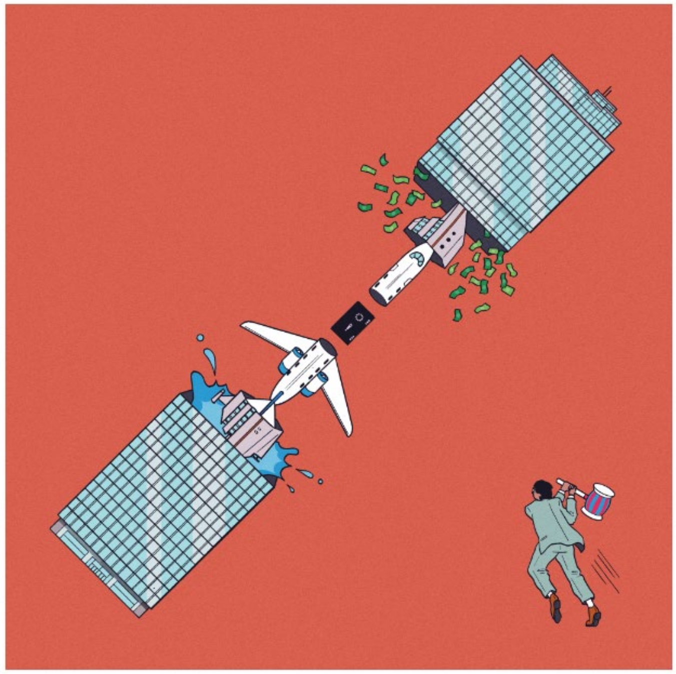
The New York Times

Break the Chain Between Russian Oligarchs and Managers, and You Break Everything

March 21, 2023



By Brooke Harrington
Professor Harrington is the author of "Capital Without Borders: Wealth Managers and the One Percent."

Russian oligarchs were hit with sanctions last year in an effort to cut off Vladimir Putin's overseas lieutenants from their vast offshore wealth — an estimated 60 percent of their net worth. Mega-yachts, private jets and luxury villas were seized, sometimes with news cameras rolling. Yet for all that drama, much of the oligarchs' money was quietly moved to safer havens.

Russian oligarchs have even evaded sanctions on the home turf of one of the leading countries penalizing them — specifically, in a striking display of impunity, by investing in U.S. real estate. The Justice Department recently announced that Viktor Vekselberg — who cultivated Western leaders on behalf of Mr. Putin — had dodged U.S. sanctions on luxury properties in New York and Florida. In January the Treasury Department issued a grave warning about increasing numbers of Russian oligarchs hiding their assets in U.S. commercial real estate investments despite the sanctions.

The United States has become embroiled in a costly and seemingly fruitless game of Whac-A-Mole with Russian oligarchs. Seize or freeze their assets there, and the money ends up over here, right under our noses. This only enhances the international reputation those oligarchs have cultivated as untouchable elites.

But there is a better approach: Impose sanctions on the wealth managers who create these complex offshore shell games. A new study shows why: The wealth managers, not their elite clients, are the masterminds devising sanction-evasion strategies, as well as the Russian-doll nesting structures that conceal oligarchs' assets in shell companies and trusts. Punish the intermediaries, and the oligarchs lose access to many of the offshore networks enabling them to evade the law.

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Analyzing data from the offshore leaks of the past several years — the Panama Papers of 2016, the Paradise Papers of 2017 and the Pandora Papers of 2021 — Herbert Chang of the University of Southern California and the Dartmouth mathematicians Feng Fu and Dan Rockmore and I mapped the offshore asset networks of elites, including many of the Russians close to Mr. Putin. We discovered a complex system of secrecy that illustrates something unexpected about the offshore financial system: It exhibits a scale-free network structure, meaning it has extreme robustness to random attacks.

But it has a distinctive vulnerability: A few points in the network (like well-connected individuals in the offshore system) act as hubs holding the whole structure together. Target those hubs, and the network falls apart. When the system of secrecy shatters, so do the relationships that gave oligarchs ready access to their offshore assets.

Knowing where those vital hubs are is crucial intelligence for policymakers. Our research pinpoints areas of superfragility, as network scientists call it, in an offshore system that has proved extremely resistant to conventional legal strategies.

Russian oligarchs, more than any other group in our study — which also looked at elites from the United States, Hong Kong and China — concentrate their offshore assets in the hands of just a few wealth managers in the West. Having a small number of experts in the know helps preserve the oligarchs' secrets, but it also creates a distinctive weakness, a superfragility, that can be exploited by policymakers. In our research, sanctions applied directly to the wealth managers serving Russian oligarchs collapsed the oligarchs' offshore networks completely, effectively cutting off their pathways to evade sanctions.

This insight can put a stop to the costly game of chase that the United States and other countries have engaged in to target oligarchs' assets. Our analysis shows that multiple oligarchs use the same wealth manager. Singling out those highly connected experts means forbidding them to work with individuals like Mr. Vekselberg. Doing so would sever many oligarchs' offshore networks in one fell swoop, cutting off key access points to their wealth. This is a much more encompassing punishment, much closer to the intended effects of sanctions, than seizing a yacht or a jet.

Replacing these wealth managers with experts who won't face sanctions (those based in Dubai, for example) would be much more difficult and risky for oligarchs than it sounds. Wealth managers become the repository of their clients' secrets — financial, political and personal. Transferring those secrets to new experts is not only very costly but could also expose the oligarchs to great risk. The more people who know how the oligarchs obtained their wealth, how much they have and where it's located, the more vulnerable they are to political reprisals, asset seizures and physical danger. In the world of offshore finance, trust is not a commodity, and it cannot be purchased easily from another provider.

As for the wealth managers, provided they stopped working with those penalized clients, they would be free to carry on business as usual and maintain their livelihoods.

Sanctions strategies focused on expertise have a promising record of success. For example, Iran's decision to enter into the 2015 agreement that put limits on its nuclear program was credited in part to a policy very similar to what we are proposing: imposing sanctions on foreign legal-financial experts so that the country's leadership "could not access its foreign exchange assets held abroad," as a Congressional Research Service report put it. Sanctions on the use of expert knowledge originated decades ago with restrictions on sharing nuclear, chemical and biological weapons technology; an extension of this approach to the realm of wealth management would indicate growing recognition that offshore finance can threaten international security and stability.

Switzerland is already prosecuting some wealth managers who serve penalized oligarchs for violating rules that are not often enforced. For example, Swiss authorities hit four Gazprombank wealth managers with criminal charges for inadequate due diligence on their client Sergei Roldugin, a penalized Putin confidant.

Last year the United States, Britain and the European Union took preliminary steps to ban a few types of expert advisory services involved in creating offshore financial empires for oligarchs. These bans didn't target wealth management but some of the auxiliary experts wealth managers employ for specific tasks, like tax advisers and corporate formation specialists.

These are steps in the right direction; my colleagues and I hope our study will encourage policymakers to shift their attention to the real hubs of the system, wealth managers.

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