

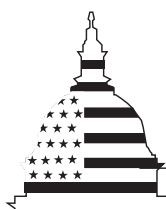
GAO

Report to the Ranking Minority Member,
Permanent Subcommittee on
Investigations, Committee on
Governmental Affairs, United States
Senate

October 2000

SUSPICIOUS BANKING ACTIVITIES

Possible Money Laundering by U.S. Corporations Formed for Russian Entities



G A O

Accountability * Integrity * Reliability



United States General Accounting Office
Washington, D.C. 20548

October 31, 2000

The Honorable Carl Levin
Ranking Minority Member
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate

Dear Senator Levin:

On February 25, 2000, you expressed concern that foreign individuals or entities can create U.S. corporations, open bank accounts in the name of the U.S. corporations, and use these bank accounts to launder money through the use of correspondent banking services.¹ You identified certain corporations that had engaged in suspicious banking activity indicating possible money laundering. Each of these corporations had been formed in the state of Delaware for unknown foreign individuals or entities. The suspicious banking activity involved correspondent bank accounts and wire transfers of funds from Eastern European banks through U.S. banks to other Eastern European banks. You initially requested that we investigate these Delaware corporations to determine how they had been formed.

We began our investigation by reviewing relevant statutes regarding the chartering of corporations in Delaware and records of the Delaware Division of Corporations pertaining to the corporations that the Subcommittee identified. We then contacted various registered agents for these corporations and identified Euro-American Corporate Services, Inc., as a Delaware-registered agent that together with a related company, International Business Creations (IBC), created corporations for Russian brokers and established bank accounts for those corporations. We brought this information to the attention of the Subcommittee. It focused its request more narrowly on Euro-American and asked us to (1) describe how it was formed and operated, (2) determine how Euro-American entered banking relationships with Citibank of New York and Commercial Bank of San Francisco, and (3) investigate the extent to which these banking relationships resulted in suspicious activity.

¹A bank or other financial organization that regularly performs services for another financial organization in a place or market to which the other does not have direct access is referred to as a correspondent bank.

We reviewed state of Delaware, Department of State, Division of Corporations' files concerning the list of companies the Subcommittee had provided to us. We contacted Delaware-registered agents for information about those companies and interviewed the Division of Corporations' Incorporation Section Administrator, who oversees corporation filings. We also spoke with a member of the Delaware State Police Intelligence Division. In addition, we reviewed relevant provisions of the Delaware Code. Further, we interviewed officials of IBC, Euro-American, Citibank, and Commercial Bank. The Permanent Subcommittee on Investigations, Senate Committee on Governmental Affairs, issued subpoenas to obtain certain bank records of IBC, Euro-American, the three principals of those corporations, and IBC/Euro-American-created corporations. We analyzed those bank records. We conducted our investigation from March to October 2000. It was performed in accordance with the quality standards for investigations as set forth by the President's Council on Integrity and Efficiency.

Results in Brief

Euro-American formed corporations pursuant to the General Corporation Law of Delaware. The corporations were granted corporation status by the state after Euro-American—as the registered agent—prepared, signed, and filed a certificate of incorporation containing very limited information. For example, Delaware law, as in some other states, has no requirement that the certificate of incorporation contain information about the principals, the principal place of business, or the specific business activity of the corporation.

We also determined that Euro-American had formed three of the Delaware corporations identified by the Subcommittee, as well as approximately 2,000 others, for Russian brokers. From 1991 through January 2000, more than \$1.4 billion in wire transfer transactions was deposited into 236 accounts opened at 2 U.S. banks: Citibank (136 accounts) and Commercial Bank (100 accounts). IBC/Euro-American established those accounts for corporations that it had created. Of the \$1.4 billion, more than \$800 million was wired from foreign countries into IBC/Euro-American accounts at Citibank. Over 70 percent of the Citibank deposits for these accounts was wire-transferred to accounts in foreign countries. Of the remaining \$600 million deposited in Commercial Bank, over 50 percent was similarly transferred into the U.S. banking system from abroad. In addition, most of the \$600 million was transferred out of the U.S. banking system. These banking activities raise questions about whether the U.S. banks were used to launder money.

Additionally, the two banks at which Euro-American established accounts failed to implement “know your customer” policies for these accounts. Implementation of effective know your customer policies permits financial institutions to understand the kind of transactions in which a particular customer is likely to engage, to identify unusual or suspicious transactions, and to report such transactions as required by the Bank Secrecy Act.² We have referred the information developed to appropriate law enforcement and regulatory agencies.

Background

Forming a Corporation in Delaware

The General Corporation Law of Delaware permits “any person, partnership, association or corporation” to form a corporation “without regard to such person’s or entity’s residence, domicile or state of incorporation” by filing a certificate of incorporation with the Division of Corporations in the Department of State.³ Every corporation must have and maintain in Delaware “a registered office which may, but need not be, the same as its place of business.”⁴

Each corporation must also appoint a registered agent to “accept service of process and otherwise perform the functions of a registered agent.”⁵ The registered agent may be the corporation itself, an individual resident of Delaware, another domestic corporation or other domestic business entity, or a foreign corporation or other foreign business entity that is authorized to do business in the state.⁶

²The Bank Secrecy Act is codified in 12 U.S.C. §§ 1829b and 1951-59 and in 31 U.S.C. §§ 5311-30.

³Del. Code Ann. tit. 8, §101.

⁴Del. Code Ann. tit. 8, §131 (a).

⁵Del. Code Ann. tit. 8, §132 (a).

⁶Del. Code Ann. tit. 8, §132 (a).

The certificate of incorporation must contain the name of the corporation, the address of the corporation's registered office in Delaware, the name and street address of its registered agent at the corporation's registered office in Delaware, and the name and mailing address of the incorporators.⁷ Our investigation revealed that for all the corporations formed by Euro-American it was both the registered agent and the incorporator. With respect to the nature of the business of the corporation, it is sufficient for the certificate of incorporation to state that "the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware."⁸ A certificate must be filed with the Division of Corporations certifying any changes with respect to the corporation's registered agent or registered address.⁹

Bank Compliance Programs Regarding Suspicious Banking Activities and Know Your Customer Policies

The Bank Secrecy Act requires banks to report suspicious banking activity relating to potential money laundering to the U.S. Treasury Department.¹⁰ The Federal Reserve System, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) are the federal regulatory agencies that examine banks. To enforce the Bank Secrecy Act, these agencies have promulgated regulations requiring banks to implement programs and procedures for recording and reporting large currency transactions and for detecting, preventing, and reporting suspicious transactions related to potential money-laundering activity.¹¹

⁷Del. Code Ann. tit. 8, §102. Additionally, if the corporation is authorized to issue only one class of stock, the certificate of incorporation must also contain the total number of shares of stock that the corporation has authority to issue and the par value of each share or a statement that all such shares are to be without par value. Del. Code Ann. tit. 8, §102(4).

⁸Del. Code Ann. tit. 8, §102.

⁹Del. Code Ann. tit. 8, §133.

¹⁰31 U.S.C. §5318(g); 31 C.F.R. §103.21; see 12 C.F.R. §§ 21.21 (OCC). Money laundering is the process of engaging in financial transactions with the proceeds of unlawful activity to conceal the existence, nature, or source of those proceeds. Two criminal money-laundering offenses are defined in 18 U.S.C. §§1956, 1957.

¹¹See 12 C.F.R. §§21.21 (OCC), 219.21-23 (Federal Reserve), and 326.8 (FDIC) (2000).

Regulators and most banks contacted during a previous GAO review¹² cited know your customer policies as one of an institution's most important means of detecting suspicious activity to comply with the Bank Secrecy Act.¹³ Know your customer policies generally commit a financial institution to verify a customer's identity, determine the customer's source of wealth, review the customer's credit and character, and understand the type of transactions the customer would typically conduct. Implementation of effective know your customer policies permits a financial institution to understand the kinds of transactions in which a particular customer is likely to engage, to identify unusual or suspicious transactions, and to report such transactions to the U.S. Department of the Treasury.

Ease of Foreign Entities in Creating U.S. Corporations Engaging in Suspicious Banking Activities

We identified the registered agents for most of the corporations named by the Subcommittee. We were able to obtain information from the files of seven of those registered agents, including Euro-American, concerning approximately half of the corporations identified by the Subcommittee. Although they did not provide specific numbers, the seven registered agents told us that a large number of the corporations in our investigation had been formed at the request of foreign individuals or entities.

Further, an officer of Euro-American informed us that his company's clients consist entirely of brokers in Moscow, Russia, who make requests for the formation of Delaware corporations and that Euro-American had formed approximately 2,000 such corporations since 1996. In our review of documents filed by Euro-American with the Delaware Division of Corporations, we found that an officer of Euro-American had signed the certificate of incorporation for each company it formed as the incorporator of the company.

The records of the registered agents we reviewed generally contain the name of the person or entity requesting the formation of the corporation but do not contain the names of the corporation's principals. Thus, neither state records nor the records of the registered agents contain the names of

¹²*Private Banking: Information on Private Banking and Its Vulnerability to Money Laundering* (GAO/GGD-98-19R, Oct. 30, 1997).

¹³While regulatory efforts to establish uniform know your customer requirements have been discontinued, Congress continues to look for ways to reinforce current anti-money-laundering laws and, more specifically, to promote due diligence in customer banking relationships.

the principals of the incorporated companies. Two registered agents informed us that they often form corporations in blocks of 10 to 20 at a time to accommodate single requests from foreign brokers. A registered agent also disclosed that these corporations are sometimes sold by the brokers to others, who may, in turn, sell them again.

In conducting our investigation, we reviewed Suspicious Activity Reports filed by three banks concerning transactions by corporations formed by Euro-American for Russian brokers. A question raised in the reports concerned whether banking transactions by these corporations were part of money-laundering schemes. For example, one report describes the following transactions by two corporations formed by Euro-American:

Corporation A initiated a series of wire transfers of money on its behalf through Absolute Bank in Moscow, Russia, to the Bank of New York in the United States, which had a correspondent banking relationship with Absolute Bank. The Bank of New York then transferred the funds to Republic National Bank of New York, which had a correspondent banking relationship with Trust Commercial Bank in Latvia. Republic National Bank, in turn, sent the funds by wire to Trust Commercial Bank in Latvia where they were deposited into Corporation B's account. Approximately \$6.8 million was moved in this fashion from Corporation A to Corporation B during a 2-month period. Using wire transfers, money was moved in large dollar amounts into and out of accounts on the same day or within 1 or 2 days.¹⁴

Relationship Between International Business Creations and Euro-American Corporate Services, Inc.

In 1991, a native of the Republic of Georgia who was residing in the United States incorporated IBC in Delaware and became its president.¹⁵ IBC opened bank accounts in the United States for corporations formed in Delaware at the request of Russian brokers. To expand his business, in 1996 IBC's president created Euro-American to (1) form corporations in Delaware for Russian brokers and (2) serve as the registered agent for such corporations and open bank accounts for them when requested. Two former IBC employees serve as the officers of Euro-American. Euro-American began charging a fee of \$350 for each company it incorporated.

¹⁴We have no information concerning either the origin of the funds wired by Corporation A or the final destination of the funds after they were deposited into Corporation B's account. Moreover, Euro-American could not provide information about the owners or the principals of these corporations.

¹⁵IBC was also incorporated in New York in 1996.

Euro-American serves as its own registered agent and lists a street address in New Castle, Delaware, as its registered address on its certificate of incorporation. We found that it was the address of Executive Offices, Inc., a company that provides office space and reception services for business tenants. An officer of Executive Offices informed us that beginning in approximately 1997, his company provided a mail drop to IBC, which is actually located in New York, New York. He later learned of the existence of Euro-American after he received large quantities of mail for it. He contacted the Delaware Division of Corporations and was informed that Euro-American had established itself as a registered agent and had listed as its registered address the mail drop rented to IBC by Executive Offices. He also learned that Euro-American served as the registered agent for 708 corporations that used the address of Executive Offices.

The officer of Executive Offices informed us that he subsequently entered into a rental agreement with Euro-American. Euro-American rents office space from Executive Offices, although no one physically occupies the office. As part of this agreement, Euro-American pays for the services of a common receptionist shared by other tenants of Executive Offices. The officer estimated that a Euro-American representative uses the office about 1 day every 3 months, which he opined was merely a “formality.” Further, all telephone calls and mail are forwarded to Euro-American in New York. An official of Delaware’s Division of Corporations advised the officer that this arrangement complies with Euro-American’s obligations as a Delaware-registered agent.

Euro-American’s Role in Forming U.S. Corporations for Russian Brokers and Opening Bank Accounts for Such Corporations

According to an employee of Euro-American, Russian brokers who obtain services from Euro-American generally order the formation of about 10 corporations at a time. Sometimes the Russian brokers furnish names for the requested companies; at other times, Euro-American simply “makes up” names for the corporations it forms. The Euro-American employee estimated that, since its inception, the company had worked with between 30 to 50 brokers in Moscow for whom it had formed about 2,000 corporations. According to the president of IBC and the Euro-American employee, Euro-American conducted no due diligence with respect to any company it incorporated because state law does not require it.

On occasion, Russian brokers requested that IBC/Euro-American open bank accounts with wire transfer capabilities for corporations that Euro-American formed. We have identified two banks at which Euro-American established such accounts: Citibank of New York and the Commercial Bank

of San Francisco. Euro-American received a fee of \$450 from the Russian brokers for each bank account opened. According to records of Citibank and Commercial Bank, IBC/Euro-American opened approximately 136 bank accounts for corporations at Citibank from 1991 through January 2000 and approximately 100 bank accounts at Commercial Bank from 1996 through 1999. The president of IBC told us that the bank accounts were formed to move money out of Russia.

The IBC president told officers of both Citibank and Commercial Bank that he had conducted investigations of the companies for which he opened accounts. He admitted to us that he made such representations to the banks but that he in fact had not investigated the companies. He also told us that Euro-American is currently being liquidated due in part to concerns about money-laundering issues that were raised in 1999 when the media reported allegations that Russian organized crime had laundered billions of dollars through the Bank of New York.

Relationship Between Citibank of New York and IBC/Euro-American

A Citibank account officer at a particular Citibank branch told us that the president of IBC first became a Citibank customer about 10 years ago when he established IBC. At that time, IBC's president informed Citibank that he assisted Russian business clients in opening bank accounts in the United States. When he established IBC's Citibank account, the president of IBC was required to provide two forms of identification, such as a passport and credit card, and documents relating to IBC, such as incorporation papers. Between 1992 and April 2000, IBC had four accounts at Citibank into which approximately \$280 million was deposited through wire transfers. Virtually all of these funds were subsequently wired out of the accounts.

The relationship between Citibank and IBC expanded in 1996 when Euro-American was formed and IBC/Euro-American began referring Russian companies to Citibank for the purpose of opening accounts. According to the Citibank account officer, the president of IBC vouched for the newly formed companies and said that he knew the officers of the companies personally, by reputation, or as a result of conducting his own investigation. Citibank opened the accounts based upon the IBC president's representations, with the stipulation that the customers would personally appear at Citibank with appropriate identification within 30 days of opening the account. A Euro-American employee served as a Russian interpreter for those customers who personally appeared at Citibank to open accounts. Citibank did not conduct due diligence regarding IBC/Euro-American-referred customers.¹⁶

A Citibank official advised us that the bank closed some of the accounts opened for IBC clients because the clients had failed to appear personally at Citibank offices within 30 days after the accounts were opened. He added that the accounts were fully functional for the initial 30-day period, allowing wire transfer capabilities, and that all transactions in and out of these accounts were by wire transfers. Although we do not know the number of IBC/Euro-American referred Citibank customers who appeared personally at the bank, our review of records obtained from Citibank indicates that no accounts of IBC/Euro-American referred customers were closed within 4 months of being opened. Further, more than \$800 million was deposited through wire transfer transactions from foreign countries into IBC/Euro-American client accounts at Citibank. Over 70 percent of these deposits was subsequently moved out of the U.S. banking system through wire transfer transactions to accounts in foreign countries. According to a Citibank official, these deposits included funds from Russia; and Citibank no longer opens accounts for clients of IBC/Euro-American because of concerns over suspicious account activity.

¹⁶We previously reported that Citibank's failure to enforce its know your customer policy facilitated a money-laundering scheme that disguised the origin, destination, and beneficial owner of the funds involved. See *Private Banking: Raul Salinas, Citibank, and Alleged Money Laundering* (GAO/OSI-99-1, Oct. 30, 1998).

Relationship Between Commercial Bank and IBC/Euro-American

As previously discussed, IBC/Euro-American also opened approximately 100 bank accounts at Commercial Bank of San Francisco for corporations it had formed for Russian brokers. We reviewed bank statements made available through the Subcommittee's subpoena which revealed more than \$600 million in wire transfers into these bank accounts. A Commercial Bank employee familiar with the records provided to the Subcommittee stated that over 50 percent of the wire transfers originated from foreign sources. The employee added that most of the \$600 million was subsequently wire-transferred abroad. Our review of the bank records indicates that the foreign sources included wire transfers into and from Eastern Europe.

According to the president of Commercial Bank, two Russians purchased about 9 percent of the bank's stock for \$1 million in March 1995. One of these individuals suggested that the bank hire him as a consultant to obtain new business from Russian depositors. Consequently, the bank entered into an agreement with East Industrial Financial Society, a corporation owned by this individual. East Industrial became the only full-time contractor soliciting business for the bank from April 1996 through March 1998.¹⁷ This individual (hereinafter "the Russian director")¹⁸ became a member of the Board of Directors of Commercial Bank in May 1997.

The IBC president informed us that another Russian introduced him to the Russian director in 1996. At that time, the Russian director suggested that IBC open bank accounts with Commercial Bank for U.S. corporations that IBC had formed for its Russian clients. As a result, in April 1996 IBC entered into a contract with East Industrial. The agreement provided that IBC would introduce potential banking customers to East Industrial, which would establish accounts for them with the Private Banking Group of Commercial Bank.¹⁹

¹⁷Under the contract, Commercial Bank paid a service fee to East Industrial.

¹⁸We have obtained information that indicates that this individual has had a close relationship with companies associated with members of the former Soviet Union's intelligence agency.

¹⁹IBC was to receive a service fee for business it introduced to Commercial Bank based on a percentage of average daily deposits in customer accounts once certain conditions were met. However, both the Russian director and the president of IBC stated that no service fees were paid to IBC.

The Russian director, who also served as the Director of Private Banking and the Director of the International Department at Commercial Bank, resigned from the Board of Directors and his other positions with the bank in December 1999, effective January 14, 2000. The president of Commercial Bank informed us that, during the period that the Russian director was a director or consultant to the bank, 40 percent of total bank deposits was from customers referred to it by IBC/Euro-American.

Commercial Bank officials stated that they had relied on representations made by IBC's president that he knew the clients he introduced and that Commercial Bank had conducted no independent due diligence concerning IBC/Euro-American referred customers. IBC/Euro-American clients were not required to appear in person at the bank to open accounts; instead, accounts were opened by mail. Commercial Bank officials also informed us that the bank filed Suspicious Activity Reports concerning activity in accounts of IBC/Euro-American clients and that it stopped opening accounts for IBC/Euro-American in 1999 due to numerous instances of suspicious transactions by its clients. We were also told that the International Department would be closed due to problems relating to the suspicious banking activities of its customers. The International Department closed on June 30, 2000; and Commercial Bank was recently sold.

Conclusion

It is relatively easy for foreign individuals or entities to hide their identities while forming shell corporations that can be used for the purpose of laundering money. Further, the money-laundering provisions of the Bank Secrecy Act require banks to identify suspicious activity and to report that activity to federal authorities. While the banking industry points to voluntary know your customer policies as implementing the requirements of the act, in this case two banks violated the principles of those policies. We previously reported similar violations by one of these banks.²⁰ The violations by the two banks in our current investigation facilitated the transfer of approximately \$1 billion from Eastern Europe, through U.S. banks, and back to Eastern Europe by corporations formed for Russian brokers. These transfers raise concerns that the U.S. banking system may have been used to launder money. We have referred the information developed to appropriate law enforcement and regulatory agencies.

²⁰*Private Banking: Raul Salinas, Citibank, and Alleged Money Laundering* (GAO/OSI-99-1, Oct. 30, 1998).

As arranged with your office, unless you announce its contents earlier, we plan no further distribution of this report until 30 days after the date on this letter. At that time, we will make copies of this letter available to interested congressional committees and others on request. If you have any questions or need additional information, please contact Deputy Director Ronald Malfi at (202) 512-6722. William McDaniel and Woodrow H. Hunt, Jr. were key contributors to this case.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Robert H. Hast". The signature is fluid and cursive, with the first name "Robert" and last name "Hast" being the most prominent parts.

Robert H. Hast
Managing Director
Office of Special Investigations

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