

# **CORRUPTION IN INTERNATIONAL BANKING AND FINANCIAL SYSTEMS**

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## **Abstract**

Money laundering made easy. If you are a criminal, corruption in a bank takes a lot of the worry out of laundering your illicit funds. This report provides some examples of where corruption in international banking and financial systems has occurred. It will show some of the common elements of this type of activity and lessons to be learned by those interested in crime prevention, detection and prosecution.

### **Case Study 1 – Bank of Credit and Commerce International (BCCI)**

*“The only laws that are permanent are the laws of nature. Everything else is flexible. We can always work in and around the laws. The laws change.”*

**Agha Hasan Abedi (1989)**

**Founder, BCCI**

*“(The bank) should more appropriately be called (the) “ Bank of Crooks and Criminals.”*

**Robert Gates (1991)**

**(then) Assistant Director, US Central Intelligence Agency**

The Bank of Credit and Commerce International (BCCI) was created in India before independence from British rule. After independence and partition of the sub-continent in 1947, BCCI moved to Pakistan.

In 1958, BCCI’s founder, **Agha Hasan Abedi**, formed a new bank known as United Bank which was licensed by the Pakistani government. Within ten years, and with considerable political patronage, United Bank became the second largest bank in Pakistan and its operations expanded into other countries, including many in the Middle East.

In the early 1970s, Abedi prepared to move the United Bank outside Pakistan due to the changing political climate. The new government had plans to exercise more control over financial institutions. Abedi’s desire to relocate was considered suspicious and he was placed under house arrest.

During his house arrest, Abedi dreamed of his bank becoming international, providing a link between economically developed and developing nations. He planned to locate it outside Pakistan to compete with Western banks by offering not only financial services, but also involvement in areas as diverse as shipping, insurance, commodities, real estate and even charitable works.

To realise his international ambitions, Abedi needed financial support and cultivated a relationship with the **Sheikh Zayed bin Sultan al Nahyan**, the ruler of the oil-rich state of Abu Dhabi. Following the involvement of the Sheikh in BCCI, the Bank’s assets were at any time, often half made up of assets derived from Abu Dhabi, the Sheikh and his family.

The Bank of America, which hoped to use Abedi’s connections to expand its activities in the Middle East, became a 25% shareholder in September 1972 and provided BCCI with the much-needed acceptability necessary to gain links with Western financial institutions. On the strength of its Bank of America connections, BCCI was allowed to operate from its six offices - in London, Luxembourg, Lebanon, Dubai, Sharjah, and Abu Dhabi.

Abedi wishing to further expand and avoid regulatory supervision, chose Luxembourg, a place known in financial circles to be a “loosely-regulated banking centre” in which to incorporate BCCI. Later, he created a holding company, BCCI Holdings in order to split the Bank in two parts. BCCI (SA) with head offices in Luxembourg, and BCCI Overseas with head offices in the Grand Cayman Islands.

The Luxembourg office handled European and Middle East operations while the Grand Cayman office dealt with developing countries. This organisational split was also accompanied by the creation of a series of parallel entities to circumvent local regulations.

BCCI's expansion was rapid. In 1976 it moved its head office to London although it remained incorporated in Luxembourg. By 1977, BCCI became the world's fastest growing bank, operating from 146 branches (including 45 in the United Kingdom) in 43 countries including Africa, the Far East and the Americas. Its assets for the same period increased from \$200 million to approximately \$2.2 billion. By the mid-1980s, it was operating from 73 countries with assets of around \$22 billion.

To assist this rapid expansion, BCCI staff were often pressured into accepting any business that came their way, legal or otherwise, and would often be penalised for rejecting business. The organisational structure was segregated so that the nature of one unit's activities would not be known to another, and where senior officials were discouraged from “asking too many questions”.

Another example of this compartmentalisation was BCCI's decision to divide its operations between two auditors (Price Waterhouse and Ernst & Whinney, neither of whom had the right to audit all BCCI operations), this was a significant factor in helping BCCI to hide fraud during its early years. For more than a decade, neither of BCCI's auditors objected to this practice. However, Ernst & Whinney did resign as Auditors in 1986.

Mid 1970s the US authorities rejected BCCI attempt to purchase an American Bank. The major concern was the absence of a primary designated regulator and lender of last resort to supervise BCCI's consolidated banking operations. BCCI was forced to rely upon Bank of America as its correspondent bank. The development and expansion of BCCI was dependent on a link to the United States since all its activities were in US Dollars (as the dominant world currency). The Bank of America relationship gradually deteriorated, as BCCI officials were not always forthcoming with information and documents requested by Bank of America. They eventually sold their stake in BCCI in 1980 although they remained BCCI's clearing bank.

Abedi enlisted the help of senior US political figures and in the late 1970s overcame regulatory obstacles to acquire four major banks, including the National Bank of Georgia and Financial General Bankshares/First American Bank, operating from seven states and Washington DC. In violation of US federal banking laws, the US acquisitions were made in the names of secret nominees in order to conceal BCCI's involvement and circumvent requirements to file financial information and to have a recognised regulator.

The Bank of England welcomed BCCI's presence in the United Kingdom even though it was concerned about the absence of a single international regulator and lender of last resort. BCCI did little banking business in Luxembourg and the Luxembourg Banking Commission felt that “it was impossible to supervise BCCI (SA) effectively from Luxembourg”. Following enactment of the *Banking Act of 1979*, the Bank of England licensed BCCI (SA) as a deposit taking institution (although not a full bank) based, in part, on the assurance that “external auditors were not qualifying the reports”.

BCCI's activities in many of the 73 countries in which it operated were dependent on the widespread use of pay-offs to prominent political figures. BCCI would obtain an important figure's agreement to give BCCI deposits from a country's Central Bank, exclusive handling of a country's use of U.S. commodity credits. BCCI gained preferential treatment on the processing of money coming in and out of the country where monetary controls were in place, the right to own a bank, secretly if necessary, in countries where foreign banks were not legal, or other questionable means of securing assets or profits. In return, BCCI would pay bribes to the figure, or give him other reward in the form of goods and/or services.

The result was that BCCI had relationships that ranged from the questionable, to the improper, to the fully corrupt with officials from countries all over the world. Amongst those countries were; Argentina, Bangladesh, Botswana, Brazil, Cameroon, China, Colombia, the Congo, Ghana, Guatemala, the Ivory Coast, India, Jamaica, Kuwait, Lebanon, Mauritius, Morocco, Nigeria, Pakistan, Panama, Peru, Saudi Arabia, Senegal, Sri Lanka, Sudan, Suriname, Tunisia, the United Arab Emirates, the United States, Zambia, and Zimbabwe.

To manage the \$10 billion pool of cash that lay in its international network, BCCI decided to centralise its treasury operations in 1982. However, the Banks excursions into the money markets were not very successful and its officials resorted to "creative accounting" to cover trading losses.

One of the techniques employed was to sell large quantities of 'options' to purchase currency or securities at a set price at a later date. The proceeds of these sales were shown in the books as profits. As liabilities materialised, BCCI was forced to sell even more contracts to keep the cash flow and profits running. The workings of a classic Ponzi scheme began. As BCCI's internal operations were split, it was also possible for executives to move the accounts around and cover-up their losses.

The complicated structure involving its use of shell corporations, bank confidentiality and secrecy havens, a layered corporate structure of front-men and nominees together with the endemic corruption ingrained in BCCI's operations made it an ideal environment for crime.

BCCI's criminality included:

- Fraud by BCCI and BCCI customers involving billions of dollars; money laundering in Europe, Africa, Asia, and the Americas;
- BCCI's bribery of officials in most of those locations,
- Support of terrorism, arms trafficking, and the sale of nuclear technologies;
- Management of prostitution;
- The commission and facilitation of income tax evasion, smuggling, and illegal immigration;
- Illicit purchases of banks and real estate.

In October 1988 the US authorities in Tampa, Florida indicted BCCI and its officers on charges of fraud, money laundering and falsifying bank records following an elaborate sting operation conducted by US Customs. The BCCI attorneys argued that it was inevitable that a bank operating in so many countries and where banking laws afforded maximum secrecy would be used by drug traffickers. In January 1990 in its guilty plea BCCI was only admitting that a few of its employees had engaged in money laundering and their guilt was based solely on a theory of corporate responsibility.

However, following the Tampa indictments nobody believed BCCI were unknowingly involved in money laundering. One BCCI official told investigators in the spring of 1992:

*“The degree of BCCI-US's reliance on money laundering as a principal business was demonstrated by what happened when BCCI put into place a "compliance program" as part of its January 1990 plea agreement resolving the Tampa money laundering case: business dropped noticeably, especially referrals from other BCCI locations, because neither BCCI nor its customers wanted to provide details about the customers' businesses.”*

BCCI's clients for money laundering included Panamanian General Manuel Noriega, for whom it managed some \$23 million of criminal proceeds out of its London branches; Pablo Escobar, of the Medellin cartel; Rodriguez Gacha, of the Medellin cartel; and several members of the Ochoa family.

Despite the US money laundering scandal and the reports from Price Waterhouse (UK auditors) advice that they had found serious problems with the BCCI, the Bank of England's response was not to close BCCI down, but find a way to prevent its collapse. In hindsight, many ideas as to why this happened, including fears that repercussions in the Middle East would result, to suspicions that BCCI had been involved in ongoing intelligence activities at the time, have been circulated.

In April 1990, the Bank of England reached an agreement with BCCI, Abu Dhabi, and Price Waterhouse to keep BCCI from collapsing. Under the agreement, Abu Dhabi agreed to guarantee BCCI's losses and Price Waterhouse agreed to certify BCCI's books. BCCI was permitted to move its headquarters, officers and records to Abu Dhabi. Consequently innocent depositors and creditors were deceived into believing that BCCI had no serious financial problems. Following the eventual closure of the Bank in June 1991, investigators from the US and elsewhere were hampered in their enquiries by essential documents and witnesses being in the grasp of the Abu Dhabi government.

On July 5, 1991, when BCCI was closed, some one million small depositors in BCCI around the world lost their deposits. There is no way of knowing even now precisely who were among all those who lost money. BCCI made frequent use of "managers' ledgers" or numbered accounts for its most sensitive depositors, whose identities were typically kept secret from everyone other than their personal banker at BCCI. Given the anonymity, the secrecy, and the source of the income behind many of these deposits, some depositors, including governmental officials or agencies, have not necessarily been in a position to assert claims to the money they have lost.

When New York District Attorney Robert Morgenthau announced the indictment on July 29, 1992 of BCCI's former heads, Agha Hasan Abedi and Swaleh Naqvi, and two of BCCI's front-men, Ghaith Pharaon and Faisal Saud Al Fulaij, he alleged, in some detail, how BCCI systematically engaged in criminal activity with officials and prominent political figures from many countries to generate assets for BCCI's Ponzi scheme, both from the governments involved, and from innocent, legitimate depositors.

There is no doubt that there was a corporate culture at BCCI of secrecy, fraud, deception and looking the other way at money coming from criminal enterprises. This culture extended to the highest level of the bank and probably started in the early 1980's. Bank officials were advised by US Customs undercover agents that money being deposited in the bank came from cocaine sales.

Money laundering of the proceeds of narcotics trafficking becomes a relatively easy thing to do when a banking institution such as BCCI and a number of its key officials cooperate fully in the laundering activity.

## **Case Study 2 – Operation Casablanca**

The United States Customs Service began an investigation in an attempt to identify those involved in the laundering of drug trafficking proceeds being moved from the United States to Colombia in late 1995 to May 1998. The investigation was later given the name Operation Casablanca. The investigation involved the use of a former drug trafficker/money launderer to play the role of a United States based money broker working with the Cali drug cartels to move millions of dollars in drug proceeds.

In January 1997, a Venezuelan lawyer, Carmen Salima Yrigoyen was introduced to undercover operatives by a Colombian money launderer Oscar Armando Saavedra. Yrigoyen stated that she had connections in the Caracas financial system who could assist them in money laundering. In early 1997, after \$650,000 had already been laundered, Yrigoyen introduced the undercover agents to a person who could organise the opening of off-shore accounts, Carlos Izurieta Valery, who worked for a United States based company, Gabriel Holding. Yrigoyen and Valery assured the undercover agents that they could safely move \$4-5 million a month through these accounts.

During the course of these money laundering activities undercover agents told the Venezuelan bankers they dealt with that the funds were drug proceeds of the Cali cartel, much to the annoyance of the lawyer Yrigoyen who reportedly stated, "It's one thing to be honest with others, it's another thing to make a confession. Believe me he knows the money belongs to drug traffickers, but you don't have to confess it to him. Leave your sins to a priest."

At one point, to overcome the problem of her occasional unavailability to her clients, Yrigoyen introduced the agents to her law partner Jose Perez assuring them that he could be trusted and knew all about the systems that had been put in place. That system involved the opening of "straw" accounts, to which money was wire transferred. Withdrawals were then made in the form of bank checks or bank drafts drawn on the Mexican banks' corresponding accounts at banking institutions in the United States.

Bankers and Banks implicated in the scheme and charged in relation to the investigation Operation Casablanca included:

- Esperanza de Saad - Banco Industrial de Venezuela (BIV) Executive Vice President/General Manager of the Miami branch (laundered approximately \$4mil)
- Marco Tulio Henriquez - Banco Del Caribe Vice President in Caracas.
- Bancomer, S.A (pleaded guilty and agreed to forfeit \$9.4 million plus pay \$500,000 fine)
- Banca Serfin, S.A (pleaded guilty and agreed to the forfeiture of \$4.2 million plus pay \$500,000 fine.)

A third Mexican bank, Confia, S.A., which had been purchased by Citicorp, agreed in a civil action to the forfeiture of \$12.2 million. Criminal charges against Confia were formally dismissed.

The United States has seized more than \$52 million from Mexican and Colombian defendants in domestic bank accounts of nine other Mexican banks that were not criminally indicted, plus an additional \$1.3million in cash. The United States also seeks the forfeiture of \$23 million in foreign accounts in 18 other countries.

Customs agents in Miami were able to arrest Carmen Salima Yrigoyen, Esperanza de Saad and Carlos Izurieta Valery. Two others indicted Robertor Vivas and Marco Tulio Henriquez, are believed to be in Venezuela. The Venezuelans Carmen Salima Yrigoyen, 45, Carlos Izurieta Valery, 54, and Esperanza De Saad, 56, were convicted in December 1999, of various money laundering-related counts. Yrigoyen was found guilty of 23 felony counts; and faces a maximum possible penalty of 460 years in federal prison. Valery and De Saad were found guilty of 11 counts and each could be sentenced to as much as 220 years in prison. Sentencing should be finalised in April 2000. On the eve of his trial, defendant Jose Perez (law partner of Yrigoyen), pleaded guilty to a felony count of conspiring to launder money and was sentenced to time served, which was approximately 17 months.

11 money brokers and other employees of Mexican banks pleaded guilty to criminal charges. Among this group was Victor Manuel Alcala Navarro, also known as Dr. Navarro, who pleaded guilty to 28 felony counts for introducing the confidential informant to Mexican bankers who were willing to launder drug money.

Approximately \$60 million was laundered through Mexican banks during the operation. The Mexican government has pledged to prosecute five defendants who were arrested in Mexico, and 17 defendants are fugitives who are wanted by US authorities. In total, 115 defendants have been charged. 40 people have been convicted in relation to Operation Casablanca so far.

Following the conviction of Yrigoyen, Valery and De Saad in late 1999 the following press release was made by US Attorney Mayorkas:

“This United States Attorney's Office is proud to have led the largest and most successful money laundering prosecution in this country's history, our prosecutors, along with our colleagues in law enforcement, have worked around the clock for nearly three years to ensure that individuals involved in the laundering of hundreds of millions of dollars in narcotics proceeds were brought to justice. The jury has spoken, and justice has been achieved.”

### **Case Study 3 – Bank of New York**

The money laundering scheme which it is alleged moved more than \$7 billion from Russia through the Bank of New York, had its beginning from a friendship formed at the Moscow Finance Institute in the late 1980s. Ivan Bronov and Kiril Gusev after working independently in various roles within the Moscow finance world, joined forces in 1995 as employees of the Depozitarno-Kliringovy Bank (DKB). Bronov was responsible for correspondent banking business and Gusev handled the Bank's import-export clients.

Another man that formed part of the original money pipeline was Aleksey Volkov. Volkov met Bronov and a colleague Dmitri Kochkin when they held positions in the small bank Industriya Servis prior to a plunge in the ruble that closed many banks in 1995. Kochkin and Volkov ran a US formed company, General Forex Corp from 1994. General Forex was little more than an account held with Citibank, a mail drop in Long Island and a one-room office in New York's Queens district fitted out with computers. Their trade was to help Moscow businessmen to move money abroad without attracting adverse attention. General Forex was the first version of what became Benex International Co.

At the end of 1995, worried by the heavy traffic of General Forex transfers, Citibank announced that they planned to close the account. Volkov and Kochkin turned to their colleague Gusev for advice. Gusev had an idea of who might be able to help. In 1994 he had met through his work in currency trading a dynamic lady installing currency exchange software for the Bank of New York. Lucy Edwards was born Ludmilla Pritsker in Leningrad and was an enthusiastic promoter of the Bank of New York services in Russia. Her Russian husband, Peter Berlin owned a company Benex International that he hoped to use as a conference business, providing advice to Russian bankers wishing to operate within the US financial system.

Gusev approached Edwards for advice on replacing General Forex. She recommended that Gusev and his colleagues meet with her husband as his company Benex already had established an account with Bank of New York. The deal was struck, Berlin met with Gusev and Bronov's representative Volkov, the one room office of the former General Forex was fitted with Bank of New York software that allowed transfers to and from the Benex account using a personal computer.

Clients of Benex would go first to the main floor of DKB and send a small amount to the overseas supplier to whom they owed money, a larger sum would be wired to Benex's Bank of New York account. The client then went to a small office on the fifth floor in the DKB bank building, where a young lady working New York hours would take down the name of the supplier, their bank account number and other details to prepare instructions for payment to send the workers in the Benex office in Queens. Payments to the supplier were then made from Benex once the funds from the wire transfer hit the Benex account. This allowed the Russian client to evade taxes and duties in Russia.

To further complicate the transfers Benex set up shell companies for the clients to draw from and set up another money transfer business in California, Sinex Corp. Sinex Corp was sometimes worked into the loop between Russia and Benex. In 1996, Sinex obtained a bank license from Nauru an offshore banking haven. Sinex Bank opened an account in San Francisco to facilitate transfers for Benex. Interestingly Sinex Bank also opened an account in Sydney although the transactions on this account were not substantial. The San Francisco account held by Commercial Bank was frozen when Sinex failed to confirm that it had renewed its Nauru banking license in 1998. Other entities connected with Benex's clients were; BECS International LLC, Flamingo Bank and Lowland Inc.

The Benex system was not only used for tax and duty evasion. Investigators of alleged Russian mob activities uncovered suspicious transfers through Benex in 1998 and delivered two subpoenas. Later in July 1998 Peter Berlin was issued with a subpoena to appear before a grand jury. In August police seized discs and documents from Ms Edwards London flat and what followed was an investigation involving the FBI and UK authorities tracking thousands of transfers to dozens of countries all over the world. One such transaction was believed to be a \$300,000 ransom payment from a Russian kidnapping. Many others suggest questionable activities conducted by former IMF and World Bank officials in Russia and by people that were close to former President Boris Yeltsin.

Recent reports indicate that some of truth of what went on may soon come to light, with Edwards and Berlin pleading guilty to money laundering but hoping for reduced sentences in return for their co-operation with the authorities. Amongst the revelations to date is that Berlin has admitted to having met with an alleged Russian mob boss Semion Mogilevitch twice in the Ukraine and London. Investigators suspect that around \$200 million of proceeds



from criminal activity such as arms dealing, prostitution and other illegal activities, was laundered by Mogilevitch and his associates through the Benex scheme. Edwards admitted to preparing false documents to assist clients to obtain visas to the US. The couple have also admitted netting \$1.8 million in commissions from their business and evading taxation. They both could face a maximum of ten years in prison in addition to the forfeiture of assets including funds held in two Swiss bank accounts.

### **Common Elements**

As can be seen from the case studies presented the existence of corruption within banking and financial systems allows for the operation of money laundering activity over a long period before it is detected. The mingling of illicit funds with the huge volume of legitimate transactions using regular financial systems provides cover, especially when employees of banks or financial service providers work with the criminals to deflect adverse attention from authorities and regulators.

Other elements that may not have been applied with criminal intent include:

- Poor regulation – as in the case of the Bank of England/Luxembourg authorities in the BCCI case
- Agreeing to undertake duties of an Auditor without securing sufficient knowledge of the entire organisation - Price Waterhouse and Ernst & Whinney and BCCI
- Association with suspect entities in the hope of promoting their own aims – as in the case of the Bank of America and BCCI (increased connections to the Middle East) and the undercover operatives in Operation Casablanca making use of the struggling Mexican financial system over-anxious to increase their cash holdings
- Poor or non-existent application of the “Know your customer rule” by Banks as in the case of the Bank of New York believing that Benex was an import/export company
- Poor supervision of its employees by Banks – as in both Operation Casablanca and the Bank of New York/Benex cases. How was Edwards able to install software that tapped into the Bank of New York for Benex with no-one questioning the relationship?

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### **Lessons to be learned – Can it happen here?**

As Law Enforcement officers we are very much at the mercy of the legislative environments in which we operate.

It is hoped that the regulations followed by our Reserve Bank would protect us from an organisation such as the BCCI. However, it is noted that despite the concerns of both the Luxembourg and Bank of England authorities at the absence of a primary designated regulator and lender of last resort to supervise BCCI's consolidated banking operations they still allowed it to operate. Possibly because of the apparent success that it was achieving, and that an illusion created by the rapid expansion and the supposed backing of wealthy Middle Easterners. What of the foreign banks operating in Australia, have they satisfied all of the written and unwritten requirements of the Reserve Bank? There is certainly one aspect of non-compliance with the Financial Transaction Reports Act 1988 that I know of regularly experienced with some foreign banks here. That is the reporting of certain transaction details in a form which is unable to be easily interpreted by AUSTRAC or law enforcement analysis, the Chinese Commercial Code.

The success of Operation Casablanca could not be reproduced in Australia, simply because if we employed the tactics used by US Customs we would breach Australian law. The legislation to allow for controlled operations of this nature is yet to be passed in this country. But the question has been raised that even if we did have such legislation, would Australia be prepared to take the action that the US did in achieving their aims? Does Australia feel sufficiently powerful to send investigators into another jurisdiction and virtually storm their financial institutions as the US have done in the past?

Finally, on a more positive note it would appear that the type of financial activity involved in the Benex/Bank of New York case would have almost certainly brought a more timely law enforcement response in Australia. The existence of AUSTRAC and the legislation that created it, allows for the analysis of reportable financial transactions. The analysis includes the monitoring and targeting of certain patterns of activity which have been programmed into computer systems after models of suspicious activity have been established through regulatory and law enforcement experience. However, detecting the activity is one thing, taking action against it is another. Funds transferred from Russia do come to Australia. Often law enforcement suspect that the funds are proceeds of crime but without evidence of the predicate offences in Russia for example, and a direct link from the funds to those offences, Commonwealth money laundering charges cannot be laid.

Steps to address some of the difficulties experienced by law enforcement officers in applying the Commonwealth Proceeds of Crime Act 1987 have been taken in the form of an Australian Law Reform Report "Confiscation that Counts" which recommends various changes to the existing law.

## **References and Acknowledgements**

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