



Proximal Consulting Archived White Papers



The Proximal Consulting white paper series began when Proximal Consulting launched in 1999. The white papers provided precise and detailed information on cutting edge business crime topics during a period when the Internet as a source of business information was in its infancy. We are now making these white papers available again.

Whilst the specific cases and examples used in the white papers are historical, the fundamental issues and potential red flags have remained the same.

Please note that the white papers are provided as an un-edited archive: any content, laws, regulations or similar were correct at the time of publishing, but may now be out of date.

PROXIMAL CONSULTING WHITE PAPER 14 ORGANIZED CRIME IN RUSSIA & THE CIS: CAPITAL FLIGHT OR MONEY LAUNDERING?

An estimated £37.5 billion has been moved out of the country to overseas financial centres since 1992 - and continues to leave the country at a rate of £9.4 billion per year. A further £25 billion is literally kept under mattresses within Russia, because of the inbred distrust of both the fiscal authorities and the banking system. These two figures total more than the amount of western aid - so as soon as money is pumped in a higher amount is removed from circulation. The overriding reason for capital flight is the tax system of which a draconian communist regime would be proud: up to 90% of business profits disappear in this way and salaries above \$75 per month are highly taxed. According to the financial journal Kommersant, more than \$40 million has been transferred to banks in Britain over the last few years. Britain is a popular destination for Russian mafia money as it is generally invested in profitable property in the smartest areas of London. Overall transfers from central Europe to Switzerland more than doubled from 1992 to some CHF 4.4 billion in 1994, but there is no way of knowing how much of that money is soiled. Swiss prosecutors claim that Russian mafia groups have laundered some \$40 billion through banks in Switzerland since 1991. The somewhat ironical situation that prosperous Russians face is that the authorities at home regard people with money as criminals, so wealth is smuggled out to the west...to be greeted with suspicions that the funds are the proceeds of crime. Herein lies the conundrum: banking institutions across the world are seeking new customer markets and central Europe is a key development area - but which potential new bank customer is engaged in capital flight and which is a money launderer? Alternatively the more cynical approach (and possibly the one more akin to reality) is the comment that London wants the dirty Russian money but city bankers just wish the Russians would launder it in somewhere else (Austria for instance) first.

THE JOINT VENTURE SCAM

As far back as 1996 over 200,000 joint venture companies had been set up in Moscow to engage in phoney trading to legitimize criminal income and expenditure between Russia and the rest of the world. A Russian Interior Ministry official has admitted that more than £16 billion has been moved out of Russia back into western banks along this route. Other more recent estimates put the figure at over \$1 billion per month as being illegally exported from Russia into foreign bank accounts in this way. The system employed by these joint venture companies is simple: goods or services are ordered by the Russian companies from their subsidiary businesses in the EU. Either the invoices are greatly inflated, the difference being the amount to be laundered or the entire invoice is false, representing the whole amount which is being washed. Either way the amounts can be legitimately sent to the west. The true value of whatever is imported is immaterial: if there is a loss on its sale in the east or anywhere else where the false invoicing system is used, this is an acceptable business expense, compensated a hundred times over by the profit gained in the first place from drugs and arms sales or other organized crime activities. One such scheme was discovered in St Petersburg where it was suspected that up to \$50 million had been pumped out of the city's economy using 25 companies. One of these companies was a car dealer which insisted that payments for vehicles should be made to the Zurich based account of an offshore company - 70 vehicles were sold in this way with a total of \$4 million. The money was then apparently transferred back to St Petersburg to pay for the car, which was presented to its proud new owners. However the money which appeared in St Petersburg was not the same money as in Zurich - but a replacement amount from the proceeds of organized crime which in this way had been legitimized into the banking system. An interesting variation of the money laundering theme is where Russians are investing in non existent time share property to wash dirty funds - the western "salesman" obviously taking a percentage.

ORGANIZED CRIME AS A CENTRAL EUROPEAN PROBLEM

Organized crime problems are not only confined to Russia; major difficulties have surfaced in other central European states:

- 1994: Prague - 16% of businesses had been threatened with extortion (Institute of Criminology and Prevention of Anti Social Behaviour)
- In 1993 Czech Interior Ministry confirmed that over 17,000 cases of white collar crime were reported, up 350% on 1989- in 1993 of all types of crime economic crime grew the fastest
- Hungary's Business Protection Co-ordination Secretariat recorded 32,000 cases of financial crime in 1994, up 162% on 1990. Fraud in 1994 cost the Hungarian economy \$147M
- Polish police recorded more than 40,000 cases of economic crime in the first 9 months of 1995, up 34% on the same period in 1994

- In Slovakia over 7000 financial crimes were recorded in the first 9 months of 1995


In 1994 a scheme to raise \$1.2 billion through the sale of fraudulent securities in Banka Bohemia was discovered by the US Securities and Exchange Commission after the purchase by a US church institution of notes worth \$13.2 million for \$8 million through a London investment house. The guarantees were signed by authorized officials at the bank, though they were not recorded in the Bank's books. They did not meet Czech foreign exchange regulations and Banka Bohemia did not have a licence to issue them.

In September 1995 close to 500 million korunas of securities were stolen using false documents from the central securities register of the Czech Republic which holds 1.8 trillion korunas of securities. As the law stood then any person bearing identification and notarised full powers of the owner may apply for the transfer of securities to his account over the counter. In this case a man bearing a stolen identity card in one case and a forged British passport in the other stole the stock and fled the country before the fraud was discovered.

Meanwhile in the Ukraine the country's parliament approved in February 1996 tougher minimum requirements for the starting capital of commercial banks. A parliamentary deputy has predicted that three quarters of Ukraine's 200+ banks would probably fold because of the measure, adding that about 40% of the country's banks have starting capital which is worth the price of a three room apartment in Kiev.

Then there is Bulgaria where warring mafia groups originating from the sport of wrestling fight it out for control of business life in Sofia and the Black Sea resorts. Not adverse to either extreme violence or murder they specialize in extortion of western companies setting up offices or businesses in the country, blackmail through protection/insurance, money laundering, illegal banking activities, pyramid schemes, tax evasion, VAT related offences, prostitution, racketeering and extensive corruption of government and police officials. Added to this are the counterfeiting of every product from spirits to computer programs which are then exported to European countries. The criminals make little effort to disguise their activities in Sofia or their guns. Neither are their crimes hidden: it has been very common for high value western cars to be stolen when stopped at traffic lights by the forcible removal of the owner/driver. In fact by the end of 1997 organized crime was so endemic in Bulgaria - and many western companies had effectively either made it a no go area or would not commit any more resources to it - that it was seriously threatening to push the country's fragile economy over the looming precipice.

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