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Money laundering typologies in Ukraine in 2004-2005

The State Committee for Financial Monitoring of Ukraine

CONTENT

Annotation

These materials examine the most common money laundering trends and schemes in 2004-2005. The typologies contain results of researches of state authorities – participants of the system for combating money laundering. Particularly, it presents examples of real cases related to money laundering.

Mostly these are the mechanisms containing complicated, tangled, multilayer transactions. One scheme can contain converting into cash transactions; securities purchase transactions; payments to non-residents from offshore zones/jurisdictions; fictitious foreign economic transactions and illegal reimbursement of VAT from the state budget; false documents; use of stolen passports; establishment of front companies etc.

That is why classification of money laundering schemes is carried out according to their key components. The schemes' format is based on the methodology described in the manual „Combating money-laundering: legal, organizational and practical aspects".

To avoid doubling, examples of schemes are arranged according to the most "typical" components under items 1-7 of section 2. The majority of examples are very typical for each, since this research deals with the most typical set of money-laundering tools. They are as follows: «front companies – foreign economic transactions (goods, services, securities, reinsurance, etc.) – offshores – cash converting».

Foreword

Growing vulnerability of financial system leads to its use by criminals for purposes of money laundering, which is one of the most dangerous consequences of shadow economy development. The total scope of shadow economy includes crime proceeds and legalized proceeds[1]. For Ukraine, it is a substantial quantitative index, which seriously influences criminalization of the society and covers all fields.

Estimates of shadow sector in Ukraine — different methodological approaches applied — indicate that it remains considerably high and reaches 30% GDP. More exquisite forms and schemes of shadow transactions are applied[2]. In general, according to different sources, the scope of shadow sector of economy in Ukraine exceeds the critical (25—30% GDP), as well as «normal» level (10—15%)[3]. According to the Ministry of Economy, this index exceeded 34% in 2004[4].

One of the most substantial sources of shadow economy growth is the possibility of unhampered laundering and use of criminal assets. Money laundering has extremely negative influence upon society. First of all this phenomenon presents threat to economic security of the state, because it enables infringers to legalize crime proceeds and, consequently, leads to commitment of even more serious crimes. Money laundering affects interests of legal business and reputation of its certain segments and participants, undermines confidence of the society in the financial system as a whole, and threatens proper functioning of credit-financial institutions of the state.

Under existing conditions, we have to pay great attention to the outflow of capital abroad. This step makes possible not only "laundering" crime proceeds, but also allows owners of semi-legal or illegal funds in Ukraine to considerably escape control over their assets on behalf of state authorities and institutions.

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[1] «Laundering» is obtaining funds from criminal actions. Tax crime in Ukraine is not a predicate offence regarding money-laundering. Actually laundering is carried out through legalizing of criminal assets, all taxes paid.

[2] Currently, there is a great difference in evaluations of the level of shadowing of Ukrainian economy. Thus, this index is fluctuating from 20% to 60%. Annual Address of the President of Ukraine to the Verkhovna Rada indicates 35% of the "shadow".

[3] According to OECD, shadowing of world economy increased 6.2% annually within the last 5 years, at the same time economy grew 3.5%. According to FATF estimates, real scopes of shadow economy in developed countries reached 17% GDP, in developing countries — 40% GDP, in countries with transition economy — more than 20% GDP.
V. Sidenko, O. Baranovsky. PROBLEMS OF PROPERTY AND LEGALIZATION OF FUNDS AND PROCEEDS IN UKRAINE // International social-political weekly «The Mirror of the Week». – 2004. - № 18 (493).

[4] The Ministry of Economy of Ukraine. Evaluation and analysis of the level of shadow economy under the outcomes of 2004 //Trends in shadow economy in Ukraine. – №2005-2 (15).

I. General trends

Combating money laundering is rather combating consequences than causes of these negative social phenomena. The situation in Ukraine proves this statement.

Combating money laundering is an integral part of the plans developed by the Government to combat corruption, which remains a serious problem at all levels of most areas.

Experience of state authorities shows that illegal proceeds are mainly obtained as a result of the following violations:

- economic crimes (illegal manufacturing, storing and selling of excise-duty goods and violation of business and banking activity procedures);
- corruption;
- tax evasion and fraud (including privatization machinations);
- contraband and crimes against property;
- drug trafficking.

Certain sectors of economy are still cash-oriented, with restricted use of non-cash financial instruments.

The main problem is that «launderers» constantly develop new methods to legalize crime proceeds. In development of new ideas and technologies modern criminals are always a step before law enforcement authorities. Fraudsters regularly change currency, money laundering methods, international financial institutions used to legalize criminal assets.

The main money laundering methods can be effectively used by criminals in all the areas of economy, especially in financial sector, foreign economy and industry.

Major infringements in Ukrainian financial system are illegal credit transactions and illegal use of budget funds. False documents (account reports, passports etc.) as well as "shell-companies" are usually used for machinations.

Credit and financial institutions remain "popular" in money laundering schemes both in Ukraine and all over the world. "Launderers" usually use banks in underdeveloped countries where there is no anti money laundering (AML) legislation at all or it functions just nominally. Illegal funds are invested in deposits, securities and even insurance policies.

There are various ways of capital outflow. There are both physical transfer of cash abroad, and conclusion of foreign economy contracts on import of goods, services, intellectual property rights, on use of schemes involving offshore companies. As a result, money laundering through offshore zones and illegal reimbursement of VAT[5] has become a problem on a national scope.

[5] Not tax evasion is meant, but its illegal compensation (illegal acquisition of state assets).

II. Typical money laundering schemes

Widespread modern money laundering schemes contain a lot of versatile elements and tools for their implementation. That is why it is difficult and sometimes even impossible to classify typical schemes according to certain categories.

Outflow of capital through export-import transactions, increase in amounts of obligations under short-term credits, rise of payments for catering private external debt and scope of payments under the stocks of Ukrainian companies owned by non-residents require special attention. The largest scopes of exported products cover ferrous metals, energy materials, organic chemical compounds and inorganic chemical materials.

According to the Ministry of Economy, in the Ist quarter of 2005 the outflow of capital abroad was conducted through payment for financial, insurance, computer and information services and other business services, direct investment abroad through contributions of Ukrainian banks into statutory funds of Baltic and Russian banks.

The reasons of considerable outflow of capital from Ukraine in 2005, are as follows:

- unpredictable macroeconomic development, instable economic and political situation;
- wait-and-see attitude of investors because of reprivatization risks and revocation of tax benefits in economic zones and territories of priority development;
- considerable level of economy regulation and lack of guarantees of business activity protection;
- risk of non-reimbursement of loans by the state;
- amendments to the legislation on investment and foreign economy activities.

Foreign economic activity of business entities is characterized by fictitious and suspicious export transactions aimed at groundless reimbursement of VAT and legalization of criminal assets. Thus, companies export non-typical types of goods, which are passed through commitments who are not responsible for financial regulation. Moreover, criminal cash and securities transactions both in Ukraine and abroad are also still "in favor".

The most "successful" tools and methods of illegal transactions in foreign economic activity are as follows:

- purchase of companies, securities of foreign companies and real estate abroad;
-payment for services provided to foreign partners (marketing, advertising campaign, etc.);
- use of «structuring» of transactions[6];
- export of currency funds abroad using plastic credit cards;
- export of foreign cash currency by individuals.

Detection of laundering schemes requires deep complex analysis of circumstances of executed transactions, complex examination of its participants, as well as interaction between various law enforcement authorities, entities of initial financial monitoring.

[6] «Structuring» of transactions – targeted transfer at one or several accounts in foreign bank is divided into several transfers, each of which is less than the established by legislation amounts subject to banking registration and obligatory informing of state authorities.

The main elements of examination of participants of suspicious transactions are the following:

- legality of statutory documents;
- authenticity of founders' person;
- economic content of business activity and financial activity as a whole;
- correspondence of real purposes of entity's activity to the declared ones;
- reality and legality of agreements with other entities;
- dynamics of commodity turnover and relevant financial calculations;
- grounded (services, works) prices.

1. Legal entities with signs of fictitiousness

Almost all large money laundering mechanisms are characterized by the participation of fictitious companies[7]. Organizations are often established for a short period of time with the help of false documents or a man of straw. Crime proceeds are transferred to such organizations. Further, they are converted and transferred to accounts of their own organizations, often registered in offshore zones. These very organizations legalize dirty funds through the accounts of different companies.

For example, to carry out import transactions an affiliated company or an independent company in offshore zones is established to conclude contracts with Ukrainian organizations on delivery of various goods to Ukraine. Large amounts of money are transferred to guarantee fulfillment contracts. However, the goods are not imported in Ukraine, and funds are transferred to accounts of other companies.

Since "shell-companies" are not forbidden, they are used in money laundering and terrorist financing schemes to mask illegal funds. They are easily established and connected with other shell-companies all over the world. If a front company is established in a country with strict legislation on confidentiality of financial institutions, it is almost impossible to identify owners or directors of such companies and, thus, it is almost impossible to trace real owner of crime proceeds. That is why front companies are efficient tools to break the scheme while collecting evidence of its activity.

In Ukraine, companies established for money laundering undergo full state registration procedure. But state authorities can detect signs of fictitiousness during a check-up. Usually fictitious companies are established through the purchase of an existing company or through establishment of a new one (using illegal methods).

Operation periods of such companies vary greatly: from several days to several years. Sometimes they avoid registration for tax record (but at the same time for some period they can carry out business activity, have stamp and account in a bank). Or, conversely, other companies can report to tax authorities for a long period of time. Such differences depend on the purpose of establishment of fictitious companies.

In general, **fictitious companies** can be divided into 3 groups:

1. <u>«Black» company – for a single transaction.</u>

[7] Other widespread names of such companies are as follows: «front»; «one-day»; «butterfly»; «empty»; «phantoms»; with signs of fictitiousness; «grey companies»; «black companies»; «buffer companies».

Usually, such company is registered with a lost or stolen passport, passport of a dead person, homeless or hired man of straw; intended for minimal term of activity, has neither accounting documentation nor tax records.

For example, if a company owner of illegal goods intends to legalize one large consignment of goods, it dispatches foods to a "black" company. It formalizes all the necessary invoices, loads goods, receives payments in cash and disappears. Cash comes to the company-producer, the goods are sold.

2. «Grey» company – for multiple transactions.

Here a more complicated mechanism is established. Fictitious company must have false director, report to the tax administration on a regular basis and invoices for illegal products. Usually, invoices are obtained from other fictitious company, situated in other region of the country, which complicates detection of the scheme.

3. «Buffer» company – for strengthening the mechanism.

Buffers yet more puzzle state authorities and save time for liquidation of fictitious company covered by the buffer (especially when there are several buffers).

On the one hand, buffer defends real company against penalties, because it is an absolutely legal institution and all transactions with it are completely transparent. In other words, it is front but "pure" company which participates in the scheme as an intermediary and protective device. Buffer purchases goods from other fictitious company for further resale.

On the other hand, if a real company is inspected, buffer makes it impossible for supervisory authorities to immediately trace the «black» fictitious company. The buffer immediately informs the «black» fictitious company and drags time out, in order it could cover tracks and disappear in time; or declares bankruptcy.

Thus, the **typical features of companies with signs of fictitiousness** are as follows:

- lack of information on real business activity of a company (in the country of registration);
- impossibility to define places of residence of employees of the company and/or its directors (authorized delegates, representatives) or kind of activity of the company;
- obvious contradiction between turnover on company accounts and sums of tax payments;
- integration of functions of a founder, a manager and a chief accountant of a company in one person.

The mentioned methodology to use fictitious companies is widespread and modified for export-import transactions, converting centers, illegal reimbursement of VAT, schemes with securities, off-shores etc.

Example1. Legalization of funds through fictitious companies within a state.

Money from contraband goods is transferred to the account of «grey»/buffer company. Smuggled goods are usually substantially overpriced. A buffer provides a real company with all the necessary invoices. Then, the buffer transfers money at the account of the «black» fictitious company which, according to the documents, imported goods in Ukraine. The fictitious company provides buffer with all the necessary invoices, transfers money for cash in, and disappears.

The scheme is often used to import excise-duty goods (alcoholic beverages and tobacco goods) into Ukraine from the neighboring states. For legitimate sale, the «black» company also falsifies documents of the contraband goods and purchases excise stamps. In case of illegal sale, the scheme becomes much simpler because the need to legalize the goods disappears. Just after being smuggled, the goods are sold to the wholesale firm which distributes it through its retail network.

Example 2. Legalization of funds through fictitious companies with participation of non-residents.

A foreign company-producer of goods sells it to a foreign intermediary company at world price. The intermediary is usually fictitious. At delivery of goods into Ukraine the intermediary substantially reduces volumes of the contract in import documentation. For example, the price of goods can be several times underestimated, the brand of goods can be substituted with a cheaper one, amount or weight of goods can be decreased, etc.

The customs service confirms accuracy of the documents of the intermediary company and the real company pays decreased taxes and duties selling the goods at Ukrainian prices (several times higher than stated at the customs). Such scheme is actively applied in import of oil products, food, household and industrial chemicals, clothes, electronics, and furniture.

Fictitious companies are used to decrease profits of a legal company, for example, through non-commodity transactions (marketing, transport, consulting and other services). After this, money, transferred by the real company to fictitious firms, are cashed in and fall into the hands of the schemes organizers.

Scheme designers are often owners of a real company and owners of a fictitious foreign intermediary company. If it is so, the cash obtained remains in the real company. If three different persons are involved, the money is distributed according to the prior agreement among the participants.

The above mentioned schemes require substantial expenses. Taking into consideration the amount of money involved in each transaction in the scheme and complicated nature of the latter, exceptionally accurate organization and coordination of the whole process is required. That is why such schemes can be implemented only by large companies with substantial funds and serious contacts.

Customs authorities play an important role in detection of such schemes. Criminals need to avoid their attention, to make detection of violations of legislation on import of goods into Ukraine impossible.

2. Export-import transactions (fictitious, speculative)

Foreign economic transactions constituted the main channel of capital outflow from the state during the last decade. This block deals with trade transactions and, therefore, can not be detected by regular control over the capital turnover. First of all these are:

- underestimation of price for exported goods;
- untimely return of currency earnings;
- overestimation of price for imported goods;
- false import contracts, false credit agreements, etc.

A part of exported shadow capital later returns to the state as foreign investments. Earnings of nonresidents quite often considerably increase their real investment. Most of such transactions are executed with participation of fictitious companies and firms registered in offshore zones.

Thus, **basic methods and typical features** of criminal assets legalization at execution of foreign economic transactions include:

1. Deliberate change of volumes of profits / expenses:

- agreed underestimation of real cost of executed works, provided services, delivered goods in accounting and payment documents without accountant records (including underestimation of amounts in invoices at export transactions);
- incomplete return of currency obtained from export transaction on bank account (part of it remains abroad);
- masking payments for unaccounted products as financial assistance;
- producer illegally increases scopes of ready products and expenses to find purchasers of the latter.

For example, a company – producer of highly commercial products establishes a company under control with an exclusive right to sell the products. The seller company concludes an agreement with a nonresident company, which is under control of the same company. According to the agreement the nonresident company is obliged to search purchasers of these goods products in global market for a considerable reward. Actually, there is no search for purchaser companies at all; produced goods are acquired by the same purchasers which used to buy them before. Substantial funds are being accumulated at the account of the nonresident company under control. In some period of time the accumulated funds are used, for example, to buy producer-company stocks;

- use of contracts on purchase and sale of essential amount of expensive goods with so called double source of payment.

For example, an agreement (foreign contract) on purchase of products (raw materials, electronics, oil products, alcoholic beverages etc.) is concluded under extremely profitable terms: resale can make profit up to 100%. Actually, supplier (seller) gets payment from two sources. The first payment on the grounds of a single invoice billed by a company exceeds 50% of actual cost of the goods and is officially made by the purchaser. The second payment is often made in cash through the cashier's office or personally delivered to the

seller. Official profit of a seller, obtained from resale of contraband goods is called «laundered» money;

- use of credit-mortgaging scheme with the help of the bank under control;
- execution of export-import transactions by non-specialized companies for a certain type of products (metal production, etc.).

For example, doubtful export of ready-made products from alloyed corrosion resistant stainless steel by factories – producers is widespread. Quite a legal scheme of export of stainless steel in the form of ingot product[8] *is carried out;*

- use of various promissory notes schemes.

For example, local companies are divided into several legal entities, and all payments are assigned to one of them – the most unprofitable. One company carries out payments by means of promissory notes from the other one. Then these promissory notes are given to the third legal entity, promissory notes of which are used as payments. The first company is profitable. Local banks often participate in the scheme involving promissory notes.

2. Masking transactions:

- execution of financial economic transactions without documents registration involving substantial sums of money;
- opening several payment accounts in different banks and carrying out of payment transactions through these accounts without accounting registration;
- false bankruptcy of an organization at the end of tax reporting period or prior to the forthcoming inspection, or after tax check-up which detected large sums of tax evasion;
- registration of companies in one district or one city while opening accounts in the banks of other cities;
- conclusion of false contracts and agreements to conceal real financial and economic transactions (false supply agreements, agreements on provision of services, leasing agreements, etc.) including contraband export, profits from which are transferred to foreign companies or to foreign accounts;
- export through offshore affiliated companies at reduced prices with further resale at market prices;
- financial transactions, avoiding payment accounts, and using affiliated and commercial structures, offshore companies for mutual payments;
- financial and economic and foreign economic transactions through the accounts of companies established under false documents;
- transfer of funds in foreign currency under deliberately false contracts; failure to return currency proceeds. *This method is implemented, as a rule, at prior agreement of all the participants of foreign economic agreement.*

Types of schemes of crime proceeds legalization with export-import transactions:

1. Export at understated prices **(Figure 1).**

Products are sold at underestimated prices, as a rule, by the companies, registered in offshores which are really controlled by the Ukrainian enterprises or natural persons.

[8] According to the information of the State Customs Service of Ukraine.

Then, an off-shore company resells products at world prices, which allows to keep all profit on its accounts. Export of ready-made products as if they are raw materials or poor quality products is a variant to reduce export prices.

Scheme. Ukrainian company creates a subsidiary company abroad (as a rule, in an offshore). This company often acts as an intermediary. A contract on goods delivery is signed (usually raw materials), but these goods are immediately sent to the third company, from which "its" company takes the proper contract. Ukrainian company sells goods to "its" company at a price lower than the world one, that enables it to sell these goods to the third company at world average price and to get profit**.**

At the same time, a "one-day company" variant is widespread. This mechanism assumes creation of a small private enterprise that is engaged in export of raw materials or goods and is used as protection for a more solid firm or company. Similar mechanism is implemented through granting a large credit by the commercial bank to a "one-day company", created through front persons by bank itself or by one of its leaders.

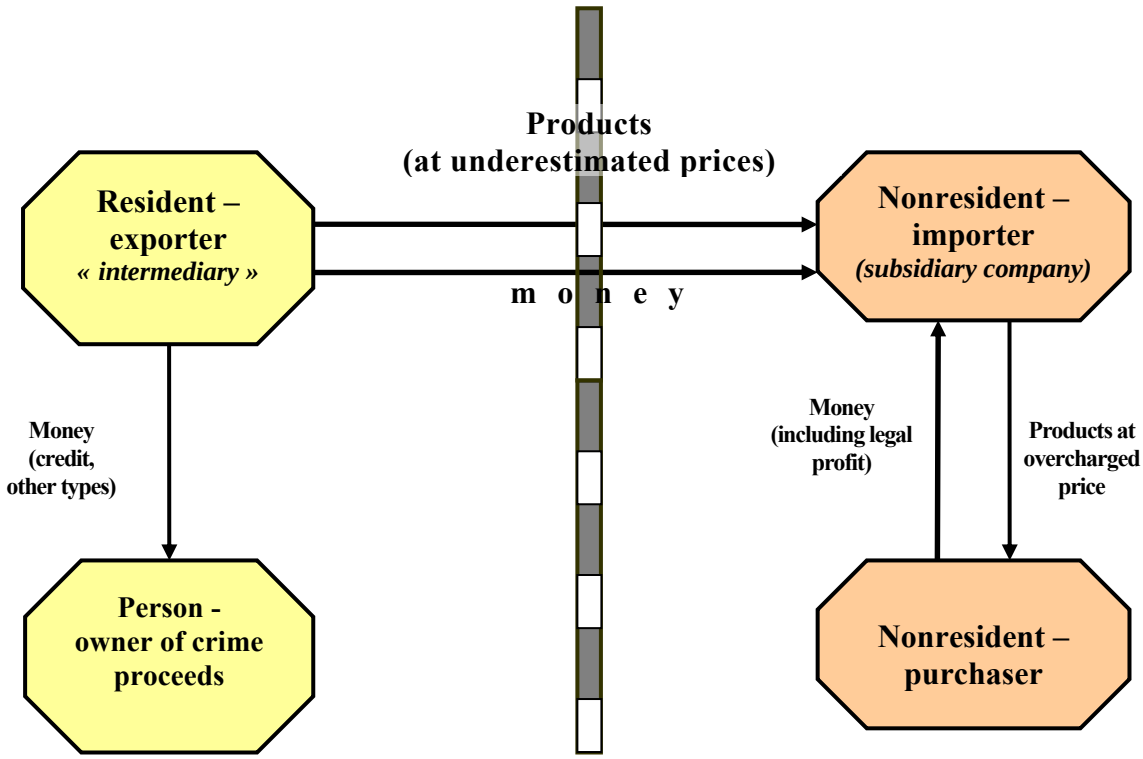

Figure 1

2. Export at overcharge

Scheme. A "launderer" reaches a secret agreement with a foreign company - goods recipient to conclude a contract at deliberately overcharged price. Namely, amounts of advance payments on import are charged (including fictitious contracts on import of goods and services) and fictitious prepayment under import agreements is carried out. Later on, purchaser pays half the difference of contract and real price of goods.

One of the methods is to mask scrap-metal as simplest goods. Minimum of financial resources is spent to produce them and to draw up documents, taking into consideration state control over metal export (contracts on export registration, prohibition of export of alloyed

black, colored metals scrap as goods made on commission, export quality certificate of the products exceptionally by specialized metallurgical processing enterprises (semi-processed materials) of the metallurgical processing of colored metals scrap and their alloys in the shape of ingots, high rates of export duty and other).

Example 1[9]. July, 2005, facts of official position abuse by officials from one of Kharkiv state factories were revealed. The infringers violated current customs and export legislation of Ukraine when they were fulfilling foreign economic contract. They concluded a range of preliminary unprofitable agreements on metal production purchasing, that did not meet specification requirements, and its cost was considerably overcharged. Actions of officials caused damage to the state in amount more than 1, 6 million UAH. They carried out products delivery abroad, following which purposely with lucrative motives they did not return the currency proceeds to Ukraine, what caused losses in a sum more than 200 thousands UAH.

Note. A criminal case was initiated under the fact of evasion from foreign currency proceeds return and official position abuse by the leaders of the abovementioned state enterprise under crimes features, foreseen by Paragraph 3, Article 207 (evasion from foreign currency proceeds return), Paragraph 2, Article 364 (abuse of power or official position), Article 209 (legalization (laundering) of crime proceeds), Paragraph , Article 191 (peculation, appropriation of property by official position abuse) of the Criminal Code of Ukraine.

Example 2[10]. An entity of foreign-economic activity LTD "M" carried out customs registration of some goods in different customs agencies of Ukraine. Moreover, customs registration of metal production was carried out with violation of current legislation in terms of customs registration of "waste products and scrap of metals". In particular, according to the agreement of commission more than 90 customs registrations of CCD were carried out. Exported load was "ingots of corrosion-proof unmerging steel, alloyed, raw". To avoid criteria under which monitoring is conducted, each registration is divided into two CCD with equal importance and invoice cost. In fact, the examination confirmed that under the guise of the certified loads, export customs registration of foundry waste products is carried out, for which supplier enterprise especially orders and develops technical terms.

Note. Under the results of further examination of LTD "M" activity the criminal case was initiated.

3. Pseudo-export, pseudo-import **(Figure 2)**

The most typical way of illegal activity of legal persons, that are specialized on organization of fictitious export - import transactions, is so-called «erroneous» transit of certain types of goods.

[9] Under press-centre materials of Department of Security Service of Ukraine in Kharkov region.

10 Under the information of State Customs Service of Ukraine.

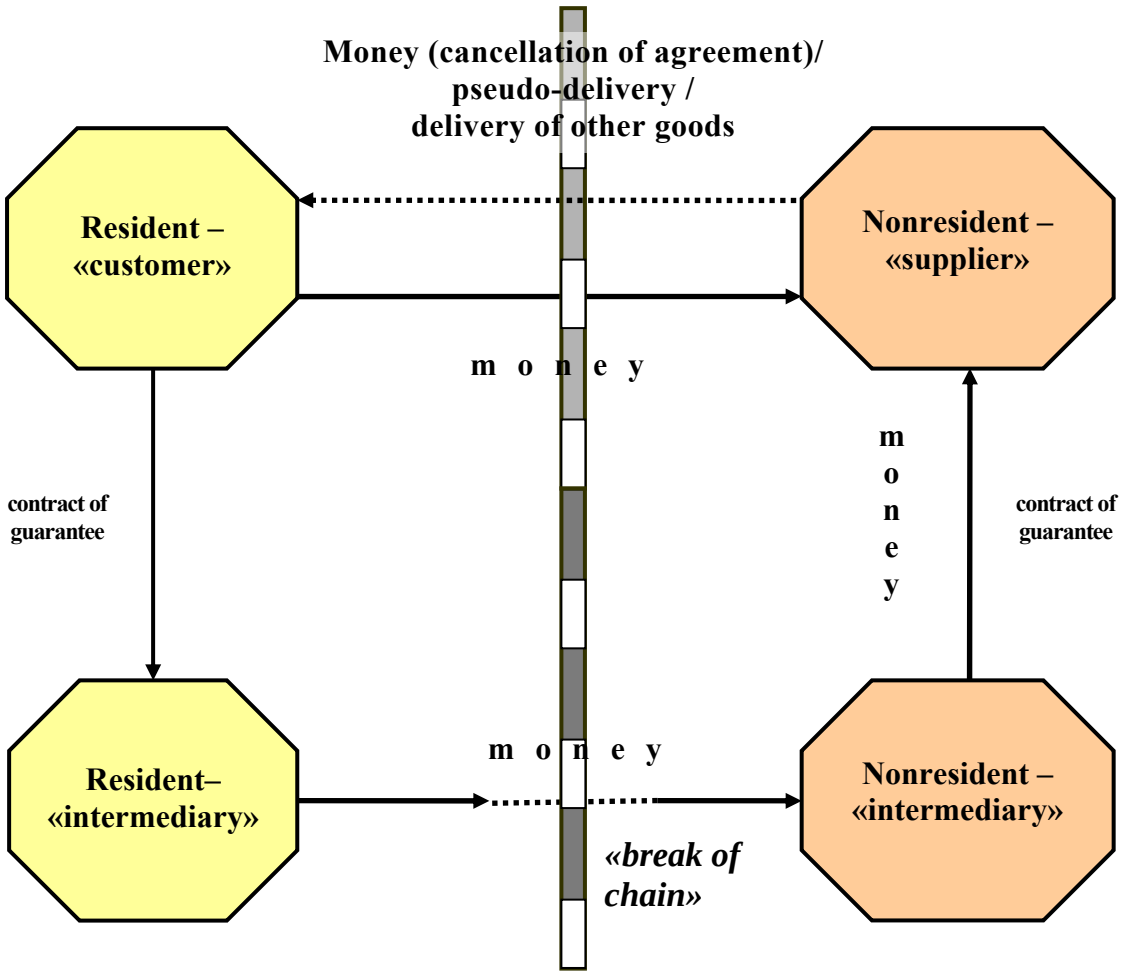

Figure 2

Schemes with imitation of foreign economic activity, usage of financial instruments of commercial banks, services of agents and ungrounded overcharging of prices on the exported goods are more difficult. Such schemes are carried out through services of accountable or interested bank institutions. They serve all basic calculations on scheme, allocate credit resources, issue securities (transactions on opening and repayment of credits, transactions with bank securities are integral part of financial mechanism), provide currency calculations. All the calculations are carried out within one day. Such activity is put on systematic basis and, in essence, is original service of Ukrainian banks, which the most actively introduce "shadow" technologies.

The Law of Ukraine „On Foreign Economic Activity" envisages the possibility of goods import without their actual importation on the customs territory of Ukraine, when import delivery of goods is carried out in one third of the country on CIP terms („Incoterms 2000"). Accordingly, permanent tendency was formed in Ukraine: currency funds are transferred abroad and in future are directed to accounts in foreign banks or are returned to Ukraine under the guise of investments.

Carrying out of pseudo-export transactions supposes possible participation of frontier and internal customs employees, as well as banks employees in this type of crime. Organizers and developers of criminal schemes often have criminal contacts in other regions, where the process of funds into cash conversion is carried out. Also, while carrying

out foreign economic transactions, front companies registered in neighboring states are used. In addition, non-commodity (pseudo-export) transactions aimed at illegal VAT reimbursement and proceeds legalization and —with excise goods – evasion from excise tax payment is used.

The simplest scheme presupposes registration of trade and material values purchase from fictitious companies and their further export to countries and territories remote from Ukraine (Asia, Africa and others). Actually, trade and material values are not transported and do not cross the border; there are no contractual or import bilateral relations with residents in Ukraine. Calculations are imitated by commercial banks that specialize on "converting" services (promissory notes schemes and others). The role of intermediaries is given to enterprises from the third countries, for example, from Baltic region.

The above-mentioned mechanisms are mainly used by large «launderers» (especially those that regularly import goods (raw materials mostly). In fact, such transactions allow redeeming import VAT payment obligations with the fictitious tax credit.

Example 1.[11] Ukrainian enterprise transferred 30,6 million USD for advertising campaign through its account in a Baltic bank to an enterprise registered in the USA. The Ukrainian enterprise was registered and had only one contractor that transferred considerable sums to the account of this enterprise as payment for securities. Thus, the day funds were received they were transferred to the nonresident. Funds were sent abroad to fulfill the foreign economic agreement between the Ukrainian enterprise and nonresident concluded with violations of current Ukrainian legislation, namely:

- the was signed by a person without necessary powers;
- the contract envisaged settlement account which was actually opened in a banking institution only in 15 days upon signature.

Example 2.[12] A group of Ukrainian enterprises transferred 35,2 million USD abroad for paper to accounts (Baltic banks) of enterprises registered in the USA. Further, funds were transferred to accounts of Ukrainian enterprises under the guise of fulfillment of a foreign economic contracts on goods export. Sometimes the declared goods (precious metals ware) were actually received by the enterprise engaged in utilization of scrap metal. Such «carousel scheme» aimed at VAT reimbursement.

Example 3.[13] Directors of Ukrainian enterprise carried out pseudo-export transactions on the basis of concluded agreements of fictitious nature. In 2002-2003 the aforementioned officials together with heads of a number of Ukrainian enterprises with sufficient VAT obligations carried out export goods deliveries to Lithuania on the total sum over 30 million UAH. A number of fictitious firms, including foreign ones, established on the basis of foreign economic agreements participated in the scheme. The sum exceeds 20 times the sum of the contract. Further, the mentioned goods were legally imported to

[11] Under materials of the SCFM of Ukraine.

12Under materials of the SCFM of Ukraine.

[13] Under press-centre materials of Department of Security Service of Ukraine in Kharkov region.

Ukraine according to an agreement with one of Kyiv enterprises. As a result, 5,4 million UAH of VAT payments didn't enter the state budget.

Note. Under materials of the Department of Prosecutor's Office in Kharkiv region a criminal case was initiated under the fact of crimes committed by officials of this enterprise according to Paragraph 5, Article 191 (peculation, appropriation of property by official position abuse), Article 209 (legalization (laundering) of crime proceeds), Paragraph 2, Article 212 (tax, dues and compulsory payments evasion), Paragraph 2, Article 364 (abuse of power or official position) of the Criminal Code of Ukraine.

Contraband transactions.

Practice proves that **the most widespread scheme** for contraband goods to cross the border is when the legal payer (non-resident or resident) registers the documents to transit goods through the customs territory of Ukraine. In Ukraine the documents are reregistered to fit the agreement between residents of Ukraine that grants allegedly legal status to contraband goods.

As a rule, fictitiously created entities of entrepreneurial activity are used to legalize goods of criminal origin or goods with which criminal actions (for example, contraband import) were carried out. Documents on sale of goods are drawn up on behalf of a fictitious firm and all payments are made with it. Further, the funds were illegally converted into foreign currency and transferred to foreign goods supplier.

A widespread **variant of the scheme** to «launder» illegal goods is to legalize them by a fictitious firm. A small part of legal goods is delivered from the producer to the fictitious firm to mask illegal transactions. Thus, there is a possibility to «launder» goods of illegal origin with the help of Certificate of Quality. Further, the received funds are converted in cash through natural persons - entrepreneurs. These persons deliver cash to heads of the enterprise - producer. If there is a need to invest in production, the price of legal goods is increased.

Example.[14] A group of people receives criminal proceeds from contraband import of elite cars of foreign production with their further legalization by men of straw with false documents stating that cars were produced and sold in this country. The same number of elite cars is bought, imported illegally, and sold with false under documents. The funds are legalized as investment transactions of natural persons to create and develop their (legal) enterprises on cars repair-sale.

Note. *April 1, 2005, the Government approved the «Stop Contraband» State Program (Resolution of CMU # 260). The program is designed to prevent and combat contraband, to provide system approach to domestic market protection from contraband goods and support of domestic producers, to settle problems of the state budget and to create favorable conditions for economy development. The Resolution of the Government developed steps to combat contraband in 2005-2006. Implementation of the Program will allow achieve the following results:*
- to eliminate causes of contraband activity;

[14] Under materials of the Ministry of Internal Affairs of Ukraine.

- to increase efficiency of border and customs control;
- to decrease volumes of contraband activity through channeling contraband goods import in legal turnover;
- to improve informative co-operation of state agencies.

3. «Carousel commodity schemes» which are accompanied by illegal VAT reimbursement from the budget

Through foreign economic activity criminals continue to apply mechanisms of appropriation of considerable volumes of budget funds at the cost of illegal value-added tax reimbursement. As a rule, these crimes are directly or indirectly committed by bank officials. They extensively use information falsification concerning financial and economic activity of enterprises, estimation of their cost, mortgage availability etc.

Along with macroeconomic factors (GDP and exchange rate dynamics, volumes and structure of foreign economic transactions, legislative reforms, taxation policy etc.) which influence VAT balance of the state budget and its absolute indexes, there exists risk of illegal VAT reimbursement, which is a part of crime proceeds legalization.

Today the issue of strengthening control over the export of certain goods outside the customs territory and prevention illegal VAT reimbursement by enterprises – exporters is one of the urgent issues for the countries considered. Due to the schemes similar to import-export transactions considerable sums of money are not received by the state budget.

Practically, the state cannot provide for full VAT payment to the budget by suppliers and companies prior to them in the technological chains. It can be explained by a great number of the participants and complication of the export chains structure. There are firms that have benefits, represent arrears increase, or rearrange debts or front one-day-companies, on which taxed base is transferred by transfer pricing and money in these firms is simply withdrawn in cash or transferred to other companies through promissory notes. The above-mentioned companies can comprise components of such chain. As a result, amounts of reimbursement from the budget exceed VAT amounts paid to the budget at all stages of goods export.

Statistics of crimes, which are disclosed by the law enforcement authorities shows that in some cases the illegal VAT reimbursement in export transactions reaches 0, 6 billion of UAH (0, 113 billion of USD).

The general scheme of «carousel» type includes money receipt by an exporter from a nonresident-importer; break of transactions «chain» in the scheme at the moment of money transferring to the importer; introduction of nonresident's money for further «slew» **(Figure 3).** In other words, payments sent abroad can be repeatedly returned to the country by nonresidents.

According to the legislation, for the subject of agreement (goods/service) zero rate of VAT is envisaged (so that reimbursement from the state budget is used) and the second part of the scheme is «masked». In the process of money transferring from an exporter to an importer all paper evidences are destroyed (false contracts, customs documents etc).

With the purpose of illegal VAT receipt, dirty funds are slewed through converting centers (a number of fictitious enterprises). Funds are deposited to the account of fictitious firm. A bank uses funds to buy currency ordered by a firm allegedly for goods payment, which should come from abroad under fictitious agreement with a foreign firm. Caring out foreign economic transactions (products export) criminals prefer foreign contractors from

the offshore zones, concluding agreements on considerably different prices, comparing to other countries.

For funds transmission from an «exporter» to an «importer» transactions with securities are often used, including payable to bearer securities. In this way «break of the chain» of the documentary confirmed transactions is provided in the scheme.

In case of real import, scheme organizers would be forced to pay VAT and customs duties and, as a result, they would meet a loss. Therefore, the key point is the absence of actual import, which is accompanied by forgery of documents.

To reimburse VAT criminals apply several ways of money transferring:

- under contract on pre-pays without further goods delivery;
- allegedly for goods delivery (false customs declaration granting);
- allegedly for services (internet sites development, marketing services, etc.)

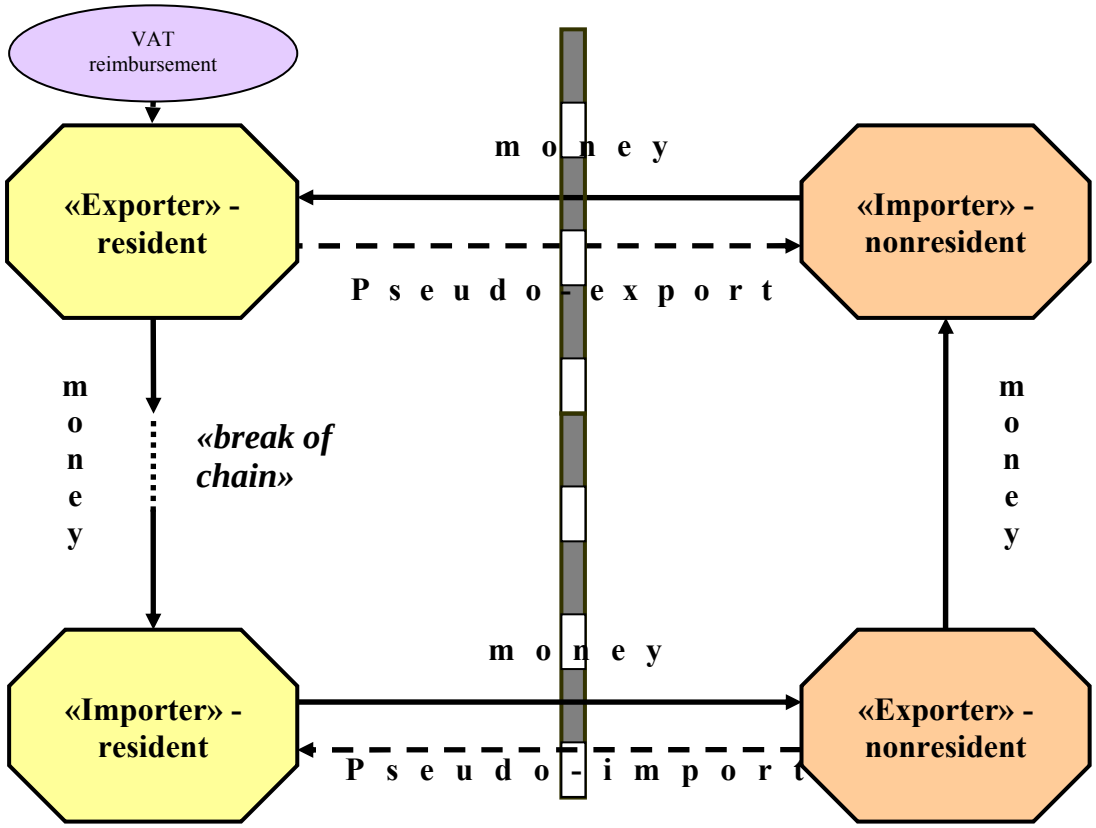

Figure 3

Type of the scheme - creation of artificial tax credit by overcharge.

One of the modifications of VAT fraud is practically similar scheme, which is realized within the borders of the country. In this case, instead of export purchase at overcharge that gives the right for tax credit takes place. For groundless tax reimbursement front firm (or group of firms – the «converting center») are participating in the scheme. Having completed transactions they disappear with all documents. Low technological goods or even scrap-metal are products exported at higher than world prices.

There is a variation of export machinations at overcharge. These machinations include repeated export transactions (directly or concluding treaties of commission) conducted with the same products which under documents are marked as hi-tech equipment (automated alarm systems, etc.) but, in fact, these objects are of little value or they belong to the obsolete equipment. In other words, firstly, the export of hi-tech equipment (automated alarm systems, lines of juices extraction, etc.) is documented under the guise of low-priced goods. Secondly, either the obsolete equipment or materials (fuel oil, armature, rolled metal) are exported considerably overcharged.

The next type is the application of scheme with price increase at the expense of the cost value of fictitious production (for example, receipt of spare parts from fictitious firms), when the enterprise – producer is announced to be a bankrupt and is liquidated before export transactions start. As a result of transactions VAT is directly reimbursed and during import transactions examination through promissory note is conducted.

Example. According to CCD the enterprise exports different kinds of equipment. The invoice cost of goods reaches huge amounts, groundless both from economic and market point of view.

Practically the scheme is implemented using bank instruments. One and the same bank operates all basic payments. It gives credits, issues securities (transactions on credits opening and covering, transactions with bank securities is an integral part of financial mechanism) and provides currency payments. Only insignificant part of transactions that is, as a rule, equal to the sum of illegal income, becomes separated and is carried out by a bank–partner.

All payments in the chain are made very quickly, usually, within a day. This mechanism is controlled by one and the same bank-operator. This activity has a systematic character and, in fact, is a kind of bank service provided.

Using this scheme exported goods return to Ukraine with prices considerably lower compare to export ones. Later on goods are legalized at overestimated price through fictitious and transit companies and are used in the re-export scheme.

Criminal proceeds are converted into cash and distributed among participants of the scheme. The surplus is transferred to the account of the foreign importer and then is returned as the official export profit.

In all cases foreign economic agreements were concluded with the Russian Federation enterprises which are established by “related” people or bank officials. Actually, the goods are shipped to the address of enterprises from The Great Britain, Cyprus, Latvia that complicates check-up of real export and further transition of goods. Besides, this gives a possibility either to “loose” goods or to return them to Ukraine at the cost of import (at minimum price) to provide the following cycle of export transactions.

Currency revenues from abroad for export transactions are provided by means of pseudo import transactions according to fictitious foreign economic agreements and CCD. For this purpose with a help of bank-operator fictitious enterprises are. As a result, the necessary amount of currency comes to the addresses of Russian enterprises. This money is further used for payments for equipment.

The main users of these mechanisms are enterprises, which constantly import goods (mostly – raw materials). The abovementioned transactions allow to discharge obligations concerning the payment of "import" VAT by means of established tax credit.

Thus, the main typical characteristics of agreements, which are a part of described schemes, are as follows:

- cyclic recurrence of one-type transactions, which are carried out among the participants of the scheme;
- use of fictitious or false contracts as a ground for transactions;
- short terms of payment (often within one day);
- first confirmation of supply by different companies which are involved into the scheme, is documented within a day;
- participation of fictitious firms ("shell-firms") in the scheme, namely: absence of information on actual activity of the enterprise in the country of registration; failure to determine physical location; obvious discrepancy between the turnover on the accounts of the company and the sums of tax payments, which are paid; combination in one person of company founder, director and chief accountant duties;
- use of off-shore companies and off-shore jurisdictions in the schemes of illegal VAT reimbursement;
- settlement accounts of a supplier and a buyer are in the same bank;
- payments of a nonresident buyer for exported goods are carried out from the account of a bank-resident;
- no economic effect from payments for transactions with promissory notes, bearer securities, which are included into the scheme;
- counterfeit of goods import.

Within the frames of the scheme of this type, the following financial transactions can arouse **suspicion**:

- receipt of bank credit or loans from a legal person in the amount of VAT reimbursement (initial scheme financing);
- discrepancy between the cost of goods or services envisaged by a contract and their real value;
- inconsistency in the export/import cost of goods at the customs of different countries;
- obvious discrepancy between grounds of incoming/outgoing payments within the frames of a single production cycle simulated by the scheme;
- passing of one and the same sum through the accounts of numerous scheme participants within a banking day;
- demand (for the first time) of VAT reimbursement by the company which has partners-enterprises with unknown address of registration;
- subject of an agreement is "popular" among tax swindlers goods (software, optics, plastic dies, etc.).

4. Transactions with nonresidents registered in offshore zones

Foreign economic transactions with the attraction of offshore zones is the area of increased risk which requires special attention of the state authorities. Nowadays financial transactions in offshore zones are very popular. For example, some services of offshore banks are very inviting. They can freely manipulate with their capitals and pay interests to their clients not being involved into tax schemes.

Note. *The number of countries in the world that can be referred to offshore zones reaches almost five dozens. These are states where the legislation allows registration and operation of International Business Companies. Besides, there are countries that legally are not offshore ones but their local legislation gives the possibility to save 3-5 % in tax payments. Taking into account the pace of offshore zones expansion and disappearing, their registration is quite relative.*

The ideal model of the offshore activity does not envisage any criminal or illegal actions but really helps to lessen (but not absolutely avoid) the burden of taxes. Other advantages of such zones include free outflow of profit, soft currency regulations, and favorable conditions for foreign investors. Financial stability of the offshore zones and confidentiality of investments (identity of firm owners is not divulged, the registration procedure is considerably simplified) are also very attractive for businessmen and financial "dealers". The confidentiality of investments can be violated only in case of criminal prosecution of the investor and sometimes it is inviolable (in some offshore zones shares are emitted "to bearer").

The governments of many countries put the defined offshore jurisdictions to the so-called "black lists". The "black list" of the Cabinet of Ministers of Ukraine contains practically all classic offshore zones. Regardless of the fact that the Cabinet of Ministers of Ukraine annually updates and promulgates the list (with nearly 40 jurisdictions in it[15]), as a rule, 5-7 territories which are typically offshore ones avoid being included into this list. Besides, there are countries, which are not offshore by definition. With these countries Ukraine has conventions on non-admission of double taxation. Using special schemes and working through these countries there is a possibility to reduce taxes to the minimum.

Every year nearly 3-4 offshore zones disappear in the world and the same amount disappears. This gives room for realization of crime proceeds legalization schemes as the government can not respond to these changes so fast. Today one of the most serious problems is offshore zones (anonymous investors who do not have any responsibility in particular) that can be registered in Europe and the USA.

In money turnover offshore zone is the main filter where crime proceeds are laundered. On the next stage of legalization funds are directed to the offshore zones (in cash, bank remittances or securities). Later on the offshore banks with the help of electronic payment systems transfer money to other countries. They return to the home country or come to the countries with high bank confidentiality (for example, Switzerland, Singapore)

[15] As for April 01, 2005 – 38 territories were put into the list if offshore zones (Resolution of the Cabinet of Ministers of Ukraine №77-p).

for further «laundering». Besides, offshore zones are used for illegal commodity transactions (including fictitious ones).

For foreign economic transactions with the attraction of offshore zones enterprises use technologies and fraudulent schemes which allow to control prices in foreign economic activity, accumulate and use capital, plan and minimize taxes, to carry out illegal VAT reimbursement, and legalize criminal proceeds.

Financial transactions on transferring funds of the institutions of any form of property (including state-owned) to the accounts of fictitious enterprises with their further outflow abroad through the offshore companies are the most widespread and dangerous for the state.

Taking into account considerable volumes of goods export through offshore intermediaries, Ukraine does not receive large amounts of funds from the real cost of goods which remain on the accounts in offshore countries. According to the Ministry of Economy, in the period of January – June 2005 the supplies of goods to the offshore zones reduced by 34, 4 % compare to the last year. As well as in recent years, the largest supplies were carried out to the British Virgin Islands and Panama[16]. The study of the export structure through the offshore zones shows that it has highly liquid goods, namely, oil products, sunflower-seed oil, chemicals etc. Concerning the price range of the majority of goods, export reaches the average level according to which supplies to Ukraine were carried out.

The analysis of modern tendencies proves that the crime proceeds laundering schemes have become more complicated. If earlier offshore companies appeared to be the direct owners of Ukrainian enterprises, today European firms-intermediaries are involved into the chain Ukrainian enterprise – offshore company. Thus, with the purpose of legalization criminals transfer crime proceeds to the offshore jurisdiction, for example, to Hong-Kong. The Hong-Kong company retransfers money to the Dutch holding company which, in its turn, invests Ukrainian enterprise. Besides, nowadays there are offshore structures registration schemes which do not include two essential characteristics of referring them to the offshore structures, such as addresses of the company and the bank-operator. It makes possible for the company-nonresident (“offshore”) to appeal to the court.

The general characteristics of the crime proceeds legalization «offshore schemes» are as follows:

- use of fictitious or false contracts with offshore companies as the basic documents for international transactions;
- carrying out of transactions to the accounts of offshore companies in the third county;
- minimal terms of residence of the transferred funds on the accounts of offshore companies in the country of their registration or in the third country;
- further movement of funds by means of their distribution among different jurisdictions;
- availability of offshore companies accounts for credit organizations of international financial centers;

[16] From April 01, 20.05 Resolution of the Cabinet of Ministers of Ukraine No. 82-p excluded Panama from the list of offshore zones.

- reoccurrence of similar components of electronic transfers schemes;
- involvement of more than one offshore company into the scheme of inter-payments;
- payments by the companies residents from their accounts in offshore jurisdictions;
- participation of front company-resident in the financial transaction scheme on the account of which crime proceeds are put initially;
- availability of the account of natural person – owner of crime proceeds in the foreign bank in the country with high international reputation.

The **signs of suspiciousness** of financial transactions with offshore natural persons and territories are as follows:

- the subject of the contract (services, other results of intellectual activities) can not be objectively identified by the supervisory authorities;
- credit / loan from the offshore company or from the account in the offshore jurisdiction at interest rate, which sufficiently differs from interest rates in internal and external market, and return of the credit/loan;
- obvious discrepancy between the cost of goods or services mentioned in the contract and their real cost;
- obvious discrepancy between grounds for incoming and outgoing payments (money for construction works, for example, are all spent on payment of consulting services);
- too many grounds for payments to one account (for different kinds of commodities or services);
- transaction to the account of offshore company which is not the party of the contract;
- repeated transferring of large, equal in volume sums of money;
- use, at least, of one account of affiliated with organizer offshore company scheme, which is opened in so called "transit" bank of the third country on the territory, which does not have the offshore jurisdiction status.
- availability of one or two «amiable» companies-nonresidents, which have accounts in banks on the territory of countries with high international reputation (financial centers).

Thus, there are several major **ways of offshore zones involvement** into the money laundering schemes:

1. Direct involvement

It concerns attraction of the offshore zone which is not included into the Cabinet of Ministers of Ukraine "black list". There is a real possibility of registration of the controlled offshore companies in the states, which are not determined by the Resolutions of the Cabinet of Ministers of Ukraine and the Directives of the National Bank of Ukraine as offshore zones (for example, in Montenegro). In this case, all information on founders, statutory documents, activity, and commodity turnover of enterprise is confidential.

2. Participation of the intermediary from the non-offshore country

If the firm does not want to change offshore partner very often it is enough to add one more intermediary. That is to add an agent firm from "non-offshore" country to the offshore company - Ukrainian firm scheme. The most suitable countries for such a company are Great Britain and Czech Republic. The legislation of these countries permits to conclude direct contract with offshore company without tax increase.

3. Offshore company masking.

Opening of an account in the non-offshore country and acquiring "corporative office" there helps to mask offshore company. In this case, the firm works in the non-offshore country virtually. This is cheaper than the registration of a new offshore company. Besides, since the list of the Cabinet of Ministers of Ukraine is updated once a year, there is a threat that newly registered offshore is to be abandoned in several months.

For example, an offshore company uses address of the bank (as agreed) which is registered in the non-offshore zone. The change of the address of the firm itself becomes possible with the help of the institutions that provide for services of domiciliation of legal persons. Money is transferred to Ukraine through European bank-intermediary and bank commission is considered to be a payment for business security.

General "offshore" scheme (Figure 4).

A person-resident of Ukraine transfers money received from foreign economic transactions to the offshore company (or to the non-offshore company which account is in the offshore zone). Then funds are "slewed" abroad ("break of the transaction chain"). The received income, as well as, the "pure" money can remain abroad or fully or partially return to Ukraine through foreign economic agreements (under the guise of commodity contracts, investments etc.).

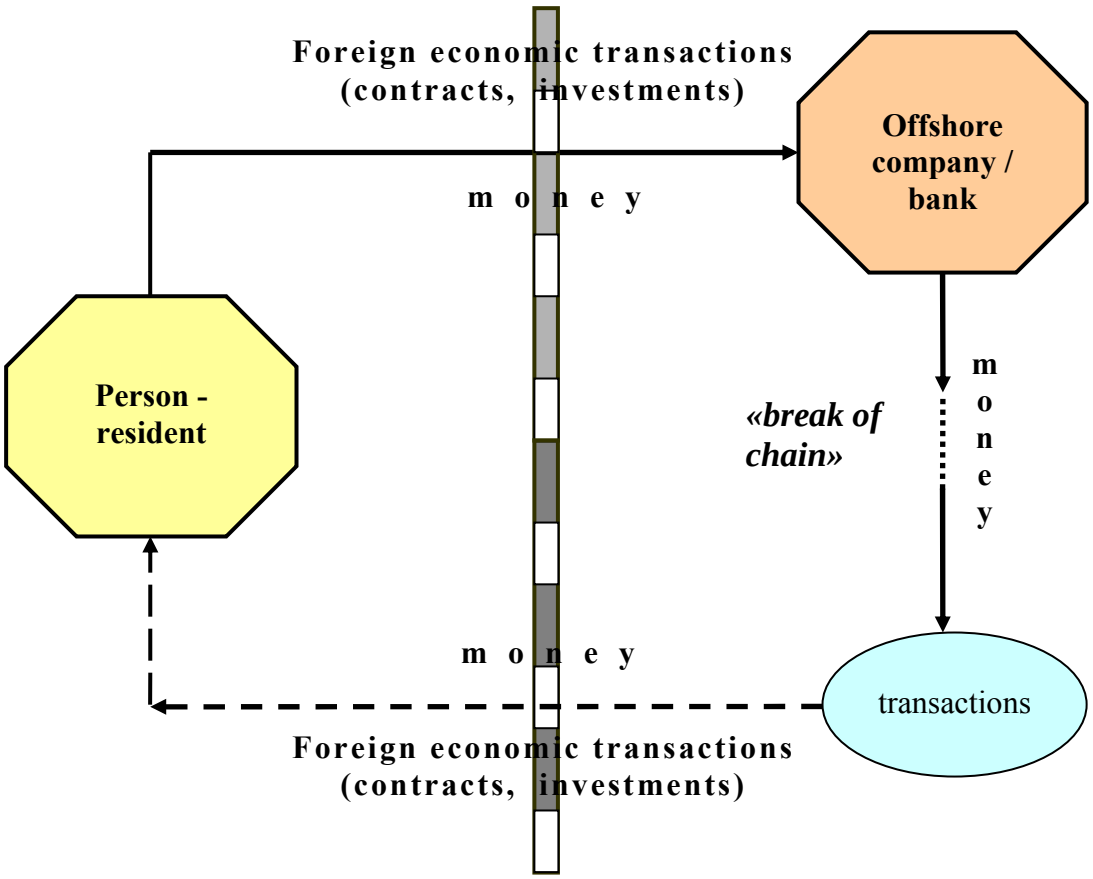

Figure 4

Proceeding from the aim of money laundering, the following **variants of offshore use** in criminal schemes are possible:

1. Manipulation with export and import prices.

The domestic enterprises sell goods to the offshore intermediary at reduced export prices with further their sale by offshore company at world pieces. As a rule, these goods belong to the "seller". The difference in prices is transferred to the controlled accounts of people involved.

2. Use of bank crediting scheme.

For example, a bank gives credits to the residents of Ukraine for them to carry out advance payments according to the foreign economic contracts. Further these funds are transferred to the accounts of nonresidents in the offshore banks. According to the legislation, this money returns to a Ukrainian bank in 90 days as the firm nonresident didn't meet the requirements of the agreement. Although, during this period of time credit funds of a Ukrainian bank are used in the commercial activity of the offshore structures and the income remains abroad.

3. Partial or 100% advanced payment to the accounts of the offshore commercial structures.

Foreign economic agreements on goods or services are concluded with the offshore commercial structures but the domestic customers do not receive these goods or services.

4.Credits from the offshore companies.

Interests for the credits usage go to the accounts of foreign firms by means of intellectual property (patents, trade marks, programs etc.) registration in the offshore zones. Later on these funds are transferred to the offshore companies as a payment for the usage of the above-mentioned property.

5. Securities transactions.

The capital is transferred to the accounts of the controlled offshore firms using mechanisms of securities purchase from the controlled Ukrainian entrepreneurs. The securities are bought at low prices, as a rule, at their nominal value according to the evaluation taking into account the residual cost in the process of shares issue or privatization or they can be bought at lower than nominal prices. Further, these securities are sold to another Ukrainian firm at the prices which are considerably higher compare to the previous sale. The difference goes to the accounts of foreign banks. Later on, these funds return to the Ukrainian economy in the form of investments, contributions to the statutory funds of domestic enterprises, etc.

Example. [17] A Ukrainian bank received foreign currency with the purpose of payment as "renewal of account by resident". This money came to the settlement account of nonresident investor (registered on the British Virgin Islands). The same day transaction on the sale of foreign currency was carried out. As the result, funds in the national currency of Ukraine were transferred to the account of the nonresident-investor. After that, all funds from the account of the nonresident-investor were spent on share purchase and contributions to the statutory funds of Ukrainian companies (securities traders). These companies, in their turn, established consortium the statutory fund of which is formed at the expense of the same funds of the nonresident-investor. The consortium, which was actually under control of the nonresident-investor (with the help of certain Ukrainian companies), took part in the tender on privatization of Ukrainian enterprise, which has a strategic significance for the economy of Ukraine. According to the tender rules, any offshore company could not be accepted for participation directly.

[17] According to the materials of the SCFM of Ukraine.

5. Transactions with securities

The securities market is an attractive mechanism to launder crime proceeds because it is characterized by variety and simplicity of sale conditions (for example, electronic bidding) and by possibility to carry out transactions without paying attention to geographical limitations.

Illegal funds which are laundered through the securities market can be formed both out of sector and within its framework. For criminal funds formed out of sector, movement of securities or establishment of legal entities is used as a mechanism to mask sources of these funds. In the course of criminal actions within the sector, such as manipulations with shares, appropriation, use of confidential information to one's advantage, funds received by criminals should further be legalized. In both cases securities market gives double possibility to a criminal: to legalize criminal capital and to receive additional income from its use. Regardless of cash acceptance limitations, brokers accept it, violating rules prescribed by law.

A criminal may need some help from market professional, that's why proceeding from volumes of financial resources accessible to criminal groups, there is a risk of corrupt relations aimed at introduction of criminals into the market. At the same time broker's confidence in client's respectability estimated by other broker, financial institution, or part that directed client's funds for investment can become a serious hazard.

Securities can be used to "break the chain" of transactions in the scheme of legalization aimed at masking traces of illegal transactions, change of securities owners, physical movement of funds, converting into cash. Use of securities to bearer to launder funds through external economic (export – import, investment) transactions, including "carousel schemes", accompanied by illegal VAT compensation from budget present special threats.

According to the State Commission on Securities and Stock Market, general level of transactions with securities by nonresidents increased in 2005. In particular, in the 1st quarter of 2005 negative balance of securities purchase and sale transactions by nonresidents was observed, which testifies the presence of some tendency in capital outflow out of Ukrainian borders through financial instruments.

Typical characteristics of crime proceeds legalization on securities market are as follows:

- purchase by domestic (fictitious, as a rule) enterprises under agreements commissions of share holdings (often non-liquid) of Ukrainian entities of entrepreneurial activity from firms-nonresidents at prices higher than their market value;
- purchase of liquid shares of Ukrainian enterprises by residents through enterprises registered in offshore zones, other countries and territories with simplified system of registration or privileged taxation;
- regular conclusion of terminal contracts by an enterprise or use of other derivative financial instruments (options, futures, forwards) which do not envisage supply of basic assets under transactions with one or several contractors. It results in permanent incomes or permanent losses of this enterprise during considerable period of time;

- single sale/purchase by a enterprise of a large securities book which do not freely turnover in organized market at prices substantially different from market prices (at that an enterprise is not a professional participant of securities market and securities are not passed to him to discharge contractor's unsettled debt);

- purchase of shares of enterprises (in particular industrial ones) as well as blocking share holdings of privatized enterprises, which remained in the state property, with transfer of these shares at the disposal of structures under control; securities acquisition from investment companies;

- conclusion of agreements by an enterprise with the same party concerning purchase and sale of the same securities.

Most typical variants of illegal capital export abroad by means of purchase-sale of Ukrainian issuers' securities by nonresidents:

1. <u>Shares Transactions.</u>

A person purchases shares at a very low price and sells them to its authorized delegates at price several hundreds or thousands times higher than their real value (directly or through brokers).

Scheme. Ukrainian enterprises within the framework of agreements-commissions purchase share holdings of Ukrainian enterprises from nonresident firms at prices considerably higher than their market value. It enables to groundlessly export considerable amounts of currency abroad with further obtaining "laundered" crime proceeds outside the country. As a rule, fictitious enterprises are involved in such schemes, which carry out further securities purchase at final payment. Moreover the considerable part of funds is transferred from Ukraine by means of off-shore companies. Complete support by banking institution which provides all calculations spectrum during carrying out of transactions (from giving credits, collateral acceptance and issuing bills for obtaining and converting currency abroad) is obligatory condition for operation.

One of variants of the mentioned scheme is special issue of shares.

Scheme. With swindle purposes, for artificial overstating («pumping») of securities value of any issuer, a company is created or purchased. The price of its shares of is gradually «blown up» by means of fictitious agreements on stock exchange which covers laundering of «dirty» money. After that, shares are sold not only to participants of the scheme for further laundering, but also to outside investors which invest money in «promising» shares. Some time later, the company transfers all money abroad (in an offshore country, as a rule) and reports about the bankruptcy or just disappears.

Example 1. A resident of Ukraine purchases shares of a domestic enterprise, as a rule – non-liquid securities, thus it is possible to purchase them at low price. Later, shares at the same low price are sold to a nonresident of Ukraine, as a rule — an offshore company. The first nonresident sells the mentioned shares at the same price to other nonresident (most of all also offshore company). After that, this (second) nonresident sells shares to the Ukrainian enterprise at price ten times higher than the initial price. The volume of capital export approximately equals to the difference between the last contract between nonresident and resident of Ukraine (high shares price) and the first agreement (low shares price).

Example 2.[18] To form statutory funds of enterprises the non-liquid shares are used (estimated many times higher than the purchase price). The new registered issue of shares can be used for different transactions, including forming of statutory funds of other business entities at face value or higher. The mentioned scheme, first of all, can be used for expenditures minimization to create fictitious enterprise which can be used in fictitious or illegal business activity schemes. Also, direct money laundering is possible by way of share issue distribution among uninformed investors.

Example 3.[19] A group of Ukrainian enterprises used the classic scheme of money laundering using securities. Two Latvian citizens bought up «trash» securities (shares) at very low price (with payment postponement) and then sold them overpriced to the group participants. These transactions were not manipulations at the stock market, because the mentioned securities did not turnover in the organized market.

Ukrainian norms of currency regulation determined certain conditions for funds transfer abroad. One of the «easiest» ways to transfer funds abroad is to add funds to an account in a foreign bank by nonresident (least amount of documents is required).

Thus, gentleman from Latvia transferred 211 million USD from Ukrainian banks to allegedly their own accounts in Latvian banks. The funds origin was explained as reimbursement of investments. In fact, the investments were not directed to Ukraine.

The mentioned accounts did not belong to Latvians. They were managers only, and the real owners were two companies registered in the USA. The first company was under investigation of DEA (Drug Enforcement Administration, USA), another one actively participated in other schemes related to illegal VAT reimbursement from the State Budget of Ukraine and promissory notes machinations.

Example 4.[20] Insurance company officials systematically carried out transactions using securities to bearer, which were not placed in depositaries. Violating current legislation, these persons on the basis of securities exchange contract purchased deposit certificates of a bank in amount over 4 million UAH. At that, the report on execution of financial transaction was not provided to SCFM of Ukraine, which is an obligatory condition for some entities (banks, stock and commodity exchanges, gambling institutions, insurance companies etc). Moreover, insurers concluded contracts on purchase-sale of shares of an enterprise, issued in simple document form in amount over 1 million UAH, and also did not report the authority.

*Note**.** Under the facts of detected violations the prosecution bodies initiated a criminal case under Article 209-1 of the Criminal Code of Ukraine, which envisages a large fine or imprisonment up to two years. According to the same Article criminal proceedings shall be instituted against officials of both banks. The employees of one of them gave out funds in total amount of 130,000 USD to a private person and did not reported to the SCFM of Ukraine. The other bank acted similar, it gave out 15 millions, and then 8 million UAH to the same person.*

[18] According to the State Stock Market and Securities Commission.

[19] According to the SCFM of Ukraine.

[20] According to the Ministry of Interior Department in Donetsk Oblast.

Securities to bearer are actively used in illegal schemes to convert funds into cash. Saving depositaries and promissory notes with blanket endorsement allow to complicate and hide effectively the mechanism of masking tracks of documents since the moment they were received and to provide anonymity of getting profits.

3. <u>Saving certificates transactions.</u>

Scheme. A fictitious firm aimed at converting funds into cash purchases saving certificates on bearer from a bank. (Such activity usually continues for several months). Since certificates transactions raise detection risk, the support of bank employees is necessary for effective realization of such scheme. Connection with bank employees enables not only quick carrying out of transactions but also using preventive measures in good time to avoid additional interest of supervisory bodies. Certificates are given to a natural front person who presents them for payment at bank cash desk. On final stage, the cash obtained is passed to the «clients».

4. <u>Promissory notes transactions.</u>

Scheme. An owner of dirty funds makes out a promissory note with blanket endorsement to pay for some commodity or service from firm A; often such firm is one-day firm.

Paragraph 1.2 of the Statute on the Procedure of carrying out of promissory notes transactions by banks in national currency on the territory of Ukraine, ratified by Resolution of the NBU Board as of 16.12.2002 # 508, determines: «blanket bill endorsement is the form of promissory note transmission, under which natural or legal person, passing the promissory note, affixes signature without indicating person which becomes the owner of promissory note. The promissory note becomes bearer security».

During certain transactions (counterfeiting of accounting and payment documents is possible) firm B obtains this promissory note. Firm B presents it for payment to the owner and obtains legalized funds. For instance, a promissory note can be passed to a firm employee, who will get funds on it, presenting forged or stolen passport.

Addressed bill also can be used in the schemes, as a mortgage for obtaining available credit by a natural person in a bank or pawn-shop. Also, a nonresident who presents for payment the promissory note addressed by a bank can participate in the scheme. Addressed promissory note is convenient, because its use raises transactions safety; however, additional co-operation with the bank multiplies the terms of their execution, that is why they often use the not addressed promissory notes for laundering.

Note. *Experience of Russian Federation is a striking example of counteraction to the «promissory note schemes», where the bills schemes are actively used for cash obtaining transactions. Statistics indicates that the promissory notes of Saving Bank of Russian Federation (the largest issuer of promissory notes on bearer) turned out as most popular with criminals. For instance, on the territory of Republic of Tatarstan the majority of forged bills transactions was carried out with bills of Saving Bank of Russian Federation (totally forged or with overpriced face value). To counteract the problem appeared, Saving Bank of Russian Federation interrupted issue of promissory notes on bearer in October 2005. Instead, promissory notes will be issued with the monthly retire term, that is getting money*

after such promissory note will be possible only 30 days after issue. Other banks of the country are joining such innovations («Vneshtorgbank», «Yuniastrum Bank»).

Example.[21] Ukrainian enterprises resold promissory notes (the first contract was very «cheap», the last one was very «expensive») and legalized proceeds from securities sale. Companies had the same address and were registered using forged documents. Dirty funds were distributed within the criminal group. Basic ways of further «laundering» of funds were as follows.

An American firm G concludes with an American firm H a contract on purchase and sale of farming equipment in amount of USD 37 million. At the same time, Ukrainian legal person (from a group that carries out promissory notes schemes) stood as guarantor for execution of the contract. Firm J (USA) contributes money to the statutory fund of firm D. The amount is similar to the contract on farming equipment – USD **37 million**. At the same time, firm H does not deliver equipment. And firm D pays USD 37 million under the contract of guarantee, and also pays similar amount to the firm J in form of foreign investments reimbursement.

American companies H and J had addresses in Belgium and Great Britain correspondingly. However, the same person was their registrar. In addition, the companies had the same founders – two companies from Belize and Niue.

[21] According to the SCFM of Ukraine.

6. *Transactions on converting funds into cash*

The schemes of illegal converting funds into cash are very attractive for criminals. Except money, a lot of different goods and properties are involved into a shadow turnover. Money from their selling is accumulated in the shadow sector and supplement illegal money supply.

As a rule, the so-called converting centers deal with transactions designed to develop the system of shadow assets turnover. These centers belong to the financial structures which have strictly defined powers and duties. They operate within banks or involving bank employees and have the network of fictitious enterprises and currency exchange offices.

Practically all shadow financial flows go through illegal banks and the law enforcement bodies fail to obtain information on them because of the legislative limitations. The participants of such centers carry out illegal activity under the disguise of legal business.

As a rule, transactions on converting funds into cash are an indispensable part of the crime proceeds legalization process. Criminals use the services of converting centers to exchange non-cash national currency into cash or into the currency of highly developed foreign countries.

Transactions of a well-organized converting center are sufficiently protected from the control of law enforcement bodies. In case of interest to the accounts of firms-participants of converting center, assets are transferred to the accounts of the fore-organized reserve firms. There can be several reserve firms. It helps to gain time and finally hide the money.

The instruments of crime proceeds conversion:

1. Use of fictitious firms.

The enterprises - clients of a "converting" center transfer the non-cash funds to the accounts of numerous fictitious firms registered by this center. They pretend to have business relations, forge contracts, documents for funds accounting and charges confirmations and, accordingly, the subject of funds transfer (commodity deliveries, services).

2. Use of the foreign banks accounts.

Organized criminal groups actively provide services on opening accounts in foreign banks. These accounts can be used both for conversion transactions and for illegal financial transactions connected with concealing of currency earning, crime proceeds legalization, etc. These banks and the representative offices of the companies are often located in the Baltic countries.

3. Falsification of foreign economic activity.

The schemes with the use of fictitious foreign economic activity of specially created enterprises have become popular among the methods of illegal conversion. Very often, these firms are registered in the offshore zones. The criminals continue to develop and improve the schemes of illegal financial transactions after the conversion of funds into cash (and transfer abroad) using loro accounts was suspended (by the Resolution of NBU # 209, April 25, 2000).

4. Use of the front natural persons (including their settlement accounts).

Using the “bank - client” system while operating accounts money can be transferred to the accounts of natural persons for quasi-provided goods (services, work, etc). The settlement accounts for front natural persons are opened under false documents with the help of persons under control. Former criminals and drug addicts are usually involved into the “conversion” schemes. The same categories of people, as well, as the lost passports are used for registration of firms which also comprise a part of the schemes. Plastic charge cards and ATMs are very popular in cash transactions as well.

The transfer of assets to the accounts of natural persons with their further conversion into cash or withdrawal of cash by legal persons as a payment for purchase and sale agreement (often purchase of agricultural goods) is the **characteristic feature** of these schemes. In general, a lot of participants - from several dozens to several hundreds - are involved to ensure these schemes operation.

The general scheme of converting centers use can be as following **(Figure 6).**

An X-firm wishes to convert non-cash «dirty» money into cash. For this purpose it transfers money to the account of a buffer firm and receives the documentary confirmation on services or works provided (invoices). The buffer firm conducts similar transaction with a «black» firm. To find the grounds for the money transfer to the accounts of fictitious firms the transactions are being forged (as a rule, they are non-commodity transactions – marketing and consulting services etc.). Then a «black» firm purchases goods from a producer or a wholesaler and sells them. After this, the firm disappears and the trader, which purchases goods, passes cash to an X-firm.

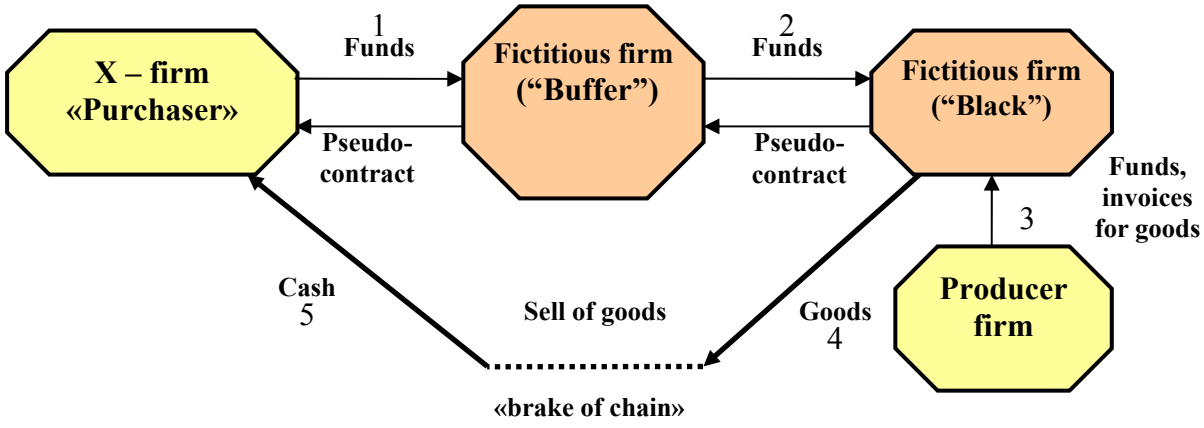

Figure 6

Bank transactions are **one of the most common ways** of money conversion.

In this case, a “black” firm transfers money to the accounts of natural persons as the gratuitous financial help (or money for the fictitiously provided goods, services, or work). These accounts are opened with lost passports or passports of homeless people or false certificates of authority. As soon as money come, a courier immediately draws it out and further money is forwarded to an X-firm. Goods are purchased from an illegal producer by

cash, afterwards they are sold. The services of illegal conversion of UAH cash into hard currency (with further transfer to the foreign banks accounts) are also provided for the clients of the converting centers.

Example. Two fictitious enterprises simultaneously open their accounts in a bank. The first enterprise (enterprise A), with the help of the converting centers, gives its requisites to the clients who wish to convert their funds into cash. The requisites and any information on the second one (enterprise B) are confidential.

Assets from the clients, which daily come to the settlement account of enterprise A, go to the account of enterprise B by means of internal bank transactions, which is proved by the corresponding documents. These funds stay on this account till the end of the banking day or to the moment of their transferring to another bank. As the assets must be transferred from the account of enterprise A, they return to its account at the last moment.

At the end of the banking day, or when the funds leave the bank, the internal bank documents on coming the funds to the account of enterprise B are destroyed and such transaction is reflected nowhere. In case of the account seizure of enterprise A by the law enforcement authorities, the latter receive documents, which prove that funds came to the account of enterprise D. While the decision to seize the account of enterprise B is not made, funds leave the bank from the account of this firm. New taking to the account of enterprise A is forwarded back to the payers.

In order to get cash in foreign currency the scheme becomes more complicated. In this case, **fictitious export-import transactions** are necessary.

Scheme. A buffer takes non-cash payments from a firm, which wishes to get cash. The Baltic countries are the most attractive for this kind of transactions. Further, the funds are transferred to the account of the fictitious firm-importer, which concluded a foreign economic agreement with a fictitious Baltic exporter. The Ukrainian bank owner of the converting center (the actual owner of a number of firms: buffers, fictitious exporters and importers) under the disguise of foreign economic contract purchases non-cash US dollars on the inter-bank currency exchange which are further transferred to the account of a fictitious exporter. The exporter, in its turn, transfers money to the account of a fictitious importer. Finally, the non-cash US dollars return to the account of the fictitious exporter.

Example 1. Enterprises, which wish to convert their funds into cash, carry out payments to the address of a fictitious firm, which has the opened currency account. This firm through the authorized bank purchases currency on the inter-bank currency exchange which is allegedly needed to fulfill the foreign economic agreement (import of consumer goods, as a rule). The bank purchases currency by the order of the client and transfers funds abroad to the account known. However, goods, envisaged by the agreement, do not come to Ukraine or they are smuggled. The UAH supply got from the selling of these goods is also converted. The average operation term of a fictitious firm is up to three months (while tax authorities impose sanctions on the overdue foreign economic agreement) The turnover makes on average UAH 20-30 million per month.

Example 2. [22] The offices of the converting center, where the employees of the center with the help of computers and the "bank-client" system of modem communication traced flow of assets to the bank accounts, carried out machinations abroad and drew up documents of the fictitious enterprises. The scheme-makers registered enterprises using false and lost documents and opened accounts for these firms in two banks of Kiev. Money was transferred by businessmen to the settlement accounts of the fictitious enterprises under the contracts accompanied by false invoices. There were more than thirty of this kind of firms.

The funds were converted into US dollars, Euro and UAH and then, with the assigned interest for conversion services, they were appropriated by the heads of the customer-enterprises. The daily assets turnover of the center reached more than a million of UAH. The center consisted of 24 fictitious enterprises. With the help of the criminal investigation by the law enforces over 1 million of UAH was returned from the shadow turnover and arrested on bank accounts.

Note. *The investigation continues to examine the evidences of the criminal group illegal activity, determine number of fictitious structures and is trying to find people the documents of whom were used for the firms registration. The criminal complaint against the "converter" will be lodged on two Articles of the Criminal Code of Ukraine - on fictitious entrepreneurship and legalization (laundering) of the crime proceeds and property (Articles 205, 209).*

[22] According to the information of press center of Kiev Department of Security Service of Ukraine.

7. Reinsurance transactions

Insurance can be used to fulfill absolutely legal tasks: to decrease tax burden (due to difference of taxation in insurance and real sectors)[23].

Ukrainian insurance market undergoes process of establishment (in terms of legislative regulation, taxation system and financial potential). Insufficient capitalization of insurance market is the problem of money shortage in the country. Thus, use of foreign reinsurance is a logical choice and a necessary condition to guarantee financial stability and growth of national insurance system. Cover-not is signed between an insurer and a re-insurer when a part of risk is assigned to reinsurance. The document stipulates the sum of responsibility (sum insured) and reinsurance payment.

On the other hand, a great number of illegal schemes of overseas money transfers are connected to reinsurance. For example, financial risks insurance is an ideal instrument for money laundering. Often, the risk of abuses rises when dealing with non-resident reinsurance companies which do not have Standart&Poors or MOODY' rating.

Reinsurance is almost an ideal method to reimburse damages through redistribution of insurance reserves (primary insurance fund). An insurance company submits to one or more re-insurers a part of risk that exceeds its financial potential, as well as provides acceptable homogeneity of risks and balanced insurance portfolio.[24]

Imperfection of legislation allows one-day companies to function during only one quarter. They are used to make considerable overseas payments and are immediately closed. License null, another «transit» company is bought (for example, fictitious structures in Chornobyl area).

The results of researches made by the State Commission for Regulation of Financial Services Market of Ukraine in 2003 shows that no more than 2% of amounts took out using reinsurance went to Ukraine as insurance payments. About 80% - were directed to non-insurance organizations of Baltic countries which do not even have licenses allowing engagement in insurance and reinsurance and are not supervised by their countries.

The campaign to combat illegal overseas capital outflow through reinsurance was initiated in Ukraine in 2004. Decree of the President of Ukraine “On the System of Measures for Elimination of Reasons and Conditions Assisting to Criminality and Corruption” upon which the National Bank of Ukraine and the State Commission for Regulation of Financial Services Market of Ukraine were committed to enhance counteraction to money laundering and money outflow overseas.

As a result, Resolution #124 “On Adoption of the Procedure and Requirements to Fulfillment of Reinsurance with an Insurer (Re-insurer) — Non-Resident” was adopted. It stipulates enhanced control over reinsurance of Ukrainian insurers[25] by non-residents.

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[23] According to State Commission for Regulation of Financial Services Market of Ukraine many problems lie in specific nature of existing taxation system of insurance activity. Income tax rate in Ukraine constitutes 25% and gross revenue rate of an insurance company – 3%. If convert this 3% to equivalent of income tax rate, we’ll receive 11%. Thus, sufficient amount of schemes regarding income tax evasion can be carried out though insurance.

[24] Portfolio of insurance is a total amount of risks taken for insurance by an insurance company on certain period.

[25] In accordance with the Procedure, approved by the Cabinet of Ministers of Ukraine, the three principle conditions are necessary to carry out such transactions:

Also, in January, 2005, the Standard binding insurance companies to coordinate reinsurance agreements with the State Commission for Regulation of Financial Services Market of Ukraine prior to permission to purchase currency, was implemented (Resolution of the National Bank of Ukraine of January 14, 2005).

As a result of innovations mentioned, 68 insurance companies obligated by a regulator to terminate agreements with insurers non-residents which do not correspond current legislation, underwent sanctions by a regulator.

Note. *According to the State Commission for Regulation of Financial Services Market of Ukraine, reinsurance level in gross premiums in Ukraine in 2004 constituted 60%, and for the first six months of 2005 reduced up to 49%. And this applies both to residents and non-residents. For comparison: in 2003 reinsurance level on non-residents increased to maximum value (35%), in 2004 it began to decrease (10%), and in the first half-year of 2005 became 3%, that is the lowest index in the last few years. Reinsurance level of residents grew naturally, although generally the reinsurance share of in gross premiums reduced naturally through diminishing of transactions on capital took out. Including 80% of reinsurance volumes directed to the Baltic countries in 2003-2004. In 2005 the volumes of overseas reinsurance reduced, since the channel was closed.*

C**haracteristic features of insurance company** engaged in money laundering scheme can be as follows:

- low solvency; payments level (less than 20% of earnings);
- large volumes of insurance payments on most "popular" kinds of insurance (financial risks, property);
- high indexes of reinsurance transactions volumes (non-residents especially);
- limited information, non-publicity.

The **features of schemes** of overseas reinsurance are as follows:

- low financial reliability (stability) of insurers and non-resident reinsures; or sharp change of rating within reinsurance agreement term of validity;
- location of insurers and re-insurers non-residents is a country, which does not take part in international cooperation in the sphere of prevention and counteraction to legalization (laundering) of crime proceeds from and terrorist financing, or offshore area or country with favorable tax conditions;
- conclusion of retrocession agreements with suspicious persons;
- non-standard or obviously economically unprofitable conditions of insurance/reinsurance agreement (subject of insurance, sums insured, insurance/reinsurance payment and procedure payment, etc.).

- state supervision over insurance and reinsurance activity should be carried out in the country where company non-resident is registered. I.e. if legislation does not foresee such supervision, Ukrainian companies do not have the right to conclude reinsurance agreements with companies of this country.
- insurer non-resident with whom such agreement can be concluded shall have continuous insurance business non less than three years prior the date of agreement conclusion.
- insurer non-resident shall not have the facts of legislation violation in insurance and reinsurance sphere, as well as in terms of money laundering.

Moreover, this Resolution obliges insurers to inform SCFM of Ukraine on conclusion of reinsurance agreement with company non-resident within 10 days.

In this connection, a scheme can be implemented **by means of**:

- front persons (including "one-day" insurance companies);
- transactions with insurers (re-insurers) non-residents that do not have a license and are not covered by insurance supervision;
- falsification of financial stability rating (false overstating);
- falsification of insured accident;
- non-fulfillment of conditions of reinsurance/insurance agreements by re-insurers;
- conclusion of reinsurance agreements with participation of front brokers non-residents.

Under Ukrainian legislation such brokers should have permanent representative offices in Ukraine registered as taxpayers and included to the State Register of Insurance and Reinsurance Brokers.

Thus, the **widespread variants** of criminal profits legalization through an insurance company are as follows:

1. Conclusion of a fictitious insurance agreement.

Having purchased an insurance policy, for example, of health insurance on a considerable sum of "dirty" funds and having feigned (on paper only) an insignificant home accident, a fully legal profit can be achieved. Surely, this scheme is implemented in conspiracy with an insurer.

2. Insurance payments reimbursement.

Dirty funds, placed as insurance payment, are reimbursed ahead of schedule on the requirement of insures. In case of such ahead of schedule agreement dissolution a small fine or forfeit is paid to insurance company, but the money received can be used in official financial system. Thus, the "break of chain" in laundering scheme is provided.

A "mistaken" insurance payment charging is another scheme variant.

3. Reinsurance overseas **(Figure 7).**

The scheme of reinsurance application can be implemented also within the country. But its efficiency is sharply reduced: implementation is considerably complicated – expenditures and risk of exposure are multiplied (taking into account the categories and risk level which can be assumed by reinsurance internal market). Insurance agreement is reinsured overseas; funds on absolutely legal grounds are submitted to a foreign company (often from offshore jurisdiction). Payment over the insurance agreement (policy) is carried out by a client that wishes to legalize funds or an affiliated with an insurer company. To implement the scheme an insurer can create through affiliated structures a reinsurance company in offshore zone (it can cost several hundreds USD). To expose and prove the illegality of criminal mechanism is very difficult.

Scheme. An insurance company in Ukraine takes the risk on insurance. Often, an insurance payment on this risk is either impossible or improbable (for example, risk of destruction of a large capital building of air transport falling). Then such agreement is being reinsured overseas at a foreign company which does not have a license to insurance activity. Payments on such agreement do not take place; at the same time the volumes of insurance payments can become very large.

Note. *According to the State Commission for Regulation of Financial Services Market of Ukraine, during the last years the Ukrainian companies submitted hundreds of millions of UAH to the Latvian insurance companies which were deprived of licenses for illegal activity. That is, per se, they did belong neither to insurance nor to reinsurance).*

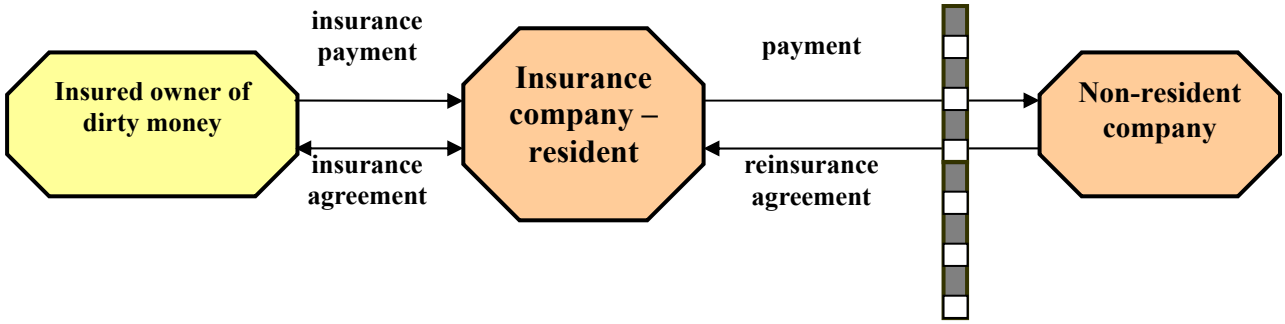

Figure 7

Example 1.[26]

Part 1

At the end of 2003 on the account of non-resident DS (in Lithuanian bank) a group of Ukrainian insurers transferred currency assets of 2.3 millions USD. In accordance with payment documents, money transfer for company DS was carried out upon reinsurance agreements, cover-notes (confirmation of risk acceptance to reinsurance).

At the end of 2004 from the accounts of resident of Ukraine - investment company P 150.7 millions UAH (or 28.4 millions USD) were transferred to the bank accounts in Latvian banks of non-resident MD.

Money is removed overseas through the company MD (in particular, a few Ukrainian insurance companies transferred 18.8 millions USD to the company MD according to retrocession agreements) due to the courts decisions, stating that MD is being acknowledged as a foreign investor, and a number of banks, in which it has its accounts, are obligated to fulfill requests of MD on the purchase of foreign currency and subsequent its transfer overseas (including cases where there is no requirement to issue certificate on actual arrival of money to Ukraine).

Ukrainian insurance companies did not have the right to reinsure the risks with companies MD and DS. In fact, company MD had a license to carry out insurance broker activity since October, 1995 till September, 2002, after what this permission was cancelled. License of DS was suspended since May, 2001.

February, 2004, the State Commission on Regulation of Financial Services Market of Ukraine made 21 insurance companies takes measures to break reinsurance agreements with these companies.

Part 2

At the same time, residents participants of mentioned machinations implemented a scheme of artificial creation of indebtedness as to non-resident MD. The purpose of financial

[26] According to the SCFM of Ukraine and the State Commission on Regulation of Financial Services Market of Ukraine.

and economic transactions complex is to form grounds for overseas transfer of significant amounts of money. Namely: subject of transactions is securities purchase-sale at prices 19 and 136 times higher that their nominal cost. Transactions are also characterized by connections between Ukrainian companies-participants through founders, shareholders, directors and short temporary period of implementation.

A non-resident company T concludes an agreement on purchase and sale of shares of a Ukrainian factory with MD on 412.8 millions USD that 19 times exceeds their nominal cost. Securities are sold to the Ukrainian insurance company B with which agreement on general conditions of risks reinsurance and on cross claims reckoning was concluded.

Further, company I repurchases these shares at the same price from an insurance company and delegates them to company G. Company G is insured with insurance company B (concludes an agreement on voluntarily insurance on 412.8 millions USD) and concludes an agreement of requirement assignment with MD. In its turn, company G sells shares of investment company P at price 136 times higher than nominal.

The citizen of Lithuania C related to the company P, transferred overseas money on the accounts of Latvian banks on the total amount of 28.2 millions USD (150 millions UAH). Mister C grounded these transfers as return of investments on their accounts abroad. It appeared that this person for a long period of time was unemployed and did not carry out entrepreneurial or financial activity on the territory of Lithuania. Criminal record in 1996 lately he often left the country. In fact, beneficial owner of one of the accounts was an American company. It was also the basic recipient of money from other account opened for the Lithuanian.

Example 2.[27] Director of state association A, aiming at association money appropriation, abusing official position, concluded an agreement of voluntarily property and financial risks insurance with company C, by which insured accidents are practically impossible. In accordance with this agreement, association A transferred on the accounts of insurer cashless funds 140 millions UAH as insurance premiums.

Later on, these cashless funds, according to reinsurance agreement between Ukrainian insurance company C and Austrian insurance company CD, were transferred to accounts of the second one. Under other reinsurance agreement, insurance company CD allegedly in connection with the "appearance" of insured accident transfers 100 millions UAH from sum received to Ukrainian insurance company K on coverage of insurance risks association B. Association B was created by front persons and is under control of insurer.

From accounts of association B, director of association A transferred cashless funds to number of fictitious private entities of entrepreneurial activity, withdrew and appropriate cash. With the purpose of legalization of part of appropriated funds director of association A used front person as of cofounder. He created an own legal association, formed his charter fund, purchased apartment for association, office equipment etc. Other part of criminal funds was legalized due to investing in construction of elite housing objects.

[27] According to data of the Security Service of Ukraine.

Summary

To combat crime proceeds legalization we need to know basic schemes of laundering, typical features of their components, instruments of implementation and to constantly trace tendencies and new possibilities of schemes modification.

Typical parameters of suspicious money laundering transactions and their participants are as follows:

1. Companies with signs of fictitious:

- no information on activities a company carries out as a business entity (in the country of registration);
- impossible to define places of residence of company's employees and/or directors (authorized delegates, representatives) or kind of company's activity;
- obvious contradiction between turnovers on company accounts and sums of tax payments;
- integration of functions of a founder, a manager and a chief accountant of a company in one person.

2. Offshore "laundering" transactions:

- use of fictitious or false contracts with offshore companies to carry out international transactions;
- subsequent transfer of funds dispersing them in different jurisdictions;
- repetition of elements of the same type in electronic transfer schemes;
- participation in scheme of inter-payments of more than one offshore company;
- participation of a front resident company in the scheme of financial transactions. Initially, crime proceeds are deposited on bank accounts of this company;
- subject of the contract (services, other products of intellectual activity) defies verification on behalf of supervisory authorities;
- granting of a credit/loan by an offshore company or from an account in offshore jurisdiction with an interest rate substantially different from interest rates at internal and external market; as well as paying it back;
- obvious contradictions in commodities or services value stated in a contract and their real value;
- obvious contradictions in grounds of incoming/outgoing payments (for example, funds given for construction works are paid for consulting services);
- transfer of funds to an account of an offshore company that is not a party to the contract.

3. Foreign economic "laundering" transactions including illegal VAT reimbursement from budget:

- recurrence of transactions of the same type executed by participants of a scheme;
- use of fictitious or false agreements for transactions execution;
- payments made in a very short period of time (often within one day);

- primary confirmation of delivery by different companies participating in a scheme, processed within one day;
- participation of fictitious companies in a scheme;
- using offshore companies and offshore jurisdictions in schemes;
- settlement accounts of supplier and buyer are opened in the same bank;
- a non-resident buyer pays for exported goods through a resident bank;
- no economic effect from transactions with promissory notes, securities to bearer included in a scheme;
- falsification of goods import;
- granting bank credit or loan from a legal entity in the amount of VAT reimbursement;
- the cost of goods or services stated in the agreement contradicts the real one;
- the cost of goods declared to the customs of different countries while exporting contradicts the cost of the same goods while importing;
- obvious disparity of grounds of incoming/outgoing payments within the production cycle imitated by the scheme;
- within one bank day the same sum of money "travels" through accounts of scheme participants;
- agreements are concluded on goods "popular" among fraudsters (software, optical elements, plastic stamps, etc).

4. "Laundering" transactions at securities market:

- purchase of share holdings by domestic (generally, fictitious) associations according to commission agreements of (often non-liquid) Ukrainian entities of entrepreneurial activity from non-resident companies at prices considerably higher than their market value;
- a company concludes agreements with one and the same party on purchase and sale of the same securities.

5. Reinsurance aimed at "laundering":

- low financial reliability (stability) of insurers and non-resident reinsures; or sharp change of rating within reinsurance agreement term of validity;
- a non cooperative country in the AML/CFT sphere, an offshore area or a country with favorable tax conditions is the location of insurers and non-resident reinsures;
- conclusion of retrocession agreements with suspicious persons;
- unprofitable or non-typical conditions of insurance/reinsurance agreement (subject of insurance, amounts insured, insurance/reinsurance payment and payment procedure, etc).

The presented data can be used by entities of initial financial monitoring to detect financial transactions related to money legalization, by law enforcement agencies to conduct investigations, by other state authorities – participants of counteraction system as methodical materials to fulfill their functions.

To enhance detection of money laundering schemes we need to strengthen cooperation of all participants of the counteraction system. Information exchange between SCFM of Ukraine and other state authorities needs subsequent development, especially

access to databases (first of all taxes, customs, law enforcement authorities, regulators of financial services markets). At the same time cooperation with financial intelligence units of other countries with regard to financial investigation needs improvement.