NEWS > International

Watching overseas funds

September 1, 1999: 8:25 a.m. ET

Alleged Russian mob money laundering raises questions about bank safeguards

By Staff Writer M. Corey Goldman

NEW YORK (CNNfn) - What's being dubbed as the largest case of money laundering involving a U.S. bank -- concerning billions of dollars in funds from Russian organized crime -- has revealed a complicated system that forces banks to decide for themselves when to question the source of profitable business.

As dozens of investigators from two continents begin the process of digging to the bottom of the dirty money pile, questions are emerging about the multitude of safeguards in place -- both in the U.S. and in other countries -- that supposedly prevent illicit funds from finding their way into the international banking system.

"As long as people have money they are always going to try to do inappropriate things with it," said Thomas Johnson, director of the Banking Administration Institute in Washington, which monitors and reports on banking issues to the U.S. government. "The real question is how banks and government authorities deal with that and whether their safeguards really work."

The facts

The saga that's brought money laundering issues to the fore this summer allegedly began back in 1994, when Russia's International Monetary Fund representative, Konstantin Kagalovsky, left the organization to join Menatep Bank in Moscow.

Over the next three years, it's alleged, Kagalovsky arranged to funnel billions of IMF money meant to help transfer Russia's communist economy into a capitalist one through a private company called Benex Worldwide Ltd. Eventually, the money went into and back out of Bank of New York (BK) and Republic National Bank, a unit of Republic Bancorp (RBNC), as well as several institutions in Europe, including the Union Bank of Switzerland AG and Deutsche Bank AG and its Bankers Trust Unit.

In 1998, Republic Bank alerted authorities about unusually large wire transfers coming through its coffers from Russia. From that point, British and U.S. law enforcement officials monitored the ebb and flow of cash through both banks, including monitoring an account at Republic Bank specifically held open at their request.

Last week, Bank of New York suspended one of its upper echelon executives, Natasha Gurfinkel Kagalovsky, and fired the other, Russian-born Lucy Edwards, both of whom worked for the bank's Eastern European division. Konstantin Kagalovsky is Natasha Kagalovsky's husband.

The players

On Monday, Bank of New York Chairman Thomas Renyi told employees in an internal memo that the bank is "thoroughly examining our funds transfer controls and processes" in the wake of the allegations. IMF head Michel Camdessus said Tuesday that he still plans on giving Russia its next credit payment of a $4.5 billion, despite the ongoing scandal.

Other key players include Peter Berlin, Edwards' husband who allegedly opened Benex-related accounts at Bank of New York, and Semyon Mogilevitch, an alleged Russian money launderer, drug trafficker, arms dealer and murderer who at one point was suspected of channeling funds through YBM Magnex International Inc., a now-defunct industrial magnet producer whose shares were listed on the Toronto Stock Exchange.

Mogilevitch could not be reached directly by CNNfn for comment. Last week, though, he told Russian newspapers that the Federal Bureau of Investigation's accusations were an unfounded attempt to instill fear about Russian organized crime and to get additional funding from Congress. He also told the newspaper that the closest he's come to money laundering was when he "accidentally washed $5 I'd left in a shirt pocket."

"Once I accidentally washed $5 I'd left in a shirt pocket. I must say they looked a lot cleaner after that."

—Semyon Yukovich Mogilevich

To date, no person or organization has officially been charged with any wrongdoing by any government group or organization.

Analysts who cover bank stocks and analyze the financial health of those companies have chosen to stick to their models rather than voice their opinions on money laundering. Virtually all levels of U.S. government involved in the investigation, as well as the IMF, are staying mum on their findings. And most significantly, though not unexpected, the banks themselves are revealing as little as possible to the public.

The rules

"Bankers do not want to be a part of any kind of fraud," said Robert Rowe, regulatory council for the Independent Bankers' Association of America in Washington D.C. "Obviously it's very bad publicity and they want to be as far removed as they can."

But the banks are publicly involved in the money laundering discussion because of laws enacted over the past three decades concerning the practice.

It started with the Bank Secrecy Act in 1970, which required banks to keep records of all financial transactions so investigators could trace them if they needed to. It also made it law for banks to report any cash transactions in excess of $10,000.

Click above for a timeline of the various U.S. money laundering Acts

Banks and some liberty groups weren't all that fond of the Bank Secrecy Act and in 1974 attempted to have it declared unconstitutional. They argued against the act on a number of grounds, including the Fourth Amendment protection against unreasonable searches and seizures and the Fifth Amendment protection against self-incrimination.

The U.S. Supreme Court rejected the claims, noting that the information sought from the reporting banks concerned transactions to which the banks themselves had been parties.

The system

In 1986, the Money Laundering Control Act was passed, making it an illegal activity in its own right, and in 1990 the Financial Crimes Enforcement Network (FinCEN) was created - an organization specifically used to detect financial crimes.

The Annunzio-Wylie Money Laundering Act in 1992 toughened up the laws even more. It made it illegal for a bank not to report any kind of suspicious banking activity. It also required that all financial institutions conduct internal anti-money laundering programs and keep special records of large transactions.

From 1995 on, a series of amendments was enacted, culminating with the final rule that allows U.S. banks to exempt a domestic business that uses lots of cash, so long as the business has been a customer for one year -- in other words, no reporting necessary.

What exists today is a system where banks, by law, must police themselves and report those activities to authorities, according to the experts. While government agencies handle the paperwork and bureaucracy, when it comes to laundering cash, it is up to the banks themselves to spot it happening in the first place.

The outcome

"Banks, by law, are required to know their customers," said John Cairns, a partner and banking legal expert with Wilkie, Farr and Gallager in New York. "What becomes difficult from the banks' point of view is being suspect of a situation that may or may not prove to be something wrong."

In Britain, where other financial institutions are being investigated for involvement in the same money laundering ring, supervisory authority rests with the Financial Services Authority, a recent creation that has taken over the former regulatory functions of the Bank of England. But even the FSA is powerless to actually enforce laws -- it can only relay concerns to the proper authorities, who then must decide whether to pursue the issue.

"The FSA doesn't have any powers to enforce money-laundering regulations," said Kate Burns, an FSA spokeswoman. She noted that legislation aimed at reducing "financial crime" is still winding its way through British Parliament.

Swiss banks, which are synonymous for bank secrecy, do attempt to keep close track of the money that flows in and out of their doors each day, including verifying a client's identity and back-checking documents for validity, according to Christoph Meier, a UBS spokesman. However, with billions of dollars zipping around each day, those types of safe measures can prove difficult to maintain.

And there's the same issue that exists in the U.S. -- that it's up to the financial institutions to sniff out and weed out the rats among their clients. And the sniffing has started at Bank of New York's front door.

The result

"This more than likely looked like great business and they may not have been looking at it as closely as they should have," Rowe said. "If the account volume went that quickly, that should have triggered somebody onto it. Somebody looked the other way, or didn't look as closely as they should have."

Indeed, the Bank of New York, like any other major bank, has a team of compliance officers and other staff members that comb records daily in search of irregularities. If an irregularity is spotted -- a larger-than-usual deposit or withdrawal or increased activity in a particular account -- an internal investigation is launched.

Once that process is completed, the findings are sent to state and federal regulators, who then decide whether or not to further the investigation.

"Some of those reports are filed and then go into a black hole," Rowe said. "Other times there are no reports. The processes were there, but just because they're in place doesn't necessarily mean that people are going to follow them."

Investigators will have their work cut out for them in the months ahead as they piece together exactly who took what and put it in which bank account. The list of players may grow. The amount of laundered money may increase. Arrests may be made.

But the real issue -- how a scheme involving such an exorbitant amount of money sloshing through major financial institutions over such a long period of time could go unnoticed, or whether it really did go unnoticed at all -- will take years to unravel and perhaps even amended laws to fix.

"There's no question that the system gets taken advantage of," said the BAI's Johnson. "There are very talented people out there taking advantage, it's constantly evolving and there will likely always be a way around it."

"It's a compliment to the U.S. banking system that, whatever the purpose, people would rather have their money in U.S. banks than anywhere else," Johnson said. "If you had a horrible banking system, then these issues wouldn't happen."

-- with additional reporting from CNNfn.com's London bureau

RELATED STORIES

Russian scandal widens - Aug. 26, 1999

RELATED SITES

IMF

World Bank

U.S. Treasury

Bank of New York

Republic National Bank

Note: Pages will open in a new browser window
External sites are not endorsed by CNNmoney

Closed Captioning

Site Map