational efforts about aims, objectives and key findings made between my peers (Head of Compliance of state/private/global) can also be considered as contributions. By raising awareness about my thesis, I am building a coalition between my peers and therefore informing and changing practice.

Another kind of individual contribution to practice is communicating on certain aspects and peculiarities of financial regulatory compliance through publication of various articles. During my PhD journey, 15 articles were published in the Russian official journals, including magazines of the Central Bank of Russia, International Compliance Association official magazine 'InCompliance' and in the Journal of Financial Regulation and Compliance of Emerald Group Publishing Limited (see Shalimova 2010a, 2010b, 2010c, 2011, 2012, 2013, 2014a, 2014b, 2014c, 2014d, 2014e, 2017, 2019a, 2019b, 2020). They could reveal aspects of the practice of research and can be valuable message for future generations. These publications provide a good range of case studies for practitioners. Besides this, I regularly help shape policy by making these articles available in the practitioner's journals and professional magazines, as well as having written a compliance manual for practitioners working in Russia.

The above can be considered as my major contribution to policy and practice, as my research is a practical applied theory, in contrast to a piece of theoretical research. In summary, this thesis presents a

significant contribution to the existing body of compliance knowledge with the overarching aim of offering new insights into the nature of banking compliance, set within a Russian regulatory regime in the context of global and multi-institutional interests. A key doctrine of this thesis can be highlighted in terms of instigating a nature of change in the way of thinking about compliance, not only from a scholarly or even practical perspective on solely regulatory issues, but also with a broader application across other disciplines.

6.4 Personal observations about future implications for compliance

As a reflective practitioner, this study has afforded a valuable opportunity to combine theoretical and practical approaches in everyday compliance activities. It is hoped that such processes as holistic examination and using analytical tools to deconstruct meanings, as well as re-conceptualising and re-contextualising interpretations, will have a positive impact for compliance professionals around the world. The study enabled me to look at the issues of the meaning of compliance, its understanding and interpretation from various angles, to see that irrespective of the same legal definition various individuals, units in the organization, organizations themselves do interpret it differently. This understanding broaden my view from one country's and one regulator's level when similar policies applicable to many countries where compliance requirements and specifics are interpreted by each regulator, interpreted and implemented by the regulated in a slightly different way. For example, how different cultures apply Global KYC Policy based on their local specifics. All these developments enabled me to progress in my career path and become AFC Head for Central and Eastern Europe and Israel.

Considering about an area for further research, the proposed conceptual framework of meaning, process, and context used in this study, as well as understanding of concept of change provides the possibility to re-acknowledge the entire regulatory process and to continue with productive feature research in this area.

Outcomes might be different, if practitioners were to approach the subject by considering the three abovementioned concepts, i.e. meaning, process, context, enabling them to realise that there are many ambiguities involving interpretive flexibility, alongside the dialectical relationship, contextual aspects and structural changes affecting the relationship between the regulator and the regulated. The other area of further research is to consider the proposed conceptual framework of compliance from the bigger international perspectives of international financial institutions, such as International Monetary Fund (IMF), World Bank, the European Central Bank (ECB) and others.

This thesis reinforces the idea of communality and can be considered as contributing to the basic values and assumptions shared by the overall compliance discourse community. As compliance is

not static, it continues to evolve as new insights emanating from the discourse community enhance existing practices. Institutional theory was also a very useful theory for deepening this understanding. Having a broader and deeper understanding of the meaning of compliance and its inter-dependence with context helped me to make a deeper assessment of strategies of all actors with special focus on AML/CFT issues. The lessons learned specified in this thesis will be continue to be shared with compliance practitioners, regulators, compliance associations within the financial markets in order to achieve aligned understanding and build coalition of co-thinkers.

Epistemological Position

This thesis constitutes a nine-year research journey into the compliance world. With a law degree and over 10 years of legal experience, the key epistemological position at the start of this research journey is best described by legal positivism, as all of Russia's judicial decisions are based on civil law, thus the theory of legal positivism is very relevant to the Russian legal system.

Around halfway through this research process, an initial shift toward interpretivism emerged in acknowledging that what is written in social conventions does not necessarily equate to the truth of what is happening in reality. Moreover, as a compliance practitioner, being able to assess compliance on a practical level further reinforced the notion that there is no absolute truth and that all claims are theory-dependent. The semi-structural interviews also revealed that the notion of a so-called 'shared' reality constructed by one bank is markedly different to the shared reality of another, as each constructs their reality in accordance with its own internal and external influences and interests. In a broader context, this applies to governments, supranational bodies, international organisations and every other stakeholder group involved in compliance.

Compliance as a concept is full of ambiguities and a one-size-fits-all solution cannot be applied universally to different scenarios. This can lead to more innovative behaviour on the part of the regulator and regulated entities. Moreover, compliance involves a high level of interpretive flexibility that leads to differences in understanding and treatment of the same phenomenon depending on the interests of stakeholder groups and the sociocultural context. As such, the epistemological approach of this study is ultimately best described as interpretive relativism, as compliance is a variable that requires interpretation. To this end, case study research methodology is fully suited to the aims and objectives of this thesis.

6.5 Further Research

Further to Pettigrew (2012) 'any study is a moment in a process'. As outlined above, a number of changes occurred over the duration of this research, which commenced as a broad and somewhat

unfocused investigation into compliance, before focusing in more detail on the key area of AML/CFT compliance specifically, thereby permitting a detailed assessment of this particular area of financial crime compliance. While this thesis provides an analysis of the meaning, process and context of compliance, more research is needed into these three elements, especially the context of compliance, which significantly impacts compliance development globally. In addition, there is considerable scope to investigate other areas of financial crime, such as economic sanctions, anti-bribery and corruption, fraud and cybercrime. As each of these areas is very broad, further research and analysis is likely to be far reaching for both academics and professional experts.

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Appendices

Appendix 1

The considerations of Baldwin, Scott and Hood (1998) on the three different notions of regulation are provided here.

Regulation is a popular subject of study in several disciplines across and beyond the social sciences. It is studied by scholars who advance different theoretical perspectives, using various research methodologies, and based on different assumptions about the relations between regulation and the political process. Not surprisingly, the various definitions of regulation reflect specific disciplinary concerns, are oriented towards different research methods, and reflect to a significant extent the unique personal, national, and historical experience of the formulator of the definition. In these circumstances it would be futile and somewhat nonsensical to offer one authoritative definition of the notion of regulation that holds across the divides. Still, some benefit may accrue from the exchange of ideas between these various approaches through a discussion of the various meanings and a clarification of how they reflect different research agendas and disciplinary concerns. To tackle this task the focus is drawn mainly on Baldwin et al (1998), who identify three main meanings for the notion of regulation: (a) targeted rules; (b) all modes of state intervention in the economy; and (c) all mechanisms of social control, by whomsoever exercised (Ogus, 1994).

The three meanings of regulation are described in three circles that expand from the narrowest meaning of regulation (I) to its broadest (III). In its narrowest and simplest sense, ’regulation refers to the promulgation of an authoritative set of rules, accompanied by some mechanism, typically a public agency, for monitoring and promoting compliance with these rules‘ (Baldwin et al, 1998). A second meaning of regulation refers to ’all the efforts of state agencies to steer the economy‘. This meaning is broader than the first since it includes, in addition to rule-making, measures such as taxation, subsidies, redistribution, and public ownership. The third meaning of regulation is broader still, and encompasses all mechanisms of social control, including unintentional and non-state processes.

According to Baldwin et al (1998), it extends ’to mechanisms which are not the products of state activity, nor part of any institutional arrangement, such as the development of social norms and the effects of markets in modifying behavior. Thus a notion of intentionality about the development of norms is dropped, and anything producing effects on behaviour is capable of being considered as regulatory. Furthermore a wide range of activities which may involve legal or quasi-legal norms, but without mechanisms for monitoring and enforcement, might come within the definition’.

In addition, these three meaning reflect different research agendas and different disciplinary concerns. Let's start with the pre-1990s transatlantic difference in the meaning of regulation. Until the end of the 1980s, scholars outside the United States tended to employ the word 'regulation' to denote the general instruments of government for the control of the economy and society (meaning II). The notions of 'regulation' and 'intervention' were used almost interchangeably (Majone, 1994). The situation was different in the United States, where the notion of regulation had acquired a narrower meaning in response to the rise in the number of independent regulatory institutions and the consequent crystallisation of regulatory practices into a theory of governance. The global spread of the wave of regulatory reforms, and especially the establishment of independent regulatory institutions in various sectors of the economy (especially in the utilities), led to some convergence in the meanings of regulation: towards the narrowest and away from the second, which had more general use. This movement was strengthened by a shift in the way some economists used the notion of regulation. As noted by Ogus (1994), economists, unlike lawyers (and, we add, political scientists in the United States), used to employ the word 'regulation' in its broad sense. This meaning was acceptable and probably successful in conveying a widespread distaste for over-regulation, yet it was rather too broad, given the growth of institutional economics and law and economics scholarship.

At the same time, it seems that the third meaning of regulation (all mechanisms of social control) is making headway in the socio-legal and the constructivist literature. This seems to be driven by the growth of semi- consensual international regimes for the governance of 'global problems' such as weapons of mass destruction and climate change. New regulatory regimes are at least partly established through voluntary agreements, without recourse to strong monitoring and enforcement mechanisms and with apparent disregard for values of 'national sovereignty'. The normative questions that arise from this definition, the problems of monitoring and enforcement mechanism, and the interests in supranational and international regulatory regimes make this notion of regulation especially attractive for lawyers, sociologists of law, and scholars of international relations and international political economy.

Appendix 2

Further to Gunningham (2011) regulators from the United States, United Kingdom, Australia, and other countries have adopted a variety of distinctive intervention strategies – or ideal types – which have been discussed widely in the literature.

Intervention Strategies: Models Identified in the Regulatory Literature

From a review of the regulatory literature, seven distinctive (but often mutually compatible) regulatory enforcement and compliance strategies can be identified.

Advice and Persuasion: Negotiation, information provision and education characterize this strategy. The threat of enforcement remains, so far as possible, in the background, and only to be actually invoked in extreme cases where the regulated entity remains uncooperative and intransigent.

Deterrence: This strategy is accusatory and adversarial. Energy is devoted to detecting violations, establishing guilt and penalizing violators for past wrongdoing. It assumes that profit-seeking firms take costly measures to comply with public policy goals only when they are specifically required to do so by law and when they believe that legal noncompliance is likely to be detected and harshly penalized.

Responsive Regulation: This strategy is premised on the view that the best outcomes will be achieved if inspectors adapt to (or are responsive to) the actions of regulatees. Regulators should explore a range of approaches to encourage capacity building but must be prepared to escalate up a pyramid of sanctions when earlier steps are unsuccessful. Escalation occurs only where dialogue fails, and regulators de-escalate when met with a positive response. Indeed, it is preferable to escalate up a pyramid of supports, praising and rewarding good behaviour and only resorting to the pyramid of sanctions where such behaviour is not forthcoming. Implicit in responsive regulation is a dynamic model in which the strengths of different forms of regulation compensate for each other's weaknesses.

Risk-Based Regulation: This strategy involves the targeting of regulatory resources based on the degree of risk which duty holders' activities pose to the regulator's objectives, and it calls for applying principles of identifying, assessing, and controlling risks in determining how inspectors should intervene in the affairs of regulated enterprises.

***Smart Regulation*:** This strategy is a form of regulatory pluralism that embraces flexible, imaginative, and innovative forms of social control, harnessing businesses and third parties acting as surrogate regulators in addition to direct government intervention. The underlying rationale is that, in the majority of circumstances, the use of multiple rather than single policy instruments, and a broader range of regulatory actors, will produce better regulation. As such, it argues that the implementation of complementary combinations of instruments and participants tailored to meet the imperatives of

particular issues, can accomplish public policy goals more effectively, with greater social acceptance and at less cost to the state.

Meta-Regulation: This strategy involves government 'regulating at a distance' by risk managing the risk management of individual enterprises. This implies requiring or encouraging enterprises to put in place their own systems of internal control and management (via systems, plans, and risk management more generally). These are then scrutinized by regulators who take the necessary action to ensure that these mechanisms are working effectively. The goal is to induce companies themselves to acquire the specialized skills and knowledge to self-regulate, subject to external scrutiny. Accordingly, the regulator's main intervention role is to oversee and audit the plans put in place by the regulated organization.

Criteria Strategies: These strategies provide inspectors and other decision-makers with a list of criteria they should consider in arriving at a decision in any given case. There is no prescriptive formula and which mechanism(s) to be used in any particular case will depend on the circumstances.

Appendix 3

The most important provisions for international compliance regulation are contained within the following US laws:

(i) Foreign Corrupt Practices Act 1977 (FCPA),

(ii) Sarbanes-Oxley Act (SOX),

(iii) Dodd-Frank Wall Street Reform,

(ii) Consumer Protection Act.

1. **Foreign Corrupt Practices Act (FCPA)**

The Foreign Corrupt Practices Act (1977) (the FCPA), as amended, 15 U.S.C. §§ 78dd-1, et seq. ("FCPA"), was enacted for the purpose of making it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. Specifically, the anti-bribery provisions of the FCPA prohibit the willful use of the mails or any means of instrumentality of interstate commerce corruptly in furtherance of any offer, payment, promise to pay, or authorization of the payment of money or anything of value to any person, while knowing that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly, to a foreign official to influence the foreign official in his or her official capacity, induce the foreign official to do or omit to do an act in violation of his or her lawful duty, or to secure any improper advantage in order to assist in obtaining or retaining business for or with, or directing business to, any person.

The Act also applies to any act by U.S. businesses, foreign corporations trading securities in the U.S., American nationals, citizens, and residents acting in furtherance of a foreign corrupt practice whether or not they are physically present in the U.S. This is considered the nationality principle of the act. Whenever businesses decide to follow the unethical road, there are consequences including high financial penalties. Any individuals that are involved in those activities may face prison time. This act was passed to make it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business. In the case of foreign natural and legal persons, the Act covers their deeds if they are in the U.S. at the time of the corrupt conduct. This is considered the protective principle of the act. Further, the Act governs not only payments to foreign officials, candidates, and parties, but any other recipient if part of the bribe is ultimately attributable to a foreign official, candidate, or party. These payments are not restricted to monetary forms and may include anything of value. This is considered the territoriality principle of the act.

The anti-bribery provisions of the FCPA make it unlawful for a U.S. person, and certain foreign issuers of securities, to make a payment to a foreign official for the purpose of obtaining or retaining business for or with, or directing business to, any person. Since the 1998 Amendment of FCPA they also apply to foreign firms and persons who take any act in furtherance of such a corrupt payment while in the U.S. The meaning of foreign official is broad. For example, an owner of a bank who is also the minister of finance would count as a foreign official according to the U.S. government. Doctors at government-owned or managed hospitals are also considered to be foreign officials under the FCPA, as is anyone working for a government-owned or managed institution or enterprise. Employees of international organizations such as the United Nations are also considered to be foreign officials under the FCPA. A 2014 federal appellate court decision has provided guidance on how the term 'foreign official' is defined under FCPA.

Especially in emerging markets with relatively high levels of official corruption, such import and export operations present a 'perfect storm' of FCPA compliance risk, involving the confluence of: (i) interactions with government officials (often poorly compensated); (ii) dependence upon third parties (customs brokers, freight forwarders, consultants and import/export agents) who may subscribe to very different (and lax) business ethical principles and standards; (iii) relatively high rates of customs duties and import and export taxes; and (iv) a lack of transparency in international trade laws, regulations and procedural requirements. This article, therefore, identifies the key FCPA compliance issues and challenges arising in connection with import and export operations, and presents a series of warnings and recommendations to mitigate the compliance risks associated with those operations.

Differences between the UK Bribery Act and the US Foreign Corrupt Practices Act

The UK Bribery Act (the Bribery Act) was passed on 8 April 2010 and comes into force on 1 July 2011. Until recently, international anti-corruption enforcement has been largely dominated by the US Foreign Corrupt Practices Act 1977 (the FCPA).

The Bribery Act, however, represents part of a broader international trend and has an even wider application than the FCPA. While organisations may consider that their anti-corruption procedures are sufficiently robust for the purposes of the FCPA, this may not be the case where the Bribery Act is concerned. It is therefore important for organisations operating on a global basis to be aware of the differences between the FCPA and the Bribery Act and to be prepared for the implications of the Bribery Act coming into force.

While this briefing focuses on the differences between the Bribery Act and the FCPA there are many common aspects - not least the extra-territorial application of both laws. The extra-territorial

jurisdiction of the FCPA is extensive and has been controversial but the Bribery Act also has extensive extra-territorial jurisdiction. Commercial organisations may be vulnerable to prosecution if they carry on a business, or part of their business, in the UK, irrespective of where the bribe takes place.

The main differences between the Bribery Act and the FCPA

- **Bribery of foreign (public) officials**

Both the Bribery Act and the FCPA make it an offence to bribe foreign (public) officials. Under the Bribery Act a 'foreign public official' is defined more narrowly than under the FCPA but still includes (i) anyone who holds a foreign legislative or judicial position; (ii) individuals who exercise a public function for a foreign country, territory, public agency or public enterprise; or (iii) any official or agent of a public organisation.

- **Private-to-private bribery**

The FCPA does not cover bribery on a private level, unlike the Bribery Act, although such conduct can be caught under other US legislation.

- **Active and passive bribery**

The FCPA only covers active bribery, that is to say the giving of a bribe. In contrast, the Bribery Act prohibits both active and passive bribery i.e. the taking of a bribe.

- **Failure to prevent bribery**

The Bribery Act creates a strict liability corporate offence for failure to prevent bribery (as opposed to vicarious liability) subject to being able to establish that a company has 'adequate procedures'. Under the FCPA, however, a company subject to US jurisdiction can be held vicariously liable for acts of its employees and agents. The UK offence extends to acts of 'associated persons' which means anyone who performs services for or on behalf of the commercial organisation.

- **Intent**

Under the FCPA it must be proved that the person offering the bribe did so with a "corrupt" intent. The Bribery Act makes no requirement for a 'corrupt' or 'improper' intent in relation to the bribery of a foreign public official, although the requirement remains for the general bribery offence.

- **Facilitation payments**

The FCPA creates an exemption for facilitation payments whereas the Bribery Act makes no such exception. The Ministry of Justice guidance, however, confirms that prosecutors will exercise discretion

in determining whether to prosecute. In addition, informal guidance received from the SFO indicates that where it is considering action, it will be guided by the following six principles:

- Whether the company has a clear and issued policy;
- Whether the company has written guidance available to employees as to the procedures they must follow where a facilitation payment is requested or expected;
- Whether such procedures are really being followed (monitoring);
- Evidence that gifts are being recorded at the company;
- Proper action, collective or otherwise, to inform the appropriate authorities in countries when a breach of the policy occurs;
- The company is taking what practical steps it can to curtail such payments.

- **Promotional expenses**

The FCPA provides for a 'defence' to promotional expenses in so far as it can be demonstrated that they were a reasonable and bona fide expenditure. There is no such defence concerning promotional expenses under the Bribery Act, in relation to foreign public officials, although the Ministry of Justice has provided some comfort on this aspect in its guidance.

- **Penalties**

An individual found to have committed an offence under the Bribery Act is liable to imprisonment of up to ten years and/or to an unlimited fine. A company found guilty is subject to an unlimited fine.
For offences committed under the FCPA an individual can be fined up to US$250,000 per violation and may also be given up to five years imprisonment. A company guilty under the FCPA is liable for a fine of up to US$2,000,000 per violation.

2. **Sarbanes-Oxley Act (SOX)**

The Sarbanes-Oxley Act of 2002, enacted following the accounting disasters at Enron and WorldCom, is probably the law that most impacts publicly listed companies on the Stock Exchange since the Securities Exchange Act of 1934. In order to restore investor confidence in the financial reports of publicly listed companies on the Stock Exchange, the Sarbanes-Oxley Act makes company executives personally responsible for any falsification of financial data. A business executive who has knowingly signed in a false report is liable to a fine of up to one million dollars and can be sentenced to up to ten years in prison. Even though the law came into force in 2004, it continues to develop whilst the SEC (U.S. Securities and Exchange Commission) decides on the time for compliance and publishes rules on requirements and compliance. According to a study carried out by AMR Research, about 85% of listed

companies have planned to change their computer systems as part of their efforts for compliance with this law. AMR has estimated that businesses spent over 2.5 billion dollars to achieve compliance with Sarbanes-Oxley, for 2003 alone.

Guided by three main principles being accuracy, accessibility to information and managerial accountability, and the independence of auditors, the Act seeks to increase corporate responsibility and better protect investors to restore confidence on the market. Its primary objective is to control whether companies act responsibly with shareholders, giving them access to reliable financial accounting and transparent information. Most companies have made the changes required by the Sarbanes-Oxley and are now in the process of full documentation. Some companies have even expanded the scope of their Sarbanes-Oxley projects in order to 'understand the documentation, design and implementation of processes and controls. Most of them go well beyond the financial reporting process'.

Six major measures are distinguished:

1) The most significant measure is the 'responsibility' (see Section 302) of CEOs (Chief Executive Officer / CEO and Chief Financial Officer /CFO). Any voluntary or conscious impropriety is penalized. The managers who are caught in the act are liable to ten years' imprisonment.

2) To improve access and information reliability, companies must provide the SEC with complementary information (accounting principles guiding the presentation of accounts, out of balance sheet transactions, changes in ownership for assets owned by managers, codes of corporate ethics) (see Section 404)

3) Since 26 April, 2003, companies must have set up independent audit committees to oversee the audit process (see Section 302). They are empowered to receive complaints from shareholders or employees concerning the company's accounting and audit procedures.

4) The rotation of external auditors is also planned.

5) A new regulatory and supervision body, the Public Company Accounting Oversight Board, shall supervise the accounting firms, establish standards, investigate and punish the individuals and legal entities that violate the rules.

6) The penalties have increased considerably. The maximum sentence for fraud has increased and is now twenty five years.

The central purpose of the act is to reduce fraud, build public confidence and trust, and protect data that may affect companies and shareholders. This act consists of multiple sections, all of which require compliance by a company. The two principle sections that relate to security are Section 302 and Section 404, summarised below:

– Section 302 is intended to safeguard against faulty financial reporting. As part of this section, companies must safeguard their data responsibly so as to ensure that financial reports are not based upon faulty data, tampered data, or data that may be highly inaccurate.

– Section 404 requires the safeguards stated in Section 302 (as well as other sections) to be externally verifiable by independent auditors, so that independent auditors may disclose to shareholders and the public possible security breaches that affect company finances. Specifically, this section guarantees that the security of data cannot be hidden from auditors, and security breaches must be reported.

External auditors are required to issue an opinion on whether effective internal control over financial reporting was maintained in all material respects by management. This is in addition to the financial statement opinion regarding the accuracy of the financial statements. The requirement to issue a third opinion regarding management's assessment was removed in 2007.

The most contentious aspect of SOX is Section 404, which requires management and the external auditor to report on the adequacy of the company's internal control on financial reporting (ICFR). This is the most costly aspect of the legislation for companies to implement, as documenting and testing important financial manual and automated controls requires enormous effort. Under Section 404 of the Act, management is required to produce an 'internal control report' as part of each annual Exchange Act report. The report must affirm 'the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting'. The report must also 'contain an assessment, as of the end of the most recent fiscal year of the Company, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting'. To do this, managers are generally adopting an internal control framework such as that described in COSO.

3. **The Dodd-Frank Wall Street Reform**

The Dodd-Frank Act (fully known as the Dodd-Frank Wall Street Reform and Consumer Protection Act, (2010) is a United States federal law that places regulation of the financial industry in the hands of the government. The legislation, enacted in July 2010, aims to prevent another significant financial crisis by creating new financial regulatory processes that enforce transparency and accountability while implementing rules for consumer protection.

Because the ’Great Recession‘ of the late 2000's was due in part to low regulation and high reliance on large banks, one of the main goals of the Dodd-Frank act is to reduce federal dependence on the banks by subjecting them to a myriad of regulations and breaking up any companies that are ’too big to fail. The act created the Financial Stability Oversight Council (FSOC) to address persistent issues affecting the financial industry and prevent another recession. Banks are required to have ’funeral plans‘ for a swift and orderly shutdown in the event that the company goes under. By keeping the banking system under a closer watch, the act seeks to eliminate the need for future taxpayer-funded bailouts.

FSOC comprised of the heads of the financial regulatory agencies. The Council is generally tasked with identifying and responding to systemic risks and its duties include, among other things:

- Designating systemically important ’nonbank financial companies‘;
- Making recommendations concerning the establishment of heightened regulatory capital standards, leverage, liquidity, contingent capital, resolution plans, concentration limits, short term debt limits, enhanced disclosures and overall risk management standards for systemically important bank holding companies and ’nonbank financial companies’;’
- Collection of financial information for assessing systemic risks; and (iv) making recommendations to member agencies concerning supervisory standards, priorities, and principles.

The act also created the Consumer Financial Protection Bureau (CFPB), to protect consumers from large, unregulated banks. The CFPB consolidated the consumer protection responsibilities of a number of existing bureaus, including the Department of Housing and Urban Development, the National Credit Union Administration and the Federal Trade Commission. The CFPB works with regulators in large banks to stop business practices that hurt consumers, such as risky lending. In addition to regulatory control, the CFPB provides consumers with access to truthful information about mortgages and credit scores along with a twenty-four hour toll-free consumer hotline to report issues with financial services.

To both ensure cooperation by financial insiders and fight corruption in the financial industry, the Dodd-Frank Act contains a whistle blowing provision, wherein persons with original information about security violations can report said information to the government for a financial reward.

An Office of Financial Research is established within the Treasury Department to support the Council and the financial regulatory agencies by, among other things:

- Collecting data;
- Standardizing the types of data reported and collected; and
- Developing tools for risk management and monitoring.

The main things that we should know about the Dodd-Frank Wall Street Reform and Consumer Protection Act are:

1) Ends 'Too Big To Fail': If a big financial firm is failing, it will have only one fate: liquidation. There will be no taxpayer funded bailout. Instead, regulators will have the ability to shut down and break apart failing financial firms in a safe, orderly way – without putting the rest of the financial system at risk, and without asking the taxpayers to pay a dime.

2) Closes Loopholes in Regulation of Major Financial Firms: Loopholes that allowed firms like Lehman Brothers, Bear Stearns and AIG to operate without tough standards or oversight were major contributors to the financial crisis. The Wall Street Reform and Consumer Protection Act closes these loopholes, and create accountable regulation for all firms that pose the most risk to the financial system. It ends the ability of financial firms to avoid tough standards by manipulating their legal structure.

3) Brings Transparency to Hedge Funds: The Wall Street Reform and Consumer Protection Act requires advisers to hedge funds to register with the SEC for the first time, bringing transparency and oversight to these unregulated financial firms.

4) Constrains the Size of the Largest Firms: Financial reform will prevent any financial firm from growing by acquisition to more than 10% of the liabilities in the financial system. This will reduce the adverse effects of the failure of any single firm and prevent the further concentration of our financial system.

5) Reforms Executive Pay and Strengthen Shareholder Protections: Financial reform will give shareholders a say in the compensation of senior executives at the companies they own, and require that the compensation committees of corporate boards are independent.

6) Separates Banking and Speculative Trading – the Volcker Rule: The Wall Street Reform and Consumer Protection Act safeguards taxpayers and depositors by separating risky, speculative "proprietary trading" from the business of banking.

7) Strongest Consumer Protections Ever: Instead of seven federal agencies with only partial responsibilities for consumer protection, there will be the Consumer Financial Protection Bureau whose sole responsibility is establishing clear rules of the road for banks, mortgage companies, payday lenders, credit card lenders, and other financial service firms and for enforcing these rules. From now on, every consumer will be empowered with the clear and concise information they need to make financial decisions that are best for them.

8) Cracks Down on the Abuses in the Mortgage Markets at the Center of the Crisis: The Wall Street Reform and Consumer Protection Act bans abusive practices in the mortgage markets, like those where brokers got paid more to put families into higher priced loans than those they qualified for, and require mortgage brokers and banks to consider a family's ability to repay when making a loan. The reforms will also require lenders and Wall Street loan packagers to keep skin in the game when selling off loans to investors and make full disclosure so investors know what's in those packages. Reforms of credit rating agencies will help make sure investors do not rely unwisely on their ratings on these packages.

9) Safer, More Transparent Derivatives Market to Help Main Street Businesses: By bringing the derivatives markets out of the shadows, the Wall Street Reform and Consumer Protection Act benefits those businesses that use derivatives to manage their commercial risks. Financial form will benefit Main Street companies at the expense of Wall Street's hidden fees. That's good for every farmer and every manufacturer that uses derivatives the way they were meant to be used. Derivatives reform also means the taxpayer won't be on the hook for reckless risks of an AIG.

10) Supports Long Term Job Growth by Helping Prevent Future Crises: By making the financial system safer and stronger, the Wall Street Reform and Consumer Protection Act will reduce the chances that a financial crisis deprives businesses of the credit they need to grow and to create jobs. Financial reform will ensure businesses a more stable and predictable source of credit through the business cycle and reduce the risk of a sharp and sudden cut-off because of financial panic.

4. **The Consumer Protection Act.**

The Consumer Protect Act, Act No 68 of 2008 (CPA or Act), which became law at midnight on the 31st March 2011 has radically shifted the balance of power from the service provider/supplier to the consumer/customer when it comes to the question of defective and damaged goods.

The CPA has a number of Chapters:

Chapter 1 deals with the interpretation, purpose and application of the CPA. This section is used to interpret the CPA as well as determine whether the CPA applies to a particular transaction or not.

Chapter 2 deals with fundamental consumer rights. This chapter is further divided into Parts with each part dealing with a particular consumer right, such as the 'Right of Equality in Consumer Market', 'the Consumer's Right to Privacy' and so on. A discussion of certain of these rights will be the main focus of this publication.

Chapters 3, 5 and 6 deal with the Protection of Consumer Rights, National Consumer Institutions and Enforcement of the CPA.

Chapter 4 regulates Business Names and Industry Codes of Conduct.

Schedule 2 contains certain transitional provisions dealing with, for example, effective dates for the CPA and when the CPA will apply to pre-existing agreements (i.e. transactions that occurred prior to the effective dates as defined).

Non-compliance

The Act establishes the National Consumer Commission, which will have certain enforcement functions including the ability to issue compliance notices and to conduct investigations. In addition, certain conduct will result in criminal liability (albeit that liability will only arise in limited instances) as well as administrative fines.

Administrative fines can be imposed for prohibited conduct (i.e. an act or omission in contravention of the Act) or required conduct. The amount of the fine can be as much as 10% of the respondent's annual turnover or R1 million (whichever is the greater). In determining the amount of the fine, the Tribunal (The Consumer Tribunal) is required to consider, for example, the nature, duration, gravity of the contravention, loss or damage arising as a result thereof etc.

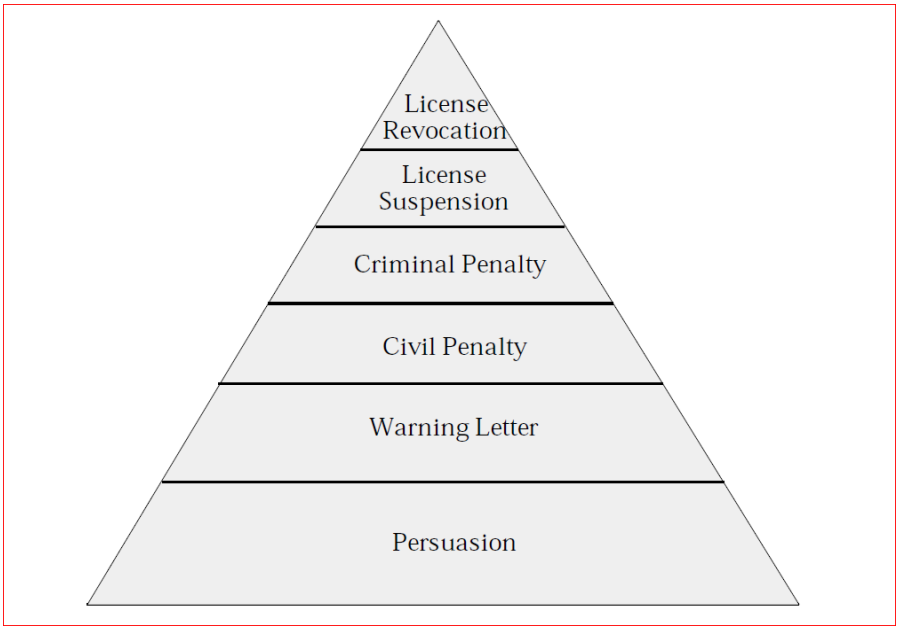
Appendix 4

The best known formulation of this flexible approach to achieving compliance is encapsulated in a pyramid associated with a concept entitled 'responsive regulation', based on publications by Ayres and Braithwaite (1992) and others.

Pyramid of enforcement strategies

Regulators and those engaged in preventing corruption have much in common. Indeed anti-corruption agencies might be regarded as regulators themselves. Without taking a firm view on that point the common features of these two groups include that they both have a public interest objective whether that is public health and safety or public integrity. Both are concerned with understanding and promoting ways to increase behaviour that conforms to desired standards of conduct and reduce non-complying behaviour. Both activities employ similar tools to achieve their objectives. Traditionally the choice of tools has been between those that deter certain behaviour of one hand and those that encourage, other, behaviours on the other. These approaches are often labelled 'deterrent and compliant' or 'punish and persuade' (Ayres and Braithwaite, 1992). The distinction is generally consistent with one made between rules-based and values-based approaches to organisational ethics, or integrity, management.

Applied to the work of an anti-corruption agency (ACA) this distinction is explicit in the stated functions of most ACAs to both investigate corruption or misconduct and promote integrity. Any practitioner will say that these are not alternatives and both types of tools must be engaged.

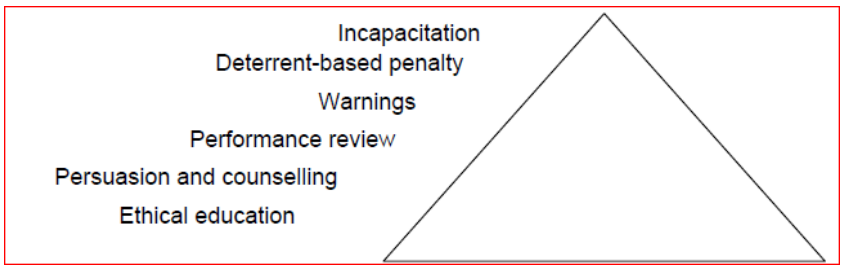


Source: Ayres, I. and Braithwaite, J. (1992), *Responsive Regulation: Transcending the Deregulation Debate*, *Oxford University Press, New York, p. 35.*

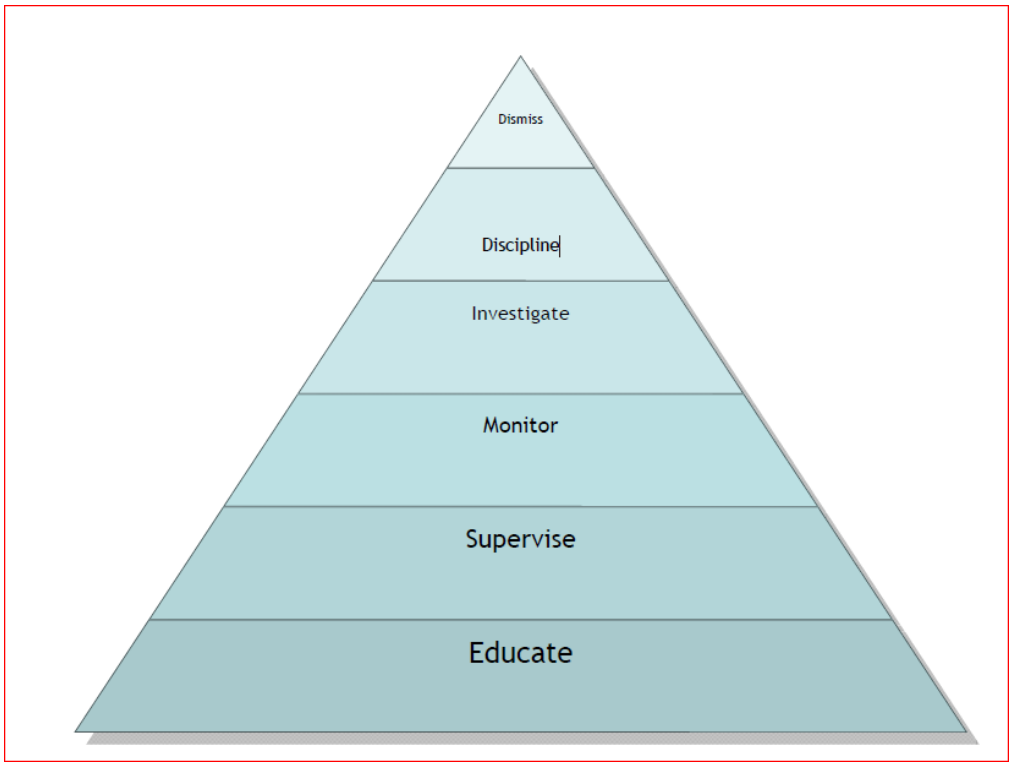
Integrating these two approaches was one of the goals of the 'enforcement pyramid' (originally devised by Ayres and Braithwaite (1992), which has become a touchstone of modern regulatory theory. The pyramid is a model of the way that regulators can influence the behaviour of regulates by drawing on both punitive and persuasive methods as required to respond to the conduct of a particular regulate. The wide base of the pyramid is given to methods that have no penalty attached to them but operate by persuasion. Regulators are expected to work upwards through the escalating ranks leaving the most punitive measures until it is clear that the behaviour of the regulator is not amenable to any less drastic action.

The most attractive feature of the pyramid is that unlike the OIS models discussed here which give little guidance about how their various elements should be applied in any particular context, the pyramid is clear in advocating an escalation approach based on the behaviour of the regulated in a given regulatory environment. The strategic orientation (as required by the OIS model) of the pyramid comes from this idea that each level is engaged in turn in response to the regulated's conduct. A critical difference in the use of these two models is that the pyramid is designed for use by public regulatory authorities not inside organisations. In Australia, the pyramid has been adapted to many regulatory contexts including revenue collection, health and safety and the enforcement of quarantine rules for imports. Applications of the pyramid still usually occur in context of the regulation of an industry or statutory regime such as revenue collection, environmental protection and enforcement of safety standards.

The pyramid can be adapted, at least superficially, to the organisational context with few adjustments. The first is the identity of the regulated. When the regulatory environment is an organisation, rather than a community or industry, the individual employee is the subject of the enforcement pyramid but within a particular context. The second adjustment follows the first. If the regulate is the employee, then the 'regulator' must be the management of the organisation in the form of the supervisors and managers who have the authority to represent the organisation for the purposes of managing compliance. In his application of the Ayres and Braithwaite's (1992) pyramid to the enforcement of compliance with an organisation's code of conduct Brien (2001) proposed the following model ~~(2001):~~



This pyramid is concerned with the enforcement of a particular regulatory tool, the code of conduct, it does not aim to incorporate the whole of an organisation's integrity system. An initial attempt to do so could look like the following model which captures the essential principle of diversity, by incorporating both persuasive tools (training, counselling) and punitive ones (discipline and dismissal). It also allows for escalation in applying mechanisms by beginning with widespread education about rules, reinforced by supervision of employee compliance with the rules, closer monitoring and, in the event of breach, the capacity to report, investigate, discipline and/or dismiss the employee.



OIS Pyramid version1

Even this pyramid does not include the full range of mechanisms that are articulated in most OIS models or exist in most organisational governance arrangements. Systems for performance management, internal reporting, regular audit cycles, accountability and control are all routine features of organisational governance that, as the OIS models all acknowledge are designed to operate continuously regardless of non-compliant events to which management in the role of regulator might

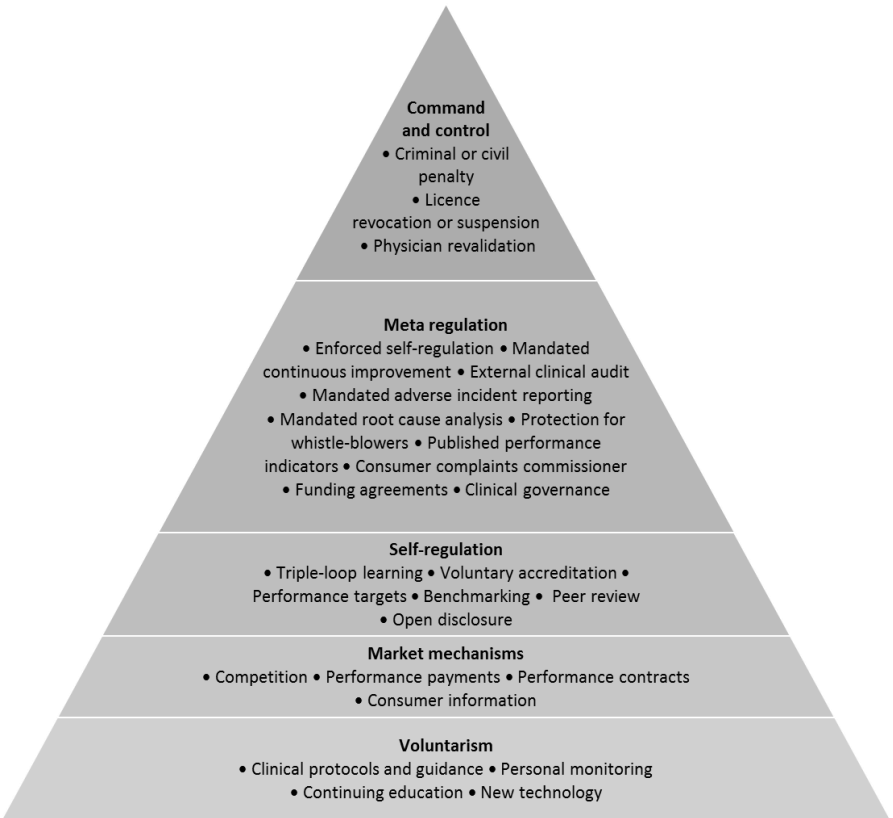
respond with escalation up the pyramid. Not only might this pyramid be incomplete, it still suggests a 'catching crooks' paradigm that depends on reactive intervention by the regulator prompted by the employee's behaviour. As Black (2001a) says it is 'trapped in the compliance/deterrence dialectic' seeing regulators as only either punishing or persuading. She argues that regulators can take on other roles, giving as examples conciliation, education and the importance of building regulatory capacity within organisations. These roles all resonate with the principles of an OIS.

They are also roles that might be labelled 'preventive' in Sparrow's (2000) classification of regulatory mechanisms as reactive, proactive or preventive. Preventative mechanisms such as organisational or work structures and education might be classified as proactive in some contexts. Equally early detection can easily lead into reactive measures.

These measures can be seen as part of a continuum that could look like the following:

PROACTIVE	PREVENTATIVE	REACTIVE
Research/intelligence ⇨ education ⇨ structure ⇨ control ⇨ early detection ⇨ investigation ⇨ penalty		

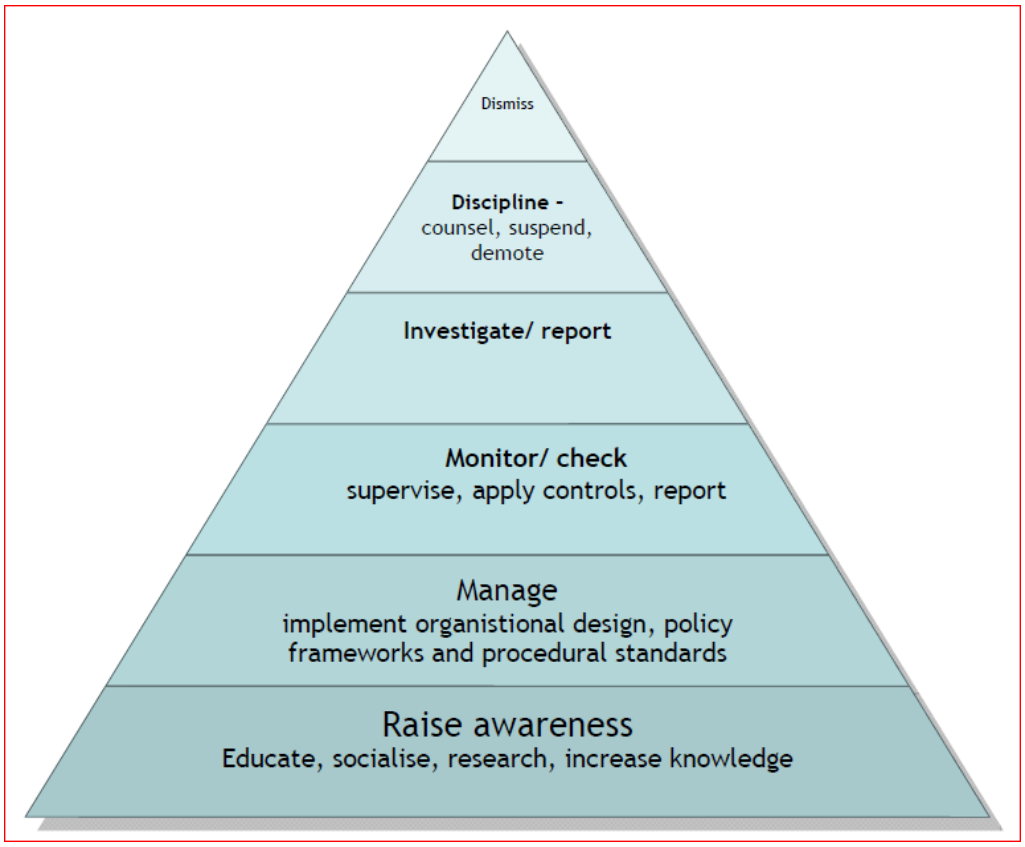
The following model has met this challenge by expanding the middle of the pyramid to include a wide range of mechanisms that exist in the regulatory environment for quality and safety in health care (Healy and Braithwaite, 2005).



Regulatory pyramid and examples of safety and quality mechanisms (Healy and Braithwaite 2005)

The way these mechanisms are ordered might also be instructive for a public sector agency. The pyramid progresses from broad base to narrow peak according to the degree of regulatory intervention required as well as the likely scope of its application. In an organisation the mechanisms at the lower levels of the pyramid will apply to all employees. Mechanisms are being operated in the absence of any known misconduct for the purposes of promoting organisational integrity, an ethical climate or corruption resistance (depending on which OIS model is being implemented). They will continue to apply to all employees even as some employees begin to move up the pyramid.

Based on this example, the next version of the organisational integrity pyramid would appear as:



OIS Pyramid version 2

The next consideration in applying the pyramid to OIS mechanisms is how the escalation process would actually work. Black (2001a) maintains that 'compulsory escalation' up the pyramid is too simplistic and rigid for most regulators and this may be the case in many organisations. The infinite nuance and complexity of organisational behaviour calls for the maximum discretion that might legitimately be allowed in the circumstances. Nevertheless the purpose of our present exercise is to find ways to guide managers' decisions about applying OIS mechanisms in their organisations and the

concept of escalation is one useful way to consider what a strategic application of and OIS might look like.

The below table tests the adapted pyramid with a worked example of an organizational response to an employee's undeclared conflict of interest in an organisation. It is a simple, and hypothetical, example but it shows demonstrates that the pyramid is capable of modelling a relationship between the regulated-regulator even when it exists inside an organisation and engage preventative as well as reactive mechanisms. The OIS mechanisms that are employed appear in italics.

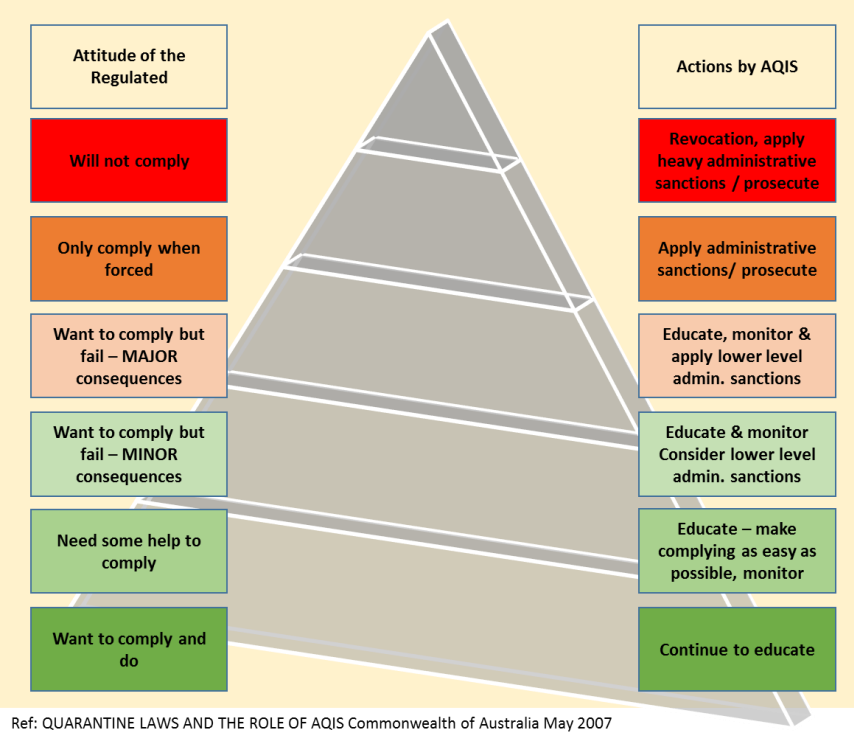
Objective	Example
Level 1: Raise awareness	A new employee receives an *induction* that includes a copy of and training in the *code of conduct* that refers to conflicts of interest procedures.
Level 2: Manage	The employee goes to work in the organisation's procurement division and is consequently subject to the organisation's *conflict of interest procedures* which require disclosures of conflicts of interest (potential, actual and perceived) as a standard declaration in all purchasing documentation submitted for approval.
Level 3: Monitor and check	The manager of the procurement division *authorises purchases* based on the *documentation* submitted and reviews any conflicts disclosures made. The *database of conflict of interest declarations* are reviewed by the designated conflicts of interest officer on a regular basis. The organisation's internal audit program conducts a *2 year cycle of file audits* that includes procurement records.
Level 4: Report and investigate	The organisation has a confidential *internal reporting system* for employees to report improper conduct that breaches proper procedure. An allegation that the employee has awarded a contract to a related contractor is received this way. The organisation's *internal investigations staff* investigate the allegations with reference to the informant, the conflicts database and the audit report and establishes that the allegation has substance.
Level 5: Discipline	Based on the findings of fact (eg, small amount of money, no direct personal benefit, the related contractor met the specifications) the employee is *formally warned* and *demoted*. ALTERNATIVELY, OR IN THE EVENT OF REPEATED CONDUCT …
Level 6: Dismiss	Based on the seriousness of the conduct the employee is *dismissed* from the organisation.

In this example the actions of the regulator employer become more specific to the individual employee at each level of intervention. Measures at the first level apply to all employees. Those at the next level apply to those working in procurement and so on until the persistent perpetrator is punished.

Larmour and Wolanin (2001), for example, divide 'most people who work in organisations' into three groups, those who:

- want to do the right thing and need varying degrees of guidance about what the right thing is to do;
- are too timid to take the risk of operating outside the rules and limit any deviance to technical, sometimes clever, compliance with rules;
- will operate outside the rules entirely regardless.

The AQIS enforcement pyramid (Commonwealth of Australia 2007) uses similar classifications to explicitly make connections between regulatory tools and regulates.



Ref: QUARANTINE LAWS AND THE ROLE OF AQIS Commonwealth of Australia May 2007

Black (2001a) suggests four contextual factors that can affect regulatory effectiveness: the legal framework, the broader context, organisational practices and relationships between regulator and regulatee.

At the organisational level these factors can be adapted to:

- the quality of the organisation's policies and procedures,
- the environment in which the organisation operates such as industry, government policy framework, social and economic changes,
- the organisation's operating norms and practices, and
- the way managers manage their staff and the organisation.

Some norms and practices become the kind of 'under the radar behaviour' that might constitute invisible risks such as withholding effort, or shirking, in the workplace (Bennett and Naumann, 2006). In the language of fraud detection they can be 'red flags' ('anomalies that are behavioural, statistical or organisational' (Grabosky and Duffield, 2001) and can indicate a larger problem if enough information is available to identify them.

The regulatory personality of managers in organisations have characteristics that can influence the way individual employees comply with organisational rules. Braithwaite's spectrum of regulator types that can help understand the regulatory behaviour of an organisation's managers (quoted in Black 2001a):

Even at lower levels of management those seen as organisational leaders are understood to influence the moral decision making of others (such as employees') by their own moral decision making and by their leadership style (Trevino, Hartman and Brown, 2000). Tomlinson and Greenberg, for example, concluded that employee theft in an organisation can be influenced by employees seeing managers engage in improper conduct themselves (2006) or perceiving injustice in the workplace. Sunahara (2004) reached similar conclusions in studies of police misconduct and tolerance of misconduct. The fair, or unfair, treatment of employees is something that is often within an individual manager's control and part of the management style of some organisations. In Brien's analysis using the pyramid to guide regulatory interventions in fact helps to promote fairness. He maintains that escalating enforcement on the basis of principles of 'proportionality and due process' (Black 2001a) engenders trust which 'encourages ethical action'.

To maintain the pyramid shape this kind of information could be captured at Level 4 – Investigate or the model might include an arrow that directs the information to Level 1 – Awareness where ideally a risk assessment is performed in any event. As it stands, the pyramid implies that information has been collected and analysed at a number of points. Level 1 Raise awareness identifies 'education; knowledge; socialisation; and research' as activities. The risk assessment process could be included in this level as well or it could form a foundation for the pyramid to rest on.

Appendix 5

This Appendix contains a sketch of all seven case studies presented in the Chapter 4, namely (i) VTB Bank and (ii) Bank of Moscow (merged into VTB); (iii) BNP Paribas; (iv) JP Morgan; (v) Bank Uralsib; (vi) GE Money; (vii) Deutsche Bank, that outline for each specified banks their organisational structure and compliance governance structure, the relationship between the compliance function with senior executives and with other internal departments, the relationship between the bank and the regulator and, finally, any known regulatory breaches or violations.

Name of the Bank	**Status of the Bank** (State/ Private/ Foreign)	**Market share**	**Core categories of customers**	**Net profit**
VTB (with merged Bank of Moscow)	State	VTB Group is a leader in the Russian and international financial services markets, and is Russia's second-largest financial group. The Group has an extensive branch network in Russia with over 1,350 offices, and has a presence in the world's key financial centres.	Corporate and retail customers	RUB 140 billion (2018 year)
BNP PARIBAS	Foreign	BNP Paribas is a French international banking group. It is the world's 8th largest bank by total assets, and currently operates with a presence in 77 countries (as of Nov'17).	Corporate and retail customers	RUB 7.7 billion (2017 year)
JP Morgan Chase	Foreign	J.P. Morgan is the world's 6th largest bank by total assets, has operated in Europe for nearly 200 years and has a sophisticated local market presence across Europe, the Middle East and Africa (EMEA).	Corporate and retail customers	USD 25.4 billion

URALSIB	Private	Public JSC «Bank Uralsib» - on of the leading commercial bank in Russia, included in TOP30 Russian banks. Main business activity - retail, corporate and investment-banking business.	Corporate and retail customers	9Month 2018 net profit Rub 5.6 billion
Sovcombank (GE MONEY BANK)	Private	Sovcombank is one of the largest in terms of assets and most profitable banking groups in the Russian Federation (TOP-30).	Corporate and retail customers	9Month 2018 net profit Rub 5.5 billion
DEUTSCHE BANK	Foreign	Deutsche Bank is Germany's leading bank, with a strong position in Europe and a significant presence in the Americas and Asia Pacific. It is the world's 15th largest bank.	Corporate and retail customers	EUR 6.2 billion (Q3 2018 year)

1-2. VTB Bank with merged Bank of Moscow

General information:

VTB Group is an international provider of financial services, comprised of over 20 credit institutions and financial companies operating across all key areas of the financial markets.

VTB Group is a holding company with one strategically aligned development model, including a common brand, centralised financial and risk management, and integrated compliance systems.

VTB Group's global network is unique to the Russian banking industry. It enables the group to facilitate international partnerships and promote Russian companies aiming to engage with global markets.

VTB Group operates a large international network across CIS countries; Armenia, Ukraine, Belarus, Kazakhstan and Azerbaijan. VTB also has banks in Austria and Germany which are part of the European sub-holding headed by VTB Bank (Europe) SE. The Group also has subsidiary and affiliated banks in the United Kingdom, Cyprus, Georgia and Angola and branches in China and India and VTB Capital has branch in Singapore.

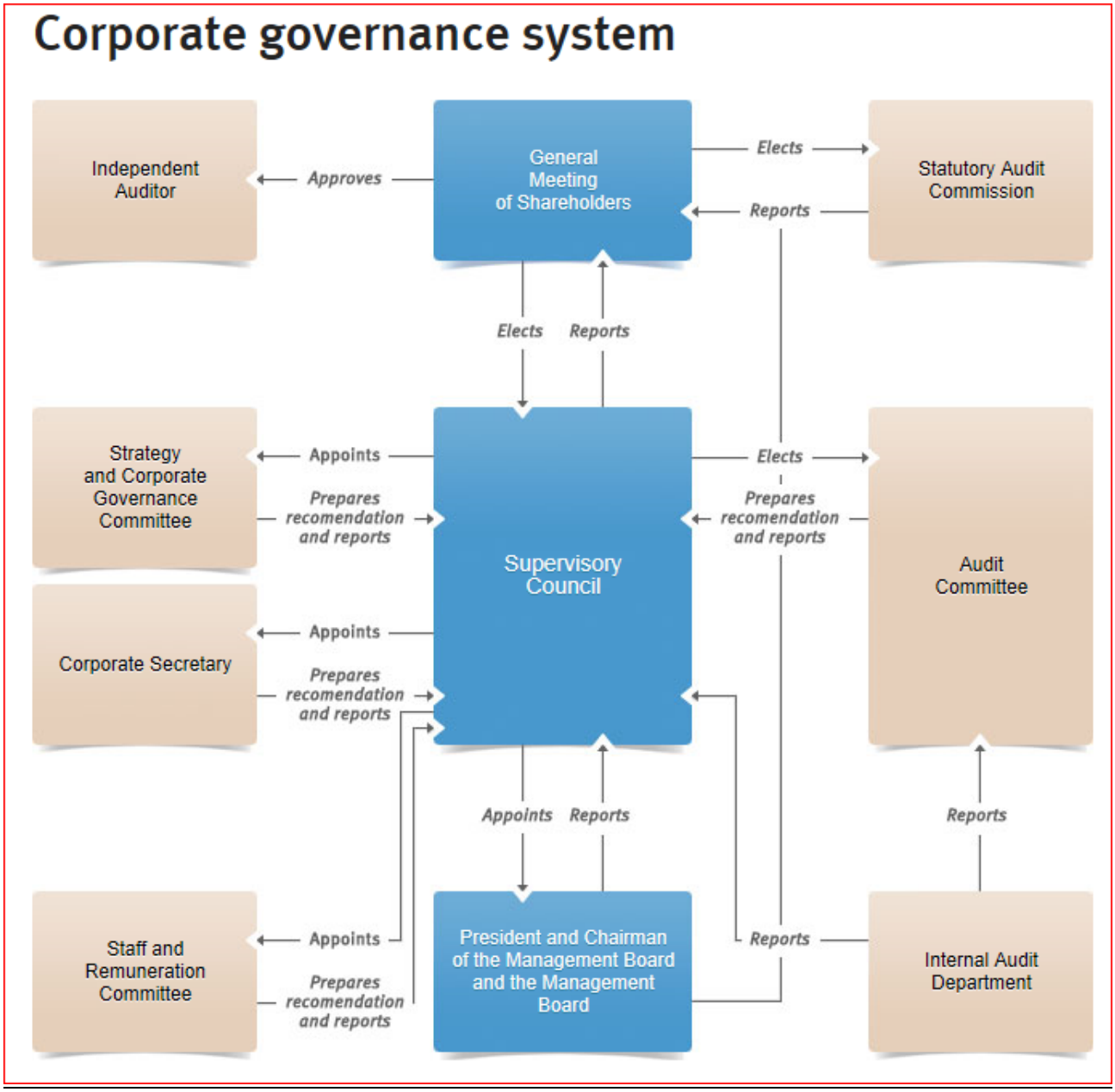
As of 1 December 2018, the Bank's majority shareholder is the Russian Federation, which owns 60.93% of the bank's ordinary shares through the Federal Agency for State Property Management. The Ministry of Finance of the Russian Federation holds 100% of Type 1 preference shares, and the Deposit Insurance Agency holds 100% of Type 2 preference shares of the Bank. The aggregate stake of the Russian Federation (through the Federal Agency for State Property Management and the Ministry of Finance), and the Deposit Insurance Agency is 92.23% of the Bank's share capital.

Traditionally, VTB Bank's core business focus is corporate customers. Main areas of business in this segment are to provide integrated services to groups of companies that generate revenue of Rub 10+ bln in the «market-based» industries and to serve major construction firms, government institutions and defense contractors, and also to deal with mid-sized businesses. As for operations with mid-sized enterprises, the bank provides customers that report revenue of Rub 300 mln to Rub 10 bln with a wide range of standard banking services, and also specialized services to municipal companies. Integrated corporate services include remote banking, guarantees, documentary and depositary operations, stock market transactions, precious metal operations, etc.

VTB Bank's clientele is around 4,000 major corporate customers and borrowers, among which the following companies stand out: Gazprom, Rosneft, Moscow Regional Energy Selling Company, Atomstroyexport, NPO Saturn, National Reinsurance Company, Polymetal, Mikhaylovsky GOK, TMK, SUEC, Rostelecom, Synergy Group, Tekhnologiya Metallov Group, Russkoye More Group, Dixie Group, X5 Retail Group N. V., Seventh Continent, M. Video, Detsky Mir, and Sportmaster.

As a result of integration with the Bank of Moscow, since May 2016 VTB Bank has served retail customers (earlier retail operations and also those involving small businesses were centered at VTB 24, another VTB Group bank). At present, VTB Bank provides households and small enterprises with a full range of banking services, including credit and deposit products, cash settlement services, currency exchange and documentary operations, and remote banking.

Governance system:



VTB Bank's corporate governance system is based on the principal of full compliance with the requirements of Russian legislation and the Bank of Russia, and the recommendations of the Russian Federal Financial Markets Service. It also takes into account best international practices, including globally recognized principles of corporate governance developed by the Organization for Economic Cooperation and Development (OECD, 2004). VTB Bank seeks to ensure that all its shareholders are treated equally, and to give them an opportunity to participate in the management of the Bank via the Annual General Meeting of Shareholders, and to exercise their right to receive dividends and information about the Bank's operations.

The Annual General Meeting of Shareholders is VTB's supreme governing body. The Bank's Supervisory Council, which is elected by the shareholders and reports to them, provides strategic management and oversight of the work of the executive bodies, namely the President and Chairman of the Management Board. The executive bodies are responsible for the day-to-day management of the Bank and for carrying out the tasks entrusted to them by the shareholders and the Supervisory Council.

VTB Bank has set up an effective system of corporate governance and internal control of its financial and economic affairs as a means of safeguarding the rights and lawful interests of its shareholders. The Supervisory Council oversees the Audit Committee which, in conjunction with the Internal Audit Department , supports the management function in ensuring the smooth running of the Bank's operations. The Audit Commission monitors the Bank's compliance with the relevant laws and regulations and the legality of its business transactions.

The Supervisory Council's Strategy and Corporate Governance Committee was established in order to optimise the decision-making process of the Supervisory Council on issues of strategic development and to improve VTB's corporate governance, and to prepare proposals on the strategic management of the Bank's own capital.

The governance system strategy for 2010–2015 aims to bring the strategy into line with VTB Group's current objectives, including strengthening the role of product and business lines.

VRB is not a member of VTB Group. However, the Bank may exercise significant influence over its activities due to its large holding of VRB shares. VTB Group governance aims to leverage the Group's competitive edge, increase its share of target markets, enhance its performance indicators and strengthen VTB Group's capitalization.

VTB Internal Control

The internal control system comprises a number of bodies that collectively ensure that VTB complies with Russian law and the Bank's own internal regulations.

Internal control aims to ensure:

- the economic efficiency of the Bank's transactions and other deals, as well as efficient asset and liability management;
- accurate, complete, objective and timely preparation and submission of financial, accounting, statistical and other reporting, as well as information security;

- compliance with regulations and standards for self-regulating organizations (or professional participants of the securities market), as well as VTB Bank legal documents and internal regulations;
- that VTB Bank is not involved in any illegal activity, including legalization of the proceeds of crime and funding of terrorism.

The main aim of internal control is to support consistent and efficient business operations by the Bank's executive governing bodies and heads of business units.

Risk Management

Risk-taking is a core part of business, and risk management is therefore a core control function. The principal risks facing business are credit risk, liquidity risk, market risk and operational risk. At Group level, risk management includes risk evaluation and monitoring, oversight of size and distribution of risks, and identification of efficient methods to optimise the risk-reward balance of operations.

VTB's risk management is based on the following principles:

- analysis and management of financial risks on a consolidated basis, covering all of the Group's Russian and international subsidiary banks and key financial and non-financial companies;
- delineation of Group members' levels of competency, and clear allocation of decision-making responsibilities among collective bodies and individual officers and managers;
- independence of risk assessment and control functions from business and operational banking functions;
- application of state-of-the-art risk-assessment methods and models;
- a rigorous reporting system at each level of management.

Preventing money laundering and the financing of terrorism

VTB's anti-money laundering and counter terrorist financing policy (AML/CTF) is developed in line with Federal Law No.115-FL dated 07.08.2001 'Measures to Combat Money Laundering and the Financing of Terrorism' and Bank of Russia recommendations.

On measures taken by JSC VTB Bank to prevent money laundering and the financing of terrorism

In accordance with the Federal Law 'On Measures to Combat Money Laundering and the Financing of Terrorism' and Bank of Russia recommendations to enact internal control on money

laundering and the financing of terrorism, VTB Bank Group developed and implemented: a consolidated policy on countering money laundering and terrorist financing (available at www.vtb.ru); internal control rules on countering money laundering and terrorist financing; and the directive on preparing and submitting information covered by the Federal law 'On Measures to Combat Money Laundering and the Financing of Terrorism'.

JSC VTB Bank appointed Alexander G. Yakovlev (Phone: +7 (495) 783-13-25, Fax: (495) 739-77-98, e-mail: alexander.yakovlev@msk.vtb.ru), the Head of Compliance Control and Financial Monitoring of VTB Bank, to oversee Bank divisions' compliance with measures to combat money laundering and terrorist financing, and to implement programmes to this end.

JSC VTB Bank does not establish or maintain relations with non-resident banks that do not have any standing regulatory bodies on the territory of the countries of their incorporation. JSC VTB Bank has no accounts in banks registered in those countries that do not abide by regulations to counter money laundering and terrorist financing (as can be understood from international sources).

The main objectives of the VTB Group compliance control system are:

1.) Compliance of VTB Group companies with the legislation of the country of registration, internal regulations, standards of self-regulatory organisations, and common business practice;

2.) Effective management of regulatory (compliance) risks;

3.) Creation and maintenance of an effective system of governance information and reporting;

4.) Preventing the involvement of VTB Group stakeholders or employees in unlawful activities (including corruption), improper use of insider information and market manipulation;

5.) Maintenance of VTB Group's strong reputation and raising its investment appeal on the financial market.

The main requirements of the internal control (compliance) system, the standards and principles of its functioning within VTB Group, the distribution of powers and areas of responsibility are set out in the Group's internal documents.

Prevention of money laundering and financing of terrorism.

Implementing the functional coordination of VTB Group companies' activities in the sphere of preventing money laundering and terrorism financing (hereinafter AML/CFT), VTB Bank has developed

Group-wide standards of financial monitoring and is ensuring compliance on the part of subsidiaries. Ongoing communication between specialist divisions of Group companies means money-laundering and terrorist-financing risks can be managed on a systematic basis.

The Bank pays close attention to the effectiveness of its internal audit system for AML/CFT, considering it an investment into the Bank's stability, reliability and good reputation, as well as a guarantee for the protection of the interests of creditors and depositors.

As part of its efforts to maintain a high- quality client base, VTB Bank carries out all necessary client identification and investigation procedures, and also works systematically with financial institutions in the form of correspondent relations. In the process of this work with correspondent banks, information about measures being implemented in the sphere of AML/CFT is periodically exchanged, and the monitoring and oversight over client operations are constantly being improved.

Drafts of all internal documents setting out procedures for providing banking products and services are submitted for obligatory assessment to identify any possible abuse of the product (service) for money laundering purposes. If necessary, measures to minimise these potential risks are taken by establishing the necessary control procedures.

Training Bank personnel is an essential element in the development of an internal control system for AML/CFT goals and is conducted in accordance with the requirements of the Bank of Russia and the Russian Federal Financial Monitoring Service.

The Bank set up internal Anti-Money Laundering and Counter-Financing of Terrorism (hereinafter referred to as AML/CFT) policies and guidelines designed to counter money laundering and terrorism financing, which are to be followed up by all Bank business units, its branches and offices operating on the territory of the Russian Federation. The Bank of Moscow entities incorporated and operating outside the Russian Federation are subject to the AML/CFT laws of the countries of their jurisdiction.

The principal aims and objectives of the Bank AML/CFT policies are:

- To ensure that the Bank of Moscow entities comply with all relevant money laundering legislation/regulations in jurisdictions they are incorporated and operate.
- To ensure the identification of the customers and beneficiaries and proper management of money laundering risk, terrorism financing.
- To monitor their accurate implementation.
- To protect good name and business reputation of the Bank of Moscow and of its customers.
- To promote a Know Your Customer policy as a key principle for the Bank business operations.

- The minimum standards applicable to all Bank entities include:
- Activity the Financial Control and Compliance Department (FCCD) for implementing AML/CFT policies and procedures and for compliance with relevant legislation, regulations, rules and best practices within the Bank.
- Establishing and maintaining a risk based approach while accessing and managing money laundering and terrorism financing risks.
- Establishing and maintaining risk-based Know Your Customer procedures, identification and verification guidelines, customer due diligence, including enhanced due diligence for high risks customers.
- Internal procedures for reporting of mandatory and/or suspicious transactions/activities.
- Maintenance of appropriate records within the required periods.
- Training of all relevant employees on the provisions of relevant anti-money laundering legislation and internal rules.

Maintenance of appropriate line of communication, internal controls, monitoring and reporting to ensure that the AML/CFT policies are fully understood and are being complied in practice.

All Bank employees are to adhere to these standards in preventing the use of its products and services for money laundering and terrorism financing purposes.

Declaration by a group of Russian banks

In order to combat the penetration of criminal capital into national economies and to counter the financing of terrorist activities, many countries in the world have created or are in the process of creating national mechanisms to counteract the laundering of criminal income and join forces in this area under the auspices of international organizations.

The Russian Federation also joined the international system of measures aimed at preventing the legalization of criminal income and terrorist funding and is an active participant of the Financial Action Task Force (FATF) and the Egmont Group. Russian law on money laundering and financing for terrorism incorporates major recommendations developed by the international community.

Since many products and services offered by banks are used as instruments for money laundering and in funding terrorism, and given the need to act in accordance with the applicable Russian law in this area.

THE SBERBANK OF THE RUSSIAN FEDERATION, VTB BANK, VNESHECONOMBANK, ALFA BANK, BANK OF MOSCOW, BANK ZENIT, INTERNATIONAL MOSCOW BANK, and RAIFFEISENBANK AUSTRIA

(MOSCOW)

declare that, in their professional activities, they will be guided by the following principles:

- Declaring the inadmissibility of the Bank's utilization for money laundering and terrorism financing purposes;
- Identifying all Bank customers;
- Applying the 'know ycustomer' principle to each of the Bank's customers;
- Banning the opening of bearer accounts;
- Establishing correspondent relations only with financial institutions that take measures aimed at preventing money laundering and the financing of terrorism;
- Banning correspondent relations and transactions with 'shell banks' that have no physical presence at their registered address;
- Informing the Federal executive body empowered to fight money laundering and terrorism financing (FSFM) in a timely fashion of transactions subject to reporting.

Given the complexity of the measures the Russian banking community must take in its work to combat money laundering and the funding of terrorism, in addition to meeting Russian legal requirements and implementing recommendations by those international organizations of which the Russian Federation is a part, these banks will also undertake joint actions, including:

- Sharing experience in the area of internal controls aimed at preventing money laundering and the financing of terrorism;
- Developing joint approaches to implementing the principle 'Know ycustomer';
- Jointly developing methods to identify suspicious transactions and financial schemes and of the standard characteristics of money laundering and terrorism financing transactions;
- Pursuing a united policy towards correspondent banks;
- Developing a unified approach to staff training on the issues of money laundering and funding for terrorism; holding joint training seminars, round tables, research-and-practical conferences;
- Preparing joint proposals on improving the legal and normative base regarding money laundering and funding for terrorism and sending them to the Bank of Russia, the Federal Service for Financial Markets and the Federal Service for Financial Monitoring; rendering practical assistance to these institutions in the development of normative documents in this field;
- Developing coordination between these 8 banks on a voluntary basis;
- Developing cooperation with Russian and foreign banks, their groups and associations interested in strengthening and improving Russian and international systems of money laundering and the funding of terrorism.

Other Russian credit institutions that share principles and intentions outlined are welcome to sign up to this Declaration.

Links:

http://www.vtb.ru/group/management/
http://www.vtb.ru/ir/governance/
http://www.vtb.com/group/management/
http://www.vtb.com/group/management/guide/
http://www.vtb.com/group/management/council/
http://www.vtb.com/financial/policy/

2. BNP Paribas

General information:

With both a retail banking section and investment banking operations, the bank is present on five continents. Its retail banking networks serves more than 30 million customers in its three domestic markets, France, Belgium and Italy through several brands such as BNL and Fortis. The retail bank also operates in the Mediterranean region and in Africa. In the Americas, it operates in the western United States as Bank of the West and is Hawaii's most important banking group through its majority-owned subsidiary First Hawaiian Bank. As an investment bank and international financial services provider for corporate and institutional clients, it is present across Europe, the Americas, and Asia. BNP Paribas is the largest French banking group and the largest bank in the Eurozone. It became one of the five largest banks in the world following the 2008 financial crisis. Despite some legal difficulties in the United States in 2014, including being fined the largest ever sum as reparation for violating US sanctions, it remains one of the ten largest banks worldwide.

The firm is a universal bank split into two strategic business units: Retail Banking & Services, and Corporate and Institutional Banking (Global Markets, Security Services, Treasury, Finance and advisory). Retail Banking & Services includes the Group's retail banking networks and specialized financial services in France and around the world. It is divided into:

- Domestic Markets (comprises the Group‘s 4 retail banking networks in the Eurozone and 3 specialised business lines:

  - Arval (full-service, long-term corporate vehicle leasing);
  - BNP Paribas Leasing Solutions (rental and financing solutions);

- BNP Paribas Personal Investors (digital banking and investment services).
- Cash Management and Factoring round off the services offered to corporate clients.
- BNP Paribas Wealth Management is developing its private banking model in the Group‘s domestic markets.

- International Financial Services (IFS) (comprises diversified, complementary business activities and is present in more than 60 countries.

  BNP Paribas Personal Finance offers credit solutions to individuals in around 28 countries through strong brands such as Cetelem, Cofinoga and Findomestic. International Retail Banking encompasses the Group‘s retail banks in 15 non-eurozone countries, including Bank of the West in the United States,TEB in Turkey and BGŻ BNP Paribas in Poland. BNP Paribas Cardif provides savings and protection solutions in 36 countries, insuring individuals, their personal projects and assets. In addition, IFS has 3 specialised business lines that are leaders in asset management and private banking: BNP Paribas Wealth Management (private banking); BNP Paribas Asset Management; and BNP Paribas Real Estate (real estate services).

  In Russia there are 4 BNPP group entities, which provide the following services:

  1) Corporate and Investment Banking ("BNP PARIBAS Bank» JSC);
  2) Retail banking services ("Setelem Bank" LLC, the share of BNP Paribas 20,8%, the rest of the Savings Bank);
  3) Leasing services (cars) ("HARWAL" LLC).
  4) Insurance (JSC "Insurance company Cardif").

Corporate Governance

The Board of Directors is a collegial body that collectively represents all shareholders and acts at all times in the corporate interests of the Bank. It is tasked with monitoring its own composition and effectiveness in advancing the Bank’s interests and carrying out its duties.

The Corporate Governance Code referred to by BNP Paribas on a voluntary basis in this report is the Corporate Governance Code for Listed Companies published by the French employers’ organization Association Francaise des Entreprises Privees (Afep) and Mouvement des Entreprises de France (Medef). BNP Paribas applies the recommendations of this Code, hereinafter referred to as the Corporate Governance Code, which can be viewed on the Afep website (http://www.afep.com) and the Medef website (http://www.medef.com). In addition, the special guidelines on the participation of the shareholders at the Shareholders’ General Meeting are laid out in article 18, Title V Shareholders

Meetings of the Bank's Articles of Association published in the Registration Document and the annual financial report, in the section Founding Documents and Articles of Association.

Principles of Governance

The Internal Rules of the Board of Directors are appended to this report. They lay out the way the Board operates, the division of responsibilities between Executive Management and the Board of Directors, the mandates and operations of the specialised Committees and the behaviexpected of Directors and non-voting Directors.

a. The duties of the Board of Directors

- The Internal Rules adopted by the Board in 1997 define the duties of the Board and of its specialized Committees. They are updated periodically to comply with current laws, regulations and market guidelines, and to keep pace with best practice in the area of corporate governance. The last update was made in early 2014 in order to include the June 2013 version of the Corporate Governance Code.
- The specialised committees of the Board of Directors are the Financial Statements Committee, the Internal Control, Risk Management and Compliance Committee, the Corporate Governance and Nominations Committee and the Compensation Committee.

The Internal Control, Risk Management and Compliance Committee carries out its duties in a way that is independent of and complementary to the Financial Statements Committee, which is responsible for monitoring matters relating to the preparation and auditing of accounting and financial information. These two committees meet together twice a year to deal with issues relating to the risks and provisioning policy of BNP Paribas, to consider the internal and external audit plans, and to prepare the work of the Board on the assessment of risk management policies and mechanisms. In 2014, it was decided that any risks liable to have a material impact on the financial statements would henceforth be systematically reviewed at a joint meeting of the two Committees, which work on the basis of documentation prepared jointly by the Group's Chief Financial Officer and the Head of Group Risk Management, and, when necessary, by the General Counsel. These three people and the Head of Compliance attend meetings, thereby allowing a comprehensive review of risks.

The composition of the two Committees and the work they do in their respective fields are intended to fulfil the requirements of banking and prudential discipline, whether provided by law, contained in provisions defined by regulators and supervisors, or included in rules imposed by BNP Paribas itself to ensure the quality of its internal control and risk policy.

b. Separation of the functions of Chairman and Chief Executive Officer

Since 2003 BNP Paribas elected to separate the offices of Chairman of the Board and Chief Executive Officer. This choice, maintained since then, is consistent with the obligations imposed on credit institutions since 2014.

The duties of the Chairman.

The Chairman is responsible for ensuring that the quality of the relationship with shareholders is maintained, coordinating closely with any steps taken by Executive Management in this area. In this connection, the Chairman chairs the Shareholder Liaison Committee, whose task is to assist the Bank in its communications with individual shareholders; several times a year, he invites the shareholders to meetings where the

Company's strategy is explained.

The Chairman provides support and advice to the Chief Executive Officer, while respecting his executive responsibilities. The Chairman organizes his activities so as to ensure his availability and put his experience to the Group's service. His duties are contributory in nature and do not confer any executive power on him. They do not in any way restrict the powers of the Chief Executive Officer, who has sole operational responsibility for the Group. At the request of the Chief Executive Officer, he can take part in any internal meeting on subjects relating to strategy, organisation, investment or disinvestment projects, risks and financial information. He expresses his opinions without prejudice to the remit of the Board of Directors.

Coordinating closely with Executive Management, the Chairman can represent the Group in its high-level relationships, particularly with major clients and public authorities, both at national and international level. The Chairman provides support for the teams responsible for covering major companies and international financial institutions; he also contributes to the development of the Bank's advisory activities, particularly by assisting in the completion of major corporate finance transactions. He provides support for Executive Management, or, at its request, represents the Bank in its relationships with national and international financial and monetary authorities. He plays an active part in discussions concerning regulatory developments and public policies affecting the Bank, and, more generally, the banking sector.

The Chairman contributes to promoting the values and image of BNP Paribas, both within the Group and externally. He expresses his views on the principles of action governing BNP Paribas, in

particular in the field of professional ethics. He contributes to enhancing the Group's image through the responsibilities he exercises personally in national and/or international public bodies.

The powers of the Chief Executive Officer

The Chief Executive Officer has the broadest powers to act in all circumstances on behalf of BNP Paribas, and to represent the Bank in its relation with third parties. He has authority over the entire Group, and is responsible for the organisation of internal control procedures and for all the information required by the regulations in that regard.

He exercises his powers within the limitations of the corporate object, and subject to any powers expressly attributed by law to the General Meeting of Shareholders and Board of Directors. Internally, the Internal Rules of the Board of Directors provide that the Chief Executive Officer shall request its prior approval for all investment or disinvestment decisions (other than portfolio transactions) in an amount in excess of EUR 250 million, and for any proposal to acquire or dispose of shareholdings in excess of that threshold (other than portfolio transactions) (§ 1)(1). The Chief Executive Officer must also ask the Board's Financial Statements Committee for prior approval of any non-audit related assignment involving fees in an amount of over EUR 1 million (excluding VAT).

c. Membership of the Board – Directors' independence

The composition of the Board of Directors and change thereto

Upon the proposal of the Board of Directors, the Annual General Meeting of Shareholders of 14 May 2014 renewed the term of Baudouin Prot, Jean-Francois Lepetit and Fields Wicker-Miurin, ratified the appointment of Monique Cohen to replace Daniela Weber-Rey, and reappointing her for a three-year term, and appointed Daniela Schwarzer to replace Helene Ploix, whose term expired at the end of the Meeting. Sixteen Directors attended this General Meeting.

At the end of the General Meeting of 14 May 2017, the Board of Directors had 16 members, 14 of whom had been appointed by the shareholders.

d. The Directors' Code of Ethics

As far as the Board is aware, none of the Directors is in a situation of conflict of interests. In any event, the Board's Internal Rules (§ 19) require them to report any, even potential, situation of conflict of interests and to refrain from taking part in voting on the relevant decision. The Internal Rules also require Directors to stand down should they no longer feel capable of fulfilling their duties on the Board.

As far as the Board is aware, there are no family ties between the members of the Board, and none of them has been found guilty of fraud or been associated, as the member of an administrative, management or supervisory body, or as the Chief Executive Officer, with any insolvency, receivership or liquidation proceedings during at least the last five years.

As far as the Board is aware, no member of the Board of Directors is subject to any official public accusation and/or penalty. No Director has been prohibited from acting in an official capacity during at least the last five years.

Apart from regulated agreements and commitments, there are no arrangements or agreements with key shareholders, customers, suppliers or other persons that involve the selection of any member of the Board of Directors.

The Directors must carry out their duties in a responsible manner, particularly as regards the regulations relating to insider dealing. They are notably required to comply with legal requirements relating to the definition, communication and use of insider information. Under the terms of the Internal Rules, they must also refrain from carrying out any transactions in relation to BNP Paribas shares that could be regarded as speculative (§ 18).

The Directors are informed of the periods during which they may, save in special circumstances, carry out any transactions in relation to BNP Paribas shares (§ 18).

Pursuant to the application of accounting standards, the Directors have confirmed that they have not received any financial support from BNP Paribas or from any company in the Group that was not provided on market terms.

e. Directors' training and information

– Pursuant to the Internal Rules, every Director can ask the Chairman or the Chief Executive Officer to provide him with all the documents and information necessary for him to carry out his duties, to participate effectively in the meetings of the Board of Directors and to take informed decisions, provided that such documents are necessary to the decisions to be taken and connected with the Board's powers (§ 4).

– The Directors have unrestricted access to the minutes of meetings of Board Committees.

– Meetings of the Committees provide an opportunity to update the Directors on the topical issues on the agenda. In addition, the Board is kept informed of changes in the banking regulations and reference texts concerning governance.

– An expanded Corporate Governance and Nominations Committee meeting was held on 23 September 2014 on the implementation of the governance component of the European Capital Requirement Directive 4 (CRD 4), which was transposed into French law in 2014. The final texts relative to the transposition were published in late 2014, and work is underway within the Committees and the Board of Directors to make the necessary adjustments.

– Upon taking up office, new Directors receive documentation about the Group, its characteristics, organization and recent financial statements, together with a set of references on the information available on the Group's website. The Board Secretary provides them with the main legal provisions relating to the definition, communication and use of insider information. He provides them with the Board's Internal Rules and organizes a programme of working meetings between them and the Group's operational and line managers, relevant to the requirements of their position and personal priorities.

– In 2018, recently appointed or elected Directors and those who wished to take part were invited to attend a half-day presentation devoted to risk, and a full day devoted to the BNP Paribas Securities Services (BP2S) business, its change and positioning change to accounting standards, stress tests and the Asset Quality Review (AQR) of the 130 largest European banks operating in the euro area and stress tests undertaken by the European banking authorities (risks), and the German and Polish markets. Directors who attended were able to meet the managers responsible for the relevant areas.

Compliance and internal control

The Board of Directors was given copies of the 2017 Report on Compliance and the 2017 Report on Permanent Control, Operational Risk and the Going Concern. It heard the comments of the Chairman of the Internal Control, Risk Management and Compliance Committee on these reports. It was informed of developments in the resources allocated to internal control.

It was briefed on the key results of periodic controls performed in 2017 and the first half of 2018, as well as a summary of the key observations made by General Inspection.

The Board noted that the audit plans presented by the Statutory Auditors enabled them to perform their work satisfactorily.

It was briefed on the findings of the control and security programme implemented by Executive Management, notably in respect of market trading. It reviewed the amount of gains and losses due to operational incidents and major disputes.

The Board monitored the implementation of the remediation plan requested by the US authorities, representing the translation of commitments made by BNP Paribas to control activities carried out in US dollars.

The Board was informed of the establishment by the Executive Management of change to the internal control system and the reinforcement of compliance and control means and procedures. The main thrusts of this change are the integration of the compliance line, under a new operational model, and the legal line, the creation of a Group Supervisory and Control Committee and the establishment of an Ethics Committee.

The Board, without the presence of the Chairman or the Chief Executive Officer, heard the report on the discussions held by the Internal Control, Risk Management and Compliance Committee with the Head of General Inspection, the Head of Periodic Control, the Head of Permanent Control and Compliance, the Head of ALM-Treasury and the Head of Group Risk Management, whose remit covers the whole of the Group's risk policy.

The Board reviewed the exchange of correspondence with the Autorite de Controle Prudentiel et de Resolution (ACPR) and the comments of the Internal Control, Risk Management and Compliance Committee. It was informed about relations with the foreign regulators, as reported by Executive Management.

BNP Paribas Group Financial Security Program

Subject: BNP Paribas Group Financial Security Program

BNP Paribas ("BNPP" or "the Bank") is a French multinational financial services company headquartered in Paris, France. The Bank is supervised on a consolidated basis by the Autorité de Contrôle Prudentiel et de Résolution and the European Central Bank. BNPP, including its branches and subsidiaries ("BNPP Group") is committed to economic sanctions compliance, the prevention of money laundering and the fight against corruption and terrorist financing.[1]

As part of these efforts, BNPP Group has adopted and maintains a risk-based compliance program (the "Financial Security Program") reasonably designed to ensure conformity with applicable anti-money laundering, anti-corruption, counter-terrorist financing, and Sanctions[2] laws and regulations in the territories in which BNPP Group operates. Significant resources and personnel are dedicated to this end, within an integrated Compliance Function.

The Financial Security Program consists of policies, procedures, training and controls (including independent testing) which are informed by international best practices.

As part of the Financial Security Program, the Bank has established standards in anti-money laundering, compliance with Sanctions, anti-corruption and counter-terrorist financing including:

- A Know Your Customer program designed to identify and confirm the identity of its customers, including, where applicable, their respective beneficial owners[3] and proxy holders;
- Enhanced due diligence for high-risk clients, politically exposed persons, or situations of increased risk;

- A policy not to process or otherwise engage in activity (regardless of currency) for, on behalf of, or for the benefit of, any individual, entity or organization targeted by French, European Union, United States authorities, United Nations or other applicable sanctions regimes (in particular, any activity involving directly or indirectly, Cuba, Iran, North Korea, Sudan, or Syria);
- Enhanced vigilance regarding financial institutions or territories which may be controlled by terrorist organisations targeted by French, European Union, United States authorities or United Nations, as well as scrutiny of payment transfers to/from these financial institutions or territories;
- Processes to update, as appropriate, customer due diligence information;
- Systems and processes to detect and report suspicious activity to the appropriate regulatory body; and
- Customer database screening, transaction filtering (prior to execution) reasonably designed to ensure compliance with Sanctions.

One of the main tasks of Compliance is to help ensure that BNP Paribas remains a trustworthy Bank, not only by complying with laws and regulations, but also by complying with the spirit of laws and regulations.

The Compliance function is evolving. Regulatory, geopolitical and societal changes place Compliance more and more at the crossroads of the strategy and everyday action of the bank and its customers.

Compliance also has to ensure the security of the Group, its business lines and territories, which implies adapting to the growing demands of regulators, customers and public opinion.

BNPP Group has adopted and maintains a risk-based compliance program ("the Financial Security Program") reasonably redesigned to ensure conformity with applicable AML, anti-corruption, counter-terrorist financing, and Sanctions laws and regulations in the territories in which BNPP Group operates. Significant resources and personnel are dedicated to this end, within an integrated Compliance function. The Financial Security Program consists of policies, procedures, trainings and controls (including independent testing) which are informed by international best practices.

Compliance function includes:

- Know Your Client (KYC)

The KYC Domain defines the Group policies related to client knowledge (identification, information and documentation, risk assessment, acceptance process) and monitors their enforcement. It assists the Business Lines in the policies implementation and operational efficiency. It also defines the generic control plan and key metrics related to the KYC process.

- Financial Security

The “Group Financial Security” (GFS) domain is a department divided into two teams, one located in Paris and the other in NYC. GFS Paris is primarily responsible for the prevention of money laundering and the fight against corruption and terrorist financing, while the main role of GFS U.S. is to supervise and coordinate the Group’s efforts to comply with U.S. and other international sanctions and embargoes.

- Protection of Interests of Clients (PIC)

The mission of the « Protection of Interests of Clients » (PIC) domain is to make sure that BNP Paribas clients:

  - are offered products and services that truly meet their needs
  - are provided with clear and accurate information on product features, costs and risks.
  - In that purpose, the PIC domain is ensuring Compliance with complex and changing local regulations designed to protect the clients’ interests:

- throughout the duration of its relationship with the clients,
- throughout the life cycle of all products and services that BNP Paribas develops or sells.

PIC Compliance Officers work therefore with business lines to help them reinforce the primacy of clients' interests in their practices.

- Market Integrity

The “Market Integrity” domain is committed to ensure the Group activities compliance with:

1. The rules applicable to : circulation of confidential and privileged information and prevention of insider trading, operations on financial instruments, pre and post market transparency rules, prevention and detection of market abuse, detection and management of conflict-of-interest situation.

2. The rules governing the organisation and rules of conduct applicable to the Group as a producer of financial services and instruments.

- Professional Ethics

Professional Ethics refer to the professional behavior of the Group’s employees: the domain ensures that their private interests do not prevail over the professional responsibilities of the Group’s employees. As such, the domain establishes professional conduct rules, part of the Group Code of Conduct, aiming at protecting the Group and its employees against the risk of corruption, market abuse and conflicts of interests.

Links:

Corporate Governance http://www.bnpparibas.com/en/about-us/corporate-governance/board-directors
Compliance http://www.bnpparibas.com/en/about-us/compliance
https://group.bnpparibas/en/press-release/bnp-paribas-announces-creation-company-engagement-department-appointment-nathalie-hartmann-head-compliance
Archives and History Department http://www.bnpparibas.com/en/about-us/corporate-culture/history/archives-and-history-department
BNP PARIBAS strengthens its control Mechanisms http://www.bnpparibas.com/en/news/press-release/bnp-paribas-strengthens-its-control-mechanisms

3. **JP Morgan**

J.P. Morgan Chase is a publicly traded and a registered bank holding company headquartered in New York, USA. J.P. Morgan is a global leader in financial services, offering solutions to the world's most important corporations, governments and institutions in more than 100 countries. The Firm and its Foundation give approximately US$200 million annually to nonprofit organizations around the world. CB "J.P. Morgan Bank International" (LLC) in Russia offers a broad range of financial and banking services to legal entities, including treasury services, currency conversion operations, money market transactions, securities and derivatives trading, custody services and trade finance. Only corporate customers in Russia.

Shareholders: "J.P. Morgan International Finance Limited" – over 99.99%, "J.P. Morgan Limited" – less than 0.01%.

Corporate Governance

1. Functions of the Board

1.1 Criteria for composition of the Board, selection of new directors

Setting the criteria for composition of the Board and the selection of new directors are Board functions. In fulfilling its responsibilities, the Corporate Governance and Nominating Committee periodically reviews the criteria for composition of the Board and evaluates potential new candidates for Board membership. The committee then makes recommendations to the Board. In general, the Board wishes to balance the needs for professional knowledge, business expertise, varied industry knowledge, financial expertise, and CEO-level business management experience, while striving to ensure diversity of representation among its members. Following these principles, the Board seeks to select nominees who combine leadership and business management experience, experience in disciplines relevant to the Firm and its businesses, and personal qualities reflecting integrity, judgment, achievement, effectiveness and willingness to appropriately challenge management.

1.2 Assessing the Board's performance

The Board annually reviews the performance of the Board as a whole, including the flow of information to the Board and Board committees from management and to the Board as a whole from Board committee chairs, with a view to increasing the effectiveness of the Board. Such review is conducted by the non-management directors, guided by the Lead Independent Director. The Corporate

Governance and Nominating Committee periodically appraises the framework for assessment of Board performance and the Board self-evaluation discussion.

1.3 Formal evaluation of the Chairman and the Chief Executive Officer

The Board makes an evaluation of the Chairman and Chief Executive Officer at least annually. This will normally be in January in connection with a review of executive officer annual compensation. Such evaluation is conducted by the non-management directors, guided by the Lead Independent Director. The Compensation and Management Development Committee reviews the performance of the Chairman and Chief Executive Officer in preparation for discussion by the Board.

1.4 Succession planning and management development

Succession planning is considered at least annually by the non-management directors with the Chief Executive Officer. The Compensation and Management Development Committee reviews the succession plan for the Chief Executive Officer in preparation for discussion by the Board, with such discussion guided by the Lead Independent Director. The Compensation and Management Development Committee also reviews the succession plan for members of the Operating Committee other than the Chief Executive Officer.

1.5 Strategic reviews

The full Board shall engage in discussions on strategic issues and ensure that there is sufficient time devoted to director interchange on these subjects.

1.6 Board and management compensation review

The Corporate Governance and Nominating Committee makes periodic recommendations to the Board regarding director compensation. The Board believes it is desirable that a significant portion of overall director compensation be linked to JPMorgan Chase & Co. stock, and the Board's total compensation (excluding services as Lead Independent Director, director of a subsidiary or a member of a limited-duration committee) includes not less than two-thirds stock-based compensation.

Non-management directors receive no compensation from the Firm other than in their capacity as a member of the Board or a committee of the Board or as a member of a board or committee of a board of a subsidiary of the Firm. Officer-directors receive no separate compensation for their Board service.

Compensation of the Chief Executive Officer and any other officer-director is approved by the Compensation and Management Development Committee and then submitted to the Board for its ratification, with discussion of compensation of the Chief Executive Officer guided by the Lead Independent Director. Compensation for members of the Operating Committee, other than officer-directors, is approved by the Compensation and Management Development Committee, which reviews its decisions with the Board.

2. Board composition

2.1 Size and composition of the Board

While the Board's size is set in the By-laws to be in a range of 8 to 18 directors, the preference is to maintain a smaller Board for the sake of efficiency. A substantial majority of directors will be independent directors under the New York Stock Exchange's independence standards.

2.2 Definition of independence

Independence determinations. The Board may determine a director to be independent if the Board has affirmatively determined that the director has no material relationship with the Firm, either directly or as a partner, shareholder or officer of an organization that has a relationship with the Firm. Independence determinations will be made on an annual basis at the time the Board approves director nominees for inclusion in the proxy statement and, if a director joins the Board between annual meetings, at such time. Each director shall notify the Board of any change in circumstances that may put his or her independence as defined in these Corporate Governance Principles at issue. If so notified, the Board will reevaluate, as promptly as practicable thereafter, such director's independence. For these purposes, a director will not be deemed independent if:

(i) the director is, or has been within the last three years, an employee of the Firm or an immediate family member of the director is, or has been within the last three years, an executive officer of the Firm; (ii) the director or an immediate family member of the director has received, during any 12-month period within the last three years, more than $120,000 in direct compensation from the Firm, other than (a) director and committee fees and pension or other deferred compensation for prior service (provided that such compensation is not contingent in any way on continued service) and (b) compensation received by a family member for service as a non-executive employee of the Firm; (iii) the director is a current partner or employee of the Firm's independent registered public accounting firm, an immediate family member of the director is a current partner of such accounting firm or a current employee of such accounting firm who personally works on JPMorgan Chase's audit, or the director or an immediate family member of the director was within the last three years (but is no longer) a partner

or employee of such accounting firm and personally worked on JPMorgan Chase's audit within that time; (iv) the director or an immediate family member of the director is, or has been within the last three years, employed as an executive officer of a company in which a present executive officer of the Firm at the same time serves or served on the compensation committee of that company's board of directors; or (v) within the preceding three years, the director accepted any consulting, advisory or other compensation from the Firm, other than compensation in the director's capacity as a member of the Board or a committee of the Board or as a member of a board or committee of a board of a subsidiary of the Firm.

An ’immediate family member‘ includes a person's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who shares such person's home.

Relationship to an entity. The relationship between the Firm and an entity will be considered in determining director independence where a director serves as an officer of the entity or, in the case of a for-profit entity, where the director is a general partner of or owns more than 5% of the entity. Such relationships will not be deemed relevant to the independence of a director who is a non-management director or a retired officer of the entity unless the Board determines otherwise.

For-profit entities. Where a director is an officer of a for-profit entity that is a client of the Firm, whether as borrower, trading counterparty or otherwise, the financial relationship between the Firm and the entity will not be deemed material to a director's independence if the relationship was entered into in the ordinary course of business of the Firm and on terms substantially similar to those that would be offered to comparable counterparties in similar circumstances.

A director who is an employee, or whose immediate family member is an executive officer, of another company that makes payments to or receives payments from the Firm for property or services in an amount which, in any single fiscal year, exceeds the greater of $1 million or 2% of such other company's consolidated gross revenues will not be deemed independent until three years after falling below such threshold.

For these purposes, payments exclude loans and repayments of principal on loans, payments arising from investments by the entity in the Firm's securities or the Firm in the entity's securities, and payments from trading and other similar financial relationships.

Where a director is a partner or associate of, or Of Counsel to, a law firm that provides services to the Firm, the relationship will not be deemed material if neither the director nor an immediate family member of the director provides such services to the Firm and the payments from the Firm do not

exceed the greater of $1 million or 2% of the law firm's consolidated gross revenues in each of the past three years.

Not-for-profit entities. The Firm encourages contributions by employees to not-for-profit entities and matches such contributions by eligible employees to eligible institutions within certain limits by grants made by the Firm (directly or through The JPMorgan Chase Foundation). The Firm also supports not-for-profit entities through grants and other support unrelated to the Matching Gift Program. Where a director is an officer of a not-for-profit entity, contributions by the Firm will not be deemed material if, excluding matching funds from the Firm, they do not exceed the greater of $1 million or 2% of the not-for-profit entity's consolidated gross revenues.

Banking and other financial services. The Firm provides banking services, extensions of credit and other financial services in the ordinary course of its business. The Sarbanes-Oxley Act prohibits loans to directors, as well as executive officers, except certain loans in the ordinary course of business and loans by an insured depository institution subject to Regulation O of the Board of Governors of the Federal Reserve System. Any loans to directors are made pursuant to applicable law, including the Sarbanes-Oxley Act and Regulation O. Regulation O also applies to banking relationships with certain family members of a director and to entities owned or controlled by a director. All such relationships that are in the ordinary course of business will not be deemed material for director independence determinations unless a director has an extension of credit that is on a non-accrual basis. Where a subsidiary of the Firm is an underwriter in an initial public offering, the Firm will not allocate any of such shares to directors.

2.3 Former officer-directors

As a general rule, an officer-director may not serve on the Board beyond the date he or she retires or resigns as a full-time officer.

2.4 Change of job responsibility

A director will offer his or her resignation following the loss of principal occupation other than through normal retirement. Directors will provide prior notice in writing to the Corporate Governance and Nominating Committee of any change in their occupation or any proposed service on the board of a public or private company or any governmental position.

2.5 Director tenure

The Board does not believe it appropriate to institute fixed limits on the tenure of directors because the Firm and the Board would thereby be deprived of experience and knowledge.

2.6 Retirement age

It is expected that non-management directors will retire from the Board on the eve of the annual meeting in the calendar year following the year in which the director will be age 72; provided, however, that a non-management director may stand for re-election (i) for one additional term if proxies for the next annual meeting will be solicited within six months of such director's 72nd birthday or (ii) for one or more additional terms if the Board determines (with such director abstaining) to nominate such director for re-election to each additional term.

The Board expects non-management directors in the year prior to their scheduled retirement, and each year thereafter if they are re-elected to additional terms, to communicate to the Chairman, in advance of each annual election, an offer not to stand for re-election. The Chairman shall refer the offer to the Corporate Governance and Nominating Committee for review. The Corporate Governance and Nominating Committee's review and recommendation will be presented to the Board for a determination whether the director's offer should be accepted or rejected.

2.7 Limits on board and audit committee memberships

Each person serving as a director must devote the time and attention necessary to fulfill the obligations of a director. Key obligations include appropriate attendance at Board and committee meetings and appropriate review of preparatory material. Directors are also expected to attend the annual meeting of shareholders. Unless the Board determines that the carrying out of a director's responsibilities to the Firm will not be adversely affected by the director's other directorships: an officer-director will not serve on the board of more than two other public companies; directors who also serve as chief executive officers will not serve on more than a total of two public company boards in addition to the company of which they are CEO and the Firm; and directors who are not chief executive officers will not serve on more than fpublic company boards in addition to the Firm.

If a member of the Audit Committee wishes to serve on more than a total of three audit committees, the Board must approve such additional service before the director accepts the additional position.

2.8 Majority voting for directors

The By-laws provide for majority voting for directors in non-contested elections. The vote required for election of a director by the stockholders shall, except in a contested election, be the affirmative vote of a majority of the votes cast in favor of or withheld from the election of a nominee at a meeting of stockholders. For this purpose, a ’majority of the votes cast‘ shall mean that the number of votes cast ’for‘ a director's election exceeds the number of votes cast ’against‘ that director's election, with ’abstentions‘ and ’broker nonvotes‘ (or other shares of stock of the Firm similarly not entitled to vote on such election) not counted as votes cast either ’for‘ or ’against‘ that director's election.

In a contested election, directors shall be elected by a plurality of the votes cast at a meeting of stockholders by the holders of shares present in person or by proxy at the meeting and entitled to vote in the election. An election shall be considered contested if there are more nominees for election than positions on the board of directors to be filled by election at the meeting.

In any non-contested election of directors, any incumbent director nominee who receives a greater number of votes withheld from his or her election than in favor of his or her election shall immediately tender his or her resignation, and the Board of Directors shall decide, through a process managed by the Corporate Governance and Nominating Committee, whether to accept the resignation at its next regularly scheduled Board meeting held not less than 45 days after such election. The Board's explanation of its decision shall be promptly disclosed through a public statement.

2.9 Stock ownership requirements

It is generally desirable for non-executive directors to own a significant number of shares or share equivalents of JPMorgan Chase & Co. stock, and for new directors to work toward that goal. All non-employee directors are required to own at least 3,000 shares of Common Stock or vested RSUs at all times during their tenure, with a transition period of one year for new directors. Directors also agree that for as long as they serve as directors of the Firm, they will retain all shares of the Firm's common stock purchased on the open market or received pursuant to their service as a Board member. Shares held personally by a director may not be held in margin accounts or otherwise pledged as collateral. Any exceptions to the foregoing shall be discussed with the Corporate Governance and Nominating Committee.

Code of Conduct and Code of Ethics for Finance Professionals

Integrity and reputation depend on ability to do the right thing, even when it’s not the easy thing. The Code of Conduct is a collection of rules and policy statements intended to assist employees and directors in making decisions about their conduct in relation to the firm’s business. The Code is based on fundamental understanding that no one at JPMorgan Chase should ever sacrifice integrity — or

give the impression that they have — even if they think it would help the firm's business. This Code of Ethics for Finance Professionals applies to the Chief Executive Officer, President, Chief Financial Officer, and Chief Accounting Officer of JPMorgan Chase & Co. (the 'firm') and to all other professionals of the firm worldwide serving in a finance, accounting, corporate treasury, tax or investor relations role.

The purpose of this Code of Ethics for Finance Professionals is to promote honest and ethical conduct and compliance with the law, particularly as related to the maintenance of the firm's financial books and records and the preparation of its financial statements. The obligations of this Code of Ethics for Finance Professionals supplement, but do not replace, the firm's Code of Conduct. As a finance professional of the firm, you are expected to:

- Engage in and promote ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships, and to disclose to the Office of the Secretary any material transaction or relationship that reasonably could be expected to give rise to such a conflict.
- Carry out responsibilities honestly, in good faith and with integrity, due care and diligence, exercising at all times the best independent judgment.
- Assist in the production of full, fair, accurate, timely and understandable disclosure in reports and documents that the firm and its subsidiaries file with, or submit to, the Securities and Exchange Commission and other regulators and in other public communications made by the firm.
- Comply with applicable government laws, rules and regulations of federal, state and local governments and other appropriate regulatory agencies.
- Promptly report (anonymously, if you wish to do so) to the Audit Committee of the Board of Directors any violation of this Code of Ethics or any other matters that would compromise the integrity of the firm's financial statements. You may contact the Audit Committee by mail, by phone, or by e-mail; contact information is set forth below.
- Never to take, directly or indirectly, any action to coerce, manipulate, mislead or fraudulently influence the firm's independent auditors in the performance of their audit or review of the firm's financial statements.

Compliance with this Code of Ethics for Finance Professionals is a term and condition of employment. The firm will take all necessary actions to enforce this Code, up to and including immediate dismissal. Violations of this Code of Ethics for Finance Professionals may also constitute violations of law, which may expose both you and the firm to criminal or civil penalties.

If you have any questions about how this Code of Ethics for Finance Professionals should be applied in a particular situation, you should promptly contact the Office of the Secretary.

Compliance Program

J.P. Morgan Chase has established a **Global Sanctions Compliance Program ("GSC Program")** consisting of the following elements: (i) procedures, systems, and internal controls designed to comply with applicable sanctions;(ii) a designated person responsible for the day-to-day implementation and operation of the GSC Program; (iii) independent testing; (iv) an ongoing training program; and (v) reporting and record keeping. GSC is headed by the Director of Global Sanctions Compliance who is designated by the Head of Global Financial Crimes Compliance.

- Bank has implemented a risk-based global **Anti-money laundering (AML) Compliance Program** designed to comply with AML laws and regulations in the U.S., including the Bank Secresy Act, as amended by the USA Patriot Act (2001), and other applicable laws and regulations relating to prevention of money laundering and terrorism financing in the jurisdictions where the Bank operates. The AML Program consists of, among other things:
- Designations of a Global Head of Financial Crimes Compliance and regional AML Compliance Officers who are responsible for coordinating and monitoring day to day compliance with the AML Program for their businesses and regions respectively;
- AML risk assessments at the program, customer and product & services levels;
- Written policies, procedures, and a system of internal controls designed to facilitate ongoing compliance with applicable AML laws and regulations;
- Customer Identification Program designed to identify and verify all customers and, where applicable, beneficial owners to the extent warranted by the risk of money laundering or terrorism financing or as required by regulation;
- Performance of customer due diligence and additional due diligence on higher risk customers, including correspondent banking and private banking, and those who are assessed to be politically exposed persons;
- Risk-based measures and systems for monitoring transaction activity through customers' accounts;
- Identification and reporting of suspicious activity to appropriate regulatory authorities in accordance with applicable laws;
- AML training for appropriate personnel;
- Independent audit and compliance testing functions to review and assess the Firm for compliance with the AML Program and applicable laws;
- Prohibition from conducting business with shell banks;
- Record keeping and reporting requirements including those for cash transactions and records obtained pursuant to the Customer Identification Program, which are maintained for at least 5 years after the termination of a customer relationship.

Bank is operating under Consent Orders imposed by the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve relating to certain deficiencies in its BSA/AML Program. The Firm in the process of addressing and remediating the deficiencies identified in the Consent Orders, as required by the those orders, and in the interim has implemented certain compensating policies, procedures and processes to its BSA/AML Program.

Links:

http://www.jpmorgan.ru/pages/jpmorgan/russia/en/home
http://www.jpmorganchase.com/corporate/About-JPMC/ab-corporate-governance-principles.htm
https://www.jpmorganchase.com/corporate/About-JPMC/ab-code-of-ethics.htm

4. BANK URALSIB

General information

On November 4, 2015 the Bank of Russia board of directors approved a plan for Deposit Insurance Agency (DIA) to prevent Bank Uralsib's bankruptcy. Vladimir Kogan, a Neftegazindustriya majority shareholder, businessman and former banker, was picked as the bank's investor, and he subsequently bought 82% of the bank's shares. According to the available information, the deal was transacted for a penny. Bank Uralsib's rehabilitation plan provides for a Rub 81 bln loan to be extended by DIA (Rub 67 bln for a 10-year period and Rub 14 bln for 6 years). Later news also broke that in the course of the bank's rehabilitation its subordinated loans (around Rub 14.2 bln) will also be subject to write-down.
As of August 22, 2017 Vladimir Kogan controlled 81.81% of Bank Uralsib, with 11.35% still directly held by Nikolay Tsvetkov, Renat Akberov and Olga Vasilieva holding 1.38% and 1.37%, respectively. The rest of the shares (4.09%) is distributed among minority shareholders.

The bank's head office is in Moscow. The remote headquarters operate in Ufa. Bank Uralsib's regional sales network spans seven federal districts and 46 regions, comprising six branches and 274 points of sale as of December, 2018. The bank's ATMs number nearly 1,500, payment terminals amount to 528. In addition, the bank supports the operation of united ATM network Atlas (over 5,000 machines all across Russia). The bank's headcount slightly exceeded 8,500. Notably, Bank Uralsib wrapped up in early May 2017 the takeover of Ufa-based Bashprombank and Saint Petersburg-headquartered Bank BFA.

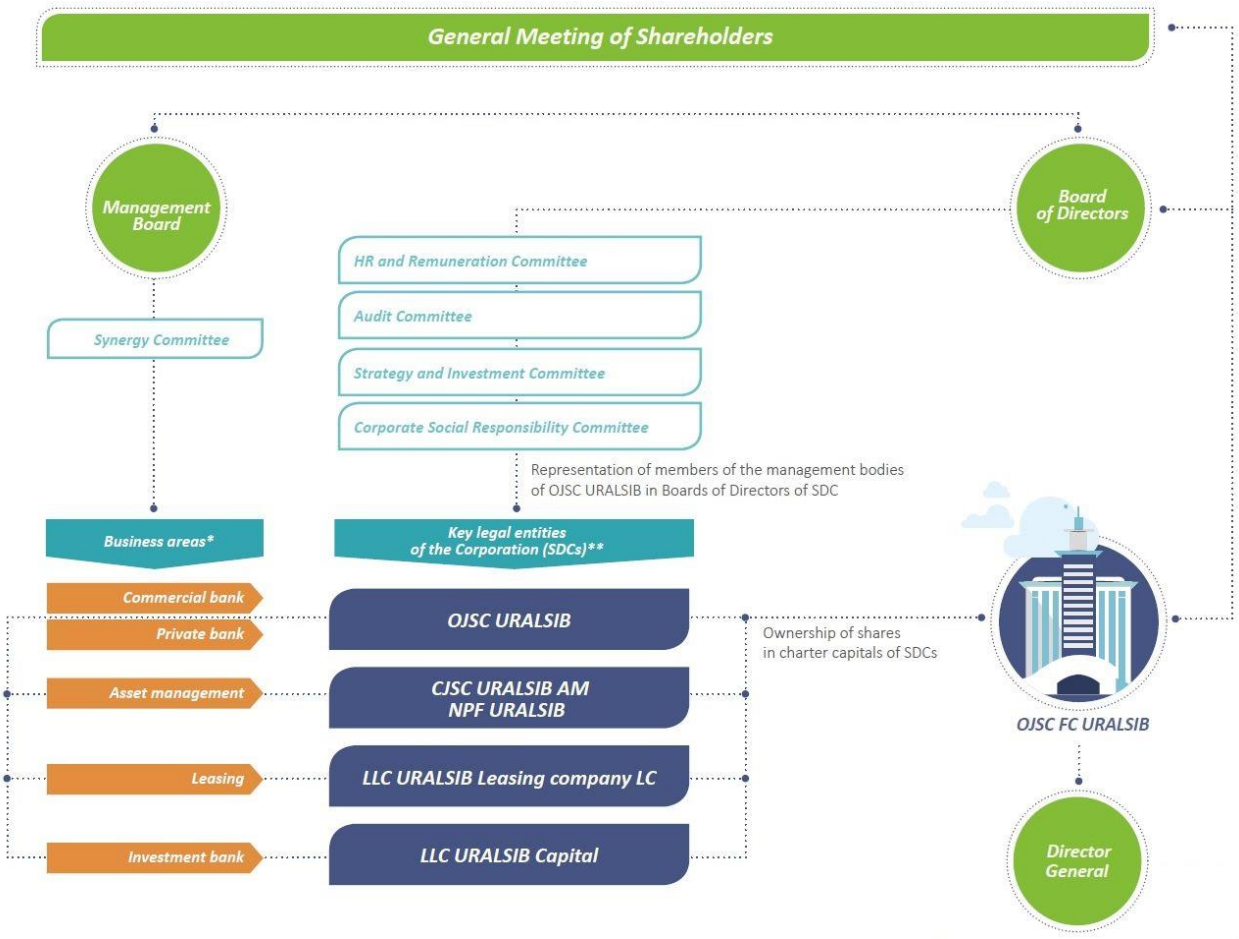
The bank serves over 100,000 corporate and more than 5 mln retail customers, offering a wide range of

banking services. Businesses and corporations are provided with cash settlement services, loans and guarantees, deposit products and promissory notes, payroll projects, corporate and customs cards, merchant and Internet acquiring solutions, trade finance, precious metal operations and other services (including leasing, investment services, etc.). Households are offered loans (mortgage, auto and consumer loans), credit and debit cards (Visa, MasterCard, and Mir), deposits and accounts, private banking, online and mobile banking, processing of utility bills, currency exchange, money transfers (including via Anelik, Contact, MoneyGram, Western Union, UNIStream, Golden Crown), and safety deposit boxes.

At different times the bank served such enterprises as Stroysnab (based in Bashkortostan), UralPromSnab, the group of companies Urals Regional Center YaMZ, Bashneftegeophizika, Ufa-City, Emperor Porcelain Works, Bashkir Social Card Register, Electrostroy, StroyLine, Lukoil-Severo-Zapadnefteprodukt, APM-Telecom, Bookmaker Company Marafon, Avers Group, Ecoservice, etc.

Corporate governance

FC URALSIB was established in March 2007 and is a holding company. The Company and its subsidiary and dependent companies form a group of companies under the umbrella brand of Financial Corporation URALSIB. The Group is not a separate entity; its member-companies have common goals and values and ownership system. A full list of subsidiary and dependent companies is published in FC URALSIB's IFRS consolidated financial statements.



Cooperation with subsidiaries and dependent companies is executed through the single social entrepreneurship model (SE); the single platform of strategic business planning on the basis of the balanced scorecards system (BSC); the single principles of social investment (SI); and a coordinated internal social policy based on the management by values approach (MBV). To increase the effectiveness of interaction between financial types of business, the Management Board of OJSC URALSIB maintains the Synergy Committee.

Along with earning profits, the shareholders established the Company for the following reasons:

- To maximize the value of corporate assets by forming a balanced investment portfolio capable of diversifying business risks and implementing inter-segmental and service synergies;
- To gain considerable market shares in business segments where essential growth and high income are expected and in relation to which the Company and its subsidiaries are positioned as advantageous and competent;
- To develop the human potential of employees and to improve the social environment quality in which the Company and its subsidiaries operate.

The legal entities that make up the Group are engaged mainly in banking (headed up by OJSC URALSIB), leasing (headed up by URALSIB Leasing Company LLC), investment and asset management (headed up by CJSC MC URALSIB and URALSIB Capital LLC, respectively).

To prevent potential risk, FC URALSIB makes the most of the synergistic effect resulting from the interaction of OJSC FC URALSIB and its subsidiary and dependent companies in different sectors of the financial sphere, including implementing cross-sales, product standardization and shared sales and risk management processes.

Compliance Control

FC URALSIB Group companies aim to work only with highly reliable partners, complying with Russian and international laws and regulations in the sphere of combating money laundering and capital transfer to the shadow economy subjects.

Information analysis system

URALSIB's Compliance Service uses the Transaction Request information database, which automates the reconciliation process with the Compliance Service for transactions with securities made by the Corporation employees in their own interests. These are subject to the risk of conflict of interests in accordance with the requirements of the URALSIB Financial Corporation Compliance Policy. A new version of the Compliance Policy was approved by an order of the FC CEO in May 2012.

In accordance with the Compliance Policy, the following events must be disclosed and analysed:

- Participation in any mergers of acquisitions using the employees' own funds;
- Affiliation with any company or business in any form;
- Participation, including free of charge, in the customer's governance bodies of any member company of the Corporation;
- Work in governmental bodies or in stateowned organisations in any form;
- Membership in political parties or movements;
- Financial consultancy relations providing financial services outside the framework of direct work responsibilities;
- Participation in transactions with personal assets in which FC URALSIB has a participatory or ownership share;
- Possession and access to FC URALSIB insider information.

Uralsib Compliance function is covering the following areas:

- Code of condact/ professional behavior standards;
- Whistle blowing hot-line;
- Chinese walls;
- Professional market participant;
- Insider trading and market manipulation, Conflict of interests;
- Anti-money laundering and counteraction of terrorism financing, "Know yclient"
- Anti-bribery and corruption;
- Information security.

Compliance governance is focused on the following controls:

1) Prevention (employment process, training process, approval and sign off - documents, procedures, transactions, payments, etc);

2) On-going monitoring and control (deals and transactions monitoring and analysis, control of clients' business activity, clients' relationship, control of telephone calls and other channels);

3) Complex audit of business processes;

4) Dealing with complaints;

5) Investigation process (incl. Hot line clients' and employees claims).

Combating Money Laundering and Terrorist Financing

The key principles of activities of FC URALSIB companies in the area of anti-money laundering and combating terrorism financing (AMLTF) are the following:

- Ensuring the protection of FC URALSIB companies from the receipt of criminal proceeds, and the control and management of reputation risk relating to the involvement of FC URALSIB companies in transactions which may be associated with money laundering and terrorist financing;
- Ensuring the participation of employees of FC URALSIB companies, regardless of the position they occupy, within their competence in carrying out internal control for AMLTF purposes.

Uralsib Bank in accordance with Russian AML regulation requirements has dedicated AML/CFT responsible officer, and developed Rules of internal AML control, which includes the following programs:

- AML/CFT governance structure;
- KYC program;
- Risk management program;

- Transaction monitoring and reporting program;
- Clients/transactions rejection/termination program;
- KYC delegation program;
- Sanctions program: screening and assets' freezing;
- Training program.

The Bank does not establish or maintain relations with non-resident banks that do not have permanent management bodies in the territories of the states in which they are registered. Also, the Bank does not have accounts opened within the banks registered in the states and territories that do not participate in international cooperation in the field of AML / CFT.

The above-mentioned principles are delivered through the analysis and application in FC URALSIB companies of AMLTF best practices and international standards and compliance with the requirements of the effective laws of the Russian Federation on AMLTF.

URALSIB Bank is a permanent member of dedicated committees of professional associations and self-regulated organisations of the financial market: the Association of Russian Banks, National Payment Council, and National Financial Market Council. FC URALSIB companies conduct, on a regular basis, training and assessment of the knowledge of employees to provide them with the skills and knowledge required to follow AMLTF procedures. The ’Know Your Customer‘ policy was established by the Corporation in 2008. It is intended to protect the Corporation’s interests from the actions of dishonest customers and agents, dealing, in particular, with money laundering and terrorism financing. The “Know Your Customer” policy is a part of the corporate risk management system.

Control over offering and receiving gifts

Receiving gifts from customers and counteragents, participation in hospitality events or other forms of remuneration of Company employees are determined by internal documents regulating the ethical aspects of behavior and business conduct of Company employees. Employees may accept from customers/counteragents gifts of an approximate value of no more than three thousand Russian rubles. The Company understands that refusal to accept an expensive gift may result in negative consequences for the business. An employee shall notify the Compliance Service about his or her decision to accept the gift in an established form no later than the following business day. The Compliance Service shall review the request and make a decision on approval or declining the gift. The Company’s Compliance Directorate shall keep a register of approved gifts. It is strictly forbidden to accept cash gifts.

Anti-Corruption Efforts

In 2012, URALSIB Bank approved and introduced its Anti-Corruption Policy, which sets the internal rules, standards and principles for the prevention and disclosure of corruption and bribery. The policy was developed in accordance with the effective laws of the Russian Federation, taking into account the requirements of generally accepted principles and the norms of international law, international agreements and anti-corruption legal acts, including the principles of the United Nations Global Compact. On the basis of the policy, internal procedures were developed, including a 'hot line' for reports of any known cases of past or potential violation. Loyal informers are guaranteed the Bank's protection from any form of persecution or discrimination. The procedure for preventing corruption offences, including business standards and control procedures, has been approved, as has a list of subdivisions in which employees regularly undergo anti-corruption training and testing. Corruption risks are monitored in the most vulnerable business processes, and a criteria of necessity to include anti-corruption clauses in agreements are set, with an account of the risk level depending on the agents' category and the type of relationships established. To minimize any risk of the Bank's involvement in corruption, it checks counteragents — legal entities and individuals with whom the Bank plans to sign an employment or civil contract. Staff involved in interactions with suppliers, customers, and contractors (risk groups) must complete training on anti-corruption procedures. The Bank contributes to the increase of anti-corruption awareness level and ethical business.

Links:

https://www.uralsib.ru/company/dokumenty-i-otchetnost/godovye-otchety/

5. Sovcombank (GE Money Bank)

General information

The Group identifies market niches with limited competition and focuses on achieving and maintaining strong competitive advantages in these niches.

For 2014-2017, Sovcombank had average ROE of 50% and was the most profitable banking group among top-50 largest Russian banks for this period based on published IFRS accounts. The Group was the most profitable banking group in CEE by return on capital in 2016 and 2017 according to The Banker Magazine, a subsidiary of The Financial Times Ltd.

The Group has two main segments:

- Retail. Sovcombank provides financial services and products to predominantly low- and moderate- income customers in under-banked rural areas of the Russian Federation on a cost-efficient

basis. Sovcombank operates a disruptive retail business model, which utilises low-cost retail branches cutting edge supported by Sovcombank's proprietary technology platform and by online and other sales-channels. As at 01 January 2018, the retail segment had 2,148 offices in 1,023 towns across the Russian Federation and served 3.2 million customers. Sovcombank operates the largest retail network among privately owned banks in Russia.

As of January 1, 2018, the Bank served 3 million retail customers living in 1,031 settlements through 2,148 offices. The Bank employs 11 thousand people.

- Corporate & investment Banking ("CIB"). The CIB provides financial services to the largest Russian privately- and, state-owned corporations, Russian regional governments and municipalities. Bloomberg ranked Sovcombank as the No.1 privately owned arranger of domestic bonds in Russia in 2017. The CIB enables 350 thousand micro- small- and medium-sized business participate in public procurement. In 2017, 27% of all state and municipal procurement in the Russian Federation was administrated through the Sovcombank's online platform, according to the Group's estimates based on www.zakupki.gov.ru, a governmental website that registers all public procurement auctions and tenders. In addition, in 017, the Group issued 26.6% of all bank guarantees required for state and municipal procurements in Russia.

Sovcombank, initially known as "Buoykombank", was incorporated in a village of Buoy, Kostroma Region, on 1 November 1990. In 2002 Sergey and Dmitry Khotimskiy and Mikhail Klyukin acquired 100% shares in "Buoykombank" LLC and renamed it into "Sovcombank" in 2003.
In September 2007, TBIF Financial Services B.V. ("TBIF"), a financial services company based in the Netherlands, became a 50% shareholder in Sovcombank. As a result of this transaction, Sovcombank became a sole owner of TBIF's asset in Russia, ARKA Finance, a regional consumer finance provider with a network of 612 mini-offices and 2,010 credit brokers in 140 in Siberia and Far East of Russia. In March 2009, the Group acquired 99.7% shares in "Regional Credit Bank", a regional bank specialised in consumer finance in Siberia and Far East of Russia, at a discount price. The acquisition enabled the Group to expand the retail network in an efficient and cost-effective way. Sovcombank team completed operational integration of "Regional Credit Bank" assets in December 2009.
In February 2014, Sovcombank acquired GE Money Bank Russia, a Russian subsidiary of GE Capital International Financing Corporation, which specialised in unsecured consumer lending. As a result, Sovcombank gained access to an advanced technological platform and the first class expertise in risk management and underwriting procedures, human resources and IT. Acquisition of GE Money Bank Russia enabled Sovcombank to build eventually the third largest retail distribution network in Russia after Sberbank and VTB and the leading retail distribution network in Russia among privately owned

banks, according to the Group's estimates based on data disclosed by Russian banks, as at 30 September 2017. The Group completed full operational integration of GE Money by December 2014. In 2015, Sovcombank acquired ICICI Bank Eurasia, a subsidiary of ICICI Bank India, at a discount price. Sovcombank renamed ICICI Bank Eurasia into "Sovremenniy Commercheskiy Innovatsionniy Bank" or "SCIB". In 2015 - 2016, the Group acquired and completed the operational integration of Fintender, SCIB, the underwriting centre in the city of Kazan' inherited from GE Money Bank and another financial technology company RTS-Tender. These acquisitions and integrations, created an online bank without a branch network that enables 300,000 MSMEs to participate in state procurement throughout Russia. As a result, the Group became the market leader in issuing bank guarantees for procurement in the Russian Federation, according to the Group's estimates based on information from zakupki.gov.ru, an official Russian Government website, as at 31 December 2017.

In 2015, the Group acquired 9.48% of shares in Rosevrobank. The Group further increased its ownership in Rosevrobank to 19.54% in 2016 and continued to increase its equity interest. In October 2016, Sovcombank acquired from Severgroup (a parent company of Severstal, a vertically integrated steel and mining company) Metcombank. Metcombank specialised on auto loans and had the largest car loan portfolio among privately owned banks as at 30 September 2016 according to the Group's estimates based on banki.ru. Sovcombank retained the business team and strengthened its position by rolling out Metcombank's expertise in auto loans across Sovcombank's retail network. In 2016, Sovcombank acquired Garanti Bank – Moscow, a subsidiary of Garanti Bank, Turkey's second largest privately owned bank. This acquisition helped Sovcombank to develop operations with international financial institutions and corporate lending to foreign, in particular – Turkish, companies. In January 2017, Sovcombank acquired the mortgage loan portfolio of Nordea Bank Russia which comprised a portfolio of predominantly high-quality seasoned mortgage loans. Along with this acquisition, Sovcombank joined a highly skilled team experienced in mortgage lending with best-in-class mortgage lending practices.

On 22 December 2017, Sovcombank completed the acquisition of 5.7% of shares of Rosevrobank from DEG. On 30 January 2018, Sovcombank completed acquisition of 11.0% of shares of Rosevrobank from EBRD.

Compliance structure

A well-built compliance system ensures that the number of loyal employees are about 100% turning to research in the field of fraud, according to statistics 40% of employees will behave loyally to the employer and adhere to the established final rules, 20% - are prone to abuse (to break the rules and engage in fraud), and another 40% - are undecided that is, they can go to one of these pathways. It all

depends on the internal environment, corporate culture and on the control procedures that are implemented in the company.

These three factors are aimed at achieving a global goal - to help businesses avoid trouble. Therefore, compliance - a key element of risk management and internal control systems.

SovcomBank in accordance with Russian AML regulation requirements has:

dedicated AML/CFT responsible officer, and developed Rules of internal AML control, which includes the following programs:

--- AML/CFT governance structure;

--- KYC program;

--- Risk management program;

--- Transaction monitoring and reporting program;

--- Clients/transactions rejection/termination program;

--- KYC delegation program;

--- Sanctions program: screening and assets' freezing;

--- Training program.

The Bank does not establish or maintain relations with non-resident banks that do not have permanent management bodies in the territories of the states in which they are registered. Also, the Bank does not have accounts opened within the banks registered in the states and territories that do not participate in international cooperation in the field of AML / CFT.

WHAT AN EMPLOYEE IS URGED TO KNOW

People involved in criminal activity — e.g., terrorism, narcotics, bribery, and fraud — may try to ’launder‘ the proceeds of their crimes to hide them or make them appear legitimate. More than 100 countries now have laws against money laundering, which prohibit conducting transactions that involve proceeds of criminal activities. A related concern is that legitimate funds may be used to finance terrorist activity — sometimes called ’reverse‘ money laundering. GE is committed to complying fully with all anti-money laundering and anti-terrorism laws throughout the world. GE will conduct business only with

reputable customers involved in legitimate business activities, with funds derived from legitimate sources. Each GE business is required to implement risk-based 'Know Your Customer' due diligence procedures calibrated to the risk in question, and to take reasonable steps to prevent and detect unacceptable and suspicious forms of payment. Failing to detect customer relationships and transactions that place GE at risk can severely damage GE's integrity and reputation.

WHAT AN EMPLOYEE IS URGED TO DO

Comply with all applicable laws and regulations that prohibit money laundering and support and financing of terrorism, and that require the reporting of cash or suspicious transactions. Understand how these laws apply to the business an employee works for.

Follow the business's 'know your customer' procedures. Collect and understand documentation about prospective customers, agents and business partners to ensure that they are involved in legitimate business activities and their funds come from legitimate sources.

Follow business's rules concerning acceptable forms of payment. Learn the types of payments that have become associated with money laundering (for example, multiple money orders or travelers checks, or checks on behalf of a customer from an unknown third party).

If an employee encounters a warning sign of suspicious activity, raise the concern with a designated GE anti-money laundering compliance specialist or company legal counsel and be sure to resolve the concern promptly before proceeding further with the transaction. Ensure the resolution is well documented.

WHAT AN EMPLOYEE IS URGED TO WATCH OUT FOR

- A customer, agent or proposed business partner who is reluctant to provide complete information, provides insufficient, false or suspicious information, or is anxious to avoid reporting or record keeping requirements;
- PAYMENTS using monetary instruments that appear to have no identifiable link to the customer, or have been identified as money laundering mechanisms;
- attempts by a customer or proposed business partner to pay in cash
- early repayment of a loan in cash or cash equivalents
- orders, purchases or payments that are unusual or inconsistent with the customer's trade or business
- unusually complex deal structures, payment patterns that reflect no real business purpose, or unusually favorable payment terms

- unusual fund transfers to or from countries unrelated to the transaction or not logical for the customer
- transactions involving locations identified as secrecy havens or areas of known terrorist activity, narcotics trafficking or money laundering activity
- transactions involving foreign shell or offshore banks, unlicensed money remitters or currency exchangers, or nonblank financial intermediaries
- structuring of transactions to evade record keeping or reporting requirements (for example, multiple transactions below the reportable threshold amounts)
- requests to transfer money or return deposits to a third party or unknown or unrecognized account

Links:
https://sovcombank.ru/about/corporate_governance/
https://sovcombank.ru/upload/documents/antikorrupcionnaja_politika.pdf

6. Deutsche Bank

General information

The bank is operational in 58 countries with a large presence in Europe, the Americas and Asia. Deutsche Bank AG is a German multinational investment bank and financial services company headquartered in Frankfurt, Germany.

Deutsche Bank provides commercial and investment banking, retail banking, transaction banking and asset and wealth management products and services to corporations, governments, institutional investors, small and medium-sized businesses, and private individuals.
Key elements of Deutsche Bank's strategy are:

- to be Europe's leading Corporate and Investment Bank with a global network und to grow in all important markets,
- occupying the number one private and commercial banking position in the home market of Germany, serving more than 20 million clients
- giving the asset management DWS sufficient autonomy to accelerate growth
- maintaining high levels of liquidity and CET1 capital.

As of April 2018, Deutsche Bank is the 15th largest bank in the world by total assets. As the largest German banking institution in the world, it is a component of the DAX stock market index. The company is a universal bank resting on three pillars – the Private & Commercial Bank, the Corporate & Investment Bank (CIB) and Asset Management (DWS). Its investment banking operations lie within the Bulge Bracket, often commanding substantial regional deal flow, and maintaining a variety of "sell side" and "buy side" departments.

Deutsche Bank global network includes:

—Unparalleled financial services worldwide

—2,407 branches in total, thereof 1,555 in Germany (as of March 31, 2018)
Against a backdrop of increasing globalization in the world economy, Deutsche Bank is very well-positioned, with significant regional diversification and substantial revenue streams from all the major regions of the world.

DB has established strong bases in all major emerging markets, and therefore have good prospects for business growth in fast-growing economies, including the Asia Pacific region, Central and Eastern Europe, and Latin America.

Corporate Governance and Compliance

The Management Board delegates the tasks and measures for the prevention of money laundering, the combating of the financing of terrorism, the observance of financial and trade sanctions, the fighting of other criminal activities including the combating of corruption and bribery to Anti-financial crime (AFC), independent function, which is headed by the Group Anti-Money Laundering Officer (‘Global Head of AFC’). The Management Board, however, retains its oversight duty for these tasks.

The objective of the AFC program is to be able to identify AFC risks resulting from financial crime that puts the integrity and thus the success of Deutsche Bank into question as well as to prevent them to the greatest extent possible and to manage or resolve them appropriately in the interests of everyone involved.

Within the AFC function,

1) Anti-Money Laundering (AML) unit is responsible for instituting measures to prevent money laundering and combat the financing of terrorism, including measures to:

- comply with rules and regulations regarding identification (authentication), recording and archiving;
- detect suspicious transactions and process bank-internal suspicious activity alerts; develop, update and execute internal policies, procedures and controls for the prevention of money laundering and financing of terrorism; and
- define requirements to implement the Fund Transfers Regulation.

These measures are described in the 'Anti-Money Laundering Policy – DB Group' and the 'Know Your Customer Policy – DB Group'.

2) Sanctions & Embargoes unit within the AFC function is accountable for performing measures to comply with finance and trading sanctions, especially the following:

- detecting, evaluating and, if required, ensuring the observance of sanctions-related publications and binding requirements in connection with financial and trade sanctions of the EU, Bundesbank, Germany's Federal Office for Economic Affairs and Export Control (Bundesamt für Wirtschaft und Ausfuhrkontolle – BAFA) and other authorities such as the US Office of Foreign Assets Control (OFAC) and UK Treasury Department (HMT); as well as

- preventing reputational risk in connection with weapons, red light business and gambling business as well as reputational risk resulting from permissible transactions under sanctions law with sanctioned persons and companies.

The Sanctions & Embargoes unit is responsible for developing and maintaining the 'Embargo Policy –DB Group', the 'SRC (Special Risk Countries) Policy' and the 'OFAC Policy', and for Group-wide implementation and regular review and update (at least annually) thereof.

3) Anti-Fraud & Investigations unit within the AFC function is responsible for the ongoing development of appropriate measures to prevent 'other criminal activities' that could endanger the institution's assets and for the monitoring of their implementation, especially measures to:

-comply with rules and regulation regarding identification, documentation and archiving;

- capture suspicious transactions and process internal suspicious facts;

-develop, maintain and execute internal basic principles, procedures and controls to prevent

other criminal activities.

These measures are described in the ‘Anti-Fraud Policy – DB Group’.

4) Anti-Bribery & Corruption unit is responsible for the ongoing development of appropriate measures to prevent these specific other criminal activities, in particular measures to:

- Monitoring of compliance with applicable regulations regarding the prevention of bribery, corruption and acceptance of benefits by a public official. This includes the responsibility for proper handling of gifts and entertainments as well as the maintenance of the whistleblower hotline. These measures are described in the ‘Anti-Bribery and Corruption Policy – DB Group’.

To comply with applicable regulatory and supervisory requirements, a Global Financial Crime Governance Committee (hereinafter ‘FCGC’), chaired by the Global Head of AFC, has been formed at Group level, in order to establish a central, Group-wide evidence centre for ‘other criminal activities’. The Global FCGC is being supported by the Regional FCGCs, which are chaired by the respective Regional Heads of AFC. Permanent members of these FCGCs are the Global and Regional Heads of the different AFC units, the AFC Interfaces as well as the business divisions and certain infrastructure functions. Coordination of the FCGCs and preparation of their meetings is done by a new function, the ‘Central Unit Coordination Team’.

The Bank has established a permanent and independent group-wide Compliance Department headed by a Head of Compliance. The Compliance Department performs an independent 2nd level control function that protects the Bank’s license to operate by promoting and enforcing compliance with the law and driving a culture of compliance and ethical conduct in the Bank.

The governing bodies and senior management of the Bank have primary responsibility for the management of compliance Risk, though all employees are responsible for assuring adherence, and not just members of the Compliance Department. Compliance Risk is the risk of incurring criminal or administrative sanctions, financial loss or damage to reputation as a result of failing to comply with laws, regulations, rules, expectations of regulators, the standards of self-regulatory organizations, and codes of conduct/ethics in connection with the Bank’s regulated activities. The Compliance Department performs the following activities to meet its regulatory obligations:

- Providing Guidance, Training and Setting Standards;
- Compliance Risk Management and Assurance;
- Regulation and Regulatory Engagement.

Corporate Governance: Functions of the Supervisory Board and Management Board

Bank ensures compliance with laws and regulations with the aid of special programs and structures:

- Anti-Financial Crime Committee (AFCC) Group-wide oversight and governance body aimed at curbing financial crime
- Anti-money laundering program
- Anti-corruption Guideline: System of rules for combating corruption and bribery
- Global Compliance Core Principles: Set of principles that commits the employees and senior managers to uphold principles of integrity, accountability, responsibility, fairness and considerateness
- Know-Your-Customer (KYC) Policy: System of rules for the KYC process, i.e. scrutiny of clients that is mandatory for banks in order to combat money laundering
- Compliance Control Framework
- Red Flags Monitoring Process: A process that enables the reporting of risk-related breaches. The results of the monitoring are taken into account into year-end performance assessments
- Regulatory Contact Offices: Offices of Deutsche Bank in Frankfurt am Main, London and New York that manage contacts and communication with domestic and foreign supervisory authorities

Compliance: Conformity with the law and adherence to regulations and standards

In view, responsible corporate governance does not only mean adherence to laws, regulations, and standards. It requires a stringent compliance system. Bank has defined strict rules and guidelines for staff across the entire spectrum of areas of activity. Through conformity with the law, Bank ensures that the company, its shareholders, clients and employees are protected as comprehensively as possible.

Compliance Control Framework

All of the employees of Deutsche Bank are expected to adhere to the Bank's compliance standards – by conducting themselves honestly, responsibly and ethically. Code of Ethics describes the values and standards for ethical business conduct and serves as the guiding principle for all of interactions – regardless of whether they are with clients, competitors, business partners, government and regulatory authorities, shareholders or among one another. At the same time, it forms the foundation of compliance principles, which provide Bank's staff with precise guidelines for proper behavior. In order to promote responsible behavior on the part of staff, Bank has expanded mandatory training on compliance issues. Failure to complete mandatory compliance trainings now carries clear consequences, for example in regard to compensation.

Furthermore, to support controls systems Bank has substantially expanded 'Red Flag' monitoring system. It reports all violations of compliance requirements in specific areas.

The Compliance department of Deutsche Bank is independent of operational business. Using Compliance Control Framework as a basis, Bank is raising the level of awareness of conformity with the law in operational business areas. The framework specifies the functions of the Compliance team in detail.

The team is responsible for:

- providing advice to individual business units on applicable laws, directives, standards, and regulations as well as providing compliance support
- monitoring trades, transactions and business processes in order to identify any potential compliance risk
- developing globally or locally applicable principles, standards and guidelines for Compliance, communicating them and verifying adherence
- maintaining the Bank's internal watch and restricted lists of projects to which special attention must be paid
- helping to achieve adherence to the Bank's internal confidentiality regulations ('Chinese walls')
- implementing any measures arising from the anti-money laundering program
- ensuring that any occurrences which give reason to suspect money laundering or the financing of terrorism are identified and reported to law enforcement authorities
- providing regular training and education for staff on the applicable regulations, rules and internal standards
- coordinating risk control and monitoring the management of reputational risk
- communicating with regulatory agencies around the world on a daily basis

Anti-money laundering (AML) program

Anti-money laundering program provides strong support for international efforts to combat money laundering, financing terrorism and other criminal acts. Bank scrutinizes its clients and current transactions using meticulous procedures and an automated monitoring system through this compliance program.

Deutsche Bank anti-money laundering standard complies with the German Anti-Money Laundering Act and the guidelines of the German banking supervisory authority. It is also in line with the

recommendations of the Financial Action Task Force on Money Laundering, an intergovernmental organization.

Anti-money laundering requirements apply worldwide to all business units of the bank, regardless of their location. All employees and senior managers are required to comply with them to prevent name or products and services from being misused for money laundering purposes. To ensure that the Bank always applies the best possible compliance practices, it routinely reviews goals and strategies for the prevention of money laundering.

Roles and Responsibilities

Global Head of Anti Money Laundering and Group Embargo Officer

- Chairs the Group AML Global Operating Committee(AML GOC) and is responsible for the bank's AML and Embargo strategy. The AML GOC is also responsible for escalation and sanction in case of non-compliance of internal and external requirements and lack of quality
- Represents AML at Board, Senior Group Committees and at senior corporate level as appropriate
- Manages 'Central AML' function, and controls adequacy of organizational structure and resource levels globally
- Drives communication to the Board and other stakeholders with respect to issues concerning AML
- Maintains relationships between AML and the Group's external auditors, regulatory and other authoritative bodies
- Oversees AML's global budget and resources, planning and forecasting processes
- Oversees AML related IT-systems, AML Risk Analysis, change projects, technology, operations, Management Information System (Reporting) and all AML-specific processes
- All Regional AML Heads have a functional reporting line into the Global Head of AML

Regional Head of Compliance

- The Regional Head of Compliance is responsible for the implementation of effective and efficient AML program across his/her region in line with global standards.
- Is the senior escalation point for KYC matters, Embargo and Sanction escalations, and any other areas of dispute before further escalation to the global Head of AML.
- Is responsible to inform the Global Head of AML in a timely fashion of any and all significant matters around the function.

- Is obliged to ensure that resources for AML are deployed effectively across the region to mitigate high level risk

Regional Head of AML

- Represents Group AML at senior regional level, and manages local regulatory and regional management relationships
- Formulates the regional overlay to global plans and executes regional aspects of global and local requirements
- Recruits resources in conjunction with Business Management to meet the needs of global and regional plans
- Responsible for day-to-day management and administration of regional resource pool
- Inputs to global AML strategy and plan, provision of input on regular and ad-hoc reporting requirements from Central AML
- Appoint a regional co-ordinator to act as point of contact for Central AML for information collection and dissemination

Country Anti Money Laundering Officers

- Have a direct reporting line to local management and a functional reporting line to the Regional Head of AML
- Are responsible for the implementation of the applicable Group Policies on AML, KYC and Embargo
- Ensure that local guidelines and procedures are in line with local Anti Money Laundering laws / regulations and the applicable German AML regulation
- Define within their local jurisdiction relevant policies and procedures
- Are the primary point of contact with their local regulators and law enforcement authorities
- Are responsible for the local AML Risk Analysis
- Are responsible for the implementation of adequate monitoring – research /surveillance tools
- Track and follow up on the conditions that have been imposed as part of the KYC approval
- Develop and maintain procedures and systems to ensure that unusual and suspicious transactions are reported to Group AML (if not explicitly forbidden by local law) and to local authorities in accordance with local law.
- Develop and carry out adequate controls to ensure that all applicable legal and regulatory AML requirements are being adhered to in their jurisdiction.
- Sign-off in the New Product Approval and Internal Relocation and Outsourcing (“IRO”) process as applicable.

Corruption and bribery

Within the scope of compliance program, Deutsche Bank has committed itself to fully complying with all local and international anti-corruption and anti-bribery laws. employees and senior managers are strictly prohibited from receiving, accepting, offering, paying or authorizing any bribe or any other form of corruption. Deutsche Bank also expects transparency and integrity in all business dealings to avoid any improper advantage or the appearance of questionable conduct on the part of employees or third parties with whom Bank is doing business.

To ensure compliance, Deutsche Bank has an anti-corruption policy that is backed by:

- appropriate compliance training measures for staff
- recording and monitoring of gifts and invitations
- a worldwide whistleblowing hotline for reporting suspicious cases anonymously
- risk-based procedures for monitoring third parties

Monitoring risk-related behavior

The Risk Culture program's Red Flags initiative uses objective measures to assess employees' adherence to risk-related policies and processes. It allows senior managers to address risks more effectively and creates a stronger link between behavior and reward. Employees in breach of an applicable policy or process receive a Red Flag. All Red Flags are risk-weighted depending on the severity and frequency of the incident. Aggregated Red Flag scores are taken into account in reviews of performance, pay and promotion. Since introducing Red Flags, the number of breaches has decreased steadily, indicating a positive change in risk-related behaviors.

Financial crime

Deutsche Bank is committed to ensuring the robust risk management of financial crime. There are an established an Anti Financial Crime Committee (AFCC), a group-wide oversight and governance body. Its responsibilities include ensuring conformity with the law, preventing criminal acts or exposing and investigating them – ranging from fraud and money laundering to insider trading and data theft. The AFCC examines and assesses all risks relating to such actions within the Deutsche Bank Group.

Know Your Customer or KYC

The Bank has developed effective procedures for assessing clients (Know Your Customer or KYC) and a process for accepting new clients in order to facilitate comprehensive compliance. Furthermore

they help us to minimize risks relating to money laundering, financing of terrorism and other economic crime. KYC procedures start with intensive checks before accepting a client and continue in the form of regular reviews. procedures apply not only to individuals and corporations that are or may become direct business partners, but also to people and entities that stand behind them or are indirectly linked to them

International standards and Initiatives

The approach to corporate governance conforms to general legal regulations as well stock exchange law. Its essential foundations are:

- The German Stock Corporation Act [Aktiengesetz]
- The German Corporate Governance Code (2001)
- The U.S. capital market laws
- The rules of the Securities and Exchange Commission (SEC) and the New York Stock Exchange

World Bank standards

World Bank standards on various environmental, social and governance topics are continuously developed and shape international activities.

IFC Performance Standards

The International Finance Corporation's (IFC) Performance Standards are directed towards clients, providing guidance on how to identify risks and impacts, and are designed to help avoid, mitigate, and manage risks and impacts as a way of doing business in a sustainable way, including stakeholder engagement and disclosure obligations of the client in relation to project-level activities.

The Sustainability Code (Deutscher Nachhaltigkeitskodex)

In a database the German Sustainability Code visualizes the efforts of companies to achieve sustainability. It thus creates a greater commitment to do so in a transparent and comparable manner. The German Council for Sustainable Development broadens the basis for a green economy and raises relevance of sustainability issues. The aim is to re-orientate capital allocation in sustainably oriented business models. The Sustainability Code is suitable for companies of every size and legal form.

Financial Action Task Force on Money Laundering

The Financial Action Task Force (on Money Laundering) (FATF) develops policies to combat money laundering and terrorism financing. The FATF Secretariat is housed at the headquarters of the OECD in Paris.

OFAC Standards

The Office of Foreign Assets Control (OFAC) is an agency of the United States Department of the Treasury under the auspices of the Under Secretary of the Treasury for Terrorism and Financial Intelligence. OFAC administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign states, organizations, and individuals.

OECD guidelines for multinational companies

OECD Guidelines for Multinational Enterprises are annex to the OECD Declaration on International Investment and Multinational Enterprises. They are recommendations providing principles and standards for responsible business conduct for multinational corporations operating in or from countries adhered to the Declaration. The Guidelines are legally non-binding.

Oslo Convetion on Cluster Munition

The Convention on Cluster Munitions (CCM) is an international treaty that addresses the humanitarian consequences and unacceptable harm to civilians caused by cluster munitions, through a categorical prohibition and a framework for action. The Convention prohibits all use, production, transfer and stockpiling of cluster munitions.

ILO (International Labour Organization) Standards

The International Labour Organization has long maintained and developed a system of international labour standards aimed at promoting opportunities for women and men to obtain decent and productive work, in conditions of freedom, equity, security and dignity.

Roundtable on Sustainable Palm Oil criteria

The Roundtable on Sustainable Palm Oil (RSPO) was established in 2004 with the objective of promoting the growth and use of sustainable palm oil products through credible global standards and engagement of stakeholders.

Transparency International's Corruption Perceptions Index

Since the turn of the new millennium, Transparency International has published the Corruption Perceptions Index (CPI) annually ranking 180 countries by their perceived levels of corruption by officials and politicians, as determined by expert assessments and opinion surveys.

ISO 14001

Policies

Bank has defined internal guidelines and policies in order to promote sustainability at the bank and in its core business:

- Sustainability Policy
- Code of Conduct and Ethics
- Code of Ethics for Senior Financial Officers
- ESG Guideline for the investment process
- Voting Rights Guideline for proxy voting
- Data Protection Guideline
- Environmental and Social Risk Framework
- Anti Money Laundering Policy

Links:

https://www.db.com/cr/en/concrete-compliance.htm

https://www.db.com/company/en/patriot-act--know-your-customer--anti-money-laundering.htm

https://www.db.com/company/en/media/Excerpt-of-globally-applicable-Anti-Money-Laundering-and-Anti-Financial-Crime-Standard.pdf

https://www.db.com/cr/en/datacenter/structures-risk-management.htm

Appendix 6

U.S. Anti-Money Laundering Laws

1. The Bank Secrecy Act

The Bank Secrecy Act (BSA), initially adopted in 1970, establishes the basic framework for AML obligations imposed on financial institutions. Among other things, it authorizes the Secretary of the Treasury (Treasury) to issue regulations requiring financial institutions (including broker-dealers) to keep records and file reports on financial transactions that may be useful in investigating and prosecuting money laundering and other financial crimes. The Financial Crimes Enforcement Network (FinCEN), a bureau within Treasury, has regulatory responsibilities for administering the BSA.

Rule 17a-8 under the Securities Exchange Act of 1934 (Exchange Act) requires broker-dealers to comply with the reporting, recordkeeping, and record retention rules adopted under the BSA.

***Source Documents*:**

- **Bank Secrecy Act:** The Bank Secrecy Act is codified at 31 U.S.C. §§ 5311 *et seq.* and is available at: http://www4.law.cornell.edu/uscode/html/uscode31/usc_sup_01_31_08_IV_10_53_20_II.html

- **2. The USA Patriot Act**

(v) The U.S. Patriot Act

The 'Patriot Act' is a statute enacted by the United States government that President George W. Bush signed into law on October 26, 2001. The contrived acronym stands for 'Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001' (Public Law Pub.L. 107-56) and other U.S. AML regulations applicable to such institutions. The act increases the ability of law enforcement agencies to search telephone, e-mail communications, medical, financial, and other records; eases restrictions on foreign intelligence gathering within the United States; expands the Secretary of the Treasury's authority to regulate financial transactions, particularly those involving foreign individuals and entities; and enhances the discretion of law enforcement and immigration authorities in detaining and deporting immigrants suspected of terrorism-related acts. The act also expands the definition of terrorism to include domestic terrorism, thus enlarging the number of activities to which the Patriot Act's expanded law enforcement powers can be applied. Consequently, financial institutions design their AML policies on the basis of these high standards which are then rolled

out to their subsidiaries around the world to form the AML policies and processes of such subsidiaries. So, give or take a few duly approved deviations as may be required by the local context, such institutions have identical check-lists as they try to ensure they maintain their high standards, even where lax policies exist locally.

The USA Patriot Act was enacted by Congress in 2001 in response to the September 11, 2001 terrorist attacks. Among other things, the USA Patriot Act amended and strengthened the BSA. It imposed a number of AML obligations directly on broker-dealers, including:

- AML compliance programs;
- customer identification programs;
- monitoring, detecting, and filing reports of suspicious activity;
- due diligence on foreign correspondent accounts, including prohibitions on transactions with foreign shell banks;
- due diligence on private banking accounts;
- mandatory information-sharing (in response to requests by federal law enforcement);
- compliance with 'special measures' imposed by the Secretary of the Treasury to address particular AML concerns.

Source Document:

- USA Patriot Act: Title 3 of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 296 (2001). The full text of the USA Patriot Act is available at:

  http://www.sec.gov/about/offices/ocie/aml/patriotact2001.pdf

3. AML Programs

Section 352 of the USA Patriot Act amended the BSA to require financial institutions, including broker-dealers, to establish AML programs. Broker-dealers can satisfy this requirement by implementing and maintaining an AML program that complies with SRO rule requirements. In September 2009, the SEC approved FINRA's new AML compliance rule, FINRA Rule 3310 in the *Anti-money Laundering Compliance Program*. FINRA's new rule adopts NASD Rule 3011 and most of NASD IM-3011-1 and deletes NYSE Rule 445 as duplicative. As with NASD Rule 3011 and NYSE Rule 445, FINRA Rule 3310 requires member organizations to establish risk-based AML compliance programs. Please note, however, that FINRA Rule 3310 does not contain the exception in NASD IM-3011-1 to the independent testing requirement. FINRA Rule 3310 became effective on January 1, 2010.

An AML program must be in writing and include, at a minimum:

- policies, procedures, and internal controls reasonably designed to achieve compliance with the BSA and its implementing rules;
- policies and procedures that can be reasonably expected to detect and cause the reporting of transactions under 31 U.S.C. 5318(g) and the implementing regulations thereunder; the designation of an AML compliance officer (AML Officer), including notification to the SROs;
- ongoing AML employee training;
- and an independent test of the firm's AML program, annually for most firms.

Source Documents:

AML Program Rule: 31 C.F.R. § 1023.210;

Final Rule Release: 67 Fed. Reg. 21110 (April 29, 2002) SEC Order Approving Initial NASD and NYSE AML Compliance Program Rules: Exchange Act Release No. 45798 (April 22, 2002). See also 67 Fed. Reg. 20854 (April 26, 2002);

NYSE AML Compliance Program Rules and Related Guidance: NYSE Rule 445: Anti-Money Laundering Compliance Program;

SEC Release Approving NYSE Amendment to Rule 445: Exchange Act Release No. 53176 (January 25, 2006). See also 71 Fed. Reg. 5392 (February 1, 2006). (The rule amendments refine AML compliance program requirements relating to independence, testing, and AML Officer notifications).

4. Customer Identification Programs

Section 326 of the USA Patriot Act amended the BSA to require financial institutions, including broker-dealers, to establish written customer identification programs (CIP). Treasury's implementing rule requires a broker-dealer's CIP to include, at a minimum, procedures for:

- obtaining customer identifying information from each customer prior to account opening; verifying the identity of each customer, to the extent reasonable and practicable, within a reasonable time before or after account opening;
- making and maintaining a record of information obtained relating to identity verification; determining within a reasonable time after account opening or earlier whether a customer appears on any list of known or suspected terrorist organizations designated by Treasury;

- and providing each customer with adequate notice, prior to opening an account, that information is being requested to verify the customer's identity.

The CIP rule provides that, under certain defined circumstances, broker-dealers may rely on the performance of another financial institution to fulfill some or all of the requirements of the broker-dealer's CIP. For example, in order for a broker-dealer to rely on the other financial institution the reliance must be reasonable. The other financial institution also must be subject to an AML compliance program rule and be regulated by a federal functional regulator. The broker-dealer and other financial institution must enter into a contract and the other financial institution must certify annually to the broker-dealer that it has implemented an AML program. The other financial institution must also certify to the broker-dealer that the financial institution will perform the specified requirements of the broker-dealer's CIP.

Source Documents:

Customer Identification Program Rule:

- 31 C.F.R. § 1023.220. Final Rule Release: Exchange Act Release No. 47752 (April 29, 2003). See also 68 Fed. Reg. 25113 (May 9, 2003);
- Withdrawal of the Notice of Proposed Rulemaking; Anti-Money Laundering Programs for Investment Advisers: 73 Fed. Reg. 65568 (October 30, 2008).

FinCEN Guidance:

- Guidance: Customer Identification Program Rule No-Action Position Respecting Broker-Dealers Operating Under Fully Disclosed Clearing Agreements According to Certain Functional Allocations (FIN-2008-G002; March 4, 2008)
- Ruling: Bank Secrecy Act Obligations of a U.S. Clearing Broker-Dealer Establishing a Fully Disclosed Clearing Relationship with a Foreign Financial Institution (FIN-2008-R008; June 3, 2008);

SEC Staff Guidance:

- Staff Q&A Regarding the Broker-Dealer Customer Identification Program Rule (October 1, 2003). (The Q&A provides staff guidance regarding when a broker-dealer maintaining an 'omnibus account' for a financial intermediary may treat the financial intermediary as the 'customer' for CIP purposes.)
- No-Action Letters to the Securities Industry Association ('SIA') (February 12, 2004; February 10, 2005; July 11, 2006; January 10, 2008; January 11, 2010; and January 11, 2011). (The letters provide staff guidance regarding the extent to which a broker-dealer may rely on an investment

adviser to conduct the required elements of the CIP rule, prior to such adviser being subject to an AML rule. Among other things, the 2011 letter provides additional details regarding the reasonableness of a broker-dealer's reliance on an investment adviser and also includes a requirement that the investment adviser promptly report to the broker-dealer potentially suspicious or unusual activity detected as part of the CIP being performed on the broker-dealer's behalf);

- Staff Q&A Regarding Broker-Dealer CIP Rule Responsibilities under the Agency Lending Disclosure Initiative (April 26, 2006). (The Q&A provides staff guidance on the application of the CIP rule to the Agency Lending Disclosure Initiative);
- National Exam Risk Alert — Master/Sub Accounts (September 29, 2011);

FINRA Guidance:

- Regulatory Notice 10-18: Master Accounts and Sub-Accounts (April 2010)

5. Correspondent Accounts: Prohibition on Foreign Shell Banks and Due Diligence Programs

Overview: Sections 312, 313, and 319 of the USA Patriot Act, which amended the BSA, are inter-related provisions involving accounts called 'correspondent accounts'. These inter-related provisions include prohibitions on certain types of correspondent accounts (those maintained for foreign "shell" banks) as well as requirements for risk-based due diligence of foreign correspondent accounts more generally.

A 'correspondent account' is defined as: 'any formal relationship established for a foreign financial institution to provide regular services to effect transactions in securities'.

A 'foreign financial institution' includes: (i) a foreign bank (including a foreign branch or office of a U.S. bank); (ii) a foreign branch or office of a securities broker-dealer, futures commission merchant, introducing broker in commodities, or mutual fund; (iii) a business organized under foreign law (other than a branch or office of such business in the U.S.) that if it were located in the U.S. would be a securities broker-dealer, futures commission merchant, introducing broker in commodities, or a mutual fund; and (iv) a money transmitter or currency exchange organized under foreign law (other than a branch or office of such entity in the U.S.).

In addition, Treasury has clarified that, for a broker-dealer, a 'correspondent account' includes:

- accounts to purchase, sell, lend, or otherwise hold securities, including securities repurchase arrangements;
- prime brokerage accounts that clear and settle securities transactions for clients;

- accounts for trading foreign currency;
- custody accounts for holding securities or other assets in connection with securities transactions as collateral;
- and over-the-counter derivatives contracts.

Prohibitions on Foreign Shell Banks: A broker-dealer is prohibited from establishing, maintaining, administering, or managing 'correspondent accounts' in the U.S. for, or on behalf of, foreign "shell" banks (i.e., foreign banks with no physical presence in any country). Broker-dealers also must take steps to ensure that they are not indirectly providing correspondent banking services to foreign shell banks through foreign banks with which they maintain correspondent relationships. In order to assist institutions in complying with the prohibitions on providing correspondent accounts to foreign shell banks, Treasury has provided a model certification that can be used to obtain information from foreign bank correspondents. In addition, broker-dealers must obtain records in the United States of foreign bank owners and agents for service of process (Sections 313 and 319 of the USA Patriot Act).

***Source Documents*:**

- Shell Bank Prohibition: 31 C.F.R. § 1010.630. See also 31 C.F.R. § 1010.605 (definitions).
- Final Rule Release: 67 Fed. Reg. 60562 (September 26, 2002).

FinCEN Guidance:

- FIN-2006-G003: Frequently Asked Questions: Foreign Bank Recertifications under 31 C.F.R. § 103.77 (February 3, 2006).
- FIN-2008-G001: Application of Correspondent Account Rules to the Presentation of Negotiable Instruments Received by a Covered Financial Institution for Payment (January 30, 2008).
- Ruling: Bank Secrecy Act Obligations of a U.S. Clearing Broker-Dealer Establishing a Fully Disclosed Clearing Relationship with a Foreign Financial Institution (FIN-2008-R008; June 3, 2008).

Due Diligence Regarding Foreign Correspondent Accounts: A broker-dealer is required to establish a risk-based due diligence program (that is part of its AML compliance program) for any 'correspondent accounts' maintained for foreign financial institutions. The due diligence program, which is required to be a part of the broker-dealer's overall AML program, must include appropriate, specific, risk-based policies, procedures, and controls reasonably designed to enable the broker-dealer to detect and report, on an ongoing basis, any known or suspected money laundering conducted through or involving any foreign correspondent account (Section 312 of the Patriot Act).

Treasury has finalized a related rule that states when enhanced due diligence on foreign financial institutions is required.

***Source Documents*:**

- Correspondent Account Due Diligence Rule: 31 C.F.R. § 1010.610. See also 31 C.F.R. § 1010.605 (definitions).
  Final Rule Release: 71 Fed. Reg. 496 (January 4, 2006).
- Enhanced Due Diligence Final Rule: 72 Fed. Reg. 44768 (August 9, 2007).

***NYSE Guidance*:**

- IM 06-50: Effective Dates for Section 312 of the USA Patriot Act (July 3, 2006).

6. Information Sharing with Law Enforcement and Financial Institutions

Two provisions relating to information sharing were added to the BSA by the USA Patriot Act. One provision requires broker-dealers to respond to *mandatory* requests for information made by FinCEN on behalf of federal law enforcement agencies. The other provides a safe harbor to permit and facilitate *voluntary* information sharing among financial institutions.

Mandatory Information Sharing: Section 314(a) Requests:

FinCEN's BSA information sharing rules, under Section 314(a), authorize law enforcement agencies with criminal investigative authority to request that FinCEN solicit, on the agency's behalf, certain information from a financial institution, including a broker-dealer. These requests are often referred to as 'Section 314(a) information requests'. Upon receiving a Section 314(a) request, a broker-dealer is required to search its records to determine whether it has accounts for, or has engaged in transactions with, any specified individual, entity, or organization. If the broker-dealer identifies an account or transaction identified with any individual, entity or organization named in the request, it must report certain relevant information to FinCEN. Broker-dealers also must designate a contact person (typically the firm's AML compliance officer) to receive the requests and must maintain the confidentiality of any request and any responsive reports to FinCEN.

Source Documents:

Section 314(a) Rule: 31 C.F.R. § 1010.520.
Rule Release: 67 Fed. Reg. 60579 (September 26, 2002).
Proposed Rule Release: 74 Fed. Reg. 58926 (November 16, 2009).

Final Rule Release: Broadening Access to the 314(a) program- 75 Fed. Reg. 6560 (February 10, 2010).

FinCEN Guidance:

Treasury Issues Moratorium on Section 314(a) Information Requests (November 26, 2002).

FinCEN to Reinstate USA Patriot Act Section 314(a) Information Requests (February 6, 2003).

Implementation of Web-based 314(a) Secure Communication System (February 4, 2005).

FinCEN 314(a) Fact Sheet (April 5, 2011).

Changing your Point of Contact for 314(a) (November 5, 2010).

NYSE Guidance:

IM 02-58: Temporary Moratorium on Information Requests Under Section 314 of the USA Patriot Act (December 26, 2002).

IM 03-3: Lifting of the Temporary Moratorium on Information Requests Under Section 314 of the USA Patriot Act (February 20, 2003).

NASD Guidance:

NTM 02-80: Development Regarding Treasury Information Requests Under Section 314 of the Patriot Act (December 2002).

7. Voluntary Information Sharing Among Financial Institutions: Section 314(b):

A separate safe harbor provision encourages and facilitates voluntary information sharing among participating financial institutions. The safe harbor provision, added to the BSA by Section 314(b) of the USA Patriot Act, protects financial institutions, including broker-dealers, from certain liabilities in connection with sharing certain AML related information with other financial institutions for the purposes of identifying and reporting activities that may involve terrorist acts or money laundering activities. Treasury's implementing regulations require that a financial institution or association of financial institutions that intends to share information pursuant to the regulations must file an annual notice with FinCEN, maintain procedures to protect the security and confidentiality of the information, and take reasonable steps to verify that the financial institution or association of financial institutions with which it intends to share the information has filed the required notice with FinCEN. This may be done by checking a list that FinCEN makes available. A notification form and instructions for submitting a notification form (initial or renewal) are available on FinCEN's website.

Source Documents:

Section 314(b) Rule: 31 C.F.R. § 1010.540.

Final Rule Release: 67 Fed. Reg. 60579 (September 26, 2002).

314(b) Notice Form: (http://www.fincen.gov/314b.pdf).

FinCEN Guidance:

Guidance on the Scope of Permissible Information Sharing Covered by Section 314(b) Safe Harbor of the USA Patriot Act (June 16, 2009).

8. Special Measures Imposed by the Secretary of the Treasury

Section 311 of the USA Patriot Act amended the BSA to authorize the Secretary of the Treasury to require broker-dealers to take 'special measures' to address particular money laundering concerns. The Secretary of the Treasury may impose special measures on foreign jurisdictions, financial institutions, or transactions or types of accounts found to be of 'primary money laundering concern'. There are five 'special measures', including prohibiting U.S. financial institutions from opening or maintaining certain correspondent accounts. In addition, FinCEN issued a rule proposal on November 28, 2011, which, if adopted, will impose special measures against the Islamic Republic of Iran.[11]

Source Documents:

Section 311 Information: Information about Section 311 is generally available at:

www.fincen.gov.

Section 311 Special Measures

NYSE Guidance:

IM 07-34: NASD and NYSE Joint Release Regarding Special Measures against Specified Banks Pursuant to Section 311 of the USA Patriot Act (April 18, 2007).

IM 06-58: NYSE and NASD Joint Release Regarding Special Measures Against Specified Banks Pursuant to Section 311 of the USA Patriot Act (August 14, 2006).

NASD Guidance:

NTM 07-17: NYSE and NASD Joint Release Regarding Special Measures Against Specified Banks Pursuant to Section 311 of the USA Patriot Act (April 2007).

NTM 06-41: NASD and NYSE Joint Release on Section 311 of the USA Patriot Act (August 2006).

9. OFAC Sanctions Programs and Other Lists

OFAC is an office within Treasury that administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign countries, terrorism sponsoring organizations, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction. OFAC acts under Presidential wartime and national emergency powers, as well as authority granted by specific legislation, to impose controls on transactions and freeze foreign assets under U.S. jurisdiction.

OFAC's sanctions programs are separate and distinct from, and in addition to, the AML requirements imposed on broker-dealers under the BSA.

As a tool in administering sanctions, OFAC publishes lists of sanctioned countries and persons that are continually being updated. Its list of Specially Designated Nationals and Blocked Persons (SDNs) lists individuals and entities from all over the world whose property is subject to blocking and with whom U.S. persons cannot conduct business. OFAC also administers country-based sanctions that are broader in scope than the 'list-based' programs.

In general, OFAC regulations require broker-dealers to:

- block accounts and other property or property interests of entities and individuals that appear on the SDN list;
- block accounts and other property or property interests of entities and individuals subject to blocking under OFAC country-based programs; and

- block or reject unlicensed trade and financial transactions with OFAC-specified countries, entities, and individuals.

Broker-dealers must report all blockings and rejections of prohibited transactions to OFAC within 10 days of being identified and annually. OFAC has the authority to impose substantial civil penalties administratively. To guard against engaging in OFAC prohibited transactions, one best practice that has emerged entails 'screening against the OFAC list'. OFAC has stated that it will take into account the adequacy of a firm's OFAC compliance program when it evaluates whether to impose a penalty if an OFAC violation has occurred. Firms should be aware of other lists, such as the Financial Action Task Force ('FATF') list of non-compliant countries (the 'NCCT list'). If transactions originate from or are routed to any FATF-identified countries, it might be an indication of suspicious activity.

Source Documents:

OFAC Guidance:

Program information, including the SDN list and countries subject to OFAC sanctions, is available on the OFAC website at:

www.treas.gov/ofac

Foreign Assets Control Regulations for the Securities Industry (April 29, 2004).

Economic Sanctions Enforcement Guidelines (73 FR 51933; September 2, 2008)

Opening Securities and Futures Accounts from an OFAC Perspective (November 5, 2008)

Risk Factors for OFAC Compliance in the Securities Industry (November 5, 2008)

Economic Sanctions Enforcement Guidelines (November 9, 2009)

OFAC Frequently Asked Questions, available on the OFAC website at:

http://www.treas.gov/offices/enforcement/ofac/faq/index.shtml

Other Lists:

Other lists of countries supporting international terrorism may be available at:

U.S. State Dept.: www.state.gov/s/ct

FATF: www.fatf-gafi.org.

FinCEN High Intensity Financial Crimes Areas Designation is at:

http://www.fincen.gov/le_hifcadesign.html.

Appendix 7

Department of Justice

Office of Public Affairs

FOR IMMEDIATE RELEASE

Tuesday, December 11, 2012

HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement

Bank Agrees to Enhanced Compliance Obligations, Oversight by Monitoring Connection with Five-year Agreement

Washington – HSBC Holdings plc (HSBC Group) – a United Kingdom corporation headquartered in London – and HSBC Bank USA N.A. (HSBC Bank USA) (together, HSBC) – a federally chartered banking corporation headquartered in McLean, Va. – have agreed to forfeit $1.256 billion and enter into a deferred prosecution agreement with the Justice Department for HSBC's violations of the Bank Secrecy Act (BSA), the International Emergency Economic Powers Act (IEEPA) and the Trading with the Enemy Act (TWEA). According to court documents, HSBC Bank USA violated the BSA by failing to maintain an effective anti-money laundering program and to conduct appropriate due diligence on its foreign correspondent account holders. The HSBC Group violated IEEPA and TWEA by illegally conducting transactions on behalf of customers in Cuba, Iran, Libya, Sudan and Burma – all countries that were subject to sanctions enforced by the Office of Foreign Assets Control (OFAC) at the time of the transactions.

The announcement was made by Lanny A. Breuer, Assistant Attorney General of the Justice Department's Criminal Division; Loretta Lynch, U.S. Attorney for the Eastern District of New York; and John Morton, Director of U.S. Immigration and Customs Enforcement (ICE); along with numerous law enforcement and regulatory partners. The New York County District Attorney's Office worked with the Justice Department on the sanctions portion of the investigation. Treasury Under Secretary David S. Cohen and Comptroller of the Currency Thomas J. Curry also joined in today's announcement.

A four-count felony criminal information was filed today in federal court in the Eastern District of New York charging HSBC with willfully failing to maintain an effective anti-money laundering (AML) program, willfully failing to conduct due diligence on its foreign correspondent affiliates, violating IEEPA

and violating TWEA. HSBC has waived federal indictment, agreed to the filing of the information, and has accepted responsibility for its criminal conduct and that of its employees.

'HSBC is being held accountable for stunning failures of oversight – and worse – that led the bank to permit narcotics traffickers and others to launder hundreds of millions of dollars through HSBC subsidiaries, and to facilitate hundreds of millions more in transactions with sanctioned countries', said Assistant Attorney General Breuer. 'The record of dysfunction that prevailed at HSBC for many years was astonishing. Today, HSBC is paying a heavy price for its conduct, and, under the terms of today's agreement, if the bank fails to comply with the agreement in any way, we reserve the right to fully prosecute it.'

'Today we announce the filing of criminal charges against HSBC, one of the largest financial institutions in the world', said U.S. Attorney Lynch. 'HSBC's blatant failure to implement proper anti-money laundering controls facilitated the laundering of at least $881 million in drug proceeds through the U.S. financial system. HSBC's willful flouting of U.S. sanctions laws and regulations resulted in the processing of hundreds of millions of dollars in OFAC-prohibited transactions. Today's historic agreement, which imposes the largest penalty in any BSA prosecution to date, makes it clear that all corporate citizens, no matter how large, must be held accountable for their actions.'

'Cartels and criminal organization are fueled by money and profits', said ICE Director Morton. 'Without their illicit proceeds used to fund criminal activities, the lifeblood of their operations is disrupted. Thanks to the work of Homeland Security Investigations and our El Dorado Task Force, this financial institution is being held accountable for turning a blind eye to money laundering that was occurring right before their very eyes. HSI will continue to aggressively target financial institutions whose inactions are contributing in no small way to the devastation wrought by the international drug trade. There will be also a high price to pay for enabling dangerous criminal enterprises.'

In addition to forfeiting $1.256 billion as part of its deferred prosecution agreement (DPA) with the Department of Justice, HSBC has also agreed to pay $665 million in civil penalties – $500 million to the Office of the Comptroller of the Currency (OCC) and $165 million to the Federal Reserve – for its AML program violations. The OCC penalty also satisfies a $500 million civil penalty of the Financial Crimes Enforcement Network (FinCEN). The bank's $375 million settlement agreement with OFAC is satisfied by the forfeiture to the Department of Justice. The United Kingdom's Financial Services Authority (FSA) is pursuing a separate action.

As required by the DPA, HSBC also has committed to undertake enhanced AML and other compliance obligations and structural changes within its entire global operations to prevent a repeat of

the conduct that led to this prosecution. HSBC has replaced almost all of its senior management, 'clawed back' deferred compensation bonuses given to its most senior AML and compliance officers, and has agreed to partially defer bonus compensation for its most senior executives – its group general managers and group managing directors – during the period of the five-year DPA. In addition to these measures, HSBC has made significant changes in its management structure and AML compliance functions that increase the accountability of its most senior executives for AML compliance failures.

The AML Investigation

According to court documents, from 2006 to 2010, HSBC Bank USA severely understaffed its AML compliance function and failed to implement an anti-money laundering program capable of adequately monitoring suspicious transactions and activities from HSBC Group Affilliates, particularly HSBC Mexico, one of HSBC Bank USA's largest Mexican customers. This included a failure to monitor billions of dollars in purchases of physical U.S. dollars, or 'banknotes', from these affiliates. Despite evidence of serious money laundering risks associated with doing business in Mexico, from at least 2006 to 2009, HSBC Bank USA rated Mexico as 'standard' risk, its lowest AML risk category. As a result, HSBC Bank USA failed to monitor over $670 billion in wire transfers and over $9.4 billion in purchases of physical U.S. dollars from HSBC Mexico during this period, when HSBC Mexico's own lax AML controls caused it to be the preferred financial institution for drug cartels and money launderers.

A significant portion of the laundered drug trafficking proceeds were involved in the Black Market Peso Exchange (BMPE), a complex money laundering system that is designed to move the proceeds from the sale of illegal drugs in the United States to drug cartels outside of the United States, often in Colombia. According to court documents, beginning in 2008, an investigation conducted by ICE Homeland Security Investigation's (HSI's) El Dorado Task Force, in conjunction with the U.S. Attorney's Office for the Eastern District of New York, identified multiple HSBC Mexico accounts associated with BMPE activity and revealed that drug traffickers were depositing hundreds of thousands of dollars in bulk U.S. currency each day into HSBC Mexico accounts. Since 2009, the investigation has resulted in the arrest, extradition, and conviction of numerous individuals illegally using HSBC Mexico accounts in furtherance of BMPE activity.

As a result of HSBC Bank USA's AML failures, at least $881 million in drug trafficking proceeds – including proceeds of drug trafficking by the Sinaloa Cartel in Mexico and the Norte del Valle Cartel in Colombia – were laundered through HSBC Bank USA. HSBC Group admitted it did not inform HSBC Bank USA of significant AML deficiencies at HSBC Mexico, despite knowing of these problems and their effect on the potential flow of illicit funds through HSBC Bank USA.

The Sanctions Investigation

According to court documents, from the mid-1990s through September 2006, HSBC Group allowed approximately $660 million in OFAC-prohibited transactions to be processed through U.S. financial institutions, including HSBC Bank USA. HSBC Group followed instructions from sanctioned entities such as Iran, Cuba, Sudan, Libya and Burma, to omit their names from U.S. dollar payment messages sent to HSBC Bank USA and other financial institutions located in the United States. The bank also removed information identifying the countries from U.S. dollar payment messages; deliberately used less-transparent payment messages, known as cover payments; and worked with at least one sanctioned entity to format payment messages, which prevented the bank's filters from blocking prohibited payments.

Specifically, beginning in the 1990s, HSBC Group affiliates worked with sanctioned entities to insert cautionary notes in payment messages including 'care sanctioned country', 'do not mention our name in NY', or 'do not mention Iran'. HSBC Group became aware of this improper practice in 2000. In 2003, HSBC Group's head of compliance acknowledged that amending payment messages 'could provide the basis for an action against [HSBC] Group for breach of sanctions'. Notwithstanding instructions from HSBC Group Compliance to terminate this practice, HSBC Group affiliates were permitted to engage in the practice for an additional three years through the granting of dispensations to HSBC Group policy.

Court documents show that as early as July 2001, HSBC Bank USA's chief compliance officer confronted HSBC Group's Head of Compliance on the issue of amending payments and was assured that 'Group Compliance would not support blatant attempts to avoid sanctions, or actions which would place [HSBC Bank USA] in a potentially compromising position'. As early as July 2001, HSBC Bank USA told HSBC Group's head of compliance that it was concerned that the use of cover payments prevented HSBC Bank USA from confirming whether the underlying transactions met OFAC requirements. From 2001 through 2006, HSBC Bank USA repeatedly told senior compliance officers at HSBC Group that it would not be able to properly screen sanctioned entity payments if payments were being sent using the cover method. These protests were ignored.

'Today HSBC is being held accountable for illegal transactions made through the U.S. financial system on behalf of entities subject to U.S. economic sanctions', said Debra Smith, Acting Assistant Director in Charge of the FBI's Washington Field Office. 'The FBI works closely with partner law enforcement agencies and federal regulators to ensure compliance with federal banking laws to promote integrity across financial institutions worldwide.'

'Banks are the first layer of defense against money launderers and other criminal enterprises who choose to utilize our nation's financial institutions to further their criminal activity', said Richard Weber, Chief, Internal Revenue Service-Criminal Investigation (IRS-CI). 'When a bank disregards the Bank Secrecy Act's reporting requirements, it compromises that layer of defense, making it more difficult to identify, detect and deter criminal activity. In this case, HSBC became a conduit to money laundering. The IRS is proud to partner with the other law enforcement agencies and share its world-renowned financial investigative expertise in this and other complex financial investigations.'

Manhattan District Attorney Cyrus R. Vance Jr., said, 'New York is a center of international finance, and those who use our banks as a vehicle for international crime will not be tolerated. My office has entered into Deferred Prosecution Agreements with two different banks in just the past two days, and with six banks over the past four years. Sanctions enforcement is of vital importance to our national security and the integrity of our financial system. The fight against money laundering and terror financing requires global cooperation, and our joint investigations in this and other related cases highlight the importance of coordination in the enforcement of U.S. sanctions. I thank our federal counterparts for their ongoing partnership.'

Queens County District Attorney Richard A. Brown said, 'No corporate entity should ever think itself too large to escape the consequences of assisting international drug cartels. In particular, banks have a special responsibility to use appropriate due diligence in monitoring the cash transactions flowing through their financial system and identifying the sources of that money in order not to assist in criminal activity. By allowing such illicit transactions to occur, HSBC failed in its global responsibility to us all. Hopefully, as a result of this historical settlement, we have gained the attention of not only HSBC but that of every other major financial institution so that they cannot turn a blind eye to the crime of money laundering.'

This case was prosecuted by Money Laundering and Bank Integrity Unit Trial Attorneys Joseph Markel and Craig Timm of the Criminal Division's Asset Forfeiture and Money Laundering Section, and Assistant U.S. Attorneys Alex Solomon and Daniel Silver of the U.S. Attorney's Office for the Eastern District of New York.

The AML investigation was conducted by HSI's El Dorado Task Force, a joint task force composed of members from more than 55 law enforcement agencies in New York and New Jersey, including special agents and investigators from IRS-CI and the Queens County District Attorney's Office, other federal agents, state and local police investigators and intelligence analysts, with the assistance of DEA's New York Division. The sanctions investigation was conducted by the FBI's Washington Field Office.

The Money Laundering and Bank Integrity Unit is a corps of prosecutors with a boutique practice aimed at hardening the financial system against criminal money laundering vulnerabilities by investigating and prosecuting financial institutions and professional money launderers for violations of the anti-money laundering statutes, the Bank Secrecy Act and other related statutes.

The Department of Justice expressed gratitude to William Ihlenfeld II, U.S. Attorney for the Northern District of West Virginia; Assistant District Attorney Garrett Lynch of the New York County District Attorney's Office, Major Economic Crimes Bureau; the Treasury Department's Office of Foreign Assets Control; the Board of Governors of the Federal Reserve System; and the Office of the Comptroller of the Currency for their significant and valuable assistance.

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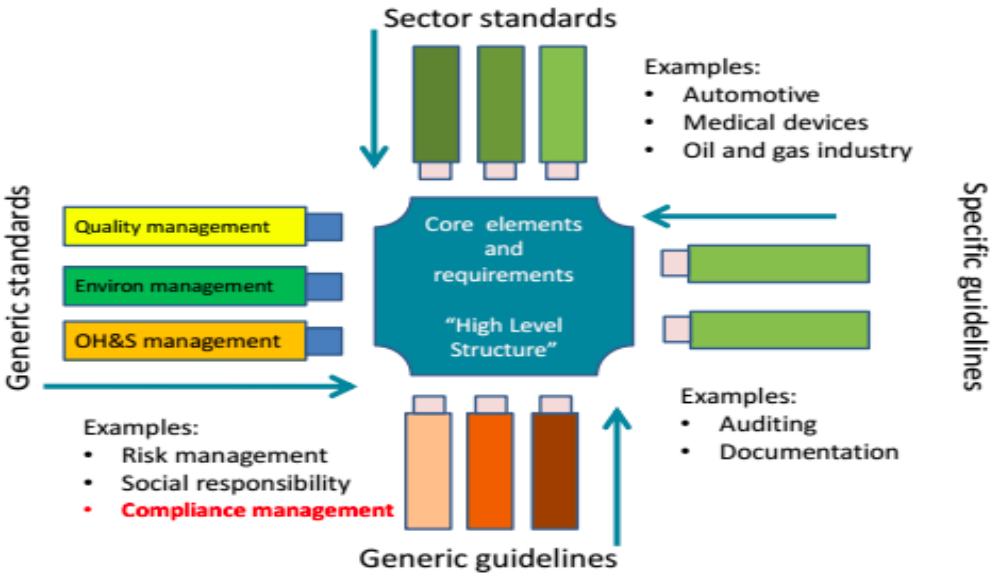
Criminal Division

Updated May 22, 2015

Appendix 8

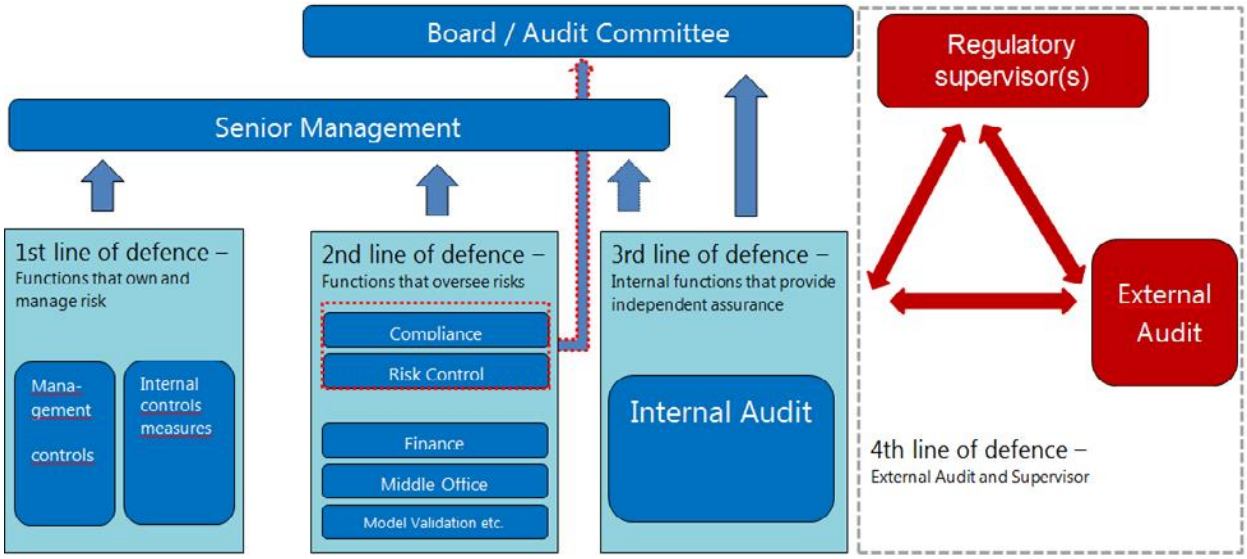
ISO compliance standards is reflected in the plug-in model outlined below.



Appendix 9

Three lines of defence model:

Four lines of defence model:



Further to Financial Stability Institute's Occasional Paper No. 11 prepared by Arndorfer and Minto (2015) by comparing how the three LoD model was envisaged and how it works in practice, four root causes of its problems and weaknesses are specified as:

a. Misaligned incentives for risk-takers in the first line of defense

Many experts agree that the most important control is the first line of defence (Lyons, 2011; Capriglione and Casalino, 2014). However, this responsibility conflicts with the objective of most risk-takers in the first line, which is to generate sufficient revenue and profits for the institution. In the past, management put greater emphasis on profits and set compensation based on the achievement of financial objectives rather than control-oriented objectives. One of the reasons underlying the

difficulties faced by UBS during the U.S. subprime crisis was insufficient controls and financial reporting systems in the context of expanding derivatives trading positions on U.S. residential mortgage-backed securities (UBS, Shareholder Report on UBS Write-downs, (2008). While the bank accumulated such positions, this information did not reach the top layers of management and was watered down in general reports, thus concealing the bank's true exposure to the U.S. mortgage market. The question remains, however, of how a bank remunerates traders that meet the control objective but fail to generate revenue for the institution. A way forward could be to introduce a compensation system comprising a flexible bonus element requiring full achievement of mandatory control objectives before any bonus is paid out.

b. Lack of organisational independence in second line functions

A common criticism of the effectiveness of controls performed by the second line is the lack of organisational independence of the control functions (Anderson and Eubanks, 2015). Most risk management functions report formally to the board. However, the de facto day-to-day reporting lines and communication channels are more likely to go to senior management than to the board. Critical control functions might lose their independence by being embedded in the organisation through engagement and exchange of information with other functions of the first and second line of defence and – over time – might adopt views typically put forward by risk-taking units rather than control units. Remuneration of the second line of defence also plays a crucial role.

c. Lack of skills and expertise in second line functions

Even if the compliance, risk management and legal functions in the second line of defence are organisationally independent, they may lack sufficient skills and expertise to effectively challenge inadequate or defective practices and controls in the first line. This might include the validation of complex models, for instance models based on internal ratings or interest-rate risk in the banking book, or providing independent valuations of illiquid or hard-to-value instruments. Remuneration and experience in first line functions are still considerably higher and more senior than in second line functions, despite the tighter regulation of variable compensation practices.

d. Inadequate and subjective risk assessment performed by internal audit

The effectiveness of the work of internal auditors largely depends on a well-established audit plan based on an annual risk assessment that is comprehensive and objective, and which is performed by individuals that have a deep understanding of the risk profile of the organisation. Further to Arndorfer and Minto (2015), outlining internal audit's review of UBS's trading desk for U.S. mortgage-

backed derivatives, control weaknesses were detected during the performance of the review, but internal audit were unable to validate and finalise their report in sufficient time. The delay proved crucial and compromised the overall good quality of the report. The above paper challenged:

> …the conventional reliance on the three-lines of defence model by arguing that it has proven less effective in 'complex' corporate structures such as the ones governing financial institutions. The Achilles heel of the three-lines-of-defence model stems from a lack of comprehensive overview of the organisational structure. This results in a sub-optimal distribution of the relevant information and ineffective control measures at multiple layers of the organisation. On top of that, deficiencies in the understanding of risk-taking policies, and their impact inside and outside the individual financial institution, as well as of the way in which relevant data have been compiled – paired with cultural and behavioural failures - are commonly argued as root causes of the recent corporate scandals in the financial industry. These are lessons that carry important implications for the efficiency of the three-lines-of-defence model and call for alternative models.

Appendix 10

1. Policy implementation

As OECD mentioned in the Report (2013) 'the bulk of the literature on policy implementation is focused on the internal dynamism of the regulator, but not on the behaviours of the regulated entities in response'. As most literature does not include any discussion about the target, namely the behaviour of regulated entities, this study seeks to address this gap and provide a fresh perspective on the behaviour of regulated banks. Implementation, according to Pressman and Wildavsky (1973) 'means just what Webster [dictionary] and Roget [thesaurus] say it does: to carry out, accomplish, fulfil, produce, complete'. According to their seminal book on the subject, 'policies imply theories... policies become programmes when, by authoritative action, the initial conditions are created ... Implementation, then, is the ability to forge subsequent links in the causal chain to obtain the desired result (p. xv)'. Van Meter and Van Horn (1975) provided a more specific definition 'policy implementation encompasses those actions by public or private individuals (or groups) that are directed at the achievement of objectives set forth in prior policy decisions'. They make a clear distinction between the interrelated concepts of implementation, performance, impact and stress. According to Raustiala and Slaughter note 'implementation is typically a critical step toward compliance, but compliance can occur without implementation; that is, without any effort or action by a government or regulated entity. If an international commitment matches current practice, implementation is unnecessary and compliance is automatic' (2002:553).

In contrast the approach developed by Elmore (1985) involved alternative policy instruments or the mechanisms that translate substantive policy goals into concrete actions. The classic example of this approach is global ML/FT policy, which is ratified by the board of directors of a global company and then cascades to all regions to adopt global ML/FT policy at the regional and national level. According to Simon (1955) the classical approach to policy implementation is known as a 'top-down' or rationalist approach. A further approach to policy implementation was offered by Sabatier and Mazmanian (1983) when they defined policy implementation 'as carrying out of a basic policy decision, usually incorporated in a statute, but which can also take the form of important executive orders or court decisions'.

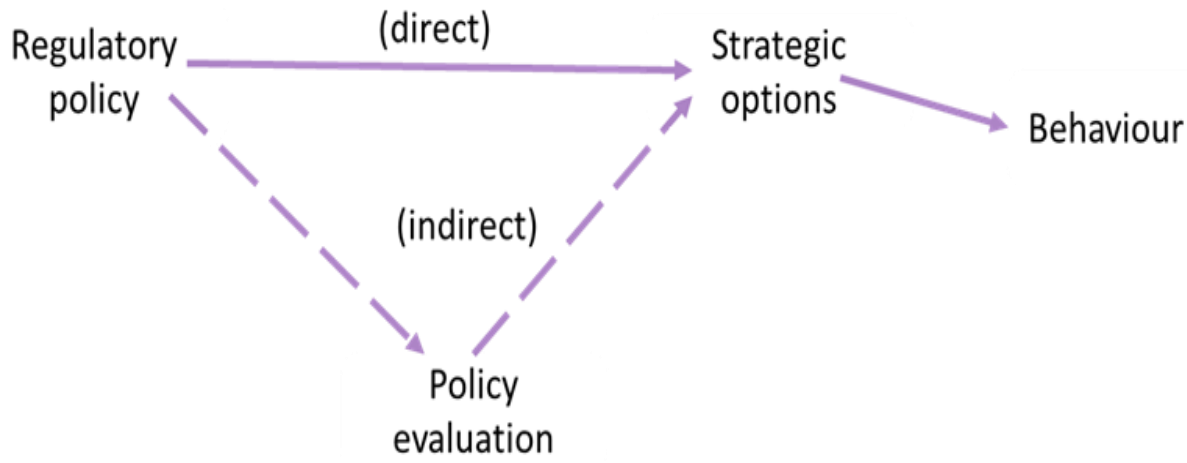
This approach can be demonstrated by the implementation procedures associated with E.U. directives, which relate to target groups. E.U. directives are applicable to all member states where the implementing bodies are knowledgeable enough to proceed with implementing E.U. policies. Further to Conteh (2011), 'the central concern shared by theoretical perspectives on policy implementation, organization and governance is to understand how government organizations interact with their external environment in the delivery of policies'.

An impressive amount of empirical work on regulatory policy and its impact on regulated firms has accumulated over the last three decades. However, in the work of Haines (1997) and others (Brehm and Hamilton, 1996; and Hutter, 2001) observed 'regulatory compliance theory remains relatively underdeveloped'. As Haines (1997) aptly underlined, '[t]he tendency is for each study to simply add to the list of empirical research, a list which grows longer, more complex, and packed ever more densely with insights that are unable to be accessed easily. As she continues, '…unless this growing list of research touches base with some formal theoretical base, repetition of insight is likely to characterize the regulation debate for some time to come' (234). There is still no consistent formal theory capable of synthesising the main findings in the field (Etienne, 2010). It is difficult to disagree with Etienne (2010), as the regulatory compliance issue is very complex. Some can be 'automatic behaviours, but some are purposeful action, and materialising motives to comply or not comply with regulation, they are principally the results of incapacity, incompetence, ignorance or misunderstanding of regulatory prescriptions' (Brehm and Hamilton, 1996; Hutter, 2001).

Other theories have attempted to combine several models of action to consider the motives of compliance behaviours, but these theories have three main shortcomings. Firstly, they are theoretically inconsistent and unrealistic. Secondly, they cannot explain how motives interact with each other. Finally, although they can describe behavioural changes resulting from actors switching from one logic or action to another as, for instance, when self-interest 'crowds out' norm orientation (Frey, 1997; McGraw and Scholz, 1991), they cannot explain them' (Parker, 2002).

Appendix 11

Adopted from Etienne (2010) the regulatory policy's impact on the regulated firm's goals and options set is channeled through either direct causal mechanisms or indirect causal mechanism. In case of indirect regulatory policy modifies the strategic options through policy evaluation, which both impact the behaviour of the actors, as outlined in the diagram below.



Adopted Sources: from Etienne (2010)

Goal setting theory has two dimensions. Firstly, it provides that one's goals and the way one defines the situation are inter-connected, and that such goals are situation-dependent. This means that the perceptions and motivations of the actors become harmonised. For example, assuming regulated firms were aware of forthcoming MiFID II obligations, the focus of attention, for example, motivation, and strategy of actions toward compliance with MiFID II would have been intensified steadily quarter by quarter by the end of 2016 before it became effective on January 1, 2017. Secondly, the implications assumed by the actor can be defined further to a variety of reference points. This means that some actions may result from several goals rather than one. For example, by introducing FATCA, Russia has demonstrated that it not only intends to comply with the U.S. laws, but also signaled to the regulated entities that similar legislation will be introduced covering Russian offshore companies.

The theory, which might be relevant to compliance and can be considered as banks' navigating strategy is self-regulating theory, proposed by Baumeister, Heatherton and Tice (1994). Baumeister and Vohs (2007) suggested that self-regulation is the self's capacity for altering its behaviours and proposed four ingredients of the self-regulation process, which are namely (i) standards; (ii) monitoring; (iii) strength (willpower) and (iv) motivation.

It is important to note that further to Baumeister (2005) 'the most important motivational conflict arises from the clashing demands of nature and culture'. Therefore it was proposed by Baumeister (2005) to look at the nature and culture 'as operating largely together, insofar as evolution selected humans for traits that made them competent to create and function in the complex social systems that became culture. However, short-term self-interest remains a chronic nexus of conflict. Culture, meanwhile, is a group system, and sometimes what is best for the group is not what is best for the individual'.