

Could the Crypto-Rouble Spell Crypto-Trouble for Sanctions?

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Russian President Vladimir Putin has directed his government to develop a state-backed cryptocurrency, according to media reports. A Putin advisor says that the “Crypto-rouble” could be used to “settle accounts with our counterparties all over the world with no regard for sanctions.” He added that Russia’s cryptocurrency would be “the same rouble, but its circulation would be restricted in a certain way.”

There’s a lot to unpack there. Broadly, establishing a cryptocurrency that the Kremlin can track defeats two of the main purposes of cryptocurrency: to provide anonymity and to remove government central banks from transactions.

But more importantly, could Putin’s dream come true? Could Russia evade U.S. sanctions through the establishment of a state-sponsored cryptocurrency?

Background

Russia’s recent enthusiasm about establishing a cryptocurrency is the latest in a series of contradictory sentiments by Mr. Putin about the potential of digital currencies. Early in 2017, Mr. Putin directed the development of new regulations on digital currencies, blockchain technology, and Initial Coin Offerings (ICOs). And in October 2017, some [reports](#) suggested that Russia would block citizens’ online access to cryptocurrency exchanges. But reportedly, Mr. Putin became interested in developing his own cryptocurrency after a meeting with the Russia-born founder of the cryptocurrency Ethereum. According to media [reports](#), legislation regulating the creation and exchange of digital currencies was introduced on December 28, 2017.

Russia’s Regulatory Dilemma

Though the large-scale commercial use of digital currencies is relatively in its infancy, if you work in the sanctions or anti-money laundering regulatory space, it is clear that the growing use of cryptocurrencies has the potential to fundamentally disrupt the compliance and enforcement framework for sanctions and AML laws. In general, the government’s ability to effectively regulate transactions depends largely on detecting problematic transactions through the regulation of middlemen, such as banks or payment processors. In most cryptocurrency models, there is by design no centralized repository of information about the transactions. That is how conventional cryptocurrencies (such as Bitcoin) work. The currency itself is a digital asset, all of whose features (including verifying the exchange of the asset, securing the transactions, and the creation of additional units) are accomplished through cooperative, decentralized computer encryption functions.

But if Russia develops a crypto-rouble, those functions would almost certainly be performed – and tracked — by the government. Government involvement is one of the central things standard cryptocurrencies seek to avoid.

Moreover, the ability of a crypto-rouble to help Russia evade U.S. sanctions is limited. Prohibited transactions would continue to be prohibited regardless of the means of exchange. Theoretically, it would be harder to get caught if you’re using currency that cannot be detected by U.S. regulators. But it is unclear just how many world financial actors would accept Russian government crypto-rouble surveillance, in exchange for protection from scrutiny by U.S. financial regulators. For this reason, the primary user of the crypto-rouble might be the Russian state itself.



Article By

[Fatema K. Merchant](#)

[Sheppard, Mullin, Richter & Hampton LLP](#)
[Global Trade Law Blog](#)

[Communications, Media & Internet](#)

[Global](#)

[Financial Institutions & Banking](#)

[Russia](#)

Current U.S. sanctions against Russia take three basic forms. First are the Sectoral Sanctions, which prohibit U.S. persons from engaging in certain transactions that finance the energy and defense sectors of Russia. In general, U.S. persons are prohibited from transactions involving new equity or certain new debt in those sectors. Sectoral sanctions also prohibit providing material support to Russia's energy sector for the production of oil. Second, there are sanctions that target named individuals and entities with which all transactions by U.S. persons are prohibited.

Established financial institutions and payment processors around the world all have automated systems to screen transactions for prohibited parties and prohibited activities. Very often, bad actors get caught when prohibited financial transactions are processed through those centralized systems.

Part of the appeal of cryptocurrencies is that they involve peer-to-peer payment systems that do not involve a regulated bank or payment processor. The lack of a regulated middleman would also make it harder to detect transactions that may violate sanctions regulations because the payor, beneficiary, and the details of the underlying transaction may be hidden.

But if a crypto-rouble were to be issued by the Russian central bank (or even by a commercial bank in Russia), then the very existence of that platform would lend itself to detection. Although the currency itself could be secure, exchanges denominated in the currency would likely flow in more predictable paths than standard cryptocurrencies. Thus it would only be a matter of time before U.S. enforcement agencies could identify red flags and investigate potentially prohibited transactions.

An executive at Gazprombank, the state-run bank that is subject to U.S. sectoral sanctions, acknowledged that "[c]rypto isn't the answer in a quick way." Russia's quest for a cryptocurrency raises interesting issues about the regulation of global trade. We will keep you updated about emerging cryptocurrencies and their regulation as events develop.

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