

Typologies report on legalization (laundering) of the proceeds from execution of financial transactions involving unmarketable securities

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General tendencies

Share of international external economic component of criminal financial transactions increases along with development of international relations and integration of Ukraine into global economic space. Special threat with regard to the said processes is constituted by concentration of criminal interests at organization of substantial flow of illegal funds abroad with its further legalization (laundering).

Legalization of the proceeds from crime has attained global nature. According to the expert's assessment, total capital flow out of CIS states aggregates near US\$11-12 million annually, including share of flow of funds of Ukrainian origin. US\$150 to 500 billion of criminal origin is being introduced into legal turnover annually worldwide. According to IMF calculations, annual incomes of criminal organizations aggregate near US\$500 billion, which is almost equal to 2% of worldwide gross product. Its legalization promotes increase of original crime and its penetration into legal economy.

In this regard, use of loopholes existing in certain states in money laundering schemes is one of characteristics of criminal assets laundering.

Thus, for example, certain states of Baltic region (Lithuania, Latvia) and off-shore jurisdictions (Belize) with strict legislative frameworks preserving banking secrecy become very attractive for criminals. Increased confidentiality is actively applied by criminals for illegal purposes.

Taking into consideration this factor, formation of certain combinations of money laundering schemes can be marked out.

For example, participants – US legal entities registered in off-shore jurisdictions, which execute transactions through the accounts in banks of Eastern Europe and Central Asia are often involved in schemes.

As a result, obtaining of any commercial or banking information from official agencies of off-shore financial centers is practically impossible.

The process of legalization of criminal proceeds itself is a complicated scheme of subsequent actions, aimed at confusion of real sources of origin of criminal assets. It is executed by its transformation from one type of assets into other by numerous different financial transactions. It worth mentioning that laundering transactions it-self is as rule legitimate financial transactions, but illegal is origin of funds used.

In the context of the said, the most popular instrument applied for legalization of criminal proceeds is:

- use of external economic transactions (export-import, crediting, investment);
- converting transactions, cash transactions;
- move of funds abroad;
- machinations with securities (shares, promissory notes);
- transactions with land;
- etc.

Criminals use various mechanisms and instruments of money laundering. Most often these are mechanisms containing complicated, confused, multi-chain transactions. One scheme can contain transactions with cash withdrawal, purchase

of securities, settlements with non-residents from off-shore zones/jurisdictions, fictitious external economic transactions and illegal machinations with VAT, false documents, use of stolen/lost passports, establishment of fictitious companies etc.

Use by criminals of various money laundering mechanisms and instruments is stipulated by intention to reach certain purposes, which can include the following:

- concealment of traces of origin of proceeds from illegal sources;
- making visibility of legality of the proceeds;
- concealment of persons who acquired (acquire) illegal proceeds and initiate the laundering process itself;
- provision of convenient and operative access to funds from illegal sources;
- creation of conditions for secure and comfortable use of funds from illegal sources;
- creation of conditions for secure investment into legal business.

That is why money laundering schemes are usually apply transactions for the break of chain of transactions in legalization scheme. It is executed for masking of traces of illegal origin of the proceeds by the means of changing owners, physical movement of funds, converting into cash.

Special attention is attracted by use of transactions with securities in such schemes, which is first of all related to its characteristics, namely simplicity of trade conditions (for example, electronic trade) and possibility to execute transactions regardless of geographical restrictions. Thus, the securities market becomes potentially attractive mechanism for money laundering.

Transaction through external economic operations (export-import, investment), including in “carousel schemes”, accompanied by VAT fraud can be an element for use of securities for money laundering.^[1]

Number of resonance cases, in which owners of large companies or participants of stock markets were accused of using insider information for gaining super profit increased during the last years.

Manipulations at the securities market and abuse of insider information forced international financial regulators to apply strict approach to disclosure by companies of information on its activity and to use of nonpublic information. That is why in 2003 the European Commission approved Directive 2003/6/EC On insider dealing and market manipulation (market abuse), enforcing requirements to disclosure of nonpublic information.

At investigation of money laundering schemes with use of securities problems related to significant number of financial transactions and high probability of mixing of illegal and legal assets. Such problem requires application of special investigation methods.

2. Investigation technique

Technique of investigation of money laundering at the securities market is similar to investigations in other areas.

At the same time, investigation of money laundering in this area requires special methods with regard to specific characteristics, such as:

- substantial number of agreements and financial transactions with securities can be concluded promptly in short period of time (or at large amounts);
- high probability of mixture of legitimate and criminal funds;
- insider transactions/manipulations of the securities market and a predicate offence are closely connected to each other.

Basic investigation stages in particular include:

- I. Obtaining of initial (“raw”) data;
- II. Emerging of suspicions, taking a decision on performance of investigation;
- III. Analysis:
 - 3.1. Establishment of transaction schemes and group of participants;
 - 3.2. Collection of additional information;
 - 3.3. Detection of discrepancy.
- IV. Preparation of materials confirming suspicions.

Further each stage of investigation shall be considered indicating specific characteristics of the securities.

- I. Obtaining of initial (“raw”) data.

At this stage obtaining by SCFM of Ukraine of reports on substantial number of agreements at the securities market is essential. Receiving of such information is regulated through application of “threshold”^[2] approach with obligatory reporting on certain transactions with securities (for example: execution of financial transactions on bearer, non-placement at depositaries, or purchase by a person of securities for cash).

Basic indications of money laundering with use of securities can be the following:

- overcharge purchase by residents of share holdings (often non-liquid) of domestic business entities at companies-nonresidents according to commission contracts;
- conclusion of contracts by legal entity with the same on purchase and later on sale of the same securities;
- transactions with saving certificates and other regularly discharged securities or securities bought out shortly after its emission;
- obtaining of property rights for a “substantial” share holding according to gift or exchange contracts;
- regular purchase transactions with further resale of unquoted securities which are not in free turnover at the organized securities market (on conditions that income of its sale is directed at purchase of highly quoted securities which are in free turnover at organized securities market);
- simultaneous putting of commission for purchase and sale of securities and other derivative financial instruments at prices with noticeable deviation from current prices by similar contracts.

At that special attention at analysis of financial transactions is in general paid to transactions:

- with securities of issuers – residents of Ukraine, executed with participation of nonresidents, including those registered in off-shores;
- with securities on bearer, non-placed at depositaries;
- on purchase of securities at cash;
- on purchase/sale of substantial share holdings, which are not in free turnover at market (when purchased/seller is not professional participant of the securities market and such securities are not transferred to him to discharge of unsettled debt).

II. Emerging of suspicions, taking a decision on performance of investigation.

Traditionally money laundering is investigated in two ways:

- “from crime to money”;
- “from money to crime”.

Among features of transactions with securities is the fact that essential amount of information on suspicious transactions and persons can be obtained also from regulators.

Detection of suspicious schemes is performed by the following indications:

- by certain transactions – more traditional by indications;
- suspicious behavior of customer, uncharacteristic activity, inconsistency between amount of transactions and incomes of participants, existing of discreditable information (criminal records, lost passport), suspicious documents etc.

In case of detection of above indications in transactions with securities, a decision shall be taken on necessity to carry out further investigation (collection of additional information).

III. Analysis.

3.1. Establishment of transaction schemes and group of participants.

At this stage capability of SCFM of Ukraine for analysis of substantial volume of information on financial transactions provided by entities initial financial monitoring, and establishment of potential money laundering scheme on the grounds of such information is of high importance. That is why application of special software is effective in this process.

Calculation of “balance” (amount of funds) of all possible participants of criminal scheme can be marked out as a basic method for establishment of such schemes. At the same time, application of such method enables tracing by SCFM of Ukraine of characteristics of transactions with securities which can be used for money laundering, including mixing of legitimate and illegal proceeds.

3.2. Collection of additional information.

At this stage obtaining of additional information related to objects of analysis of SCFM of Ukraine is essential.

In this regard access to databases of state agencies which according to legislation execute functions of regulation and supervision over activity of entities of initial financial monitoring (hereinafter – regulators) and other financial intermediaries, such as depositaries, keepers, registrars, organizers of auctions etc. is useful for SCFM of Ukraine.

Taking into consideration large volumes of information, which as a rule become object of analysis of SCFM of Ukraine, efficiency of submission of additional information to SCFM of Ukraine by law enforcement and other state agencies involved in combating money laundering is significant.

Besides, taking into consideration the fact, that securities are actively used for money laundering through external economic (export-import, investment) transactions, it is important that SCFM of Ukraine receives additional information from foreign financial intelligence units.

3.3. Detection of discrepancies.

Information, received from regulators, has great importance while studying of cases by the SCFM of Ukraine and can help to reveal and to prove «suspiciousness» of transaction of the whole scheme of transactions.

For example, laundering of proceeds from crime is carried out by means of sale and purchase at unreasonably increased prices of dubious issuer shares. Often in such schemes are used by joint-stock companies, which issue, per se, fictitious shares, even if such issue is registered in the procedure, prescribed by legislation.

Example 1.

The SCFM of Ukraine was informed by the State Commission on Securities and Stock Market on conducting of 50 LLC reorganization by means of their reorganization into joint-stock companies, the authorized capital of which constitutes 208 750 200 UAH (approximately 30,3 mln. €), which in aggregate of 50 companies constitutes 10,44 mlrd. UAH (more than 1,5 mlrd €), at that location of every company is absolutely same. The founders of each of these companies were 3 individuals, besides that 1 person from the founders was the director of all these companies.

IV. Preparation of materials, confirming suspicions.

In case of confirmation, grounding by the SCFM of Ukraine of “suspiciousness” of some transactions or transactions of the whole scheme, case referrals are submitted to the relevant law enforcement agencies.

Taking into consideration the specific character of using securities and cash in laundering of criminal proceeds, and namely the huge volume of information (concerning transactions, links, etc.), availability of relevant software of the law enforcement agencies is useful for processing of such amount of information.

3. Using securities

3.1. General problems of securities market

Securities market has certain features, which make it potentially vulnerable for money laundering ^[3]:

- securities market is actively used on the placement stage of money laundering. This is confirmed by the fact that securities purchase for illegally obtained cash can not be fully eliminated, even in those countries, which limited or forbidden to accept cash while conducting of such transactions;

- taking into consideration the fact that activities of securities market participants in this area sufficiently depends on commission charges, private

brokers or employees of brokerage firms can ignore existing norms and regulations to get reinsured against deprivation of contract and even client;

- on securities market procedures of customer due diligence or control of sources of their funds origin are not always strictly observed or are not executed until the last stage of transaction. Some experts assume that the mentioned control is already executed and in such way they lose scrutiny;

- high internationalization of the securities area means that persons, laundering money, can carry out transactions, engaging several countries, to complicate additionally and in such way to confuse different components of the laundering scheme. And again, upon engagement of several countries territory, stock market experts can assume, that relevant due diligence concerning specific customer was already carried out in another country;

- as transactions are conducted through different segments of financial services market, the right of property and control can be concealed with the help of nominee owners, legal persons, trusts, etc.

During the last years on the world stock markets, including on the national one, it is observed increase of amount of illegal transactions and violations of legislative norms.

For today the issue of importance is presented by the circulation on the securities market of “trash” securities, shares of non-existing joint-stock companies, shares of issuers, issuing of shares of which are cancelled or suspended, use in the money laundering schemes of non-liquid shares of enterprises-bankrupts, shares, which do not turnover on the exchange securities market and do not have real market price, formation of authorized capitals of companies with such shares.

Among generally economic factors, that cause increase the number of offences among the securities market participants, can be mentioned:

- conclusion of the majority of agreements at over the counter “unorganized” market, which contributes to “shadowing” of stock market and complicates state control in this area;

- absence of national index of securities, which restrains involvement of foreign investments;

- insufficiency of own capitals and technical possibilities of traders in securities, necessary for servicing of primary, and secondary securities market;

- absence of effective mechanism for protection of investor’s rights.

3.1.1. Abuse in the area of issuing and circulation of securities

Abuse with securities is widespread fact for Ukraine and encloses both issuing activities and professional activities at the market. Such situation confirms the availability of high level of risk of such abuse with the aim of money laundering.

Methods of fraud conduct on the securities market can be combined in the following groups:

- use of different forged documents;

- use of different fictitious securities;

- receipt of advanced payment in securities according to different agreements or securities as the subject of the sale and purchase agreement without their real payment;
- fraud under appearance of professional participant of securities market;
- issuing of knowingly incorrectly drawn bill of exchange, wrongly drawn endorsement, deliberate change, correction, spoiling of inscriptions on the bill of exchange;
- establishment of «financial pyramid»;
- use of specially created software or Internet network.

For example, embezzlement of shares with the help of forged transfer order (by unauthorized persons or in result of internal collusion of staff) refers to the number of classic abuses in the process of registration activities.

Among abuses the following prevail in the process of issuing activities:

- issuing into circulation of securities, which did not pass state registration;
- establishment of more favorable (artificially established preferential) conditions for purchase of securities for certain category of potential investors;
- taking by the issuer of decision on submission for registration of report on results of issuing securities issue under knowingly unreliable information;
- abuse by securities market participants in the process of depositary activities, when depositary depends on the registrar, having joint interests with the issuer.

Among offenses while carrying out professional activities on the securities market the biggest threat is presented by abuse in the process of:

- intermediary activity (broker, dealer, management), for example: unfair trade in the form of securities manipulation and use of insider information;
- clearing activities;
- organization of trade and its procedures;
- securities circulation (abuse of issuers, speculation).

Funds, received from crime, which are laundered through the securities market, can be formed both outside the market and in its framework. For criminal assets, formed outside the market, securities turnover or establishment of legal persons is used as the mechanism for concealment of the sources of origin of these assets. In the course of criminal actions inside the market, such as manipulations with shares, appropriation, use of confidential information in personal aims, funds, received by criminals shall be further legalized. Thus, criminals have possibility on securities market either legalize criminal capital, or gain additional profits executing transactions.

There is a risk of collusion with experts of the securities market based on amounts of financial resources available to criminal groups, and aimed at penetration of criminals into the market. At the same time non-application by a broker of the procedures for verification of a customer and another broker

participating in execution of transaction (investment) can be market out as important risk criterion of money laundering at the securities market.

Example 2^[4].

This example illustrates how professional activity at the securities market can be used in shadow schemes.

Thus, public corporations issued and registered options in total amount of 10.6 million items.

Options were sold to several Ukrainian companies through the stock exchange. Later, every option was localized at a group of non-residents registered in Sweden and at British Virgin Islands.

Further non-residents sold options to Ukrainian securities traders, but in amount of 13.6 items. Thus, number of transferred options increased number of issued option by 3 million items.

Such increase emerged due to repeated sell of options with the same number of certificates, and as transactions of exchange of options (transfer for paying off, substitute) between non-residents and traders in securities were executed without participation of exchange house, which contradicts Section 2 of the Rules for Issuing and Turnover of Stock Derivatives, approved by the Decision of the State Securities and Stock Market Commission of June 24, 1997 № 13, which requires placement and turnover of securities exclusively at stock exchanges or organizationally-registered non-stock trade-information systems.

Uncontrolled (without involvement of stock exchanges) movement of options to non-residents and its further repeated sale to traders in securities produced conditions for accumulation of substantial monetary funds at traders in options and its transferring into accounts of non-resident opened in banks out of Ukraine.

3.1.2. Manipulations at the securities market and insider contracts.

Use of insider information is more than urgent at global stock exchanges.

International examples.

Example 3.

Larry Ellison^[5]. Executive Director of Oracle Larry Ellison and Financial Director Jeff Henly sold securities prior to announcement by the company about decrease of incomes. In 2001 group of share holders accused Director General of Oracle Larry Ellison and Financial Director Jeff Henly of selling shares of company being aware of necessity to announce about decrease of incomes. Consideration of this case by court had no results.

To settle the situation, share holders and Larry Ellison concluded an agreement according to provisions of which Larry Ellison does not admit guilt but transfers €73.25 million of donations and pays off €16.12 million of court costs.

Though, payment of the named amounts will not seriously influence capital of Mr. Ellison (€12.45 billion), who according to Forbes is in the list of five richest persons in the USA.

Example 4.

Iosaki Tsutsumi^[6]. In March 2005 Japanese oligarch Iosaki Tsutsumi (according to Forbes a world's richest person at the end of 80th) was sentenced to 2.5 years of imprisonment. Tsutsumi bribed insiders of company Seibu Railway, in order they decreased its share capital. Falsification was detected but insiders managed to inform about it Tsutsumi beforehand, which enabled him to sell his assets and get €52.7 million.

Example 5.

George Soros^[7]. George Soros paid for illegal use of internal information in privatization of French bank Societe Generale. Soros purchased share holdings of four French companies and banks at stock exchange, including shares of Societe Generale, and in a month sold it earning. According to the version of prosecution adviser of the Government of France and the minister of Finance were sources of information on future absorption.

Example 6. Russian Federation^[8].

A scandal broke in Russia in January 2004 when certain participants of the market were accused of use of insider information from agency Standard & Poor's on future increase of sovereign rate of the Russian Federation to the investment one. Having learned about it just several hours prior to official announcement, traders managed to earn surplus profit on the grounds of sharp advance of prices at sovereign and corporate stocks. But accusations had no results – that time the Parliament had not yet adopted the Law «On insider information», which had already been submitted for voting.

The situation that takes place in Ukraine presupposes that the majority of exchanges providing listing stipulates low payment and overgoing of official quoting of securities of national issuers at some exchanges is carried out free of charge. Nevertheless, such economic encouraging measures do not favor emitters' entering on organizational markets and concentration of demand and suggestion in this market.

Small part of organized securities market distorts price formation mechanisms, deprives small share holders of the possibility to sell shares by the market price and favors appearance of shade schemes of securities circulation.

Moreover, it is impossible to define increase/reduction of securities cost quickly due to usage of insider information when taking decision on conducting transactions on securities sale-purchase.

Counteraction to illicit usage of insider information will be effective if it is possible to make trade-and-commerce move to organized market at legislative level.

Concentration of securities circulation in organized market is of top importance not only when tackling the problem of functioning transparent, liquid, investment attractive national stock exchange, but is one of factors preventing counterfeiting in securities market and capital flow-out abroad and providing economic safety of the state. Besides, reliably functioning stock exchange greatly influences the acceleration of economic growth of any country and living standards increase of its citizens.

Template money laundering scheme presupposing manipulation in securities market is the following:

In fraudulent aims and to increase securities cost of this or that issuer artificially a company is created or purchased the price on which is gradually elevating due to fictitious agreements at the exchange. Later these shares are sold not only to the scheme participants for further laundering but also to external investors that invest money in “perspective” shares. In some time this company transfers all its money abroad (as a rule, to off-shore country) and notifies on its bankruptcy or just disappears.

3.2. Use of shares in money laundering schemes

The most spread variant of shares to be used in grey schemes is their use to transfer money abroad illegally. This is carried out through sale-purchase of securities (mainly shares) of Ukrainian issuers – non-residents.

Thus, non-resident buys shares by a very low price and sells them to his/her trustees by the price several hundred or even thousand times higher than their real cost (directly or with a help of brokers). Later money accumulated on the account of non-resident is transferred abroad as investment return.

Case study 1.

Drug trader using the company that belongs to him/her or controlled by him/her conducts transactions with securities and as a result receives money that is a payment for drugs. The transactions are performed in accordance with the following scheme.

Buyer purchases from the seller (or share company controlled by drug trader), as the payment for drugs, fictitious shares. The cost of these shares is much higher than its face value. Therefore, buyer actually pays certain amount of money for drugs. And seller, actually, under shares selling cover, receives laundered money from drug trafficking.

One of the variants of described case 1 is carrying out special issue of shares.

In this case registration and these shares' entering into market are connected with formation of so named "technical" instrument for the activity of the participants of stock exchange to use it in illicit money laundering schemes, transfer money abroad and minimize taxes.

Taking into consideration abovementioned, one of essential measures preventing using shares as money laundering instrument is cancellation of shares issue by major bogus joint stock companies in legal proceedings.

Besides, typical elements of great money laundering schemes (and especially great schemes) in securities market are involvement of:

- fictitious legal entities;
- fictitious documentation for conducting transactions, lost/counterfeited documents;
- fictitious natural persons.⁹

As straw men to conduct financial transactions young men that do not have enough money, or served the term in penitentiary institutions for petty crimes, or related to illicit drug trafficking; persons without permanent place of residence; persons suffering from alcoholism; needy people and people in declining years are used.

Case study 2.

When establishing an enterprise its founders are fictitious natural persons who agree to sign registration documents for remuneration and at the instance of unknown to them people. Later these people do not take part in running business designated in the statutory documents. Actually, they do not invest assets to the statutory fund of this enterprise and do not carry out registration of emission and direct placement of issued shares. They do not carry out any activity, do not report to state tax agencies and the State Commission on Securities and Stock Exchange/ they do not have inventories and real assets on the balance of this enterprise; their shares are used by financial institutions as instruments of illicit conversion of money into cash, establishment of artificial statutory fund and money transfer abroad.

Example 7.¹⁰

To form the statutory fund the enterprises use non liquid assets, evaluated many times more than their real cost, and registered issue of new shares may be used for various transactions including formation of the statutory fund of other economic entities by face or higher value. Above mentioned scheme, above all, may be used to minimize taxes to establish bogus enterprise that can be used in the schemes of fictitious or illicit economic activity. Moreover, money laundering is also possible if shares issue is wide spread and investors are not keen in this business.

Example 8.

Considering the fact that the activity of investment funds in Ukraine is exempted of income tax, some companies use this privilege to carry out shady practices. Thus, money receipt from investors by the company is followed by their investment in securities (shares, bonds). Later on behalf of such funds the agreements are concluded to purchase interest promissory notes but the payment for received promissory notes is carried out later not with money received from investors but with money that in advance entered the account of investment fund from further sale (presentation) of mentioned promissory notes.

Example 9¹²

The officers of close corporation B carried out the scheme of appropriation of economic entity's money and change of its owner in the following way. The officials of close corporation decided to increase its statutory fund with a help of additional share issue by the amount of UAH 2, 15 million. The shares of this new issue have been purchased by some enterprises and insurance companies that received controlling interest. The part of received money from sale of shares of additional issue (UAH 650 000) has been appropriated by officials of this economic entity through money transfer to the account of bogus firm according to non-existing right concession agreement.

Example 10¹³

The citizen of Ukraine, Mr. F, illegally received money when being intermediary in the employment process of Ukrainian citizens abroad. In the result of his activity he has received income in Czech Republic in the amount of € 85 000 which legalized after acquiring in special auction 10 % of shares of public corporation B by reduced price – UAH 207 000 (face value – more than UAH 820 000). The payment has been carried out with cash. False information has been written in declaration added to the application for share purchase. Moreover, it was found out that director and founder of the public corporation was a relative of Mr F.

3.3. Use of promissory notes in money laundering schemes.

Promissory note is a note payable that means unconditional obligation of the maker to pay or his/her order to the third person to pay to the payee on maturity day a certain amount of money. But the right to receive money may be transferred to another person with endorsement (transfer sign on the reverse side of the note). Therefore, promissory note may be transferred many times from one person to another with endorsement.

Thus, usage in financial transactions promissory notes with blank endorsement let the criminals to make more complicated and conceal effectively the mechanism of securities circulation from the moment of receipt and provide anonymity of income receipt.

Case study.

The owner of “dirty” money draws as the payment for a good or service rendered by firm **A** the promissory note with blank endorsement; the firm, as a rule, is shell-firm.

In the course of certain transactions (including possible forgery of reporting and payment documents) this promissory note is received by firm **B**. Firm **B** presents this promissory note to be paid by the owner and received legalized money. For example, promissory note can be transferred to the official of the firm that receives money under it, presenting counterfeited or stolen identity document.

A domiciled promissory note as the pawn for getting a ready credit in the bank or in the pawn-shop by the natural person may be used. Besides, the scheme may involve non-resident that presents domiciled promissory note payable. Domiciled promissory note is a comfortable instrument for its usage increases the safety of transactions, but additional interaction with the bank increases the maturity date, that's why in money laundering purposes non-domiciled promissory notes are used.

Moreover, promissory notes schemes very often presuppose the cases of involvement officials of the entities of initial financial monitoring to money laundering.

Example 11¹⁵

The officials of the insurance company conducted financial transactions on a permanent basis with securities payable to bearer that have not been deposited in depositories. Violating acting legislation these persons on the base of securities exchange agreement acquired deposit certificates of one of the banks by the amount of € 586 000. And the report on conducting financial transactions has not been filed to the SCFM of Ukraine by the entities of initial financial monitoring. Moreover, insurers concluded securities sale-purchase agreements of one of the

enterprises issued in simple documentary form by the amount of € 146 500 and did not report the SCFM of Ukraine on this fact.

Note. Under the facts of revealed crimes the prosecuting bodies initiated criminal proceedings against the officials of two banks. The officials of one of them gave money by the amount of € 95 000 to a natural person twice and did not file the report to SCFM of Ukraine. Another bank conducted similar transactions – at first it gave € 2,2 million and then € 1, 17 million to the same natural person.

Example 12 ^[16]

This example shows how a money laundering scheme includes securities overpricing and promissory notes manipulation.

The group of acting enterprises in order to legalize (launder) the proceeds from crime transfers money to bogus enterprises as the payment for fictitious goods. The latter, in their turn, emit promissory notes and received money to guarantee these promissory notes are transferred to domiciliation accounts opened in the bank. The promissory notes themselves are transferred as the payment for fictitious goods to the group of bogus enterprises and, finally, are accumulated by securities trader. Securities trader pays off for received promissory notes with the group of bogus enterprises with the money deposited on domiciliation accounts trough presenting these promissory notes for payment to the bank. Bogus enterprises, in their turn, purchase, with a help of securities traders, shares the cost of which is almost zero for the price overcharged 100 times from a British company that purchased them from other company registered in the USA. Under the results of this scheme functioning British company transferred money to its own accounts in the Latvian bank by the amount of \$ 875 million that constitutes UAH 4 billion 419 million in the form of portfolio investment return.

Further, British company transfers money from the accounts opened in the Latvian bank to the account of other company registered in the USA opened in the same bank.

The criminal proceedings have been initiated, the investigation is under way. In the course of operative actions ransacks of the premises of banking institutions and enterprises involved to this scheme have been conducted. In the course of these ransacks the documents and objects that served instruments of the crime have been ejected. As the result, UAH 9 million on the accounts have been seized.

4. Conversion centers

An important element of the criminal mechanism of legalization of the proceeds from crime is usage of “conversion centers”. “Conversion centers” are derivative operations that combine using not only such elements as bogus and transit

enterprises, fictitious persons, faked-up documents, lost passports and such element as securities.

During last years banking institutions started being used as one of key instruments due to which the organizers of “conversion centers” render illicit services to the enterprises converting money. That’s nowadays the majority of such centers are banking institutions.

Money laundering mechanism very often combines with another one that makes the process of their registration more complicated.

Key link in this process are the firms with the signs of forgery that register fictitious persons. One of top objectives pursued by organizers of such businesses in the course of their registration and usage is evasion of criminal liability. That’s why the heads of bogus firms register fictitious persons.

Typical signs of bogus businesses are:

- registration in names of the persons that died, lost their passports, serve the term, insane (incapable) persons, persons that departed abroad for permanent residence, persons that provisionally transmitted their passports (ex. leaved them as a deposit), or gave passport for some time for insignificant payment.
- registration in names of the persons (from poor strata – unemployed, students etc.) that for insignificant payment agreed to register business entity in their own name (in some cases without being aware of this), executed all necessary formalities including registration in tax agencies and opening accounts in banking institutions. Later these persons had no relation to economic activity of this business entity, in other words, the enterprise carried out its financial and economic activity without agreement of director and founders;
- business entity has fictitious essential elements –it is registered in the name of fictitious, non - existing persons, or are not registered in state bodies of executive power and tax agencies.
- repurchased (reregistered) business entity – registered in the name of really existing persons that carry out legal financial and economic activity that is further reregistered (sold) through notary offices, legal firms etc. They are bought, as a rule, by the persons relating to abovementioned categories.

“Transit” business entities have the following signs:

- have a small statutory fund and minimum staff;
- the founders are the persons living in the region different from the region of the business entity registration:
- carry out certain cycle of the work constantly reflecting fixed results in tax reporting;

- officers hand over tax reports indicating certain volume of incomes;
- do not conduct foreign economic transactions;
- have wide circle of counteragents that transfer to their accounts money for inventories (services) supply, purchase of agricultural production, return of welfare etc.

Typical signs of “conversion” centre are:

- entering money to the account opened by the customer in a bank from several business entities in one settling day that in the same day are converted in different ways into cash and transferred to another account, as a result, at the end of the settling day this account has no or little money;
- writing off the legal entity’s account money in cash, not related to the nature of its activity;
- entering in cashless form and writing off the account in cashless form with payment designation not connected with constant nature of economic activity of this natural person;
- amounts of financial transactions do not correspond to financial state of the customer;
- conditions of conducting financial transactions attest to the absence of objective connection between transactions and the nature of at least one of the participant’s activity;
- conducting transactions with securities aimed at receipt of cash by the customers;
- coincidence of data of the transaction participants (ex. address of business entities);
- regular receipt of great volume of cash by natural persons – non residents/residents from their accounts in the same division of the bank (subsidiary);
- closing of accounts of the scheme participants or abrupt termination of transactions under these accounts, after receipt of cash from them or carrying out certain cycle of such transactions;

“Conversion centers” are link of money laundering stage; their participants convert cashless money into cash or vice versa, and transfer money to settlement account of business entities with the signs of forgery, disguising their illicit activity with legal one.

The accounts in the names of fictitious persons are opened with a help of controlled private notaries. The enterprises-customers of “conversion centers” transfer cashless money to the accounts of economic entities with the signs of forgery. Using “customer-bank” system in the course of managing accounts money can be operatively transferred to the accounts of natural persons, including for alleged supplied products (rendered services, carried out works). For transactions aimed at cash receipt plastic payment cards are widely used.

The entities, so named “cover groups” support connection with foreign banks where the accounts of controlled off-shore companies are opened. The place of residence of such banks and representatives of the companies are Baltic countries.

Tackling the problem on fight against activity of “conversion centers” it is necessary to pay attention to non-efficiency of available mechanisms of blocking and further writing off money from the accounts of economic entities included to “conversion centers”.

Organizers of “conversion centers” are, as a rule, experts that have corrupted liaisons with officials of appropriate banking institutions and local bodies.

To understand more clearly the activity of “conversion centers” there are some examples.

Example 13¹⁷

Cashless money with various payment designations has been transferred from a range of legal entities to the accounts of two private enterprises A and B. Later private enterprises A and B work intermittently (the work of one enterprise is followed by the work of another one) in accordance with such scheme:

- they transfer money in great volume to the accounts of the range of natural persons as the payment for securities (promissory notes) payable to bearer;
- transactions are conducted in one settling day but at different time;
- transactions with natural persons are conducted in series; the moment money are transferred to the account of one person they start being transferred to the account of another natural person.

It should be mentioned that all natural persons received passports in the same district of the same region and had accounts in the same bank.

The total amount of money transferred to the accounts of natural persons constitutes UAH 552, 6 million.

Example 14¹⁸

Cashless money as the payment for securities is transferred to settlement accounts of two legal entities that later is withdrawn in cash desk of the bank with payment designation “repurchase of securities from natural persons”. Withdrawal of cash is carried out by the official of the enterprise on the grounds of drawn checks.

Besides, cashless money as the payment for securities is transferred to personal account of abovementioned official. This money is withdrawn by the owner of the account through cash desk in the bank.

Example 15¹⁹

Money as the payment for services, securities and inventories is transferred to the account of private enterprise from a range of legal entities.

The same settling day money accumulated on the account is transferred by this private enterprise in favor of two natural persons as interest-free loan.

The same day natural persons conduct transactions on cash withdrawal through the cash desk of the bank as the payment for securities.

Example 16²⁰

Legal entities transferred cashless money to the bank and received deposit certificates.

Later these deposit certificates were transferred to natural persons through the number of transit and bogus firms. Natural person, in their turn, presented these payable deposit certificates to the bank and received cash through the cash desk.

¹ Typological research of Eurasian group on combating money laundering and terrorist financing of 2006;
www.sd.eurasiangroup.org/final2005.doc.

² The sum of conducted financial transaction, foreseen by the legislation. Such financial transaction is subject to registration by an entity of initial financial monitoring and obligatory informing to the SCFM of Ukraine. In Ukraine this amount constitutes UAH 80 000.

³ Report on money laundering typologies in 2002-2003, FATF
www.fatf-gafi.org/dataoecd/12/63/34328318.PDF

⁴ Under materials of the SCFM of Ukraine.

⁵ www.news.com.com/2100-1012_3-5967691.html

⁶ www.russianmiami.com/common/arc/story.php/200882?id_cr=122

⁷ www.isra.com/news/68416

⁸ www.bankir.ru/news/neewslne/25.o2.2004/10718

- ⁹ Fictitious persons – persons with an assistance of which directly or indirectly financial transactions are conducted to provide “link disruption” in money laundering schemes. Such persons can be used to open banking accounts, to transfer money within the country and abroad and withdraw great amount of money. While conducting transactions lost or counterfeited passports/other identification documents, passports of needy people or persons without permanent place of residence are presented as identification documents.
- ¹⁰ Under materials of the Securities and Stock Market Commission
- ¹¹ Under materials of State Tax Administration of Ukraine
- ¹² Under materials of State Tax Administration of Ukraine
- ¹³ Under materials of the SCFM of Ukraine
- ¹⁴ The Verkhovna Rada of Ukraine, the Law of Ukraine on Securities and Stock Market, 23.02.2006 N 3480-IV
- ¹⁵ Under the data of Division of the Ministry of Interior in Donetsk oblast
- ¹⁶ Under materials of the SCFM of Ukraine
- ¹⁷ Under materials of the SCFM of Ukraine
- ¹⁸ Under materials of the SCFM of Ukraine
- ¹⁹ Under materials of the SCFM of Ukraine
- ²⁰ Under materials of the SCFM of Ukraine