The Great Moscow Bank Shakedown
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By Anna Baraulina, Evgenia Pismennaya and Irina Reznik
(Bloomberg Businessweek) -- Kirill Cherkalin told his parents the piles of cash stashed at their apartment—$50 million, €1.8 million ($1.9 million), and 17 million rubles ($267,000)—were "for work." At the downtown pad he shared with a girlfriend he had shoeboxes, tote bags, and suitcases stuffed with $22 million, €6.5 million, and 794 million rubles. In his supercharged Mercedes-Benz SUV: $200,000. All told, he had some $100 million in various currencies, dozens of pricey timepieces such as gold-and-diamond Patek Philippes, four apartments, and a 5,000-square-foot house in Razdory, a leafy suburb where rich Muscovites keep homes modeled on English country estates.

Yet Cherkalin isn't a Kremlin boss or an oil-pumping oligarch. He's not even a general. Until this spring, he was a colonel heading one of dozens of subdepartments within Russia's FSB—the Federal Security Service, the main successor to the Soviet KGB.

Cherkalin, 38, was a key figure in the insular—and, for some, apparently highly lucrative—world of bank supervision. At a time when regulators were shutting down lenders at a record pace, often amid allegations of money laundering, fraud, or theft, he was a top manager in Department K, the FSB's financial sector "counterintelligence" unit. According to officials and former bankers, he and a handful of other regulators had decisive voices on which banks would be closed and whether their owners got bailouts—or jail terms.

Now in Moscow's Lefortovo Prison, Cherkalin is charged with fraud and bribery but hasn't commented on the allegations. His lawyer in November conceded in court that most of the immense wealth police found when he was arrested in April "came from sources not envisioned under the law," though he said that didn't amount to an admission of guilt.

Cherkalin's case highlights the economic footprint of the security apparatus forged during Vladimir Putin's 20 years in power. While it doesn't show up in official statistics or reports, the reach of the FSB and other law enforcement agencies extends across the business landscape, distorting markets and sapping investment. The vast sums of money at stake go a long way toward explaining why Putin hasn't followed through on years of pledges to rein in the appetites of his powerful security underlings. “They’ve become one of the key elements of the economy,” says Oleg Vyugin, a former senior official at the Bank of Russia and the Ministry of Finance. “Unfortunately, they’re an element that’s an obstacle to its normal development.”

For years the banking sector was a gold mine for the security services, combining huge, often-illicit flows of cash with plenty of leeway for officials to either turn the screws or look the other way. The numbers are big even by oil-rich Russian standards. Regulators—including the central bank—say managers stole some 7 trillion rubles ($110 billion) in assets from their banks in the past decade, and the central bank has spent more than 5 trillion rubles on bailouts or to pay off depositors at those that didn’t survive, according to Fitch Ratings. Bankers fleeing the country as their institutions failed have become such a problem that Bank of Russia Governor Elvira Nabiullina asked Putin for the power to stop them at the border. He hasn’t granted it.

Russia’s banks were in need of a cleanup as lax regulation, money laundering, and major economic downturns in 2008 and 2014 weighed on hundreds of lenders that fought for business alongside the handful of state-owned giants that dominate the market. “Banks effectively had licenses to steal money, and the owners laundered the proceeds and went abroad,” says Alexander Lebedev, a former KGB agent whose family controls the U.K.’s Evening Standard and Independent newspapers, who says his National Reserve Bank was almost driven out of business after he complained about pressure from the security services.

Not surprisingly, the International Monetary Fund has broadly praised Nabiullina’s decisive approach. In just six years she closed more than half the country’s banks, aiming to strengthen the remaining institutions so they could provide much-needed credit to the sputtering economy. “Of course, it hasn’t been painless or cost-free,” she told parliament in May.

The purge, and the billions in bailouts that came with it, created huge opportunities for graft. Failing banks could be kept afloat to continue illicit operations. Some saw their good assets stripped out and replaced with junk before regulators closed in. Once a bank failed, corrupt officials could rig the cleanup process to divert any remaining valuables to their allies at knockdown prices. “The bank purge has given this army of corrupt officials a new tool: taking banks apart,” says Alexander Sharkevich, a former senior official at the Interior Ministry responsible for financial crimes. “It’s created a massive feeding trough.”

Few in the industry think Cherkalin's arrest marks a serious effort to root out corruption. Rather, it's seen as the latest sign of infighting over the loot. In October a Moscow court sentenced another colonel, from an Interior Ministry department responsible for policing banks, to 12 years in prison for bribery and obstructing justice. Investigators found more than $125 million in cash in an otherwise empty apartment held in his sister's name. Nabiullina "can't stop people from getting rich on the banking purge, she's not the head of the FSB," says Pavel Medvedev, a banking veteran who serves as the industry's financial ombudsman. "She has no choice. The banks are rotten, but the economy also takes a hit."

For the security services, the bank cleanup has largely supplanted the torrents of illicit money that flowed out of Russia over the last two decades. The siloviki ("strongmen"), as Russians call them, skimmed a percentage in exchange for silence, former officials and bankers say. It was a dangerous game. A senior central bank official who tried to close dirty lenders was gunned down in a contract hit in Moscow in 2006. A banker was convicted of ordering his murder. But the river of cash—official statistics say $280 billion moved out in "suspicious transactions" from 2005 to 2013—has slowed dramatically amid sanctions, tighter money laundering enforcement in the West, and a Kremlin push to keep money at home.

Cherkalin, who comes from a family of KGB veterans and graduated from the FSB Academy in Moscow, got a top job at Department K in 2011. Since his arrest, a string of former bankers who fled Russia facing criminal charges over the failures of their banks have come forward with accounts of his alleged high-stakes shakedowns. Cherkalin's lawyer declined to comment on those allegations.

One of these bankers, Sergei Pugachev, was founder of Mezhprombank, a lender that declared bankruptcy in 2010. Pugachev says he has emails from Cherkalin offering to help him avoid criminal charges. Cherkalin promised to make the issue disappear for $100,000, though Pugachev says the price ultimately rose to $20 million (he says he never paid a kopeck). To hasten a decision from Pugachev, Cherkalin sent a draft of a prosecution order to show what would happen if he didn't pay. "In the end, the criminal case followed the exact scenario he laid out," Pugachev says.

Pugachev fled Russia for Britain, where he's been fighting lawsuits by creditors seeking to recover some of the $1 billionplus they say the bank owes them. Russia has charged him with embezzlement, and a U.K. judge in 2016 sentenced him to two years in prison for flouting court orders and failing to hand over evidence. Pugachev, now in France fighting extradition, calls the cases against him a political persecution.

Alexander Zheleznyak, a shareholder and executive at Probusinessbank, which was running into trouble with regulators, says he came under similar pressure from Cherkalin in 2014. The two met at the Vogue Café, a lunch spot favored by the fashion set a short walk from the FSB's yellow and brown stone headquarters on Lubyanka Square, home to Russia's secret police since czarist times.

Cherkalin, "always perfectly dressed in a new suit, pressed shirt, nice tie," Zheleznyak says, arrived in a chauffeured Range Rover SUV. The banker says Cherkalin told him the first step to resolving the issues would be to hire one of Cherkalin's men as a vice president, giving him full access inside the bank, a $10,000-a-month salary, an office, and a car—which Zheleznyak says he agreed to do. The meeting ended, Zheleznyak says, with a convivial meal, and Cherkalin picked up the tab. "I'd been working in the bank for 25 years and gone out to eat with a lot of law enforcement people, but never once did they pay," Zheleznyak recalls. "But this guy says, 'No, no, I'll get it' and paid for everyone!"

The lunch may have been free, but Cherkalin's man didn't save Probusinessbank. After the central bank revoked its license, Zheleznyak fled to the U.S., where he remains. Russian investigators have charged him with siphoning more than $1 billion out of banks where he held shares. In a sworn affidavit he says he plans to provide to U.S. officials, he dismissed those allegations as "transparent attempts to justify the Russian government's theft of the business."

When Cherkalin and two Department K colleagues were arrested in Moscow, a scuffle with police left one of his fellow suspects with a broken arm. Pugachev and Zheleznyak say Cherkalin and his now-jailed associates were part of a broader network of officials seeking to extract cash from distressed banks. They both named as a ring leader Valery Miroshnikov, a top manager at the deposit insurance agency, who resigned from his post in July and left Russia, according to people who know him. Miroshnikov didn't respond to calls on his mobile phone.

A few weeks after Cherkalin's arrest, Eva Merkacheva, an activist from a prison oversight group, visited him at Lefortovo, a notorious Moscow jail where the KGB held and tortured political detainees. She recalls Cherkalin wearing a white Givenchy sweatsuit and expensive sneakers. His cell was decorated with Orthodox icons, and he said he was keeping busy reading the Bible, she says. “He reminded me of a glamorous actor preparing for a role as a priest,” Merkacheva says. When she visited him again in August, his mood had changed: “Apparently he initially believed he would get out quickly, that he was just an accidental guest here. But then he realized he was wrong.”

Cherkalin didn’t attend November hearings on confiscating his property, leaving that to his lawyer and family members. His father, Vladimir, testified that the family was accustomed to keeping large sums of cash, saying that his own father, a 30-year veteran of the KGB’s border patrol, gave him 45 million rubles (about $1.5 million at the time) in cash in 2011 “to get his domestic situation in order.” It was that money, he said, not any ill-gotten funds from his son, that had paid for the apartment he shared with his wife in a parkside high-rise in southwest Moscow. The court seized it anyway.

As the prosecutor worked through a list of dozens of properties and assets controlled by Cherkalin and his associates, his sister, Anastasia Cherkalina, said that while she knew he’d graduated from the FSB Academy, she was unaware of the nature of his job. “We never discussed that,” she said. And she insisted that she and her parents had paid for her flat, with no help from Cherkalin. “My brother never gave me material support, only moral,” Cherkalina testified. In the end, her apartment was the only asset the court didn’t confiscate.

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