

Research Paper

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Managed Confrontation

UK Policy Towards Russia After the Salisbury Attack



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Summary

- The nerve-agent attack on Sergey and Yulia Skripal in Salisbury on 4 March 2018 was not just a brazen violation of UK sovereignty. It was also a UK policy failure. Following the murder of Aleksandr Litvinenko in 2006, the UK government failed to deter another life-threatening attack on a British national by organs of the Russian state. Russian decision-makers saw the UK as lacking purpose and resolve because its firm rhetoric was not matched by its actions.
- The UK's response to the Salisbury attack has been far stronger. It has taken robust political, diplomatic and law enforcement measures, coordinated with international partners. Yet this is still essentially a sterner version of what it tried following the Litvinenko murder – broadly 'deterrence by denial' (making it more difficult for Russia to conduct future hostile attacks on UK soil). Other aspects of the UK's post-Salisbury policy towards Russia seem ill-defined.
- Consequently, there is a danger that the UK's actions are again perceived to be out of line with its rhetoric and will thus prove ineffective as a deterrent. The UK should close the gap by making vigorous and imaginative use of financial and supervisory instruments in order to discourage future unacceptable activities by imposing a material cost on Russia – i.e. 'deterrence by punishment'.
- The government should emphasize that, once the UK has left the EU, it will give serious consideration to using the 2018 Sanctions and Anti-Money Laundering Act against Russia (or any other state) if it attacks British citizens in future. If it did use this legislation, the UK should urge its partners to adopt similar measures – multilateral action would have more impact than unilateral action – but it should be prepared to act without the EU if necessary.
- In the meantime, the UK should redouble its efforts to make the supervision of its financial sector and related industries more effective. As well as adding to the costs incurred by Russia's leadership elite, this would strengthen the resilience of UK institutions against the corrupting effects of illicit capital inflows. It would also reduce the reputational harm arising from a supervisory performance that leaves the UK open to damaging charges of double standards and undermines its influence abroad.
- Set against the UK's duty to protect the lives of its citizens, considerations of potential economic cost are of secondary importance. Organs of the Russian state have murdered and attempted to murder British citizens. The priority must be to minimize the risk that they will do so again.
- This approach is less equivocal than the UK government's present policy towards Russia appears to be. It is rooted in a judgment that the UK will more credibly deter further attacks on its citizens by putting financial and supervisory instruments at the centre of its Russia policy. And it recognizes that it is untenable to view the Russian state as a geopolitical problem and a direct threat to certain UK nationals while actively facilitating the enrichment of some of that state's elites.

Introduction

For more than a decade – and particularly since Russia launched its undeclared war against Ukraine in 2014 – the UK’s Russia policy has seemed increasingly incongruous. Political relations have become steadily more antagonistic, and these days the UK finds itself in disagreement with Russia over most major international issues. Its leaders look at the world and define its interests in ways that routinely conflict with the outlook and policy choices of their Russian counterparts (and vice versa). At the same time, the UK has continued to build economic ties with Russia, assuming that business interests can be insulated from a political relationship that has become more and more confrontational. Russia has never been a top-tier commercial partner for the UK, but UK decision-makers have consistently talked up economic relations, especially since the financial crisis of 2008. From a UK viewpoint, the biggest elements of the commercial relationship remain the multi-billion-pound direct investments by BP and Shell in Russia’s energy sector. In 2017 the value of UK exports to Russia amounted to slightly more than £6 billion, of which services contributed some £2.9 billion.¹ Various service industries – including banking, accountancy, law, property and public relations – cater to Russia’s elites. For these clients, many of them at or close to the centre of power in Moscow, an attraction of the UK is its model of ‘light touch’ regulation. Despite the EU’s imposition of Crimea- and Ukraine-related sanctions on Russia, successive UK governments have taken for granted the premise that bilateral economic relations can be largely sheltered from an increasingly problematic political relationship.

The nerve-agent poisoning of the former Russian spy Sergey Skripal, who had been granted UK citizenship, and his daughter Yulia in Salisbury on 4 March 2018 should have put paid to such thinking.² Eight days later, Prime Minister Theresa May described the incident as ‘an unlawful use of force by the Russian state against the United Kingdom’.³ If her remark means anything, it has to signify that the tension at the heart of the UK’s Russia policy is now untenable. The Salisbury attack was not just a brazen violation of UK sovereignty. It was also a UK policy failure: the failure, again, to protect a UK national from attack by organs of the Russian state. An appropriate response would involve not just a belated and emphatic prioritization of political and security interests over economic interests. It would also entail the active use of financial and supervisory tools to achieve those national security interests in order to reduce the risk of another attack, and in the knowledge that the UK would pay an economic price. Bilateral relations would retain their economic dimension, but the UK would at last align its policy thinking and actions with post-Salisbury requirements. As two British analysts wrote shortly after the attack, ‘For too long Britain has sought to meet a skilful and growing Russian state threat while servicing the interests of its major beneficiaries. This contradiction is no longer strategically or ethically sustainable.’⁴

¹ Data from the UK Office of National Statistics, www.ons.gov.uk (accessed 13 Oct. 2018).

² There were of course three other victims: Detective Sergeant Nick Bailey, who was involved in the initial response to the poisoning of the Skripals; and Dawn Sturgess and Charlie Rowley, who reportedly came across a contaminated item discarded after the attack. Dawn Sturgess died on 8 July.

³ *Hansard*, 12 March 2018.

⁴ Gould-Davies, N. and Nixey, J. (2018), ‘How Britain Can Respond to the Skripal Attack’, Chatham House Expert Comment, London: Royal Institute of International Affairs, 12 March 2018, <https://www.chathamhouse.org/expert/comment/how-britain-can-respond-skripal-attack> (accessed 13 Oct. 2018).

The UK's response to the Litvinenko murder: 'late, lame and lamentable'

The roots of this UK policy failure stretch back to 2006. In November of that year Aleksandr Litvinenko, another former Russian spy who had become a UK citizen, died in London, having been poisoned with radioactive polonium some three weeks earlier. By the time of Litvinenko's death, the two prime suspects in the crime, Russian nationals Andrey Lugovoi and Dimitry Kovtun, had fled back to Moscow, although UK law enforcement agencies were on their trail. For several months, the murder inquiry sought to identify what had happened and why, but attempts to engage the Russian authorities made little progress. Russian officials obstructed the investigation, blocking requests for information, delaying and complicating the efforts of UK police officers to interview the suspects in Moscow. Meanwhile, the Russian media sent out clouds of disinformation designed to mislead and confuse. In May 2007 the UK Crown Prosecution Service (CPS) requested the extradition of Lugovoi to stand trial for murder.⁵ The request was denied by the Russian authorities, who referred to a provision in the country's constitution prohibiting the extradition of Russian citizens. Prime Minister Gordon Brown condemned Russia's refusal as 'intolerable'.⁶

In response to Russia's refusal to extradite Lugovoi, the UK government expelled four Russian diplomats, understood to be intelligence officers, from Russia's embassy in London. It launched an internal review of cooperation with Russia, suspended negotiations for a bilateral visa-facilitation agreement, and tightened other visa arrangements (for example, introducing closer scrutiny of visa applications by visiting Russian officials). The UK also held discussions with its European partners about the need for EU–Russian relations to take account of UK concerns arising from the Litvinenko affair, although the EU's somewhat tepid response fell short of its hopes. Finally, official contact with Russia's security service, the FSB, was suspended, on the grounds that the UK authorities believed that the FSB had been involved in Litvinenko's murder.

Speaking in the House of Commons on 16 July 2007, Foreign Secretary David Miliband termed Russia's refusal to extradite Lugovoi 'extremely disappointing'. Its unwillingness to work with the UK to address the constitutional block to extradition suggested a failure 'to register either how seriously we treat this case, or the seriousness of the issues involved'. He set out the objectives that the UK's actions were intended to achieve: to advance the judicial process and to bring Litvinenko's killer(s) to justice; to 'bring home to the Russian government the consequences of their failure to co-operate' with the criminal investigation and the extradition request; and to emphasize the UK's 'commitment to protecting the safety of British citizens and visitors'. Underlining this last point, Miliband said that the government's response took account of the fact that Litvinenko's killers had put the lives of many others at risk. It was also a signal of the authorities' determination to protect the Russian community living in the UK.

At the same time, the government sought to strike a balance between punishing Russia to deter it from further attacks and maintaining cooperative relations. Miliband described Russia as 'a key international partner for the United Kingdom'. The UK wanted to work with it over a range of

⁵ In 2012 the CPS requested that Kovtun, similarly, be extradited to the UK to stand trial.

⁶ *Daily Telegraph* (2007), 'Brown: 'Hand over Litvinenko Suspect'', 23 July 2007, <https://www.telegraph.co.uk/news/uknews/1558256/Brown-Hand-over-Litvinenko-murder-suspect.html> (accessed 13 Oct. 2018).

important international issues. UK–Russia cultural exchange was extensive. Bilateral trade was ‘large and growing, including considerable benefits for the City of London’, while British companies were making ‘a major contribution to the Russian economy’.

The parliamentary debate that followed his statement showed cross-party support for the government’s approach, which was generally seen as firm. Shadow Foreign Secretary William Hague applauded ‘the tone and substance’ of Miliband’s remarks.⁷

Giving evidence to the House of Commons Foreign Affairs Committee (FAC) two days after Miliband’s statement, the then minister of state for Europe, Jim Murphy, said that ‘our relationships with Russia are strong’. He mentioned ‘the mutual benefit of economic co-operation’ and ‘shared interests in a number of international issues’. The murder of Litvinenko was, however, ‘a dreadful crime’. The Russian authorities had not treated UK concerns ‘with the seriousness that they deserved’ and had not been sufficiently cooperative. The UK’s response to Russia’s refusal to extradite Lugovoi was ‘a considered, measured response, which we think is appropriate in these circumstances’.⁸ Less than a fortnight later, minister of state for energy Malcolm Wicks travelled to Russia on scheduled business, a visit that Murphy subsequently described to the FAC as ‘constructive’.⁹

In evidence to the FAC later in 2007, Miliband reiterated the dual nature of the UK’s Russia policy:

On the one hand, economic integration between the UK and Russia has never been greater. Economic links have never been greater. You could even make the case that quite a lot of cultural interchange is strong at the moment. However, we are not on the same page on some very serious diplomatic issues. We are in a very different situation. I am sure that I do not need to tell the Committee that the murder of Mr Litvinenko on London’s streets was an extremely serious event.¹⁰

This formulation summed up the Labour government’s approach to the Litvinenko murder. Despite problems and irritants in the relationship, which also reflected wider tensions between the leading Western powers and Russia, especially after the 2008 Russian–Georgian war, the UK evidently wanted to find a middle way between penalizing Russia and maintaining constructive ties with it, including in the economic domain. Russia was, for the UK government, a challenging interlocutor, but political difficulties should not be allowed to prevent necessary cooperation.

The Conservative–Liberal Democrat coalition government that took office after the UK general election in 2010 adopted much the same stance. Emblematic of its outlook was the 2010 Strategic Defence and Security Review (SDSR), published that October. A document of some 75 pages, it contained two benign references to Russia. In the section ‘Alliances and Partnerships’, Paragraph 5.8 stated: ‘We will also look to increase bilateral cooperation with a wide range of other countries ... we are building up our political and security dialogue with China, with Russia, and with

⁷ *Hansard*, 16 July 2007.

⁸ House of Commons (2007), ‘Minutes of evidence taken before Foreign Affairs Committee. Global security: Russia’, Wednesday 18 July 2007, <https://publications.parliament.uk/pa/cm200607/cmselect/cmcaff/uc495-iii/uc49502.htm> (accessed 21 Oct. 2018).

⁹ House of Commons Foreign Affairs Committee (2007), *Global Security: Russia. Second Report of the Session, 2007–8*, London: The Stationery Office Limited, p.50, <https://publications.parliament.uk/pa/cm200708/cmselect/cmcaff/51/51.pdf> (accessed 13 Oct. 2018).

¹⁰ *Ibid.*

fast-growing economies like Brazil and Indonesia.¹¹ Russia – a fellow permanent member of the UN Security Council and a member of the G8 group of industrialized nations – remained a ‘partner’ of the UK. In September 2011 Prime Minister David Cameron was asked in the House of Commons to report on his recent visit to Moscow. He said that the UK government’s position on the Litvinenko murder had not changed ‘one jot’. However, he added, ‘I do think it is right, at the same time, to try to build a better relationship with Russia across a whole range of issues’.¹² Foul though it was, the Litvinenko murder should not obstruct strategic cooperation.

A second factor at work was commercial. To ensure that the UK recovered as quickly as possible from the financial crisis of 2008, the coalition government assigned an important role to economic diplomacy. One of three core objectives of foreign policy would be ‘increasing exports and investment, opening markets, ensuring access to resources, and promoting sustainable global growth’.¹³ Russia was not central to this ‘prosperity agenda’, but, *inter alia* as a member of the BRICS¹⁴ grouping (and because it was often, if mistakenly, seen as an emerging economy), it was of interest, particularly as a hydrocarbons producer. Russia might not be a top priority for the UK’s commercial diplomacy, but economic relations seemed to be in reasonable shape and on an upward trajectory despite political turbulence. BP’s announcement in 2012 that it would take a 19.75 per cent stake in Russia’s state-owned oil company Rosneft seemed to confirm a broadly positive trend.¹⁵

Another illustration of the importance that successive UK governments attached to the economic relationship with Russia was the Tier I (Investor) visa scheme. Introduced in February 2008 as a replacement for the Investor Immigrant route, Tier 1 was aimed at wealthy individuals from outside the European Economic Area (EEA) and Switzerland. In return for a commitment to invest £1 million (raised to £2 million in 2014) in UK government bonds, share capital or corporate bonds, applicants could seek to enter the UK for an initial period of three years and four months.¹⁶ According to research by Transparency International, between 2008 and April 2015, when tighter requirements were introduced, 3,048 Tier I (Investor) visas were issued, 706 (23.2 per cent) of these to Russians, bringing an estimated £3.2 billion (£729 million from Russians) into the UK.¹⁷ Although the Tier I programme was conceived as part of a wider effort to manage migration from non-EEA countries, commercial considerations played a role from the outset.

Russia’s annexation of Crimea and destabilization of eastern Ukraine, starting in 2014, came as a profound shock to UK official views of Russia. Policy hardened appreciably, manifested most notably in the UK’s support for the imposition of sanctions on Russia by the EU and the suspension

¹¹ HM Government (2010), *Securing Britain in an Age of Uncertainty: The strategic defence and security review*, London: The Stationery Office Limited, p.61, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/62482/strategic-defence-security-review.pdf (accessed 13 Oct. 2018). The other reference to Russia, at p.51, stated: ‘We will also work with states and groupings of countries that use the most energy – for example, US, China, India, Russia and the EU – in support of actions that reduce their oil and gas demand.’

¹² *Hansard*, 14 September 2011.

¹³ Foreign and Commonwealth Office (2010), ‘The Role of the FCO in UK Government. Written evidence from the Foreign and Commonwealth Office’, <https://publications.parliament.uk/pa/cm201011/cmselect/cmfaif/writev/fcogov/m12.htm> (accessed 13 Oct. 2018).

¹⁴ Brazil, Russia, India, China and South Africa.

¹⁵ The BP–Rosneft deal was not universally good news. For BP, it was arguably less an investment and more a forced exit from its joint venture with its previous Russian partners. In the judgment of some, it carried as much risk as benefit.

¹⁶ See Tryfounidou, A. (2017), ‘Investment Residence in the UK: past and future’, Investment Migration Council, Investment Migration Policy Brief No.1/2017, <https://investmentmigration.org/download/investment-residence-uk-past-future/> (accessed 13 Oct. 2018).

¹⁷ Transparency International (2015), *Gold Rush: Investment visas and corrupt capital flows into the UK*, pp. 10–12, Transparency International UK, <https://transparency.eu/wp-content/uploads/.../Golden-Visas-TI-UK-Gold-Rush.pdf> (accessed 13 Oct. 2018).

of Russia from the G8. The new Conservative government's 2015 National Security Strategy and Strategic Defence and Security Review, the successor to the 2010 SDSR, captured the turnaround in perceptions. Gone were the two largely positive references to Russia of the earlier version. Notably, the section on 'The resurgence of state-based threats', included in Chapter Three of the new edition, argued that 'Russia has become more aggressive, authoritarian and nationalist, increasingly defining itself in opposition to the West'; and that the illegal annexation of Crimea and destabilization of eastern Ukraine 'have shown Russia's willingness to undermine wider standards of cooperation in order to secure its perceived interests'. However, the review went on to note that Russia remained a permanent member of the UN Security Council. The UK would 'seek ways of cooperating and engaging with Russia on a range of global security issues, such as the threat from ISIL'.¹⁸

Yet, as the Cameron government's view of Russia shifted markedly, its stance on the Litvinenko murder barely shifted at all. In 2014 Home Secretary Theresa May had finally agreed to establish a public inquiry, headed by a senior judge, to investigate it.¹⁹ Based on a detailed examination of public and classified material, the inquiry report, issued in January 2016, confirmed the assessment of the police that Lugovoi and Kovtun had murdered Litvinenko. It also caused a sensation by concluding that President Putin and FSB Director Nikolai Patrushev had 'probably' sanctioned the killing.²⁰

The UK official reaction to the findings was heavy on rhetoric but light on substance. May told the House of Commons that the government took the report 'extremely seriously'. The probable involvement of the Russian state was 'deeply disturbing'. This breached 'the most fundamental tenets of international law and of civilised behaviour'. May recited the UK's actions: the expulsion of intelligence officers, tighter visa arrangements for Russian officials, a police investigation that remained open, the issuing of Interpol notices and European arrest warrants for Lugovoi and Kovtun, and requests for the extradition of Lugovoi from Russia. The government, May continued, had always made its view known to the Russian authorities 'in the strongest possible terms'. The protection of the UK from state threats was central to the mission of the UK security and intelligence services. The government would 'make full use of the measures at [its] disposal'. The UK and its partners had imposed restrictive measures on Russian entities and individuals, including Patrushev, following Russia's actions in Ukraine. Finally, the UK had written to its partners, drawing attention to the inquiry report 'and the need to take steps to prevent such a murder being committed in their streets'.²¹

¹⁸ HM Government (2015), *National Security Strategy and Strategy Defence and Security Review 2015. A Secure and Prosperous United Kingdom*, p.18, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/478933/52309_Cm_9161_NSS_SD_Review_web_only.pdf (accessed 13 Oct. 2018).

¹⁹ The inquest into Litvinenko's death had been adjourned in 2006 pending the continuation of the police investigation. In 2013, the coroner, Sir Robert Owen, proposed a public inquiry instead. The UK government objected, but in 2014 was overruled by the High Court, which asked it to reconsider. The announcement that an inquiry would be held came two days after Russian-backed separatists in eastern Ukraine shot down a civilian aircraft, Malaysian Airlines Flight MH17. See Harding, L. (2017), *A Very Expensive Poison. The Definitive Story of the Murder of Litvinenko and Russia's War with the West*, London: Guardian Books, pp. 296–300 and 332.

²⁰ The Litvinenko inquiry (2016), *Report into the death of Alexander Litvinenko*, 21 January 2016, London: Williams Lea Group on behalf of the Controller of Her Majesty's Stationery Office, p. 244, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/493860/The-Litvinenko-Inquiry-H-C-695-web.pdf (accessed 13 Oct. 2018).

²¹ *Hansard*, 21 January 2016.

In contrast with the supportive tone of the Commons debate in 2007, this time many MPs criticized the government's response as inadequate. Shadow Home Secretary Andy Burnham termed Litvinenko's murder 'an unparalleled act of state-sponsored terrorism'. He doubted that the government's response went 'anywhere near far enough'. 'Indeed, it could send a dangerous signal to Russia that our response is too weak.' MPs of all parties called for further retaliatory steps, including the imposition of economic sanctions on members of the Russian leadership.²² In the House of Lords, Lord Paddick dismissed the government's position as 'late, lame and lamentable'.²³

The UK government did take one new step following the publication of the inquiry report: the freezing of the UK-based assets of Lugovoi and Kovtun under the 2001 Anti-terrorism, Crime and Security Act. (As far as is known, neither had substantial assets in the UK.) Moving the measure, Economic Secretary to the Treasury Harriett Baldwin described this measure as 'a deterrent and a signal that this Government will not tolerate such activity on British soil'. Until the murder suspects were brought to trial, the freeze and the other measures taken by the UK would send 'a clear message that we will defend our national security and rule of law'.²⁴ The asset freeze was to be reviewed every two years. It was extended on 22 January 2018;²⁵ the Salisbury attack took place less than six weeks later. The UK government's actions had fallen short of its language. Its attempt at deterrence had failed.

The UK's response to the March 2018 Salisbury attack: 'this appalling act against our country'

The UK government's response to the attack on the Skripals was markedly different. In a statement to the House of Commons on 12 March, Prime Minister Theresa May²⁶ said that it was 'highly likely' that Russia was responsible: Russia had produced the nerve agent in question (part of a group of nerve agents termed Novichok), and was still capable of doing so; it had a record of state-sponsored assassinations abroad; and it viewed some Russian defectors as legitimate targets. It followed that there were two plausible explanations. Either this was a direct act by Russia against the UK; or the Russian state had lost control of the nerve agent and had allowed it to fall into the hands of others. The Russian ambassador to the UK had been summoned to the Foreign Office to explain which version was correct and thus account for how the nerve agent could have been deployed in Salisbury against the Skripals. He had also been informed that Russia must provide 'full and complete' disclosure of its Novichok programme to the Organisation for the Prohibition of Chemical Weapons (OPCW). Should there be no credible response from the Russian government by a deadline of 13 March, the UK would conclude that the attack amounted to 'an unlawful use of force by the Russian state against the United Kingdom'.²⁷

Updating the House of Commons on 14 March, in the absence of the demanded credible explanation from the Russian government, May stated that there was 'no alternative conclusion

²² Ibid.

²³ Ibid.

²⁴ *Hansard*, 22 February 2016.

²⁵ 'The Andrey Lugovoy and Dmitri Kovtun Freezing Order 2018', <http://www.legislation.gov.uk/ukSI/2018/60/introduction/made> (accessed 13 Oct. 2018).

²⁶ May had become Prime Minister in July 2016.

²⁷ *Hansard*, 12 March 2018.

other than that the Russian state was culpable' for the attempt on the lives of the Skripals, 'and for threatening the lives of other British citizens in Salisbury' – 'this appalling act against our country'. She then announced reprisals that went appreciably further than the UK's underwhelming response to the Litvinenko murder.²⁸

First, the UK expelled 23 diplomats believed to be intelligence officers from Russia's embassy in London, nearly four times as many as it had thrown out in 2007. This action was reinforced when, in late March, in solidarity with the UK, 26 countries announced the expulsions of more than 120 suspected intelligence officers from Russia's embassies on their territories. NATO expelled seven officials from Russia's mission at the alliance's headquarters in Brussels.²⁹ Bulgaria, Luxemburg and the EU recalled their ambassadors from Moscow for consultations. Russia's overseas intelligence networks will almost certainly have been damaged for years. From the UK government's perspective, the coordination with its allies over these large-scale expulsions was a highly effective piece of diplomatic lobbying.³⁰

Second, the UK was prepared to incur damage to political relations with Russia. Unlike in 2007, retaliatory measures were not followed by a ministerial visit to Moscow. This time, May announced the suspension of high-level bilateral contacts, including withdrawing its invitation to Russian foreign minister Sergey Lavrov to visit the UK (the reciprocal to a visit to Moscow by the then Foreign Secretary, Boris Johnson, in December 2017). Additionally, neither ministers nor members of the royal family would attend the 2018 football World Cup in Russia. In other words, hostile Russian actions guaranteed that relations would be poorer for the foreseeable future. This time, unlike in 2007, the UK made no attempt to soften retaliation with the language of cooperation, although May did say that it was not in the UK's national interest to break off all bilateral dialogue.³¹

Third, the UK made use of various law enforcement instruments. May announced that the government would introduce new legislation to strengthen national defences, including 'a targeted power to detain those suspected of hostile state activity at the UK border' (at that time permitted only with regard to terrorism). It would invoke existing powers to monitor visitors possibly engaged in activity threatening UK security. These included checks on private flights, customs and freight, as well as the freezing of Russian state assets if there was evidence that these were being used to threaten the life and property of UK nationals and residents.³² Media reports followed of more stringent checks for travellers to the UK on Russian-owned private jets,³³ and the inspection of an Aeroflot aircraft by customs officials at Heathrow airport.³⁴

²⁸ *Hansard*, 14 March 2018.

²⁹ Associated Press via VOA (2018), 'List of Countries and Others Expelling Russian Diplomats', 28 March 2018, <https://www.voanews.com/a/list-countries-others-expelling-russian-diplomats/4320638.html> (accessed 13 Oct. 2018). Latvia also blacklisted the Russian representative of a Russian company.

³⁰ In another example of diplomatic coordination aimed partly against Russia, in June the G7 established a Rapid Response Mechanism 'to strengthen our coordination to identify and respond to diverse and evolving threats to our democracies, including through sharing information and analysis, and identifying opportunities for coordinated response'. See G7 2018 Charlevoix website (2018), 'Charlevoix Commitment on Defending Democracy From Foreign Threats', 14 June 2018, <https://g7.gc.ca/en/official-documents/charlevoix-commitment-defending-democracy-from-foreign-threats/> (accessed 13 Oct. 2018).

³¹ *Hansard*, 14 March 2018.

³² *Ibid.*

³³ Elliott, F. (2018), 'Private jet searches will give Russian oligarchs a hostile reception', *The Times*, 21 March 2018, <https://www.thetimes.co.uk/article/private-jet-searches-will-give-oligarchs-a-hostile-reception-mbpbmhtc2> (accessed 13 Oct. 2018).

³⁴ BBC News (2018), 'Spy poisoning: UK plays down Russia complaint at plane search', 31 March 2018, <http://www.bbc.com/news/world-europe-43606085> (accessed 13 Oct. 2018). In addition, on 14 March the prime minister announced that the government would sponsor an

Notably, too, May's 14 March statement to the House of Commons included an implied warning to Russia not to use its cyber capabilities against the UK, asserting that the UK would make use of 'a range of tools from across the full breadth of [its] national security apparatus' against threats of 'hostile state activity'.³⁵

The UK authorities later stepped up public pressure on Russia, revealing detailed material from the forensic investigation into the Salisbury attack. On 5 September the UK police laid out evidence identifying two Russians suspected of carrying out the attack against the Skripals.³⁶ The same day, May informed the House of Commons that the government had concluded that the men in question were officers in Russia's military intelligence service, the GRU. 'This was not a rogue operation,' she said. 'It was almost certainly also approved outside the GRU at a senior level of the Russian state.'³⁷ The Crown Prosecution Service had concluded that it had sufficient evidence to bring charges against the two men for the attack on the Skripals. A European arrest warrant had been obtained in respect of the two suspects, and the UK would be seeking an Interpol 'Red Notice', although Russia's repeated refusals to allow its nationals to stand trial overseas suggested that any formal request for their extradition would be 'futile'. The men were also confirmed as the prime suspects in the case of Dawn Sturgess and Charlie Rowley.³⁸ The next day, the UK briefed a special meeting of the UN Security Council.³⁹

In important ways, therefore, the UK government's response to the attack on the Skripals was far stronger than its reactions to the Litvinenko murder and the subsequent inquiry report. Yet its impulse to shield commercial interests from the crisis engulfing the bilateral relationship was still apparent. Implemented almost exclusively along political, diplomatic and law enforcement channels, the measures adopted after the Salisbury attack were essentially a sterner version of what was tried in 2007 – broadly 'deterrence by denial' (making it more difficult to conduct future hostile attacks on UK soil). There was minimal resort to 'deterrence by punishment' (i.e. imposing a cost to discourage future unacceptable activities) beyond symbolic steps such as suspending high-level bilateral contacts and not sending ministers or members of the royal family to the World Cup.⁴⁰

As a result, in several areas the UK government's post-Salisbury policy has appeared ill-defined. A case in point is the Investor visa scheme. The then Home Secretary, Amber Rudd, told MPs on 28 March that her department was looking at how Russians who had secured Investor visas had

amendment to the draft Sanctions and Anti-Money Laundering Bill to allow for restrictive measures against those responsible for human-rights violations.

³⁵ *Hansard*, 14 March 2018. May had already issued a warning to this effect in November 2017. Buchan, L. (2017), 'Theresa May warns Russia over election meddling and vows to protect UK', *Independent*, 13 November 2017, <https://www.independent.co.uk/news/uk/politics/theresa-may-russia-election-meddling-warning-cyber-warfare-latest-uk-a8053161.html> (accessed 13 Oct. 2018).

³⁶ BBC News (2018), 'Salisbury Novichok poisoning: Russian nationals named as suspects', 5 September 2018, <https://www.bbc.com/news/uk-45421445> (accessed 13 Oct. 2018).

³⁷ *Hansard*, 5 September 2018.

³⁸ *Ibid.*

³⁹ This was part of a wider attempt, coordinated with other Western governments, to expose subversive activity by the GRU. On 6 September, the UK, US, France, Germany and Canada issued a statement expressing confidence in the UK assessment that the Salisbury attack had been carried out by GRU operatives. In July and October 2018 the US Department of Justice announced indictments for a total of 19 suspected GRU officers accused of computer hacking and other crimes. And in October 2018 the authorities in the Netherlands published detailed material on four alleged GRU officers whom they accused of attempting to hack the computer networks of the OPCW.

⁴⁰ Gould-Davies, N. (2018), 'Britain's Response to the Salisbury Attack: A Net Assessment', Chatham House Expert Comment, London: Royal Institute of International Affairs, 27 March 2018, <https://www.chathamhouse.org/expert/comment/britain-s-response-salisbury-attack-net-assessment> (accessed 13 Oct. 2018).

acquired their wealth.⁴¹ Subsequently, it was reported that Roman Abramovich, probably the best-known Russian resident in the UK, was encountering delays in renewing his Tier I visa, prompting speculation that he had fallen foul of new, tougher procedures.⁴² (He eventually withdrew his application and was granted Israeli citizenship at the end of May.) The *Observer* newspaper, citing Home Office sources, reported on 9 September that ministers considered that further restrictions on Investor visas might be needed. According to one source, an internal review of Tier I visas was under way, extending back to 2008, implying that the review encompassed more than 3,000 cases, including Investor visas granted to over 700 Russians. The same source said that ‘further changes to the Tier I scheme had not been ruled out, ‘in order to ensure that it continues to work in the national interest’.⁴³ As of late October, however, the Home Office had not indicated what conclusions – if any – its review had drawn. In the absence of any formal announcement, it is unclear whether policy on this issue has changed.

Another example where the government’s position has seemed unclear is the issue of ‘unexplained wealth orders’ (UWOs). An innovation under the 2017 Criminal Finances Act, UWOs require an investigated person to account for the sources of their assets.⁴⁴ The first order was served in February 2018. (Following the removal of reporting restrictions in October, it was revealed that the subject of the order was Zamira Hajiyeva, the wife of the former chairman of the International Bank of Azerbaijan.)⁴⁵ An impact assessment from early 2017, prior to the entry into force of the legislation, had anticipated that UWOs would be used in 20 cases per year.⁴⁶ In June 2018, however, a National Crime Agency official was reported as suggesting that a more ambitious policy might be in the offing, indicating that ‘between 120 and 140’ people were under investigation for possible UWO applications. Other officials were reported to have indicated that ‘a very significant portion’ of this group was ‘Russian or Russian-related’, and that a ‘step change’ in the use of orders was to be expected.⁴⁷ Again, however, as of late October 2018, the direction of policy was not clear.

The UK government has also appeared hesitant about accelerating work to tighten financial sector supervision. When pressed on this matter in the House of Commons on 14 March, May conveyed little sense of urgency. She confirmed that the government had been ‘taking a number of measures in relation to financial activities’ in the UK overseas territories and crown dependencies; and that it would bring forward the introduction of a public register of beneficiaries of overseas companies owning property in the UK in 2021 – an initiative promised by Cameron back in 2013.⁴⁸ Revealingly, however, it took a cross-party backbench initiative in the House of Commons at the

⁴¹ Wright, R. (2018), ‘Britain to review wealthy Russians’ visas’, *Financial Times*, 28 March 2018, <https://www.ft.com/content/4bafade6-3290-11e8-b5bf-23cb17fd1498> (accessed 21 Oct. 2018).

⁴² Carroll, O. (2018), ‘Why is Russia so nervous about the visa status of Roman Abramovich?’, *Independent*, 22 May 2018, <https://www.independent.co.uk/news/world/europe/roman-abramovich-uk-russia-visa-chelsea-kremlin-putin-a8364136.html> (accessed 13 Oct. 2018).

⁴³ Doward, J. (2018), ‘Wealthy Russians in Britain face new visa crackdown after Salisbury’, *Observer*, 9 September 2018, <https://www.theguardian.com/uk-news/2018/sep/09/home-office-review-wealthy-russian-investor-visas> (accessed 13 Oct. 2018).

⁴⁴ Home Office (2018), ‘Circular 003/2018: unexplained wealth orders’, 1 February 2018, <https://www.gov.uk/government/publications/circular-0032018-criminal-finances-act-unexplained-wealth-orders/circular-0032018-unexplained-wealth-orders#points-of-interest> (accessed 13 Oct. 2018).

⁴⁵ Thompson, B. (2018), ‘Azerbaijan bank chair’s wife named as target of unexplained wealth order’, *Financial Times*, 10 October 2018, <https://www.ft.com/content/45fecc14-cc6a-11e8-9fe5-24ad351828ab> (accessed 17 Oct. 2018).

⁴⁶ Home Office (2017), ‘Criminal Finances Bill – Unexplained Wealth Orders: Impact Assessment HO2060’, 10 January 2017, <https://www.parliament.uk/documents/impact-assessments/IA17-001D.pdf> (accessed 13 Oct. 2018).

⁴⁷ Kerbaj, R., and Shipman, T. (2018), ‘The UK National Crime Agency “dirty money” probe targets Russian oligarchs’, *Sunday Times*, 3 June 2018, <https://www.thetimes.co.uk/article/national-crime-agency-dirty-money-probe-targets-russian-oligarchs-no9sp2b7w> (accessed 13 Oct. 2018).

⁴⁸ *Hansard*, 14 March 2018.

end of April to force the government to amend the draft Sanctions and Anti-Money Laundering Bill to require Britain's overseas territories to introduce public registers of beneficial ownership by the end of 2020.⁴⁹

Meanwhile, in what was clearly bad timing for the UK government, the day after May announced the UK's response to the Salisbury attack, Russia's state-owned gas company Gazprom launched a €750 million eurobond in London. UK investors were among those competing for the issue, which was reported as being heavily oversubscribed. The following day, the Russian authorities floated a \$4 billion sovereign eurobond. This issue, too, was oversubscribed, with UK investors comprising almost half the buyers. Both times the lead manager (the 'bookrunner') was VTB Capital, a subsidiary of VTB, a Russian state-owned bank subject to US and EU sanctions (although VTB capital itself was not a designated entity under EU sanctions).⁵⁰ Rightly or wrongly, for some observers the message was clear: despite events in Salisbury, the UK still put commerce first. 'Business as usual?', tweeted the Russian embassy in London after the Gazprom eurobond issue.⁵¹

The case for a financial and supervisory policy response to the Salisbury attack

The most basic responsibility of a state is to ensure the safety and security of its citizens. By responding to the Litvinenko murder in a manner that did not deter the attack in Salisbury in March 2018, the UK government failed in this duty. Despite ministers' tough talk, particularly after the publication of the Litvinenko inquiry report, their actions lacked credibility. There was a gap between the strength of the UK's rhetoric and the rigour of its actions.

And this gap, although narrower than it was, is still there. As noted, the UK's response has concentrated overwhelmingly on the political, diplomatic and law enforcement measures announced in March. Consequently, there is a risk that its actions are again perceived to be out of line with its rhetoric and prove to be an ineffective deterrent. UK policymakers should close the gap between word and deed by putting financial and supervisory policy instruments at the centre of their response in order to inflict a cost on Russia.

Since the break-up of the Soviet Union, Russia's elites have embraced economic globalization. Western jurisdictions provide capital for Russian companies and havens in which to secure assets, whether buried in opaque offshore vehicles, invested in real estate or protected by contracts written in foreign law and subject to dispute-resolution procedures in Western courts. Certain Western countries offer opportunities for luxury consumption as well as places where spouses can live safely and where children can receive a high-class education. They provide avenues through which to pursue respectability, whether by philanthropic work or by acquiring awards and titles. Western countries are, moreover, desirable jurisdictions in which to acquire residency and citizenship. The

⁴⁹ Sabbagh, D. (2018), '“Dirty Money”: U-turn as Tories back plans to make tax havens transparent', *Guardian*, 1 May 2018, <https://www.theguardian.com/politics/2018/may/01/uk-to-introduce-public-ownership-registers-for-overseas-territories> (accessed 13 Oct. 2018).

⁵⁰ See House of Commons Foreign Affairs Committee (2018), *Moscow's Gold: Russian Corruption in the UK*, Eight Report of Session 2017-2019, p. 9, <https://publications.parliament.uk/pa/cm201719/cmselect/cmfaaff/932/932.pdf> (accessed 13 Oct. 2018).

⁵¹ Russian Embassy, UK (@RussianEmbassy) (2018), 'Successful [sic] @GazpromEN bonds sales in London with demand three times higher than the placing (€750 mln). Business as usual?', tweet, 15 March 2018, <https://twitter.com/RussianEmbassy/status/974296493355126785> (accessed 22 October 2018); cited in House of Commons Foreign Affairs Committee (2018), *Moscow's Gold*.

UK, together with its overseas territories and crown dependencies, has been an important and accommodating part of this story; sizeable inflows of Russian capital seem to have been one factor behind the UK's current account deficit.⁵² Although, since 2000, the Putin regime has tried in various ways to limit the degree to which integration into the international economy leaves Russia potentially vulnerable to external influence,⁵³ the intertwining of its elites and the global economic system presents the UK with potentially potent policy options.

So does the nature of Russia's domestic regime, which is founded on a systemic intertwining of the political and commercial realms. Because the rule of law is weak and property rights are insecure, all commercial groups build ties to state bodies and officials for patronage, protection and access to resources. Major Russian business figures – often inaccurately referred to as 'oligarchs'⁵⁴ – depend on the favour of the state for their wealth, status and security. In return, they show obedience and loyalty. They may also be called on to perform tasks for the authorities, such as investing in prestige infrastructure projects.

The symbiotic relationship between Russia's state and its business sector extends to foreign jurisdictions. At least some Russian assets abroad may well be held by intermediaries on behalf of members of Russia's leadership. One such may be Sergey Roldugin, in respect of whom allegations were raised following publication of the Panama Papers. A musician and a friend of Putin, it was claimed that Roldugin may have been involved in a chain of offshore companies, linked to associates of Russia's president and centred on offshore financial centres, that handled transactions totalling at least \$2 billion.⁵⁵ By squeezing such networks, the UK could impose costs on Russia's decision-makers.

The use of financial and supervisory tools to put pressure on members of Russia's elite – and, via them, its political leaders – would be weighted in the UK's favour. The importance of the City of London affords the UK leverage as regards Russia that most other countries lack. Russia's elites, including individuals close to the leadership, unquestionably value their access to the UK services industry. By contrast, the UK's services industry is not critically reliant on Russia, which accounted for fractionally less than 1.8 per cent of the value of UK services exports in 2017;⁵⁶ and the stock of Russian investments in the UK amounted to 0.5 per cent of total European international assets invested in the UK in 2014.⁵⁷

The UK should exploit this asymmetry in two ways. First, it should signal its readiness to exact a direct cost by sanctioning members of Russia's elite and their interests. Second, it should supervise

⁵² Harvey, O. and Winkler, R. (2015), 'Dark matter: the hidden capital flows that drive G10 exchange rates', Deutsche Bank Market Research, 9 March 2015, pp. 7–9, <https://www.documentcloud.org/documents/3036316-Special-Report-9-Mar-2015-2.html> (accessed 13 Oct. 2015).

⁵³ Gould-Davies, N. (2016), *Russia's Sovereign Globalization: Rise, Fall and Future*, Research Paper, London: Royal Institute of International Affairs, pp. 9–14, <https://www.chathamhouse.org/sites/default/files/publications/research/20160106RussiasSovereignGlobalizationGouldDaviesFinal.pdf> (accessed 13 Oct. 2018).

⁵⁴ The term exaggerates the independence and influence of the individuals concerned. The resurgence of the state under Putin has underlined their potential vulnerability, illustrated most vividly by the arrest of tycoon Mikhail Khodorkovsky in 2003 and the subsequent dismemberment of his Yukos oil company.

⁵⁵ Bernstein, J. et al. (2016), 'All Putin's Men: Secret Records Reveal Money Network Tied to Russian Leader', 3 April 2016, International Consortium of Investigative Journalists, <https://www.icij.org/investigations/panama-papers/20160403-putin-russia-offshore-network/> (accessed 13 Oct. 2018).

⁵⁶ Data from the UK Office for National Statistics, www.ons.gov.uk (accessed 13 Oct. 2018).

⁵⁷ Open Europe (2014), 'The Battle of Londongrad? How vulnerable is the city to sanctions on Russia?' <https://www.openeurope.org.uk/intelligence/foreign-policy/uk-russia-sanctions/> (accessed 13 Oct. 2018).

its financial and related industries (termed designated non-financial businesses and professions – DNFBPs) more effectively. As well as imposing a cost on the beneficiaries, the UK would shield itself more effectively from the negative impact of illicit capital inflows, enhance its governance record and be better placed to press others to adopt similar measures. Over time, the mix of steeper resolve, greater internal resilience and a stronger external reputation would combine to forge a more compelling set of policies towards Russia.

Sanctions

The legal basis for a policy of sanctions would be the 2018 Sanctions and Anti-Money Laundering (SAML) Act, designed for use after the UK has left the EU.⁵⁸ Until then, with narrow exceptions, the UK lacks an independent sanctioning capability. This explains Foreign Secretary Jeremy Hunt's call on 21 August for the EU to match the US in imposing new restrictive measures on Russia in retaliation for the Salisbury attack.⁵⁹ In the meantime, the UK government should emphasize that, once the UK has ceased to be an EU member, it will seriously consider using the SAML Act to strike against Russia (or any other state) if it attacks UK nationals.

In the event that it did use this legislation, UK sanctions against Russia would supplement the existing EU measures in place since 2014, which the UK government has pledged to maintain after Brexit. The objective – which it would be important to state clearly – would be punitive, underscoring the UK's refusal to tolerate life-threatening attacks on its citizens. Sanctions would be targeted, with individuals and entities designated according to clear criteria.⁶⁰ Effective targeting presupposes appropriate interdepartmental intelligence and analytical capabilities. This would require a significant long-term investment, drawing on expertise available in government, and supplemented by data and insights from allied governments, the private sector and non-government organizations – supporting the 'stronger partnerships across government and with the private and third sectors' by which the UK government's March 2018 National Security Capability Review sets great store.⁶¹

On its own, the UK cannot match the impact of US or EU sanctions. It should urge its partners to follow suit, although, realistically, the chances of persuading the EU to do so would be slim, barring a further breakdown in EU–Russian relations. Given the seriousness of the matter, however, if necessary the UK should be prepared to act without the EU. One implication is that, in terms of sanctions policy towards Russia, this would start to align the UK more closely with the US.

⁵⁸ 'Sanctions and Anti-Money Laundering Bill [HL]', <https://www.parliament.uk/documents/commons-public-bill-office/2017-19/compared-bills/Sanctions-and-Anti-Money-Laundering-bill-tracked-changes.pdf> (accessed 13 Oct. 2018).

⁵⁹ BBC News (2018), 'Jeremy Hunt wants "malign" Russia to face tougher sanctions', 21 August 2018, <https://www.bbc.com/news/uk-politics-45250069> (accessed 21 Oct. 2018). As required by the 1991 Chemical and Biological Weapons Control and Warfare Elimination Act, on 9 August 2018 the US government announced that it would restrict imports of certain sensitive technologies from Russia because of the Salisbury attack. The measures took effect on 22 August. The Act mandates further sanctions if, within 90 days, Russia does not certify that it has ceased the use of chemical weapons and allowed on-site inspections.

⁶⁰ For thinking about factors that might be used for Russia designations, see Åslund, A. et al. (2017), 'How to Identify the Kremlin Ruling Elite and its Agents: Criteria for the US Administration's "Kremlin Report"', Atlantic Council, 13 November 2017, <http://www.atlanticcouncil.org/blogs/new-atlanticist/how-to-identify-the-kremlin-ruling-elite-and-its-agents> (accessed 13 Oct. 2018).

⁶¹ HM Government (2018), *National Security Capability Review: Including the second annual report on implementation of the National Security Strategy and Strategic Defence and Security Review 2015*, p.10, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/705347/6.4391_CO_National-Security-Review_web.pdf (accessed 13 Oct. 2018).

Financial and supervisory policy

Resilience

In the meantime, the UK should intensify work to make the supervision of its financial sector and DNFBPs more effective. Beside adding to the costs incurred by the Russian state and elite groups entwined with it, the objectives would be to improve the resilience of UK institutions and to reduce reputational damage to the UK. The aim would not be specifically to uncover and seize large amounts of money. As one expert has pointed out, ‘the dirty money has mixed into the economy beyond recognition and separation’.⁶²

By world standards, the UK has public and private institutions with strong legal foundations. It does well in indices of rule of law and corruption, for example ranking 11th out of 113 countries in the most recent edition of the World Justice Project’s *Rule of Law Index*;⁶³ and joint 8th (with Canada, Luxembourg and the Netherlands) out of 180 countries and territories assessed for Transparency International’s latest Corruption Perceptions Index.⁶⁴ Yet the UK’s financial sector and DNFBPs face significant challenges linked with corruption and money laundering. The 2017 National Risk Assessment of Money Laundering and Terrorist Financing (NRA) identified four areas that were at least partly at ‘high risk’ from money laundering:

- **Financial services:** The 2017 NRA argued that risk associated with the UK banking sector overall ‘is not judged to have shifted substantially’ since the first assessment in 2015. Retail banking, wholesale banking, capital markets, wealth management and private banking were all assessed to be exposed to ‘high’ money laundering risks. The 2017 NRA also described the Tier I Investor visa scheme as ‘a potential avenue for the laundering of the proceeds of corruption’.
- **Accountancy services:** The 2017 NRA judged accountancy services, overall, to be at ‘high’ risk of exposure to money laundering. It identified the creation and operation of companies, the facilitation of financial transactions and tax evasion as the areas ‘at highest risk of being exploited for money laundering’.
- **Legal services:** The 2017 NRA found that ‘there is still assessed to be a high risk associated with abuse of legal services in money laundering’. It pointed to the formation of trusts and companies on behalf of clients as the area at greatest potential risk.
- **Trusts and corporate structures:** The NRA noted that these are used ‘in almost all high-end money laundering cases, including to launder the proceeds of corruption’. Assessing UK trusts as ‘low risk’, it attached ‘significantly higher risks’ to overseas trusts. It judged corporate

⁶² Keatinge, T. (2018), ‘Rolling Up Russia’s Red Money Carpet in the UK’, Royal United Services Institute, 26 March 2018, <https://rusi.org/commentary/rolling-russia%E2%80%99s-red-money-carpet-uk> (accessed 13 Oct. 2018).

⁶³ World Justice Project (2018), *Rule of Law Index 2017–2018*, Washington, DC: World Justice Project, https://worldjusticeproject.org/sites/default/files/documents/WJP_ROLI_2017-18_Online-Edition_o.pdf (accessed 13 Oct. 2018).

⁶⁴ Transparency International (2018), *Corruption Perceptions Index 2017*, https://www.transparency.org/news/feature/corruption_perceptions_index_2017 (accessed 21 Oct. 2018).

structures in the UK and overseas territories, particularly limited partnerships, as being at a 'high' risk of exposure to money laundering.⁶⁵

Moreover, doubts surround aspects of the UK's supervisory framework. The UK appears to be in reasonable shape as regards technical compliance with the requirements of the Financial Action Task Force (FATF), the independent intergovernmental body that sets standards for combating money laundering and terrorist financing. (The FATF carried out the latest mutual evaluation of the UK's supervisory system earlier in 2018, and is scheduled to publish its findings in December.) However, serious questions have been raised about the effectiveness of the UK's supervisory regime, the assessment of risk by financial institutions and DNFBPs and the resourcing of public-sector supervisory agencies.⁶⁶

Apart from the negative economic effects of exposure to large-scale suspect financial flows from Russia (and elsewhere), for example on the UK's housing market, the impact on the integrity and the workings of public and private institutions can be substantial. As well as potentially compromising individuals in sensitive positions and causing reputational harm or leaving them vulnerable to pressure, the corruption that goes hand in hand with illicit finance – and the widespread perception of it – can erode public trust in institutions. By sowing suspicion, cynicism and alienation, over time it can jeopardize the functioning of democratic and law-based systems. For these reasons, supervision of the financial sector and DNFBPs has a clear national security dimension.

The following are four examples of how vast amounts of potentially illicit money have entered the UK financial system from Russia:

- **The 'Global Laundromat':** The alleged laundering of over \$20 billion from Russia via banks in Eastern Europe and from there to a network of companies – including entities incorporated in the UK.⁶⁷
- **'Mirror trading' by Deutsche Bank:** Related corporate structures in Moscow and London bought and sold the same quantities of the same stock, worth an estimated \$10 billion, via Deutsche Bank's Russia-based subsidiary.⁶⁸
- **The 'Azerbaijan Laundromat':** Between 2012 and 2014 four UK-registered companies were part of a network of vehicles that processed an estimated \$2.9 billion of suspect finance. Among

⁶⁵ HM Treasury and Home Office (2017), *National risk assessment of money laundering and terrorist financing 2017*, pp. 29–37 and 43–64, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/655198/National_risk_assessment_of_money_laundering_and_terrorist_financing_2017_pdf_web.pdf (accessed 13 Oct. 2018). Independent analysts have queried some of the ratings in the NRA, for example the 'low' risk assigned to estate agency services.

⁶⁶ See Wood, H. (2015), *Destination 2018. Towards the FATF Evaluation of the UK*, Whitehall Report 4-15, Royal United Services Institute, <https://rusi.org/publication/whitehall-reports/destination-2018-towards-fatf-evaluation-uk> (accessed 13 Oct. 2018). See also Wood et al (2018), *Known Unknowns. Plugging the UK's Intelligence Gaps on Money Laundering Involving Professional Service Providers*, Occasional Papers, Royal United Services Institute, https://rusi.org/sites/default/files/20180409_known_unknowns_final.pdf (accessed 13 Oct. 2018).

⁶⁷ Organized Crime and Corruption Reporting Project (2017), 'The Russian Laundromat Exposed', 20 March 2017, <https://www.occrp.org/en/laundromat/the-russian-laundromat-exposed/> (accessed 13 Oct. 2018).

⁶⁸ Caesar, E. (2016), 'Deutsche Bank's \$10-Billion Scandal', *New Yorker*, 29 August, <https://www.newyorker.com/magazine/2016/08/29/deutsche-banks-10-billion-scandal> (accessed 13 Oct. 2018). Deutsche Bank was subsequently fined more than £163 million by the UK Financial Conduct Authority for failing to maintain adequate anti-money laundering controls during the relevant period. See Financial Conduct Authority (2017), 'FCA fines Deutsche Bank £163 million for serious anti-money laundering failings', 31 January 2017, <https://www.fca.org.uk/news/press-releases/fca-fines-deutsche-bank-163-million-anti-money-laundering-controls-failure> (accessed 21 Oct. 2018).

those involved were senior figures in Azerbaijan's elite and Russian entities, including Rosoboronekспорт, Russia's state-owned arms-export corporation, which is subject to US sanctions.⁶⁹

- **Property transactions:** In written evidence submitted to the House of Commons FAC in April 2018, Transparency International UK stated that UK properties with a combined estimated value of some £4.4 billion had been 'bought by those representing a high money laundering risk'. Of this total, an estimated £940 million was related to Russian individuals.⁷⁰

The UK overseas territories pose an even bigger challenge. According to one estimate, from 2007 to 2016 over seven times as much Russian money entered them (£68.4 billion) as entered the UK (£9 billion). The overseas territories accounted for 12.4 per cent of Russian money invested outside Russia, compared with 2.6 per cent in the UK. The British Virgin Islands were the second most popular destination (after Cyprus) for financial flows from Russia (£56.3 billion), and the third most popular location (after Cyprus and the Netherlands) for Russian investment (£33.7 billion).⁷¹ A prime attraction of the UK overseas territories is secrecy, particularly as regards the incorporation of anonymously owned companies. Not all Russian money entering the overseas territories is derived from corruption and money laundering, but a large proportion of it almost certainly is.

More effective supervision of the financial industry and DNFBPs would be a welcome reassertion of the national interest over the interests of sectoral groups wanting to defend the status quo. At worst, these are what one scholar terms 'the supply side of corruption': the actors in the West 'who benefit from the widespread practice of securing assets in special financial zones that provide secrecy and anonymity to their account holders'.⁷² Financial and non-financial service provision is a comparative advantage for the UK in its relations with Russia (and other countries). What is at issue is the weight that should be attached to it. The state's duty to ensure the security of its citizens surely comes before the interests of a branch of the economy. Yet for too long official thinking about the place of financial sector supervision in the UK's Russia policy has been shaped by deference towards sectoral concerns. This is a choice that successive UK governments have made; there is nothing inevitable about it. It is time to adjust the balance in favour of national security.

This is not to say that the UK has been inactive. Since the last FATF evaluation in 2007, it has transposed EU money laundering directives into national legislation. It has taken a lead at the international level, notably bringing together representatives from governments, businesses, civil society, law enforcement, sports committees and international organizations for its Anti-Corruption Summit in London in 2016.⁷³ It now has a minister of state for security and economic crime; and it has created structures to improve co-ordination between official agencies as well as between the

⁶⁹ Organized Crime and Corruption Reporting Project (undated), 'The Azerbaijan Laundromat', <https://www.occrp.org/en/azerbaijanlaundromat/> (accessed 13 Oct. 2018).

⁷⁰ Transparency International UK (2018), 'TI-UK Submission – Russian Corruption and the UK (Foreign Affairs Committee)', <http://www.transparency.org.uk/publications/ti-uk-submission-russian-corruption-and-the-uk-foreign-affairs-committee/#.WumDq4gvzIU> (accessed 13 Oct. 2018).

⁷¹ Worthy, M. (2018), 'Missing the Bigger Picture? Russian Money and the UK's Tax Havens', Global Witness, 29 April 2018, <https://www.globalwitness.org/en/blog/missing-bigger-picture-russian-money-uks-tax-havens/> (accessed 13 Oct. 2018).

⁷² Sharafutdinova, G. (2016), 'The Dynamics of Global-Domestic Institutional Interaction in Postcommunist Russia and Elsewhere', *Demokratizatsiya: The Journal of Post-Soviet Democratization*, 24:4, p. 461.

⁷³ Prime Minister's Office, 10 Downing Street and The Rt Hon David Cameron (2016), 'PM hosts major summit as part of global drive to expose, punish and drive out corruption', press release, 12 May 2016, <https://www.gov.uk/government/news/pm-announces-new-global-commitments-to-expose-punish-and-drive-out-corruption> (accessed 13 Oct. 2018).

government and the private sector.⁷⁴ The UK is, moreover, implementing meaningful reforms. In 2016 it became the first G20 country to establish a public register of beneficial owners.⁷⁵ As previously noted, starting in 2021 it will require overseas companies buying or owning property in the UK to disclose information about the ultimate owners. In April 2018 it set out proposals for reform of limited partnerships and Scottish limited partnerships that would subject them to more rigorous checks.⁷⁶ These steps are welcome. What is much less clear is whether they go far enough, whether they are being implemented quickly enough, and whether the machinery to supervise and enforce them is being properly resourced.

Reputation

The previous section included examples of financial scandals or allegations involving UK-based organisations or financial structures. No one should doubt the reputational damage inflicted by such cases, which feed the view that the UK is hypocritical in advocating legality, accountability and transparency, while applying laws and rules in ways that fall below those standards, sometimes by a wide margin. The extent to which this perception is merited is open to debate, but it is widely held. As a result, the UK leaves itself open to claims of disingenuousness when it urges action by others to combat corruption and money laundering. Besides being a source of embarrassment, even shame, the charge of double standards makes it harder for the UK to position itself as a persuasive proponent of reforms that would serve its own interests.

For the UK's policymakers, dealing with Russia is inherently difficult primarily because political leaders in Moscow do not consider the UK to be their country's equal in the global system.⁷⁷ Allegations of UK hypocrisy make this task more difficult still. Charges of Western double standards have become clichés of Kremlin propaganda. Typically, they are salvos of 'whataboutery' intended to deflect criticism of Russia, to cripple Western positions and initiatives and/or to provide a pretext for Russian actions that lack an obvious justification. For Russia's leaders, as one expert has noted, an assessment of the national interest 'far outweighs quasi-theoretical standards of acceptable international behavior'.⁷⁸ Even so, accusations of hypocrisy needlessly damage the UK's standing, making it harder for the UK government to be heard with respect and authority. And the UK's failure to enforce its own financial-sector laws and regulations as effectively as it could and should has shaped a perception in Russia of an interlocutor that does not practise what it preaches.

⁷⁴ Examples are the National Economic Crime Centre, a multi-agency body responsible for planning and co-ordinating operational responses to economic crime; the Joint Money Laundering Task Force, a body under the National Crime Agency that works with the financial sector to combat high-end money laundering; and the Office for Professional Body Anti-Money Laundering Supervision, a new regulator charged with supervising the UK's anti-money laundering regime.

⁷⁵ Lloyd, G. (2016), 'The new "people with significant control" register', 13 April 2016, Companies House, <https://companieshouse.blog.gov.uk/2016/04/13/the-new-people-with-significant-control-register/> (accessed 13 Oct. 2018).

⁷⁶ Department for Business, Energy and Industrial Strategy (2018), *Limited Partnerships: Reform of Limited Partnership Law*, 30 April 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/703603/limited-partnerships-review-of-limited-partnership-law.pdf (accessed 13 Oct. 2018).

⁷⁷ See Allan, D. (2017), 'Brexit makes it even more difficult for the UK to deal with Russia', Chatham House Expert Comment, London: Royal Institute for International Affairs, 13 December 2017, <https://www.chathamhouse.org/expert/comment/brexit-makes-it-even-more-difficult-uk-deal-russia> (accessed 13 Oct. 2018).

⁷⁸ Lo, B. (2015), *Russia and the New World Disorder*, London: Royal Institute of International Affairs and Washington DC: Brookings Institution Press, p.72.

In the words of one specialist, from 2014:

‘Why does a G8 country so easily welcome the money of our public officials?’ is probably one of the most popular questions asked about the UK amongst the Russian civic community and Russian anti-corruption NGOs.⁷⁹

From there, it is not far to the judgment that the UK need not be taken seriously – the position that it ended up in following the publication of the Litvinenko inquiry report.

The UK’s mixed performance as regards financial sector supervision has other repercussions. For the UK, acting with partners and allies is always preferable to acting unilaterally, particularly when dealing with Russia. Yet the patchiness of the UK’s own supervisory performance makes it harder to persuade others to take concerted action in this field. Even if the UK is a leader in some areas, if it put its own house in better order its appeals to others would carry more weight. As things stand, it is unable to project the influence abroad that it could.

A related issue that injures the UK’s reputation is the phenomenon of institutional arbitrage. The financial sectors of the UK and other Western jurisdictions have helped to facilitate the authoritarianism and systemic corruption that blights Russia. This challenges the assumption, which guided Western policy for much of the post-Cold War period, that integration with the global economy would drive democratization in Russia by empowering the private sector and enabling it to assert itself in its relations with the authorities there. As one scholar has put it, ‘financial internationalisation evolved hand in hand with growing authoritarianism, an increasing use of repressive methods of control, and reduced liberties for the Russian population’.⁸⁰ This is so because asset securitization overseas reduces the incentives for Russia’s elite to push for improved governance at home. Again, the implications for the UK’s much-prized reputation as a champion of democracy, human rights and rule of law are severe.

An economic cost to the UK?

Some object that sanctions and tighter supervision would hurt UK commercial interests. Business would be lost at a time of low growth and uncertain post-Brexit economic prospects. There would, moreover, be a cost to the private sector in the form of extra compliance. These arguments are outweighed by others.

First is the matter of national security. Set against the UK’s obligation to protect its citizens, considerations of potential economic cost are of secondary importance. Organs of the Russian state have murdered and attempted to murder British citizens. The priority must be to minimize the risk that they will do so again. The financial services sector and DNFBPs have had to adapt to the introduction of anti-terrorism legislation and regulations that were also deemed essential for national security; they can and must adapt again.

⁷⁹ Panfilova, E. (2014), ‘Russia Money: Too Big to Sanction?’, Transparency International, 7 March 2014, <http://www.transparency.org.uk/russian-money-too-big-to-sanction/#.WumUoYgvzIU> (accessed 13 Oct. 2018). This statement was made shortly before Russia was suspended from the G8 in March 2014.

⁸⁰ Sharafutdinova (2016), ‘The Dynamics of Global-Domestic Institutional Interaction in Postcommunist Russia and Elsewhere’, p. 458. See also Sharafutdinova, G. and Dawisha, K. (2017), ‘The Escape from Institution-Building in a Globalized World: Lessons from Russia’, *Perspectives on Politics*, 15(2), pp. 361–78.

Second, how significant would a loss of financial business from Russia be? As noted, in relative terms Russia is not a major source of investment for the UK; nor is it vital to the future of the UK's services sector. If tighter supervision did reduce financial flows from Russia, presumably some would be of dubious provenance, in which case the UK would be better off without them. And it is most unlikely that all Russian money would be driven away by having to comply with more rigorous standards. Many Russian businesses have legitimate interests and ambitions that they would still want to realize in the UK. They should be welcomed like any law-abiding commercial partners.

Third, more transparent and robust financial supervision would bring long-term gains. By turning away illicit money, not just from Russia, in time the UK would make its business environment more secure and trustworthy. As it did, it would benefit from being seen as a country that lived more clearly by its word and international commitments, reducing the divergence between what its leaders say and what many observers believe they do. In terms of its reputation and soft power, the UK would gain by being perceived as a place where the rule of law and transparency are more firmly entrenched than ever.

Fourth, and a related point, a UK prepared to countenance an economic cost would enjoy greater authority with its partners and allies because it would have signalled that it really was 'walking the walk'. Lithuania provides a telling case study. For it, the imposition of EU sanctions on Russia and Russian counter-sanctions on the EU led to a loss of exports to Russia estimated at 2.73 per cent of GDP, markedly higher than the EU median of 0.13 per cent.⁸¹ Lithuania has been one of the most credible advocates of EU restrictive measures against Russia precisely because it has been willing to incur this cost.

Russian retaliation

Another objection is that imposing sanctions on Russia would trigger retaliation. Russia would indeed retaliate,⁸² but it is important to think through the form that this would plausibly take. One suggestion, often made, is that there would be renewed pressure on BP and Shell, which during the last two decades have weathered several rounds of rough treatment from their Russian associates and Russia's state agencies. This would hardly be risk-free for Russia, however, as it would harm the operations of these companies' partners, Rosneft and Gazprom, two of the biggest generators of revenue for the Russian state and major sources of rent and patronage for the political leadership. Alternatively, Russia might impose counter-sanctions on UK exporters. If it did, UK companies would suffer. Yet Russia is not a critical export market for the UK: in 2017 it accounted for less than 1 per cent of total UK exports of goods and services.⁸³ A third possibility is that retaliation would be asymmetric, perhaps involving cyberattacks. This cannot be ruled out either but is a long-standing threat;⁸⁴ the UK would face it in any case.

⁸¹ Hanson, P. (2017), 'Western Sanctions: Helping the Russian Leadership Ride Out Recession', Chatham House Expert Comment, London: Royal Institute for International Affairs, 10 March 2017, <https://www.chathamhouse.org/expert/comment/western-sanctions-helping-russian-leadership-ride-out-recession> (accessed 13 Oct. 2017).

⁸² On 4 June 2018 Putin signed into law an act giving the president the power to impose a variety of economic and political counter-sanctions on countries that introduced restrictive measures against Russia.

⁸³ Data from the UK Office of National Statistics, www.ons.gov.uk (accessed 13 Oct. 2018).

⁸⁴ See footnote 35.

Again, corporate interests should not be allowed to trump the responsibility of the UK's government to reduce the threat posed to its citizens by the Russian state (or any other state). Ultimately, the question is whether the UK authorities really are determined to offer leadership and affirm the primacy of the national interest. In this respect, Chancellor Merkel of Germany offers an instructive lesson. In 2017 trade in goods between Russia and Germany stood at \$49.9 billion, almost four times as great as trade in goods between Russia and the UK (\$12.7 billion). German exports of goods to Russia came to \$24.2 billion, nearly six times more than UK exports of goods to Russia (\$4.1 billion).⁸⁵ Given the scale of their country's trade with Russia, German business interests opposed to EU sanctions are more vocal and more influential than their UK counterparts. Yet Merkel has been firm, insisting that Germany support the maintenance of restrictive measures on Russia.

Conclusions: implications for the UK's policy towards Russia

This paper opened with the proposition that the poisoning of Sergey and Yulia Skripal (and, subsequently, of DS Nick Bailey, Dawn Sturgess and Charlie Rowley) was not just a brazen violation of UK sovereignty. It was also a UK policy failure. Following the murder of Aleksandr Litvinenko in 2006, the UK government failed to deter another life-threatening attack on UK nationals: Russia saw the UK as lacking purpose and resolve, primarily because its firm rhetoric was not matched by its actions. The UK government's response to the Salisbury attack has been far more robust than was the case in 2007, but its words and deeds are still not synchronized. That is a recipe for trouble.

The UK government could close the gap by imposing a cost on the material interests of Russia's leaders, or those linked to them. Such an approach would incorporate two elements:

- Once the UK has left the EU, giving serious consideration to use the 2018 SAML Act to impose targeted restrictive measures on Russia – or any other state – should it murder, or attempt to murder, UK nationals in future. If it did use the Act, the UK should urge its partners to adopt similar measures – multilateral sanctions would have more impact than unilateral sanctions – but it should be prepared to act without the EU if necessary.
- In the meantime, redoubled efforts to make supervision of the UK's financial sector and DNFBPs more effective. This would prioritize addressing deficiencies highlighted by the forthcoming FATF mutual evaluation report. It would involve support for improved governance in the UK overseas territories. Crucially, it would be adequately resourced. As well as imposing a material cost on Russia's leadership elite, more effective financial sector supervision would strengthen the resilience of UK institutions against the corrupting effects of illicit capital inflows. It would also reduce the reputational harm arising from a supervisory performance that leaves the UK open to damaging charges of double standards and weakens its influence abroad.

These steps would better align the UK government's post-Salisbury rhetoric and actions. As a result, its Russia policy would be more coherent and more compelling.

⁸⁵ Data from Russia's Federal Customs Service, www.customs.ru (accessed 13 Oct. 2018).

‘Managed confrontation’, as this approach might be termed, is less equivocal than the UK government’s present policy towards Russia appears to be. A policy of managed confrontation draws a sharper line between the interests of the UK and those of Russia. It proceeds from the reality that the bilateral relationship is fundamentally adversarial, as the Litvinenko and Salisbury attacks have shown. It acknowledges that, again as the Litvinenko and Salisbury attacks show, the basis for more cooperative relations, let alone ‘partnership’, does not exist – and is most unlikely to do so in the foreseeable future. It judges that the UK will more credibly deter further attacks on its citizens by putting financial and supervisory instruments at the centre of its Russia policy. Moreover, in rejecting efforts to compartmentalize political and economic dimensions of the bilateral relationship, the policy outlined here recognizes that it is untenable to view the Russian state as a geopolitical problem and a direct threat to certain UK nationals while actively facilitating the enrichment of some of that state’s elites.

A policy of managed confrontation towards Russia would require from UK policymakers:

- **Patience and steadiness.** Much of what needs to be done involves the methodical strengthening of the UK’s institutions and the incremental improvement of its global reputation. These tasks will take time; there will be few rapid, newsworthy achievements – the quick-win ‘deliverables’ that ministers and their advisers prize. There have to be concerns about the UK government’s attention span, particularly given the domestic and foreign pressures caused by Brexit. Meanwhile, Russia will undertake plenty of attempts at noisy intimidation. The UK must hold its nerve.
- **Greater clarity.** Despite ministers’ tough talk, important aspects of the UK government’s post-Salisbury Russia policy are widely perceived as being ambiguous and hesitant. Judging by public statements, the government’s stance on UWOs and Investor visas seems vague. And it is far from clear that the government intends to use ‘non-traditional’ national security tools such as financial and supervisory policy as vigorously and as imaginatively as it could.⁸⁶
- **A related point: careful use of language.** There have been occasions when UK ministers have resorted to intemperate language when talking about Russia.⁸⁷ Offensive and provocative, such outbursts betray a lack of gravitas that demeans both the individual making the remarks and the UK. Russia poses a long-term, high-stakes challenge. The UK needs leaders who will defend and promote the national interest with sober determination.
- **Maintaining channels of communication with Russia at senior official level; and, where possible, at the political level.** The UK government should not seek ‘engagement’ for its own sake. But, notwithstanding the dire state of relations following the Salisbury attack, it still has every interest in ensuring that it uses opportunities for the difficult and frank exchanges of views

⁸⁶ See Bullough, O. (2018), ‘Forget the pledges to act – London is still a haven for dirty Russian money’, *The Guardian*, 30 September 2018 <https://www.theguardian.com/commentisfree/2018/sep/30/forget-pledges-to-act-london-still-haven-for-dirty-russian-money> (accessed 13 Oct. 2018).

⁸⁷ Two recent examples, both in March 2018, being Defence Secretary Gavin Williamson’s remark that ‘Russia should go away and shut up’, and the parallel that Boris Johnson, then Foreign Secretary, appeared to draw between Russia’s hosting of the 2018 football World Cup and Nazi Germany’s hosting of the 1936 Olympic Games.

necessary to clarify differences, to explore areas where cooperation may be feasible (although these are few), and to reduce the risk of miscalculation, misperception and accident.

- Self-reflection. At times, the UK makes life harder for itself by not living up to the legal and ethical benchmarks that it advocates. It need not swallow Russian accusations of double standards, which themselves are deeply hypocritical; nor should it permit examples of its leadership to be disparaged. The UK government should instead acknowledge that it could do certain important things differently and better – and that it would serve the country's interests more effectively if it did.

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Cover image: The Union Jack flying outside the UK embassy in Moscow on 6 March 2018.

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