RUSSIAN MONEY LAUNDERING

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Russian Money Laundering, Serial No. 106-38, Septe 21, 22, 1999 (106-1 Hearing)

PLARING

BEFORE THE

COMMITTEE ON BANKING AND FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

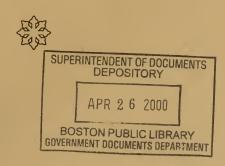
ONE HUNDRED SIXTH CONGRESS

FIRST SESSION

SEPTEMBER 21, 22, 1999

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RUSSIAN MONEY LAUNDERING

TUESDAY, SEPTEMBER 21, 1999

U.S. HOUSE OF REPRESENTATIVES, COMMITTEE ON BANKING AND FINANCIAL SERVICES,

Washington, DC.

The committee met, pursuant to call, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. James A. Leach,

[chairman of the committee], presiding.

Present: Chairman Leach; Representatives Roukema, Bereuter, Lazio, Bachus, Royce, D. Weldon of Florida, Ryan, Biggert, Terry, LaFalce, Vento, Frank, Waters, Velázquez, Bentsen, Sandlin, Inslee, Moore, Jones, and C. Weldon of Pennsylvania.

Chairman LEACH. The hearing will come to order.

The committee meets today for its fifth hearing on international financial issues this year and the third on Russia and corruption over the last twelve months. The hearings today and tomorrow will be followed this fall by others dealing specifically with Western financial assistance strategy, including the International Monetary Fund, regulatory issues attendant to preventing financial crimes, the depth of the crime and corruption problem in Russia, Russian use of offshore financial institutions and the intertwining of those institutions with the United States and other Western banks, the role of public and private United States advisers in Russia's transition to free markets, the role of the U.S. intelligence community in monitoring Russia's Central Bank and other monetary and banking matters, as well as other concerns.

Today, we will begin with an examination of recent allegations that corrupt Russian groups and individuals have infiltrated Western financial institutions. In this regard, we invited several witnesses who, according to various reports, have material knowledge of these matters, but who have declined to appear voluntarily before the committee, including Natasha Kagalovsky, former head of the Eastern European Division, Bank of New York; Lucy Edwards, formerly with the London office of the Bank of New York; Bruce Rappaport, Chairman and CEO of the Bank of New York Inter-Maritime; Mikhail Khodorkovsky, Russian oil industry executive; as well as the chairmen of several Western money center banks.

As the hearing process continues, it will be my intention to seek witness subpoenas where appropriate. We also invited Carla del Ponte, the former Chief Swiss Prosecutor. She could not come, because she took up new functions at The Hague yesterday, but she sent a statement outlining a new aggressive Swiss policy toward the scourge of money laundering which involves a hard look at

Russian corruption. I invite the committee's attention to her statement and would ask unanimous consent it be placed in the record. [The prepared statement of Carla del Ponte can be found on page

202 in the appendix.

I also invite the committee's attention to a letter from the Honorable Yuri Skuratov, the Prosecutor General of Russia, who also was invited to testify. Mr. Skuratov notes that he is "unfortunately" unable to come this week, but observed that he is "deeply convinced that the forthcoming hearings will allow him to develop valuable recommendations to the financial and law enforcement structure of Russia and the United States of America in counteracting infiltration of dirty money into our financial systems."

Mr. Skuratov has offered his personal cooperation with the committee's work. Significantly, two days after receiving the committee's invitation to testify, his apartment in Moscow was ransacked.

It is my intention that the first of our subsequent committee hearings on Russia will focus on Western assistance strategy for Russia and the possible diversion or misappropriation of those funds. Last month, Mr. LaFalce and I commissioned a GAO study to examine the effectiveness of the \$90 billion in Western assistance for Russia, particularly in light of problems of corruption and the power of the so-called "oligarchs." But recent developments warrant an additional in-depth investigation of allegations of diversion or misuse of Western assistance.

In this context, I would advise in the strongest possible terms that the Department of the Treasury insist on a full and complete audit of the relationship between the Central Bank of Russia and the IMF, particularly the activities of the CBR in the foreign exchange and treasury markets in the period of July to August 1998. Failure to do so would undercut any remaining credibility of international financial institutions dealing with Russia. Likewise, I will request this week a full GAO audit of U.S. bilateral assistance to Russia, as well as a review of multilateral assistance efforts.

The global payment system is opaque and anonymous by design, and has been made more so by the technological advances of the past decade. The same technology that has produced such great benefits for the financial services industry and the world economy as a whole has also made it enormously difficult to trace the proceeds of illegal activity once a criminal succeeds in gaining entry to the payment system. In an era where funds can be transferred among multiple accounts on multiple continents in the blink of an eye, the challenges faced by law enforcement agencies, regulators and financial institutions in trying to track dirty money through the system are enormous.

In this regard, one of the issues brought forth by recent reports of large money flows of questionable origin through Western financial institutions is the legal obligation of U.S. banks to report such activity to appropriate authorities. Under current law, depository institutions are required to file so-called "Suspicious Activity Reports," or SARs, with the Treasury Department whenever they become aware of suspicious account activity or possible violations of law. According to press reports, it was the filing of a SAR by one of the banks that will be represented at this hearing, Republic National Bank of New York, that helped alert law enforcement au-

thorities to the massive funds flow from Russia into other New

York money center banks.

Let me just conclude by stressing that this is a hearing designed to help Russia and the Russian people. It is not a hearing designed to embarrass anyone. We want to look to Russia as a country with a great future, not as a country that appears to be imploding from within, and for this reason, I would like to take a moment to speak directly to the Russian people.

[Statement from Chairman Leach in Russian.]

At this point, I would like to introduce a group of Russian parliamentarians who are visiting us this morning. I would like them to

You are very welcome. Thank you.

[The prepared statement of Hon. James Leach can be found on page 196 in the appendix.]

Chairman LEACH. Mr. LaFalce.

Mr. LAFALCE. Mr. Chairman, I don't know whether to say that I agree or disagree with those latest remarks of yours, but I am sure that I agree in large part.

Mr. FRANK. Would the gentleman yield?

I would like to just say that some of us are glad now that we didn't vote for the English-only bill, because it would have gotten

the Chairman in trouble.

Mr. LAFALCE. Mr. Chairman, thank you very much for holding these extremely important hearings. We have all become aware of the recent press reports revealing major problems in the areas of money laundering, diversion of funds, the crime and corruption in Russia that appear to have reached into the United States banking system. The situation has called into question the efficacy of our money laundering statutes and the monitoring capabilities of our international financial institutions.

I have long been concerned with the serious allegations of crime and corruption in Russia and the alleged infiltration of the country's government institutions by organized crime. Indeed, as Chairman of the Small Business Committee, I held hearings on this issue the last year I was Chairman, April 14, 1994, and then on May 12, 1994, where I had the pleasure of having the then-Assistant Secretary of the Treasury for International Policy and Financial Institutions, Dr. Summers, and we discussed this issue at con-

siderable length at that time.

With your permission, Mr. Chairman, I would like to put into the record the opening statements that I gave at those two hearings in April and May of 1994.

Chairman LEACH. Without objection.

Mr. LAFALCE. While we are not in any position to dictate how a country should run its internal affairs, we are fully entitled to an accounting of whether the funds provided by international financial institutions are to be used for their intended purposes. These funds involve significant United States taxpayer resources, and it is our duty to ensure that they are not misused.

At the same time, our National Security Adviser and the stability of the world's financial system demand our continued constructive involvement with Russia. As a democracy experiencing growing pains and still purging itself of the political and economic ghosts of its Soviet past, Russia continues to need our help. Isolating Russia and isolating ourselves from Russia would not be the solution.

It would be counterproductive.

And so I see little to gain in the simplistic options some have suggested of abandoning as substantial and as troubled an economy as Russia's. I recognize there are challenges to continued engagement, and the memorable words of Sir Winston Churchill more than a half a century ago still ring true. "I cannot forecast to you the actions of Russia; it is a riddle wrapped in a mystery inside an

enigma."

However, as painful and frustrating as the process might be, I know that the ultimate payoffs of our continued engagement with Russia are far, far greater than the risks. But it is time to ask some tough questions and to get answers that we need to make our policy of engagement work much better. We should continue to encourage economic and political reform in Russia, but we should also impose tough conditions on the assistance we give and find better mechanisms, if at all possible, for monitoring that compliance, and unless we can obtain the necessary cooperation from Russia to make that possible, our long-term involvement would be put at risk.

I think there is one area of our policy that deserves particular scrutiny and hopefully will teach us some important lessons. I personally believe that a major part of what went wrong in Russia was the manner of the privatization program in Russia. This is not a new refrain for me. I had hearings on the privatization program. I have discussed this at length; I wrote to the President on this,

and so forth.

Privatization can be very important, and it can first help achieve greater equity and new opportunity in the distribution of a society's wealth and assets; and second, can restructure key resources such as utilities, transportation, banks and trade companies to permit them to respond to market forces rather than government dictates. It can build up a small business and medium-size business class that can build up a middle-income structure within a country, that

is, if it is done right.

But there is another approach to privatization, what I refer to in my letters to the President and in my hearings in 1994 as Mexican "patron" privatization and Russian "nomenklatura" privatization, and that, in considerable part, is unfortunately the road that Russia took. Russian privatization has most often come to mean the wholesale transfer of valuable state assets to a small group of tycoons who are more interested in taking value out of the country than investing in it. This type of privatization concentrates wealth and puts an economy at risk.

Dr. Summers, who testified on this before my Small Business Committee in 1994, I would appreciate at some point in your presentation today your analysis of what went wrong, what went right, what we can learn about managing such situations in the future

and dealing with such situations.

Let me now turn to the specific issue of money laundering. Of the many public policy challenges facing lawmakers, the law enforcement community and regulators today, none may represent as significant a threat to our financial system as money laundering does. You want to get at the root of crime, follow the money, follow

the money, follow the money.

And the wholesale "cleansing" of illegitimate profits derived from criminal activities reaches staggering proportions, by some estimates, between \$100 and \$300 billion in the United States alone and perhaps one-half trillion worldwide. By comparison, this figure

dwarfs the GDP of many, many nations.

Press reports have now alleged that up to \$10 billion of possible illicit Russian money passed through one bank. That may or may not be accurate. That may or may not involve appropriate accounting—double, triple accounting. It remains to be seen. The facts of the case are very sketchy. The criminal authorities are investigating. It would be most premature for us to pass judgment on any aspect of this case without a full accounting of the facts, and since there is a criminal investigation taking place, it might be some time before we have that.

Our Banking Committee did take a good look at money laundering in 1994 when we passed the Money Laundering Suppression Act. Up until recently, the emphasis on financial institutions' compliance with cumbersome paperwork requirements worked against the effective enforcement of money laundering laws. The 1994 Act made the reporting requirements part of the Bank Secrecy Act

more meaningful and more useful to law enforcement.

But even with these targeted changes, we still learn of egregious cases that our regulatory system is supposed to catch, but misses. And often they occur in vulnerable emerging democracies like Mexico and Russia, places where the rule of law is still, unfortunately, not fully consolidated; and when the big cases strike, we begin to wonder whether the regulatory system, our first line of defense.

truly works.

I do believe, Mr. Chairman, that it would have been productive for us to examine regulatory issues in this hearing, which are ripe for revisiting, and I hope that in the very near future the bank regulators, who are not going to be here either today or tomorrow, will come before our committee to explain to us what may or may not be wrong with our current regulatory system. I would like to hear, for example, from the Federal Reserve, the regulator with respect to one bank that received a tremendous amount of publicity, the Bank of New York, for example.

With that, I thank the Chair very much.

Chairman LEACH. Well, thank you, John, and let me say that will be the subject of future hearings, which I outlined at the beginning of my statement.

Does anyone else have an opening statement?

Mr. Bereuter.

Mr. Bereuter. Thank you, Mr. Chairman. While I certainly do commend you for the obvious need to have the hearings on Russian money laundering, I appreciate the fact that you and Ranking Member LaFalce have apparently solicited the assistance of the General Accounting Office. Like the Banking and Financial Services Committee, we share a role in reviewing these issues with the International Relations Committee. I think that the bilateral assistance programs of the United States also need to be examined.

While this hearing is on Russian money laundering, the Treasury Department, of course, has the major role for our Government's participation in making decisions on multilateral development banks. One of the most important, obviously, is the International Monetary Fund. I served as the Ranking Member for many years on the subcommittee responsible for oversight of the multilateral development banks, including the IMF, and I would urge the Chairman and Subcommittee Chairman Bachus that this is an appropriate time to examine the performance of the International Monetary Fund.

In my history here I have never failed to support authorizations and appropriations for the International Monetary Fund, but in light of what has happened, I do believe that it is time to hold in abeyance any further assistance from the International Monetary Fund to Russia. I also think I would have to cast a vote of no confidence on the International Monetary Fund in their activities.

It is clear to me that they gave bad advice to Korea and Thailand in the early stages of their financial problems, and thus they complicated the situation in those countries. It is clear to me that bilateral and multilateral funds were used to shore up the election opportunities of President Yeltsin to the disadvantage of the Russian people.

I believe that we certainly need to continue bilateral assistance programs for rule of law, for democracy building, and for Nunn-Lugar, working with a variety of governors and local officials that have managed to escape the ravages of corruption in that country.

All you have to do today is to go to Cyprus to see the impact of money laundering on its economy. It has become a center of money laundering for money coming out of the former Soviet Union, including Russia. Distinguished former members of Democrat and Republican Administrations in the past have told us here on Capitol Hill in the last several months that they estimate at least 30 percent of the financial assistance going to Russia has been outright stolen—not just misused, but outright stolen—and unlike the money stolen by the robber barons of the previous century in the United States, that money was not reinvested in Russia. We are looking at one track of money laundering activities these new barons moved out of Russia today.

I do believe it is appropriate for us to examine the IMF and its role, and certainly to examine the bilateral assistance programs of the United States aimed at the central government of Russia today. For the past two years, Russian economists have been telling those of us involved in the Aspen Institute study seminars for some fifteen years, that financial assistance to the Russian central government has, in fact, been counterproductive. I urge my colleagues to think beyond money laundering, where we will focus today, on how the funds of the International Monetary Fund may have been used by false accounting, by false reports, by failed promises on the part of the Russian central government.

of the Russian central government Thank you, Mr. Chairman.

Mr. FRANK. Mr. Chairman. Chairman LEACH. Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman. There are two levels at which we have to proceed. One is the very specific inquiry into

what was obviously serious wrongdoing on the part of people within the Russian government and the failure of some oversight mechanisms, and I think that is very important that we do that; but there is a second level, and I think it is important that we balance them.

The second level is recognition that we are dealing with a major nuclear armed power and the fact is that there is a tendency, I believe, not just here, but elsewhere, for Americans to exaggerate the extent to which we here in Washington can solve all the problems in the world. We confronted a situation in post-Communist Russia of grave danger and uncertainty. Indeed, we all do tend to focus on worst cases, and clearly the degree of theft and the consequent denial of resources to the Russian people is outrageous and should be focused on.

What we ought also to remember, I remember some of the predictions that there would be mass starvation, that democracy would fall, that forces of the old Communist regime would take over, that a new kind of fascism would take over. There was also a more serious threat of nuclear proliferation. The second most heavily armed nuclear power in the history of the world was in this terrible state, and I say that, because when we come to the question of better oversight and better mechanisms, I think we should

be very stringent.

When it comes to the question of American policy in general, I will be particularly interested to hear people tell me what the alternatives were. Obviously, we faced a very difficult situation—the world's other superpower, adjusting to not being a superpower, but still being superpowerful in terms of its nuclear weapons; a nation which had no tradition of democracy entering democracy; a nation that had no tradition of a market economy being led to a market economy—and I don't doubt we should have done better. But there has to be a consideration of what our alternatives were. There has to be a consideration of what else we should have done.

I also think we are going to greet our old friend hindsight here today. Maybe I was absent that day, but I don't remember the day a motion was made on the floor of the House to cut off all aid to Russia. I might have been there; I don't remember it. I know many of us gritted our teeth and regretted some of the things that were happening, but the notion of—I guess there were two other alternatives to what we did in the grand scheme. One was to threaten the Russians with a cutoff and hope that that would produce better

results. The other would have been to cut them off.

I would like to hear all of those alternatives considered, because we have both technical and specific function of oversight of the IMF, but we are also Members of the Congress of the United States, talking about the broadest, most important strategic foreign policy questions we have. And I fear that there will be a temptation to offer no alternatives and simply to be critical of what has happened.

And, yes, we need to look at how we get better from here, but the notion that there was some clear-cut and obvious alternative to

what we did, other than trying harder to be clear.

And with regard to the Yeltsin election, obviously I don't think people should be improperly influencing elections, but I have got to be honest with you, as I looked at that cast of characters that were running in Russia, I was rooting hard for Yeltsin. Things, as they said, have gotten a little bit better. I am under no temptation to return to the land of my grandparents. I have talked to my Aunt Frannie. She is happy she is still here and not back in Minsk or

in Moscow.

So I am not suggesting everything is wonderful. I am suggesting that this policy has not been an unmitigated disaster, that there has, in fact, been a forestalling of much of the most negative suggestions about what might happen in Russia, and that the perspective we should take is that in a situation of great difficulty with very serious constraints on what we could do both bilaterally and through the IMF, let us look at how we could have done what we did better. And if someone has some grand alternative that they were advocating at the time and we didn't follow, I will be glad to hear about it.

Chairman LEACH. Thank you, Mr. Frank.

Mr. Bachus.

Mr. Bachus. Thank you. Welcome, Secretary Summers.

I would submit to my colleagues on the Banking Committee and to you that what Russia needs is a Moses, and I will say that again. What Russia needs is a Moses. They are coming from communism to democracy. They need leadership. They need a leader. If you look at India, you had Gandhi. If you look at Czecho-

If you look at India, you had Gandhi. If you look at Czechoslovakia, which is a wonderful example of a country that in 1989 had Havel step forward. You have got Walesa in Poland; even some might say, Nelson Mandela. But what Russia needs is a leader.

I think a lot of us thought that Yeltsin was that leader and maybe it is the obstacles he has faced, but until we have that strong leadership in Russia, what we have seen is predictable. We have been having hearings for three years. We have heard about the mafia. We have heard about the oligarchs. We have heard about money laundering. We have heard about generals selling weapons, lack of effective government.

There is a lot of consternation. There is a lot of concern. There is a lot of the wringing of the hands here. There is a lot of questioning, a lot of groping for answers and solutions, what I would call "chasing of rabbits," because there is just so much we can do, what Mr. Frank said. If there is not strong leadership in Russia,

our options are limited.

We met in June and we talked about Russia and the economic situation there, and I said at that time what Russia needed was time, and that is when I first compared their situation to the children of Israel wandering in the desert for forty years, trying to get ready to govern themselves; and saying that—and I introduced at that time a junior high schoolgirl's dissertation in Russia where she compared the Russian people to the children of Israel and the fact that they needed time. And she said that "they had forty years, and we may need forty years."

They need time, but they also need strong leadership. There was an article recently that said, "Who Lost Russia?" and I think that was inappropriate. But I do think it is appropriate for us to ask about who is leading Russia, who are we dealing with, who is calling the shots behind the scene and the IMF. If we continue to

pump money into this country and the leadership is not there, we are going to continue to lose. So I would simply say that I am not sure we can have an accounting or an explanation from Russia.

How valid is it going to be? Can we rely on it? They have been giving us explanations. They have been accounting for what they have been doing, and we found out that a lot of it wasn't true. I would say this. I think what we need to do at this time is to focus on their leadership and not intervene, but until there is leadership in place in Russia, I am not sure what we can do.

So that would be at least another angle.

Chairman LEACH. Thank you. Does anyone else wish to make a statement?

Ms. Velázquez.

Ms. VELÁZQUEZ. I ask unanimous consent to enter my entire statement into the record.

Chairman LEACH. Without objection, so ordered.

Ms. VELAZQUEZ. I would like to applaud you for holding this hearing in such a timely manner. While it is important that we explore the effect of Russian organized crime and money laundering, I would like to take this time to stress another aspect of the money laundering equation that seems to have been lost in this discussion so far, money laundering's close relationship to drug dealers.

In the United States alone, estimates put the amount of drug profits moving through our financial system as high as \$100 billion. Money laundering provides the life of the drug trade, allowing dealers and other criminals to thrive and have devastating social and economic consequences in our communities. That is why some of my colleagues on this committee, including Chairman Leach, Ranking Member LaFalce, Representatives Roukema, Bachus and King, joined with me in passing the Money Laundering and Financial Strategy Act which was signed into law last year.

This Act takes three important steps in combining money laundering. First, it authorizes funding to help State and local officials combat money laundering. Second, it establishes high-intensity financial crime areas which will help concentrate the law enforcement resources in the areas where they are most needed. Finally, the Act mandates the Treasury Secretary to develop the first com-

prehensive national strategy to combat money laundering.

All three of these initiatives are important in our fight against money laundering, but from a Federal standpoint the most important initiative is the strategy. Tracking down these criminals is all about following the money. The money laundering strategy, for the first time, provides law enforcement officials a road map to follow

the money.

The money laundering strategy was due in February of this year. Although it took a while to complete, we have a good basis to continue our fight against money laundering, and I want to commend Secretary Summers for completing the first comprehensive antimoney laundering strategy in our Nation's history. The Treasury Department was ready to deliver the strategy to Congress at the end of last week, but I asked that it be postponed, because Members were out of town as a result of Hurricane Floyd. It is my understanding that the strategy will be unveiled later this week.

Since becoming Treasury Secretary, Mr. Summers has shown that this strategy is a priority for his administration. I thank him, as well as Deputy Secretary Eizenstat, Under Secretary Jim Johnson, Deputy Assistant Secretary Medina and Chief Counsel Stephen McHale. For those who have questioned our need for a national money laundering strategy, the developments of the Bank of

New York case demonstrate the critical need.

One of the weaknesses in the current system is the lack of cooperation between financial institutions and law enforcement officials. In the case before us today, the Bank of New York did not file a suspicious activity report until after the Justice Department had subpoenaed account records. Had there been better cooperation between bank officials and Federal law enforcement, steps could have been taken sooner. In order for money laundering detection to work in the United States, there must be cooperation between banks and law enforcement officials.

In most money laundering cases, the banks are in the best position to know if illegal activities are taking place. The anti-money laundering strategy addresses these issues and lists among its priorities enhancing the regulatory and combative efforts between fi-

nancial institutions and law enforcement officials.

The most important aspect of this strategy may simply be that it is the first comprehensive national strategy. It puts in writing the goal for our fight against money laundering and how the various Federal agencies charged with fighting money laundering should work together. The strategy is a blueprint for building a coherent and effective anti-money laundering force, something clearly lacking now.

Thank you again, Mr. Chairman, for holding this important hear-

ing, and I look forward to hearing from our witnesses.

Chairman LEACH. Thank you. Mr. ROYCE. Mr. Chairman.

Chairman LEACH. One second. The Chair would like to suggest that if we can we hold opening statements to be as brief as possible—and let me say that we have a long day of hearings; and I recognize, as Chair, I started out with a long statement, but I am going to ask two minutes only, please.

The gentleman from California.

Mr. ROYCE. I will be brief, Mr. Chairman. Thank you.

What we are examining today is a very serious issue, one that goes to the heart of U.S.-Russia relations, and it is worth noting, I think, that Russian corruption and the Administration's response

to that challenge is not a new issue.

Three years ago this committee held a hearing on organized crime in Russia and the threat to international banking systems. We heard from representatives of the FBI, the financial crimes enforcement network, the Department of Justice, and we heard from recognized authorities on Russia; and during that hearing, I brought up questions of extreme capital flight and, most importantly, of accountability with respect to International Monetary Fund loans. Specifically, I raised concerns about the lack of money laundering laws in Russia and our own inability to impose standards on foreign banking institutions, and I questioned what guarantees we had that billions of dollars in IMF and international

loans to Russia reached their intended recipients and were not, in-

stead, diverted outside the country by organized crime.

Two years prior to that, in 1994, I said our aid to Russia should be conditioned on assurances from Russia's government, and our own, that all is being done that can be done with respect to monitoring and countering the growing threat of these crime syndicates before they can choke off the infant democratic experiment in the former Soviet Union. This is about countering a real threat to the chances for a successful transition in the former Soviet Union, and it is about stopping an international crime wave before it crests on our own shores.

Here we are five years and billions of dollars later and these questions may have risen to the level of a scandal. Unfortunately, not much has been done in the last five years. IMF Managing Director Michael Camdessus recently said it is impossible to determine whether specific capital flows from Russia, whether legal or illegal, come from a particular in-flow, such as IMF loans or export earnings. Apparently, once the IMF funds are released to the Central Bank there is no tracking where the money—in this case, \$10

billion-goes.

American taxpayers deserve better. However, the New York Times recently reported that Clinton Administration officials learned of allegations of Russian money laundering at the Bank of New York five months earlier than they acknowledged, yet the Administration continued to rally for more aid to Russia, even though they were fully aware that these funds were not reaching the intended recipients and the intended recipients were the Russian people.

Instead of making a genuine effort on critically needed structural reform, the emphasis was placed on touting feel-good stories about dubious successes in the Russian economy. So, in the end, funds flowed to a Russia where corruption ran rampant. Anti-money laundering laws were actually vetoed by Boris Yeltsin, and politicians did little but throw up their hands and say, "Well, that is the

way things are in Russia."

What I am interested in finding out today is whether the Administration has acquiesced to the cycle of corruption in Russia so it could claim reform in name only. Policies that turn a blind eye to real reform do irreparable damage to the process of democracy building. This does a tremendous disservice to the people of this country and to the people of Russia, and I look forward to hearing from our witnesses today.

Thank you, Mr. Chairman.

Chairman LEACH. Thank you very much for that very thoughtful statement.

Ms. Waters, who was helping this committee on money laundering matters. Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman and Mem-

While there needs to be much said about the IMF and the way they have handled Russia, I am not going to concentrate my few minutes talking about the IMF's role in what appears to be the laundering of money by our banks, except to say it is obvious that there is a policy that Russia is too important to fail and that we

did turn a blind eye while the IMF shuttled about \$11 billion into Russia and ignored the fact that corruption and money laundering

was going on.

I am going to concentrate my remarks on what we do here in this country about the laundering of drug money, because I do believe that we should have advanced a lot further than we have advanced in dealing with the laundering of drug money right here in our own country. We have had great opportunities to do so, and we are all to blame that we haven't done a better job. So I am not at all shocked that we have to convene once again to address the most serious issue of money laundering in the United States financial institutions.

As many of you know, I have worked very hard on the money laundering issue, particularly as it relates to drug trafficking. I was an original cosponsor of H.R. 405, the Money Laundering Deterrence Act of 1988, and had four amendments which were included in the bill. I spoke in opposition to the Citicorp/Travelers merger due to the ongoing Department of Justice investigation into money laundering and other potential financial crimes involving Raul Salinas and Citibank. I have held press conferences and sent numerous letters to the Department of Justice, the United States President and Members of the House Banking and Financial Services Committee. I have appeared on television shows and spoken on radio programs to discuss money laundering, drug trafficking and their devastating impact on America's communities.

Last year, I introduced legislation to include money laundering as a priority when the Federal Reserve considers bank applications for mergers or acquisitions, and I have recently introduced the Integrity in Banking and Money Laundering Prevention Act of 1999 to help eliminate money laundering in the banking industry.

The House Banking and Financial Services Committee can do more to ensure that our financial institutions are free from abuse by alleged drug traffickers such as Semoin Mogilevitch, one of the leading figures in the investigation of money laundering at the

Bank of New York.

My remarks today will focus on three problems with our current anti-money laundering laws and legislative solutions to each. Law enforcement officials have stated that one of the biggest problems they encounter in money laundering investigations, particularly where there is an international flow of funds such as in the case where money flows from Russia to offshore accounts and then into accounts in the United States, is the inability to reconstruct an audit trail for prosecution purposes. This was a major obstacle in the case of Raul Salinas and is an obstacle for law enforcement in the present money laundering scandal.

I have identified two areas that should be addressed to aid law enforcement in money laundering investigations. The first is proper maintenance of something known as "concentration accounts," and the second is adequate documentation of the beneficial owner of offshore accounts. Concentration accounts are business accounts maintained by a financial institution in which funds from various

sources are commingled.

In July 1997, the Federal Reserve Bank of New York issued, and I quote: "sound practice guidelines" that highlighted concentration

accounts as a weakness in money laundering controls. The Federal Reserve reported that concentration accounts could, I quote: "mask unusual transaction and flows," making it nearly impossible to es-

tablish the ownership of all funds in a single account.

During last year's money laundering hearings on H.R. 405, I asked Herbert A. Biern, a witness from the Federal Reserve's Board of Governors, Division of Banking Supervision, about the potential for money laundering through concentration accounts. He stated that banking organizations should make sure that they have clear records about fund transfers, and if banks want to use a concentration account, also called a "suspense" or "omnibus account," then they should keep proper records.

My legislative proposal would require that banks who use concentration accounts maintain all accounts in such a way as to ensure that the name of the account holder and the number of the account are associated with all account activity of the account holder. This requirement will aid law enforcement and help to protect

banks from money laundering abuses.

Similar attention must be paid to offshore accounts. Offshore accounts are havens for money laundering and drug trafficker. In the case of Raul Salinas, a phony offshore company named Troika was set up which allowed Salinas to hide the flow of illegal drug money.

In the present case, one of the key accounts through which money is suspected of being laundered belongs to a company called Benex, which investigators believe filtered money from Semoin

Mogilevitch, the alleged kingpin of Russian organized crime.

According to investigators, it is likely to take months before they can sift through the documents and penetrate the complex web of offshore companies and holding companies to determine precisely where the money came from and where it went. My legislation would aid law enforcement efforts by requiring enhanced record-

keeping of beneficial owners of such offshore accounts.

Finally, I want to address the penalties assessed against banks convicted of money laundering. We know that they laundered money. During an April 15, 1999, hearing on trends in money laundering, I asked a Department of Justice witness how many United States or foreign depository institutions had lost their charter as a result of a conviction or a civil penalty imposed for money laundering. The response I received from the U.S. Department of Justice is that no U.S. or foreign depository institution has lost its license as a result of money laundering activities in the United States.

Well, my legislation would give courts the ability to double the sentence against persons and institutions that violate United States anti-money laundering laws with respect to foreign high-intensity money laundering areas. If we do not have the courage to address the practice in our own financial institutions, the money

laundering abuses will only get worse.

I have the greatest respect for you, Mr. Chairman, but I don't have any confidence that we are going to do anything about the laundering of drug money in our banks. They are too big to touch, such as in the case of Citibank, and Russia is too big to fail. So I am going to go through this, but I want to tell you, we have not shown that we have the courage or the desire or the will to do anything about the laundering of drug money, and we have known for

a long time about the Russian mafia, what they were doing on Wall Street, and we have simply turned a blind eye. I am disappointed, and at the point that it is now revealed, we have another hearing. Well, I will sit through it.

With that, I yield back the balance of my time.

Chairman LEACH. The gentlelady has no time to yield back.

The Chair would like to ask unanimous consent that his earlier statement be revised and extended—I had quite a lot that I didn't add to the record—and that the statements of all other Members be placed in the record at this point.

I would also like to note that we have prepared a rather comprehensive new approach to strengthening our money laundering laws. I am prepared to introduce today and ask that any Members

interested in cosponsoring contact me or my staff.

At this point I would like to ask unanimous consent Mrs. Biggert, you had a statement to place in the record. Is it all right to do so?

[The prepared statement of Hon. Judy Biggert can be found on

page 216 in the appendix.]

Chairman Leach. And let me just stress as strongly as I can that money laundering may seem to be a modest crime to some people, but it is a window looking at far graver crimes. It is for that reason that it is of such significance.

At this point, I would like to welcome for his first appearance before this committee as the Secretary of the United States Treasury,

Mr. Lawrence Summers.

Mr. Summers, please proceed as you see fit.

STATEMENT OF HON. LAWRENCE H. SUMMERS, SECRETARY, DEPARTMENT OF THE TREASURY

Mr. Summers. Thank you very much, Mr. Chairman, Ranking Member LaFalce, Members of the committee. I have a rather lengthy statement that I prepared for the record which I will just attempt to summarize here and would ask you to include the entirety of the statement.

Chairman Leach. Without objection, that will occur.

Mr. SUMMERS. I am grateful for this opportunity to discuss financial policies toward Russia and the issue of money laundering more generally in light of recent reports and allegations regarding cor-

ruption, capital flight and money laundering.

Let my say at the outset, in the wake of recent allegations of money laundering through a U.S. bank, that we are fully committed to the full investigation of these allegations, to the prosecution of any crimes uncovered and to strengthening our capacity to combat future abuses.

I want to focus on four issues in my testimony: the broad context of U.S. financial policy toward Russia; the capital flight, money laundering and corruption in Russia; the very different financial policy toward Russia that we have had in place since the traumatic events of August, 1998; and our broader efforts to combat corruption and money laundering worldwide.

Turning to our policy toward Russia, it would be difficult to overestimate the seriousness of the problems facing Russia today. At the same time, the American people have an enormous national security, economic and law enforcement stake in a peaceful and successful transition to a law-based democratic market economy in Russia.

The United States has pursued these interests, both bilaterally and multilaterally, in a number of ways. We have sought to do so in a fashion that is both hard-headed and clear-eyed and puts

America's interests at the forefront.

The crucial multilateral tool to support economic reform in Russia has been conditional finance from the international financial institutions. Our support for official financing for Russia has been grounded on the recognition that we cannot want successful market reform in Russia more than Russia's government and its people do.

We have sought, in supporting the conditionality of the international financial institutions, to balance what would be best economically with what is politically realistic in the Russia context; between the desire to effect meaningful reform and the need to avoid taking decisions ourselves that Russia must ultimately embrace for itself; between the goal of dismantling the apparatus of communism and the need to cushion the impact of the process of change.

A review of the record of lending to Russia by the IMF and World Bank shows that these institutions have withheld financing when previously agreed-upon conditions have not been met, including twice in the context of the presidential election year of 1996 and including for nearly a year following the events of August, 1998.

No one here in the United States, and certainly not in Russia, can be satisfied with economic developments in Russia during the past decade. But I think it is also fair to say, Mr. Chairman, that if not all our goals or Russia's goals have been fulfilled, it is certainly equally true that not all of the fears for Russia that were common a decade ago have materialized. Russia is a very different country than it was a decade ago, with nuclear weapons no longer targeted at our cities; 1,500 nuclear weapons deactivated; with military spending one-tenth the level that it had reached in 1988. With 70 percent of Russia's economy output now generated by the private sector, the Communist system has essentially been dismantled and the state's tentacles of central control have been largely dislodged. Economic distortions created by energy prices that were held far below world prices and the easy availability of subsidized credits have been greatly reduced.

Let me turn to the specific and interrelated questions of corruption, capital flight and international money laundering in Russia.

Russia inherited huge corruption problems from the distorted economic system of the Soviet era. Since then, it has failed to establish a rule of law and a credible law enforcement system, and corruption is a continuing and serious problem. It is one that we have recognized in the policies that we have supported and urged. both in terms of structural and institutional reform, to bring about the rule of law and, as I described in more detail in my written testimony, the placing of specific conditions aimed at reducing opportunities for corruption made possible by Russia's economic and legal system.

Let me give an example that comes from the Soviet expert, Anders Aslund. In 1992, a barrel of oil cost in Russia the same

amount as a pack of Marlboros. In that economic environment, the pervasive purchase of oil at a low domestic price and sale at a large international price was a major source of profiteering. Along with subsidized credits, in one estimate it represented corruption equal

to 80 percent of GDP in that year.

The international financial institutions have worked to bring about more open markets, prices approaching international levels, limitations on the supply of subsidized credit. The creation of a functioning—of a working tax system—has been centrally directed at combatting the opportunities for corruption that those distor-

tions have permitted.

If corruption is often indicative of a vote of no confidence in a state's capacity to enforce the rule of law, capital flight is a vote of no confidence in a country's economic policies. Capital flight drains perhaps \$15 billion a year from the Russian economy. It will only be effectively addressed when an environment is created in which there are economic opportunities in Russia that make Russians want to keep their money at home.

These issues, capital flight and corruption, come together in the serious crime of money laundering. The current allegations involving money laundering through major American financial institutions only reinforce our recognition that widespread corruption in

Russia can pose a significant danger to our interests.

In a telephone conversation earlier this month, President Clinton stressed to President Yeltsin the importance of swiftly designing and enacting a strong anti-money laundering law. President Yeltsin assured President Clinton that this was indeed his intent. In the context of ongoing IMF engagement with Russia, the United States and other major IMF shareholders will be monitoring Russian developments in this area closely.

Let me turn to the current stance of policy on the part of the IMF and the other international financial institutions toward Rus-

sia.

Following the economic and financial collapse of August, 1998, the International Monetary Fund ceased lending to Russia and did not provide any financial assistance for a year. The financial approach going forward had shifted in a major way from providing new loans, new net funds to Russia in order to promote economic reform to instead partially refinancing debt coming due to the IMF as a part of an attempt to support economic stability in Russia. We have insisted that any support from the international financial institutions be based on an adequate accounting and adequate safeguards.

The new IMF program is in that way very different from all of Russia's prior programs. The funds were provided in the form of Special Drawing Rights and paid into an account at the IMF that can be used only to repay Russian obligations to the fund. Under the new IMF agreement, Russia is to repay about \$2 billion to the IMF over the next eighteen months and refinance the remaining funds coming due, thereby reducing Russia's net indebtedness to

the IMF.

Our continued support for IMF or World Bank engagement, even with these safeguards in Russia, is predicated on Russia's compli-

ance with crucial conditions to ensure financial integrity and to

safeguard any assistance provided in refinancing.

The nature of the audits with respect to subsidiaries of the Russian Central Bank and with respect to the procedures of the Russian Central Bank in granting credits and so forth are described in some detail in my testimony.

Going forward, we in the G-7 will be calling for authoritative reviews by the IMF and World Bank to identify ways more generally around the world to strengthen safeguards on the use of IMF and World Bank funds, especially in cases where there is a heightened

risk of diversion or misappropriations.

Let me just say, in response to the Chairman's inquiry, that we are fully prepared to cooperate in investigations with respect to what is taking place with respect to IMF funds in Russia; though I would caution that some of the assertions that one encounters go beyond what has yet been established by evidence, although this is something that is obviously the subject of continuing close attention.

As we work to promote the adoption of sound economic reforms in Russia and around the world, combatting corruption and pursuing policies to reduce crime will be essential components of these efforts, including through our national and bilateral programs.

This Thursday, as has been mentioned, in line with the legislation in which Congresswoman Velázquez played such a crucial role, the Treasury and Justice Departments will release the Administration's first National Money Laundering Strategy report. It contains several dozen recommendations to combat the types of criminal activity that we are discussing here today. And based on what I have been able to learn this morning, Mr. Chairman, I would say that it covers quite similar ground to your own legislation. This is an

area where we certainly look forward to working together.

During the past six-and-a-half years, we have faced very difficult questions of balance and very difficult choices in managing the United States relationship with Russia and in combatting corruption and money laundering globally. It has always been clear that Russia's transformation from a centrally-planned Communist empire, ruled by the law of force, to a democratic, market-based economy, based on the force of law, would take a great deal of time. We have sought, while always recognizing that Russia will shape its own destiny, to pursue what is the very great American interests in Russia's outcome in a hard-headed and prudent way, as we will continue to do going forward.

I welcome the opportunity for dialogue that this hearing presents on how we can all address this very crucial U.S. foreign policy and

financial policy issue.

Thank you, Mr. Chairman.

[The prepared statement of Hon. Lawrence H. Summers can be found on page 234 in the appendix.]

Chairman LEACH. I thank you, Mr. Secretary.

Let me say that I think the premise of the American policy of wanting to help Russia has always been correct. The effect of American policy is somewhat more in doubt. One of the great questions is, when one sees that efforts are counter-productive, does one shift gears? That is a profound question.

A further witness of ours, an expert on Russia, Ann Williamson, has taped a series of interviews with former Russian officials. One Russian official, a finance minister named Boris Feodorov, reported that he asked Treasury not to include an IMF loan—this would be five or six years ago—of \$1.5 billion, since he argued the loan would undermine his attempts to discipline the finance ministry. He suggested that corruption might be an issue.

Other Russians, namely Sokolov, the chief auditor of the Russian Federation of Chamber of Accounts, which is an institution roughly equivalent to the GAO, has argued that he believed that virtually all of the funds coming into Russia would be diverted for less-than-

perfect purposes.

And so the question is, what do you, as a Secretary of the Treasury, believe should be the United States' policy in terms of a circumstance where a foreign government appears to be entwined in a culture of corruption? Do we continue to aid it, because Russia is too big to fail, because a potential leader, as flawed as he may be, seems less flawed than others? Or do we say, "enough is enough," that no taxpayer anywhere can sustain the kind of "beltway" investments where taxpayer funds are revolved in foreign bank accounts and then returned to this country in the hands of foreign corrupt officials or entrepreneurs? What does our Government do at this point?

Mr. SUMMERS. Mr. Chairman, let me distinguish the issues of policy going forward from the retrospective issues that were im-

plicit in a portion of your question.

Going forward in my testimony I laid out the approach that is in place, which is an approach that does not provide new funds to Russia, but that refinances a portion of the debt of Russia that is coming due to the IMF so that Russia is on net making repayments in this period. Because, given the pervasive problems in the rule of law in Russia, we do not believe at this point that the provision of new funds would be constructive and indeed could run into some

of the risks that you described in your question.

With respect to the earlier period, a balance was always struck recognizing that the provision of funds, which, as in the case of all IMF programs, goes to Central Bank reserves which are used in the currency markets to support stability, would advance the cause of creating an economic environment in Russia in which capital flight would be limited. And indeed, if one looks to the period from 1993 to 1996 to 1997, what one sees is that Russia went from a country that was experiencing massive capital flight to a country that for several years was experiencing net capital inflows, reflecting the fact that there had been some improvements in the economic environment.

In light of the policy errors that took place in 1997, the change in international conditions toward emerging markets with the Asian financial crisis, the fall in price of oil and the unwillingness of the Russian Duma to support reforms that would bring the budget under control, Russia was ultimately unable to maintain stability, and one saw the economic and financial collapse of August, 1998. That collapse, as serious as it was, should not obscure the fact that during this period one saw quite substantial economic change, from inflation rates in the thousands of percents, from

markets that were largely closed to the outside world, from state-directed plans to a market-based system. Those changes, which operated to reduce capital flight, were part of what these international financial institution programs were about. We certainly supported them in a way that was mindful of the risks, but also mindful of the alternatives that could not have materialized without the engagement between the international financial institutions and Russia.

Chairman LEACH. I appreciate that perspective, but I think there needs to be a bit of an add-on, which is that, for the last decade, Russia has lost 40 percent of its GNP value. So one can hardly define this as success. When we look at the last IMF funding, over \$600 million went for the repayment of loans, which is an implicit acknowledgment, I believe, that prior loans had failed, and that it strikes me that it is pretty hard to defend that particular policy.

Let me just end with the notion that somehow, as we look at this "beltway" of funds—and they are stunning. When you have a 40 percent drop in GNP it is because capital flight has exceeded Western investment, which has been significant. And there does not appear to be a concerted effort to put an end to that capital flight.

There also—in a Western sense, we have always believed that public service involves some sort of idealistic—you have what appears to be a self-serving nature of some in the Russia oligarchy elite that is very troubling. I don't think that it can be simply looked at, because some alternatives look worse over a period of time. It looks as if we have been ensconcing a system that maybe deserves a little more discipline. On retrospective, do you think

that is the case or not?

Mr. Summers. Let me say, first, Mr. Chairman, that with respect to the question of capital flight, it is best to think of capital flight in Russia or in another country not so much as a cause of economic problems, but as a symptom of economic problems. Because Russia's economy wasn't working, because property rights weren't secure, because people could not have confidence in the value of the ruble, they chose to leave their money offshore or to take their money offshore. So capital flight was much less the cause of Russia's economic problems in this period than it was a consequence of an economy that, as I think we have all recognized, wasn't working in a satisfactory way.

Now, there will be debates forever, I suspect, about what economic policies Russia could best have pursued. There would be those who argue that, had they moved more rapidly with the steps of reform, the results would have been better. There would be others that will argue had they moved more slowly the results would have been better. I am not sure that we will ever know the answer to that counterfactual question, but I certainly tried to make clear that no one here or in Russia can be satisfied with the performance

of Russia's economy.

Equally, I think it has to be recognized that the historically unprecedented magnitude of the four transitions, from empire to state, from dictatorship to democracy, from a criminal state to a law-based state, and from a Communist economy without private property to a private market economy, almost certainly made it inevitable that there would be very, very substantial economic dis-

ruptions and problems during the transition, and the attempt of the international financial institutions was to influence that process in as constructive a way as possible.

Chairman LEACH. I appreciate that.

My time has expired. There are many other Members who want to ask questions, and we may come back.

I am compelled to note that what may be a system also causes

a problem. That is fairly undeniable.

Second, there is an analogy, and this is something that Ms. Waters has been working on, some of the Mexico issues. I remember years ago, after being visited by a number of very extraordinary Mexican officials, hearing the observations from the Mexican experts, they are extraordinarily well educated, but more than a few

are crooks.

Top Treasury officials have described some of the Russian team as a "dream team", but the evidence is emerging that part of their dream is self-serving. That is why I stress that public service is not about self-serving aggrandizement. It must be about idealism. It appears in this country that idealism as an element has elapsed, and that is one of the reasons there is such cynicism and hopelessness appearing in Russia today. And that is the single most important issue in many regards for American national security and foreign policy.

Mr. LaFalce.

Mr. LaFalce. Thank you very much, Mr. Chairman.

It is extremely difficult to fashion a policy and implement a policy when you are taking the former Soviet Republic, see it disintegrate into its several component states, and then watch and try to assist in the transition from what has been a centrally-planned economy to some form of market-based economy. The world does

not have much experience with that, so it was difficult.

Of course, we knew it was difficult at the time, and we knew what those difficulties were, too. We knew that crime was running rampant. We knew that they did not have adequate laws or any laws or enforcement with respect to privacy rights, property rights, bankruptcy laws, a transparency with respect to its banking system, enforcement mechanisms, adherence to international norms and standards, and so forth.

It also seems to me, though, that one of our underlying premises should have been, let's not make this situation worse. There is going to be economic dislocations. Let's mitigate the dislocations, though, so that we do not see people going with less bread. We do not see people going with less bread we do not see people going with less heat. We do not see a decline in GDP

if at all possible.

So I think this argues for a more gradual transition rather than for an immediate transition. So it is damn the torpedoes, full speed ahead. So long as we can get rid of the state-owned industries, they ultimately will be better off, and ultimately it might be a long time-frame. You have to look at the difficulties that come in between.

That is history. We have seen some good, and we have seen some bad. What are we doing today, though, within the present context? What are our imperatives? As one country, the United States, what are our imperatives as a country within the international forum that exists with respect to conditioning future involvement with

Russia and countries such as Russia? By involvement, I mean a

broad spectrum of activities including financial assistance.

What are we demanding with respect to reforms of their central bank, with respect to not just passage of legislation, but enforcement of that legislation with respect to property rights, with respect to the bankruptcy laws so there could not be precipitous withdrawal of monies. I guess we can't impose our will on another country, but we can refrain from certain types of involvement with a country unless it is done in the right way.

Do you care to respond?

Mr. SUMMERS. Congressman, let me answer your question in three ways. First, we are insisting on absolute safeguards with respect to our own money, namely the United States' own money, the IMF's money which is in part our money, in the insistence that that money not get to Russia, that it move from one IMF account to another account and that is all the money that is provided.

Mr. LAFALCE. What do you mean, from one IMF account to an-

other? For what purpose then?

Mr. Summers. For the purpose of repaying the IMF.

Mr. LAFALCE. So we are giving loans to finance pre-existing—Mr. SUMMERS. In effect, we are extending the portion of the debt that is coming due from Russia to the IMF. The remainder will be paid back directly from Russia to the IMF, and a portion is being refinanced, is being extended. Other than that, from the IMF, there is no new—

Mr. LAFALCE. So you are saying that the United States' policy and the international financial institution's policy is no new money to Russia? The only thing that we will do is engage in some paper transactions for the refinancing or at least scheduling the existing

indebtedness?

Mr. SUMMERS. That is the situation of the IMF.

With respect to the development banks, there are a limited number of loans that are directed at specific projects and specific purposes with closely monitored accounting for the use of the funds. The safety net for coal workers would be one example of such a program for the World Bank. EBRD assistance to funds for small businesses would be another example of such a program. So it is bottom-up.

Mr. LAFALCE. The total scheme of things, how much assistance would be given respectively through the IMF, which is exclusively for the refinancing of existing debt, and how much new money for these discrete purposes through the other international financial institutions—the World Bank, the European Bank—for reconstruc-

tion, development, and so forth?

Mr. Summers. Over the next year, I would expect it to be in the range of—someone behind me may correct me—a billion dollars over the next year. In toto, if you add all of the international financial institutions together, Russia would be making a net repayment to all of the international financial institutions taken together over the next year. And then, of course, U.S. bilateral assistance and, more generally, the international financial community bilateral assistance on questions like building a functioning tax system, establishing a bankruptcy law, establishing protections for minority shareholders at the Russian SAC and so forth will be conducted in

a continuing and active way, because that is part of what I think we would all agree is the long-run imperative here, which is the

establishment of the rule of law.

Mr. LAFALCE. Which comes first, the chicken or the egg? In other words, are we going to establish some of these actions as preconditions to the future assistance? That is the first question—or conditions subsequent.

The second question is, you referred to the absolute safeguards. At least with respect to the IMF future assistance, do we have either absolute or some form of safeguards with respect to non-IMF or other, either bilateral or international, financial institutions' as-

sistance?

Mr. Summers. With respect to the other international financial institutions' assistance, there are very strong safeguards with respect to the accounting. Certainly with respect to U.S. bilateral assistance there are as well.

Mr. LAFALCE. What is the nature of those safeguards?

Mr. SUMMERS. The nature of those safeguards, for example, in the bilateral assistance is that, rather than providing money, what you are doing is providing services and relying on a whole set of U.S. contracting procedures and so forth.

Mr. LAFALCE. What about when money is provided?

Mr. SUMMERS. I would be happy to give you an answer in writing of the detailed procedures at USAID, but the essence of those procedures is that the money is provided only on the basis of a clear receipt for specific services rendered. There is no money provided to Russian institutions for their general use as they see fit. It is specific funds for specific services.

Chairman LEACH. Thank you, Mr. LaFalce.

The Chair has not set a perfect model, but he is at this point going to insist on maintaining the five-minute rule. We have a number of witnesses today.

Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman.

With regard to the comments about the drop in GDP, just to put that in perspective for the American people, Russia is still the fifth most populous country, with a GDP less than the Netherlands or Denmark, and the GDP is still going down.

Mr. Secretary, congratulations on your assumption of the secretaryship. I regret that it is this subject that brings you here,

but we wish you well as you pursue that job.

I have three questions that I think you could address briefly. You mentioned we were looking for adequate accounting, of course, for the IMF funds. Given the size of that highly paid bureaucracy—some would say a bloated bureaucracy at IMF—do we have a systemic auditing that you would regard as adequate at the IMF? You also may wish to enlarge that to the World Bank.

Second, has the Treasury Department or anyone in the Administration spoken to the Russian prosecutor general, Mr. Skuratov, to try to confirm his accusation of Kremlin officials receiving kickbacks and improper market speculation on high-yield treasuries?

And, third, Mr. E. Waymarry, head of the political section of the U.S. Embassy in Moscow from 1991 to 1994, claimed in a recent article that he, "Personally saw dozens of draft reports on economic

problems that were never transmitted while the Treasury representative blocked the negative assessment of Russia's capacity to introducing a market economy rapidly by arguing that would give Larry Summers a heart attack."

Have you looked into whether or not there was an effort by Treasury people not to report what the real situation was in Russia to you when you were an Under Secretary and your boss was Sec-

retary Rubin?

Mr. SUMMERS. Let me, if I could, Congressman Bereuter, answer

the questions in the reverse of the order that you asked them.

With respect to that report, it is the first that I have heard of anything like that. While we in the Treasury like to think that we have a lot of influence in the U.S. Government, I assure you that we do not have the capacity to censor the reporting from U.S. Embassies. And certainly of all possible rationales for limiting reporting, the fact that it would shake the preconceptions of a policy official in Washington is the best reason for a report to be sent and certainly not for it not to be sent.

Mr. BEREUTER. Mr. Secretary, I am talking about self-censor. I

am not suggesting that anyone told them not to say it.

Mr. SUMMERS. I am not aware—it would be a very serious problem during a period when I am Secretary, as it would have been during the period when Secretary Rubin was Secretary, as it would have been during the period when Secretary Bentsen was Secretary, if anyone sought to prevent bad news from reaching Washington. That is the opposite of everything that we stand for as we try to work with our staffs. I don't know where that report came from.

With respect to the prosecutor general in Russia, I have not had any conversations with him. We have sought, I think appropriately, to compartmentalize the law enforcement channel with respect to ongoing investigations from the policy channel as these things are pursued. I think that is a question that would be best directed toward the officials with direct investigative responsibility. It may be

a question that is better addressed in closed session.

With respect to our satisfaction with respect to the reports that we have received, let me first say that we have strongly supported the idea that these audits are not to be done by IMF staff, but done by independent international accounting firms for some of the reasons that you cite. There have been reports that have come in that have provided clarity with respect to some issues, but there are important outstanding issues. That is why my testimony is clear that there is a set of further conditions that have to be satisfied, not just in the economic policy area, but in the integrity area, before we would be in a position to support any further disbursements of this refinancing kind to Russia.

Chairman LEACH. Thank you, Mr. Bereuter.

Mr. Frank.

Mr. Frank. Mr. Secretary, I noticed in the testimony that we are going to be getting later that one of the witnesses noted that American pressure did have an impact on Russian behavior elsewhere. He mentions the cooperation in Bosnia and Kosovo. He mentions dealing with Iran, some macro-economic policy. Obviously, we have the relative quiescence in the expansion of NATO.

I raise those because this argues the fact that pressures succeeded there—and most recently many of us were enormously grateful for the Russian position with regard to Kosovo, because I think that helped get America out of an extraordinarily excruciating moral, as well as political, dilemma. He argues that the fact that pressure succeeded there means that pressure would have succeeded here.

My question is whether to some extent the opposite might be the case. That is, if you simply accumulate pressure in all fronts without any tradeoffs that you are less likely to win. I don't say this critically. I say this critically of our structure. I wish you were here with Mr. Berger and Ms. Albright. Anybody who thinks we should have made policy toward Russia abstractly, solely on these kinds of economic and technical monetary problems, is wrong. Clearly, we

have a whole complex of issues with Russia.

So the question is, was there—I think it would be perfectly good, but my own sense is, yeah, people may have said, "Boy, this Yeltsin is no day at the beach, but on the other hand he is better than a week out in the snow" and we have some other things on the fire here. To what extent are tradeoffs and these other kinds of considerations involved? To what extent—when you talk about, for instance, cutting off Russia, if we got to the point where on these grounds that have been advanced that you thought Russia should be cut off from some of your areas, would you instruct your representative of the IMF to so vote without first checking or without talking to Secretary Albright or National Security Advisor Berger, not to mention the President?

Mr. SUMMERS. I think your very thoughtful question, Congressman Frank, really points out why making policy in this area and other related areas is so difficult. One has to distinguish, if you

like, between degrees of unsatisfactoriness.

As I referenced in my testimony, you have to make a balance between what would be economically best and what is politically realistic. I think, on the one hand, as we manage a relationship, a financial relationship with any country, it is not possible to do so outside of the context of the overall issues that that country poses. On the other hand, we have also sought to remember that the international financial institutions have a basic core mission and have a basic responsibility with respect to the management of moneies.

So, no, we would not under any circumstance tolerate money being provided without conditions or under circumstances in which the expectation was that it would simply be diverted and not be used for its intended purpose. That is a basic question of financial

integrity.

At the same time, certainly, in carrying on policy, one has to be mindful of the broad context. I think, as your comments suggest, the broad context is one where, if we had not gotten everything that we wanted in terms of Russia policy choices, it is also true that many of the things that were feared not very long ago—hyperinflation, collapse of the Russian state or return to communism and so forth, major nationalist revival in the anti-American faction have also not materialized. It is that balance that we have tried to

keep in mind as we carried on the policy on an Administration-

wide basis.

Mr. Frank. I think that part of what you are saying is one way to deal with this is to move toward more project-specific funding of the World Bank, Nunn-Lugar specific funding to deal with non-proliferation, so that to some extent the future orientation is less general budgetary support, more very specific and strings attached targeted aid. I think that is a reasonable direction to go in and may be the way to deal with this dilemma.

The second question I have is just an abstract one. The Chairman mentioned the drop in Russian GDP, and I realize it is a very significant drop. I would be interested—this is more of an abstract

than an academic question, to retrogress you for a minute.

One of the things we used to hear—and I will finish up in 30 seconds, Mr. Chairman—one of the things that we used to hear was that much of what the Russians produced in the old days, nobody wanted. Now, some of that obviously was military, but there were other goods. Do we have an analysis—obviously, there has been a drop in the production. But do we have an analysis of how much of that is a real drop in the quality of life?

Everything that I ever read when I was studying the Soviet Union beforehand said there should have been a drop in the production of a lot of things which were produced and nobody wethem. So do we have an estimate of what the real economic situation is in Russia today as it was in the last days of the overture?

Mr. SUMMERS. I will get you a more precise answer in writing

than I can give here.

In general, in approaching your question, I would just emphasize these points: 25 percent of GNP previously on some estimates was military spending, and the loss of that presumably doesn't have a direct impact on Russian living standards.

Mr. FRANK. And a positive impact on ours.

Mr. SUMMERS. It is difficult to know how to think about wages that were higher relative to the price of meat than they are today, but you couldn't get meat at the store even after you waited in line for several hours. So what you see is the wage goes less far in terms of meat, but the reality is that you couldn't get the meat at the posted price before, and, if you could, it was with hours of waiting.

All of that said, I don't think anyone can escape the conclusion that there has been a distinct reduction in living standards for at least large parts of the Russian population since 1989. I would take issue with the easy inference that has been drawn by some that

that somehow economic reform took place too rapidly.

If one looks at other countries, Ukraine, Belarus, other of the former Soviet republics where reform has taken place even less rapidly than in Russia, in many cases the fall in living standards has actually been significantly greater. And if one looks at some of the places in the Baltics or in the northern parts of Central Europe where reform has taken place more rapidly, what has happened to living standards has been somewhat more favorable.

I think the core reason why the decline has been so great has been the combination of how militarized it was and how fundamentally distorted the composition of industrial production by military need, and by industry that was based on oil at a very small fraction of the world's prices.

Chairman LEACH. Mr. Bachus.

Mr. BACHUS. Thank you, Mr. Chairman.

Mr. Secretary, I think we all know that it has been stated here that Russia is too big, it is too nuclear, it is too inflational for us to ignore. I don't think there is really any serious doubt that we are going to continue to help Russia, we are going to continue to assist Russia. And despite what we hear from time to time within the Congress, the IMF and the World Bank, other organizations to do that, because there is really no one else that can play that role. Do you agree with that?

Mr. SUMMERS. I would agree with that, although I would caution, as I have tried to articulate, that the terms of their engagement and the approaches that they pursue have to change with conditions on the ground. And then, under current conditions, much more of a bottom-up approach and much less direct support to the

foreign exchange market are appropriate.

Mr. Bachus. I guess what I am saying is the IMF and the World Bank and the United States, we are going to continue to cooperate with Russia, we are going to continue to assist Russia. I think the questions that are helpful or not, whether we do that or not, because we are going to do it—I am going to say it is a fact that that is going to be the IMF and the World Bank. I am going to approach my questioning from that standpoint, because I am going to assume those as given.

In that regard, in many of the previous IMF loans to crisis countries such as Korea, the Federal Reserve was brought in to help monitor and assist the IMF loan program. I am not aware that the Fed was asked to help implement the IMF Russia loan program. This is particularly disturbing, because there were and still are serious concerns about the effectiveness of Russia's Central Bank. Federal Reserve oversight would have been very useful since it appears that the Russian Central Bank is plagued with conflicts of

interest.

I read an interview by the chairman of the federal commission for the security market. So this is Russians that are saying that it is engaged in conflicts of interest and, in effect, if—for instance, Russia's Central Bank was acting as a regulator for the commercial banks and at the same time they were speculating in Russia's short-term government debt market, the GKO. So my question to you is this: Why didn't you or Treasury ask the Federal Reserve to help implement the Russian loan program and were you aware of the serious problems of Russia's Central Bank?

Mr. Summers. With respect to the second question first, certainly we have been aware for quite some time and most especially following the collapse in August of 1998 of integrity problems of the Russian Central Bank, and that is a crucial part of why in the current approach none of the IMF funds will actually reach the Russian Central Bank and why, even for that refinancing, there are a whole

set of conditions appended.

With respect to the Korean case that you referenced, the Fed was not involved in the direct enforcement of the IMF conditions. The Fed was, of course, involved in deliberations about U.S. policy in

this area and particularly with respect to the use of the Exchange Stabilization Fund. There were officials from the Fed who, in response to the Korean government's request, provided technical assistance. Certainly, we in Treasury would be very supportive of any technical assistance efforts that the Russian Central Bank and the Fed could agree on. That is really a policy call for the Fed to make. But it would not in my judgment be appropriate, and it has not, to my knowledge, been the practice for the Fed to be involved in any case in the enforcement of conditionality.

Mr. BACHUS. Thank you.

My second question is this: What we have seen in Russia with the organized criminal enterprises, the so-called mafia there, and also with government officials who may have been taking money out of the country, that is not something that we are not seeing in other countries. We have seen—literally forever we have been see-

ing countries looted by corrupt leaders.

I am particularly encouraged by the legislation that Chairman Leach is introducing and which I am cosponsoring, which is going to move, really—as long as we have these—we are going to have these organized criminal enterprises. Mexico, Colombia, and Russia are probably the three best known. We are going to continue to have corrupt government leaders, and others are going to launder money. It leads to terrorism, racketeering, tax evasion, drug smuggling, all of this.

There is one common denominator in all of this. That is that you have these offshore financial centers that are cloaked in secrecy and are poorly regulated and have almost no reporting. The legislation that we are introducing would move to begin to take action to stop this. It is something that we have put up with too long. It is

something that is going to need the G-7, action by the G-7.

Can you comment on that? Is the world community, the G-7—we are in a world economy. Isn't it time to shut down some of these operations or demand that they be regulated and that they report?

Mr. Summers. Yes is the answer to that question. Without being in a position here to discuss the precise provisions of the legislation that you are introducing, which I haven't had a chance to fully study, and without getting into the full details of what is in the national money laundering strategy, I think this is clearly an issue that has to be addressed; and I think it has to be addressed, frankly, for two interrelated reasons. One is the abuse that is made possible by these offshore centers. The second is the pressure these offshore centers put on the ability to regulate in our country and other major countries where satisfactory regulation becomes more difficult if there is the threat that it will simply produce recourse to offshore centers.

But my own view, and this is something that I have stressed since I became Secretary as we worked on the development of the national money laundering strategy, is that a proper approach to offshore centers is overdue. I might just say that, as part of the work on the financial architecture, there is a kind of high-level steering group in the financial regulation area, the forum that has been set up, which has three projects underway with the strong encouragement of the United States. One of those projects is directed

at the set of issues surrounding offshore centers.

Mr. Bachus. I know your proposals. They are probably eight months late coming out, but I would hope that they are going to address this issue. Because as long as we have these offshore financial centers, as long as they are poorly regulated, as long as you have the veil of secrecy, we are going to continue to give opportunity to both these criminal enterprises and to corrupt government officials. The arms trade is going to continue to flourish. Terrorism is going to continue to operate wide open. And so I would certainly hope that that is in your proposal, too, and that the United States show leadership on that issue.

Mr. SUMMERS. This is a concern that we share.

Chairman LEACH. I thank the gentleman.

At the risk of presumption, let me just add quickly to that. Our concern is American law, also international negotiations. The degree that we give advice to others—in economics there is a question of whether you should ever place controls on capital. But I don't see how any developing country should not absolutely preclude by law the movement of capital to poorly regulated financial centers supervised by offshore institutions, because the only reason for doing that is for corrupt purposes, to not track capital. I think that is a bit of advice that the international community led by the United States ought to be giving to every country in the world, and we ought to take some of it ourselves.

Ms. Waters.

Ms. WATERS. Thank you, Mr. Chairman and Members.

While we all are confessing, we know that American policy allows for criminal activity if we feel it is in the best interests of our country. That is rather bluntly stated, but that is about what we

are all saying.

I must admit I am not naive about policies that we turn a blind eye to, countries that are sometimes acting in ways that we may not necessarily agree with, but we let it happen. I am aware of Zaire and Mobutu and the fact that we let him steal the money and on and on and on.

How long have you known-Treasury known-about the money

laundering, of this Russian problem?

Mr. SUMMERS. We have been aware of the seriousness of corruption and capital flight from Russia and the likelihood that there were instances of money laundering since the beginning of the time that we were involved in Russian policy. With respect to the specific investigation that has gotten a lot of attention very recently, Treasury officials learned of it in April.

Ms. WATERS. Just this past April?

Mr. SUMMERS. The specific investigation referencing the bank,

referencing----

Ms. Waters. Was Treasury involved with the Justice Department in any way in the investigation of the Russian mafia before April?

Mr. Summers. The Treasury investigative arms have cooperated with Justice on a number of different investigations and certainly some specific investigations involving particular Russian targets, substantially prior—significantly prior to last April, yes.

Ms. WATERS. Did the Russian banks offshore, like in Antigua, play any role in this money laundering and drug money launder-

ing? There are eight Russian banks in Antigua, a place that has

60,000 people and 50 banks. Eight banks are Russian.

Mr. Summers. To the extent that it is possible with respect to an ongoing investigation, we can provide a written answer with respect to what is in the public record regarding Antigua.

With respect to offshore centers generally—

Ms. WATERS. I want to know about Russian banks in Antigua,

the eight Russian banks.

Mr. SUMMERS. To the extent that it is possible to respond to that inquiry, the investigative authorities are able to respond to that in-

quiry, I will ask them to do so promptly.

Ms. Waters. Let me follow up on what the Chairman asked. One of my pet peeves is the fact that our respectable banks wire transfer money to the banking centers in Antigua and other places, and we know why they are establishing them and what they are doing. What leadership are you going to provide to stop that practice?

Mr. SUMMERS. With respect to the general issue of offshore financial centers, sometimes referred to as havens, I expect us to provide in the context of the national money laundering strategy a set of

proposals. I think it will also indicate-

Ms. Waters. Do you want to see it stopped?

Mr. SUMMERS. Yes.

Ms. Waters. Do you want to see the practice of wire transfers to money laundering centers that we know about stopped, period? Mr. Summers. Congresswoman, we want to see abuses stopped.

We want to see abuses stopped, period. I think our challenge will

be to craft rules that stop it, that stop abuses.

Ms. Waters. Let me just say this. Given that we are not naive and we know that we have to work with countries even if they are not doing what we want them to do and they have practices that we would frown on, and Russia is important for all of the reasons stated, can you separate out drug money laundering in order for us to put our feet down and say we will not tolerate the laundering of drug money? That is my pet peeve. Let them steal IMF's money or our bilateral support, but how tough will you be on the laundering of drug money?

Mr. Summers. We will in every feasible way that we can seek to combat money laundering of all kinds that you described, including drug money. The qualification that I made with respect to our determination to do everything we could to stop abuses was simply intended to indicate that as serious as these problems are, it would be, I think, a mistake at this juncture to conclude that all financial transactions, period, that involve certain institutions and offshore

centers, are transactions of questionable legality.

Ms. WATERS. I am not concerned about trying to wrap this around everybody. I am only concerned about the laundering of drug money.

Mr. SUMMERS. We totally share your concern, Congresswoman.

Ms. WATERS. What will you do about it?

Mr. SUMMERS. In the national money laundering strategy and in the national reviews we propose legislation and administrative steps that will take all feasible steps that we can envision to go after this problem, and I might just say that we would be very grateful for any assistance and suggestions that can be provided to us as to how we can more effectively go after this, because I think

this is a very clear issue.

Ms. WATERS. I would like to co-opt the legislation and work with you. Ms. Velázquez has been working so hard on this, and others, and we want some cooperation to help us on the question of the laundering of drug money. Thank you.

Mr. SUMMERS. Let me just, if I could, note that we have acted and have issued an advisory with respect to U.S. banks specifically with regard to transactions involving Antigua, because of a set of concerns that have arisen and have been in touch with the authori-

ties in Antigua as well regarding those concerns.

Ms. Waters. Mr. Chairman, I have a list of every bank that has been convicted of the laundering of drug money. Not one has lost its charter. We have—even American Express International that was fined \$25 million. I want to tell you these fines and asset forfeitures are simply the cost of doing business for these banks. You have got to put somebody out of business.

Chairman LEACH. The gentlewoman's time has expired.

In this regard a law passed on a bipartisan basis, initiated by Ms. Velázquez, is calling for the Treasury to put forth a strategy. That is eight months in abeyance over a congressional law, and you are coming out with it this week and we are appreciative of that, but the timing is imperfect.

Secondly on the timing front, the *Financial Times* reported in the last few days that British authorities told the FBI about the issue of the Bank of New York in September. A great congressional concern has been interagency cooperation, who tells what to whom.

If Treasury did not learn about this until April, that is a rather significant time line. And so unrelated to legislation, but also involving legislation, the Congress does expect to have substantially greater coordination within the Executive Branch.

The gentleman from California.

Mr. ROYCE. Thank you, Mr. Chairman.

Mr. Secretary, I understand there is typically a due diligence standard set in order to contain risks associated with a transaction to an acceptable level. According to the New York Times, you and Secretary Rubin knew of the investigation into allegations of Russian money laundering and the Bank of New York before the latest round of IMF loans to Russia, but these allegations were not taken into account in setting conditions for the loans. Chairman Leach mentioned earlier the former Russian Finance Minister Boris Feodorov in 1993, did an interview with Ann Williamson, in which he reported that he asked you to not approve an IMF loan of \$1.5 billion since the loan would undermine his attempts to discipline the finance ministry. He further remarked we came to a modus operandi in Washington with the IMF which was essentially a carrot-donkey process. In this sense, the IMF's role was gamesmanship, because they never required any conditions for loans.

In April 1993, the IMF decided to give \$1.5 billion and on the 26th of April, the former Russian finance minister reported: "I discovered that the budget deficit had grown, because once the money was promised, it was consumed immediately, mostly through graft on government importing schemes. I always told Larry Summers, You have the money and the wish to spend it, come and spend. Of

course, this money will ultimately be deposited somewhere in Zurich.' I told Summers that." And he goes on to say, "Once the money is given, there is no motivation to reform. That is one of the reasons why I left the government," says the former Russian finance minister.

My first question would be, what information did the Treasury Department and the IMF take into consideration in order to formulate the due diligence standard as it applied to loans to Russia? Why did the allegations of money laundering not factor into these formulations, and in light of this, what specific due diligence stand-

ards have been applied to the loans to Russia?

Mr. Summers. With respect to the loans that were made subsequent to our learning of the money laundering investigation in April of 1999, those reports only reinforced what were our extraordinarily great concerns about the integrity and the handling of funds following what took place in August of 1998. Our judgment at that time was that the appropriate form of new finance was one which would be provided in the form of special drawing rights to an account at the IMF which would not be eligible for use by the Russian authorities at their discretion, but could be used only to repay the IMF. In effect they could not get their hands on the funds for a use of their choice. That was a response to concerns about integrity which were reinforced by the reports that you have described.

Mr. ROYCE. Of course Finance Minister Feodorov's statements

were from 1993.

Mr. SUMMERS. Perhaps I could just respond with respect to those

It is correct that at certain stages during his time as finance minister, it was Mr. Feodorov's view that it would be better to delay the provision of support. And indeed at a number of those points the provision of support was delayed until specific accomplishments were achieved, until there were certain specific steps taken.

I would just caution that if one looks at the period from 1993, 1994, 1995, one saw a period in which inflation rates in Russia fell

from the thousands of percent to much lower levels.

One saw in those years that much of the apparatus of the Communist state was dismantled. Clearly there was always a balance that needed to be struck between the risks of inhibiting the tendency to reform with the benefits of engagement and pushing the

process of reform along.

I would just caution that in making judgments I think it is appropriate to remember that in 1993 it was widely expected that there would be starvation in the cities, that hyper-inflation would break out, that there would be a return to communism and that the Soviet state would collapse. Those fears did not materialize. Certainly, not everything that was hoped for or all the goals that were set were achieved either.

Mr. ROYCE. Of course he also brings up his concerns about not having conditions on the loans, graft on government importing schemes and ultimately the money being deposited somewhere in Zurich. That being brought up in 1993 should have been a heads-

up.

Mr. SUMMERS. I think there were a set of controls that were in place. Of course, IMF funds go into a central bank reserve and a central bank's reserves are used in part to intervene in a currency market. There is a large volume in the currency market. The vast majority includes the proceeds of exports, and so it is very difficult to identify where a particular dollar that comes into one side of a market that is only a small portion of that side ultimately ends up.

The concern about capital flight was something that was always uppermost on everyone's mind in the design of these policies and that was why there was a strong effort to address its roots, inadequate tax collection, in subsidized credits, in inflationary policies

that caused the ruble to lose its value.

I think it is very difficult to know what the counter-factual would be if different policies had been pursued. But the attempt was to strike a balance very mindful of the dangers of capital flight and dangers of corruption.

Mr. ROYCE. Thank you, Secretary Summers.

Thank you, Mr. Chairman.

Chairman LEACH. Ms. Velázquez.

Ms. Velázquez. Mr. Summers, you said that the Treasury Department learned in April about the money laundering activities through the Bank of New York. Can you tell me what was the

Treasury Department's response?

Mr. SUMMERS. Upon learning of that information, our international colleagues in our international area notified Secretary Rubin and myself of their intention to go back to the Federal Reserve System, where they had learned of it, to see if there was any information that pointed to the diversion of IMF funds that was contained in those reports. They did that, and they learned that there was no such information.

What we did with this information was have it to serve to reinforce our large concerns about corruption and capital flight from Russia, which helped to shape the different approach to IMF en-

gagement that is in place at this point.

Ms. VELÁZQUEZ. At the time were bank regulators notified so that those organizations which most frequently access bank records and money through bank records could track any suspicious account through the Bank of New York?

Mr. SUMMERS. It was a bank regulator that notified us; namely, the Federal Reserve. And so it was presumptively aware of the situation. I might say that through this whole period there have been what I understand to be close working relationships at the investigative level between Treasury's Financial Crimes Enforcement Network and the relevant authorities in the Department of Justice.

Ms. VELÁZQUEZ. In 1998, the General Accounting Office conducted a study that found that 24 percent of Federal field agents did not know about any anti-money laundering problems or services offered by FinCEN. Would you tell me that under your leadership will the Treasury Department ensure that every law enforcement agency, whether State, Federal or local, would be aware of the resources that are available by the agencies?

Mr. SUMMERS. I can tell you that Secretary Rubin and I appointed a new director of FinCEN a few months ago and that he sees as one of his central mandates with our very strong support is assuring that there is full knowledge with respect to FinCEN's services in this area and we are more generally making sure that financial crime is something that is very much a focus throughout

the law enforcement community.

And I might say that, within Treasury, FinCEN is, of course, very involved in these issues and, just so I am very clear, FinCEN has been involved in analysis of this issue through a law enforcement channel prior to notification to policy officials in April. The IRS anti-crime unit and the Customs Service both also have had substantial roles with respect to money laundering investigations.

Ms. Velázquez. My final question, Mr. Summers, how do you think the money laundering strategies focus on intergovernmental cooperation could have assisted U.S. efforts in the early stages of

the Bank of New York case?

Mr. SUMMERS. I think there will need to be a careful examination of the approaches for sharing information both within the law enforcement compartment and between the law enforcement compartment and the more general policy area. There are a very difficult set of balances in this area, because of the importance of protecting the integrity of ongoing investigations.

Ms. VELÁZQUEZ. Thank you.

Chairman LEACH. Thank you, Ms. Velázquez.

Dr. Weldon.

Dr. Weldon of Florida. Secretary Summers, I represent the East Central coast of Florida, it is called the Space Coast. About a year-and-a-half ago we had to lay off about 600 people at Kennedy Space Center partly because the Space Shuttle wasn't flying. You may have heard on some of the reports on Hurricane Floyd there was concern about \$10 billion worth of Space Station hardware stacked up at the Space Center waiting to fly, and the reason that the Shuttle is not flying is we are waiting on a Russian component to the Space Station, something that the President had negotiated with the Russians about six years ago. This element, it is about a \$300 million element, a lot of money. I have personally met with Yuriy Koptev, the head of the Russian Space Agency, who tells me that he is not getting any money and that is why this thing is delayed. It is very frustrating to hear that some of the billions of dollars that the IMF has sent to Russia has been siphoned off for illegal purposes, and that their economy continues to spiral downward, because of this huge flight of capital.

Now, I am very pleased to hear you come before us today and say that we are not going to send them any more money and we are just going to refinance their existing debt, but I have a serious concern that maybe we should not even be doing that. By not applying the necessary pressure by asking them to repay the debt, are we in effect going to not fulfill our fiduciary responsibilities and cause the current problems that we have over there to continue?

In my follow-up question to that, do you really look at these IMF transfers in a true fiduciary way, the same way that a bank is responsible when it lends money to an individual or a corporation? Mr. SUMMERS. Dr. Weldon, let me try to respond to both parts

of your question, if I could.

With respect to the current level IMF approach, it attempts to strike a balance between being appropriately hard-headed, maintaining the pressure for the necessary change, and at the same time recognizing that our involvement or the IMF's involvement does provide the opportunity for influence on questions like integrity of accounting. The current approach also avoids what I think otherwise would be the danger if all of these loans were called at the same moment, creating a very difficult financial situation and allowing the international community to become scapegoats for very real problems in Russia. In sizing the engagement, in timing the engagement, this is exactly the kind of balance that has to be struck. It has to be struck in a hard-headed way.

With respect to the fiduciary question, if I can call it that, I think it is perhaps helpful for me to state what the nature and purpose

of IMF support in a situation like Russia is.

It goes to augment the reserves of the Russia Central Bank. Those reserves are then used in an effort to help stabilize the foreign exchange market. There is a lot of trade in the foreign exchange market. Most of trading in the foreign exchange market doesn't involve the IMF money on either side. It involves buying and selling based on people's judgments as to a price and where they want to have their money, so that it is difficult or really impossible to identify what in some sense the ultimate use of a particular dollar is. What can be audited and what has been audited is that the dollars that were provided by the IMF went for their intended use: Augmentation of Russian reserves and use in the foreign exchange market. That doesn't go to address a whole set of concerns about the selected provision of credits within Russia, about the flows of information that took place within Russia that go to the integrity of the Russian financial system where there are obviously pervasive problems.

But I think it is—without minimizing what are enormous problems of corruption and establishing financial integrity and the rule of law—misleading to suggest on the basis of the evidence that is available at this point that there have been direct diversions of IMF dollars that should have been used for reserves in the foreign

exchange market to some entirely different purpose.

Dr. Weldon. Thank you, Secretary Summers. Chairman Leach. Mr. Bentsen.

Mr. Bentsen. Thank you, Mr. Chairman.

Mr. Secretary, I have a number of questions, some of which you have already answered. The Treasury Department learned about the Bank of New York situation in April of 1999. Is the Bank of New York, is that a national bank or is it a State-chartered bank or is it a bank holding company? My question is who is the primary regulator?

Mr. Summers. The Federal Reserve. Just to be strictly accurate with the committee, the policy officials at the Treasury learned in April. There had been some cooperation at the law enforcement investigative level between Treasury and law enforcement prior to April. But Treasury learned at the policy level in April, and the

primary regulator is the Federal Reserve.

Mr. Bentsen. Do you think that it would have been appropriate once the policy level was aware of this in April 1999, do you think it would have been appropriate to then notify up the line? I guess my point is that some have made the allegation that perhaps once

Treasury became aware of this ongoing criminal investigation, that perhaps even higher levels within the Administration should have been notified of this and that they should have gone as far as perhaps to notify high levels in the Russian administration that there was a criminal investigation going on involving a U.S. bank, and by not doing so, that there is some culpability or political culpability on the part of the U.S. Administration. Don't you think that would have been inappropriate behavior on the part of the Treasury Department to interfere with an ongoing investigation, and the appropriate course of action was to allow the investigation to carry out at the appropriate levels, rather than tip off the Russians and say, "We are investigating some of your activities involving your banks"?

Mr. Summers. The practice and guidelines within which department officials operate, Congressman Bentsen, are to be very, very careful with respect to the discussion of or spread of information with respect to ongoing law enforcement investigations, and I think that history amply demonstrates the prudence of those guidelines, and that is why the approach that was taken when this information was brought to policy officials was to go back on the specific policy relevant question to the Federal Reserve through general counsel channels. But the policy practices under which department officials operate dictate that with respect to an ongoing investigation being conducted by the Justice Department, it was a decision for the Justice Department to make in terms of broader notifications.

Mr. BENTSEN. In response to a previous question asked you stated that there is currently no evidence that multilateral development fund or international financial assistance funds, IMF, World Bank, have been misused or stolen or anything to the like based upon the audits provided to the international financial institutions

and what Treasury has looked at.

There is the case of Fimaco with the offshore transfer. Was the case there that the Central Bank transferred it to their offshore entity and then turned around and purchased government bonds presumably to bolster—transferred funds in the general revenue—to bolster the government bond market, but otherwise there is no evidence at this point in time that any funds have been siphoned off for non-governmental activity?

Mr. SUMMERS. I want to make sure that we distinguish the Bank

of New York situation from the Fimaco situation.

Mr. Bentsen. Yes.

Mr. SUMMERS. With respect to Bank of New York there is no evi-

dence that there were any IMF funds diverted.

On the other question, there is ample evidence of integrity and corruption issues that have arisen in the Russian government and in the Russian Central Bank. But the report and the evidence at this point do not point to their having involved in the diversion of IMF funds to inappropriate uses. The concerns go more to the provision of ruble credits, and they go to misreporting of the underlying situation through the use of the Fimaco subsidiary.

But there are underway, as conditions for the ongoing IMF financing, further audits with respect to the ongoing activities of the Central Bank and there are further issues involving other subsidiaries of the Central Bank that have to be cleared up.

Mr. BENTSEN. Thank you. Thank you, Mr. Chairman.

Chairman LEACH. Thank you, Mr. Bentsen.

Mr. Ryan.

Mr. RYAN. Thank you for coming today, Mr. Secretary. I regret that I did not hear your opening testimony. I just flew in from Wisconsin.

I want to read you from an editorial from *The Economist* a couple of weeks ago in describing the culture of corruption within Russia and our relationship with Russia. "Far from civilizing the wreckage of the Soviet economy, economic transactions between Russia and the West are running the risk of corrupting the Western side, if only by forcing it to wink at practices which would be outlawed in more established economies. There is a particular irony in the fact that one Western party is the IMF, whose stated purpose is to propagate virtues of sound economic policy and good governance. But if the IMF's integrity has been compromised, the cause does not lie in its own sloppy controls, it lies in the collusion of the American and Russian governments to cover up failures and press the Fund into treating Russia with greater generosity than its economic performance would warrant."

It seems with news reports, with academia coming to Congress telling us that the Administration has kind of adopted a policy toward this Russian culture of corruption of "hear no evil, see no evil, know no evil," we need a new system to help the Russian people. It is my hope that this does not relegate into some kind of a partisan issue, but that we keep our eye on the ball. That is that we help the Russian people get a healthy growing economy with cur-

rency that has a solid store of value.

Have you considered, given the fact that the IMF themselves now will not send money into Russia, because they are unsure of the misuse of the funds, have you considered encouraging Russia to establish a currency board? And would a currency board be one solution which would help stabilize the currency regime in Russia, a central banking system which has been in turmoil since 1914, they have not been in full convertibility. Wouldn't a currency board be one solution that the U.S. and the IMF could encourage on Russia which would be one way to thwart the escalating corruption, and I would ask you to look at the Estonia situation with the currency board and hasn't that helped stem corruption and helped stabilize the currency market there?

Mr. Summers. Congressman, it is something that has been discussed and Mr. Feodorov, whom Congressman Royce was quoting

earlier, has actually advocated a currency board in Russia.

To be workable, a currency board system requires a set of prerequisites. It requires, because it denies the government access to the printing press, a budget that is balanced. It requires that a banking system is functioning since one loses the ability for the Central Bank to provide direct credits to banks. And it requires a substantial external component of reserves and that the external component of reserves be readily accessible by anyone wishing to take money out of the country. I think while the experience of a number of countries, including Estonia, suggest that currency boards can make very substantial positive contributions to economic stability, at this point the fiscal requisite, the stability in the banking system requisite, and the requisite that requires basic integrity in the economic environment so one is prepared to make an external financing of any capital withdrawal desired by any Russian, I think those three requisites certainly are not in place at this point.

Mr. RYAN. With all due respect, that sounds like an endorsement for the status quo. It sounds like you are putting the cart in front of the horse. Isn't a currency board and a sound banking system the prerequisite for sound fiscal policy? Isn't a currency board and a sound monetary regime basically putting the cart in front of the horse, meaning that is how we can get a good fiscal situation

cleaned up in Russia?

Mr. SUMMERS. Congressman, let me say that the status quo is very different than the policy that was in place a year ago prior to the economic and financial collapse, and it is very different in ways that are directly responsive to the concerns about corruption.

There is no question that, as you suggest in your question, a currency board can contribute to maintenance of stability. But if the appetite to spend is not commensurate with the appetite to tax, if there is no capacity to regulate wildcat banks, if the banking system is being used as an adjunct to subsidize industry, those are not things that would be solved by the imposition of a currency board.

So I think almost all economists, including many of those who are most enthusiastic about a currency board as an ultimate objective, would agree that there are very substantial steps that would have to be taken in the Russian context before a currency board

can be considered.

Mr. Ryan. Let me ask you this, and just looking at some of Stanley Fisher's articles, what if you set up a currency board and allowed foreign Western banks to go into Russia and to have sort of a banking holiday, for Russian banks in Russia to allow access to Western banks in Russia, to give us a better, transparent, incorruptible banking system. And a currency board—could that not be one solution as a way of getting monetary stability in the country without waiting for the fiscal side to develop, before then going on to the monetary side?

Mr. Summers. I think that we have stressed in all of our policy dialogue over the last few years with Russia and other countries that quite apart from the question of capital controls which involves a different set of issues, there are enormous advantages to allowing foreign banks to take an active role in a country's financial system as you propose, and we would be very supportive of

that.

Even if you had a major foreign banking presence, the basic challenge of the fiscal year of commensurate taxes and spending is an area that would also need to be addressed as a requisite to a cur-

rency board.

I think at this point in Russia's political cycle with the political calendar that we are all aware of, the initiative for such a major imminent change in Russia is not there. So I think what is important is to focus on the more incremental issues of maintaining in-

tegrity and addressing banking and addressing banking problems as the issues of this moment.

But I think the impulse behind your question that a stable

money is crucial to a stable economy is exactly right.

Mr. RYAN. So you are basically saying that you have to have the fiscal house in order before you can implement strong monetary changes?

Mr. SUMMERS. I think you would need to have a fiscal house much more in order than Russia's fiscal houses and banking sys-

tems are in order today.

Chairman LEACH. The gentleman's time has expired. At the risk of presumption, putting the currency board aside, which is a credible alternative, the United States of America encourages foreign banks. About 20 percent of our assets are controlled by foreign banks and we find it very healthy for the United States. Of modest advice to other societies, including Russia, would be to encourage the existence of foreign banks which operate under the rule of law, and I think it would be very helpful to Russian society if they were to open up to law-based banks as contrasted to a current system where many banks are money laundering centers for insiders.

Mr. Vento.

Mr. VENTO. Thank you, Mr. Chairman. I regret that I arrived late on my flight, but I did look at your testimony, Mr. Secretary.

On the issue of the IMF tranches and the new agreement that is in effect, the fact of the matter is that once the credit is extended, we have a very difficult time trying to extrapolate how that credit may be used. In a sense, these dollars really go to keep the economy and the current circumstances that are in place, the good and the bad, functioning; don't they?

Mr. SUMMERS. Under the arrangements in place going forward,

the funds will only be used to repay the IMF.

Mr. Vento. Let me interrupt, Mr. Secretary. I understand that there will be a net payback of IMF loans, but in essence the economy of Russia, with whatever the inadequate amounts going for space in some people's view, and whatever other enterprises are taking place, and some of it the corruption and the crime that is prevalent, there will in fact be sustained by this type of credit activity. These dollars are fungible. Some suggest that the efficiency is about 79 cents on \$1 in terms of what is spent.

So the fundamental decision here, I guess, is obviously in terms of new conditions, new requirements that are placed; and I read some of the list of conditions and I concur with them. I am not for a currency exchange board. I think a floating ruble is good. Even when the IMF guessed wrong last August, I think they had good

intentions, but they made a mistake.

But the issue here is one of whether or not we are going to sustain these conditions. Some have suggested that Russia and other countries that have the potential problems that they face—such as I suppose you can put China and Indonesia—are too large and they are too important to let slip away. I think that is a realization has been expressed here, perhaps not as bluntly as I am expressing, but it is a factor. We hope that gradually that they are going to grow from a Socialist, centrally controlled economy to a free market state. There are a lot of bumps in the road and there may be some

big holes. Maybe there is a black hole, I don't know. Do you want

to respond to that?

Mr. SUMMERS. Your question describes very well the kind of balances that are involved in making policy in this area trying to balance what is economically best, and what is realistically achievable in the context.

I think we need to always insist, as a base, on financial integrity with respect to the handling of assistance funds. At the same time, we need to recognize the broad political context in which we are trying to operate. We need to recognize the need for speed in dismantling the apparatus of communism. We need to recognize the unsatisfactory characteristics and the difficulties of integrity that many who come to positions of power have in many countries, and at the same time the fact that they are the representatives of the countries with whom we deal.

So I think there are a difficult set of balances that need to be struck here. Our policy has been to try, in pursuit of American in-

terests, to strike them in as appropriate a way as possible.

Mr. Vento. As you pointed out, we have \$15 billion a year of capital flight from Russia and there is an \$80 billion export market. A lot of dollars are coming out and going back. We talked about the IMF tried to take on PricewaterhouseCoopers' audit to provide some air of security. Are there auditors and auditing systems in Russia? Are there regulators? I know free market countries that don't have adequate regulators. It is sort of begging the question. They do not have. Can we really in effect audit and know where \$80 billion goes a year or try to prevent a \$15 billion loss? All of us would like to see the rubles remain in the country so they can achieve the type of economic success that we would like to see.

What is the answer? These requirements here, lack of auditing capacity, lack of regulatory capacity in the banking and financial system, to say nothing of the civil justice system, the rule of law,

these fundamentally are uneven at best, are they not?

Mr. SUMMERS. Congressman Vento, I would agree with everything that you have said about there being very substantial inadequacies in the accounting and regulatory frameworks in Russia. If you look at our own country where the problems were much, much simpler, the development of those frameworks took us a very long time.

What I think is prudent and appropriate for us is to insist on very specific auditing with respect to the specific funds that the IMF provides and rigorous safeguards with respect to those funds

from the international financial institutions.

With respect to the problem of capital flight, there is I think something that we can learn from the broad economic history, and that is that it is a King Canute-like task to try to stop capital flight by measuring every flow and putting—and erecting appropriate

barriers and having satisfactory regulation.

Capital flight stops when a broad economic environment changes to one in which a country's citizens decide that it is in their interest to make investments in their country. Until that change has been brought about, no set of administrative procedures will stop capital flight. And once that change is brought about, the administrative procedures become less important and that is why support

for the broad direction of Russian economic reform and stability in

Russia has to be a component of a prudent policy.

But I think that the important thing for us to keep in mind is that this is a long-standing task that we will be with for a long time.

Mr. Vento. Just stating a parameter, the \$15 billion in capital flight does not all come to the United States. The \$80 billion in exports does not come here. The mistakes made by the IMF in terms of the floating ruble and the devaluation of it and the sort of uncontrolled nature, not the lack of recognition, these are fundamental mistakes. I disagree and I think most of us in hindsight could do well in terms of this interpretation, but I understand that the answers to that are not easy to come to as we look ahead.

Chairman LEACH. Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman and thank you, Mr. Secretary for participating today. Last week Secretary of State Albright was quoted in the New York Times, criticizing Russian leaders for failing to combat corruption. Secretary Albright said that the Administration would no longer support further multilateral assistance to Russia unless fully adequate safeguards are in place. Additionally, I think it was in another paper, she said that a close eye is always kept on bilateral aid as well.

Do Secretary Albright's comments reflect the position of the Administration? Does that reflect what will happen with agreements that are already in the pipeline, that are already in the works?

Mr. SUMMERS. Yes, it does reflect the Administration position. And yes, with respect to all future bilateral assistance and with respect to the IMF and the international financial institutions support, we will only support disbursements based on adequate safeguards and adequate accounting.

Mrs. BIGGERT. What about those that are just about to be forth-

coming, would it be prudent to delay or cancel those as well?

Mr. Summers. It would be prudent for them not to take place until adequate accounting and adequate safeguards are in place.

Mrs. BIGGERT. So that there would be concrete evidence that

those safeguards are in place? Mr. Summers. Absolutely.

Mrs. BIGGERT. Thank you. Thank you very much.

Chairman LEACH. Thank you.

Mr. Inslee.

Mr. INSLEE. I just want to make a comment and then I have a

couple of questions.

I read from our friends in the press who sort of suggested that these hearings are to answer the question "Who lost Russia?" and I want to say that nobody "lost" Russia, Russia was not ours to lose. And if Russia loses this opportunity to go to a law-based free enterprise system, it will be Russian failure, not American, and I think it is important to say that when we think about what we can or cannot do with regard to Russia.

But if there is a new shift, when and if we ever get back to try to help them financially, and I appreciate the Administration's decision to essentially just refinance existing loans, if we ever do get back to that position, the first question: Should we consider rethinking how we offer assistance to Russia, to go to a system of

maybe more micro-credit in the sense that we make individual lending decisions on our end of the pond, so to speak, rather than

central banking decisions in Russia?

Should we simply accept the fact that we are going to have to make those lending decisions here to have credibility and integrity, at least for some period of time? And we have had, as you know, some real success in a lot of developing nations with some of our micro-lending policies with specific entrepreneurs. Should we be thinking more on those lines rather than just sort of supporting the central banking system?

Mr. Summers. Certainly I think doing as much as we possibly can in a micro-enterprise area should be very much a priority and should be something that we and the international financial insti-

tutions should strongly support.

In general over the last number of years in Russia, the constraint has frankly been less the availability of external finance for micro-enterprise than the ability to put institutions in place on the ground that can identify enough loans. Not even all the money that has been allocated for this purpose has moved, because of the need

for satisfactory control.

I think that, Congressman Inslee, in light of the substantial debts that Russia has coming due, and in light of the fact that the conditions of stability in which micro-enterprise can function does depend somewhat on the macro-economic framework, it wouldn't be a good idea for us to make a blanket judgment about moving away from macro-economic support for change in Russia, although as our current policy limited to refinancing illustrates, that is an area on which we will have to be very hard-headed going forward.

Mr. INSLEE. Is there a way, if the American taxpayer is going to be providing some financial assistance or guarantees, if you will, should we be more rigorous in directing it to things that we may have a self-interest in; for instance, the command and control system of their nuclear force? Should we be trying to tie some of our assistance and say we want to see a targeting toward some specific

concern? Should we be thinking in those terms?

Mr. SUMMERS. Yes. My discussions here today reflecting what are the responsibilities of the Treasury Department have concentrated on the work of the international financial institutions, which I think covers primarily the areas that we have been dis-

cussing.

If one looks at the broad portfolio of U.S. policy, and particularly our bilateral assistance program, I think there is no question that a crucial aspect has to be the area that the Nunn-Lugar program represented in terms of supporting targeting of nuclear materials. I think there are questions in which Senator Domenici and many others have been active involving enriched uranium and plutonium fuels from Russia.

I think there are a broader set of issues involved in defense conversion and housing for Russian military who are brought back to Russian soil. It seems to me that one of the great transformations is the defense conversion effort, and that is something that we have very large, very direct security interests in cooperating with the Russians on, and it is an area that is somewhat separate from the set of issues that we have been focused on today.

Mr. INSLEE. Thank you.

Chairman LEACH. Thank you. That concludes the last Member from our committee, but we have a guest, Mr. Weldon.

Mr. WELDON OF PENNSYLVANIA. Thank you, Mr. Chairman. I appreciate the opportunity to sit through this provocative hearing and the comments made.

I am here because I co-chair, with Congressman Steny Hoyer, the Duma-Congress Initiative, and we are very active with members of the Duma. Mr. Secretary, I was very much interested in your testimony, but before I get to that, I would like to, Mr. Chairman, introduce members of the Duma who have been invited here

to witness these hearings.

I invited, and he is here, the Chairman of the Corruption Commission of the State Duma, Alexander Kotenkov. Would you please rise? The Deputy Chairman of the State Duma Committee on Budget, Taxation, Banks and Finance, Mr. Gitin. Mr. Gitin, would you please rise? Mr. Andrei is due to arrive along with Viktor Gitin. You will have a Duma deputy testifying tomorrow in one of

your panels.

In the twelve-page statement that you made, Mr. Secretary, which was very thorough and comprehensive, and for the record I have supported every initiative the Administration has had with regard to Russia, I have lobbied for the Nunn-Lugar program and have been trying to support the engagement with Russia. But in your statement there is no mention of the Parliament in Russia. There is no mention of the word Duma or Federation Council. In fact, the only time you referred to it was after you asked a question, and this was your statement: "that things were not moving forward because of the unwillingness of the Russian Duma to bring the budget under control."

In fact, if you look at all of the concerns raised by our Government and the IMF, the budget and the privatization of land, the reforms, all of those require action by the state Duma. My contention is that has been the failure. Our policy for the past seven years, in my opinion, has been so preoccupied with our two Presidents and our Vice President and the Prime Minister that we have forgotten that Russia also lives under a Constitution and that Constitution includes a Parliament, and that Parliament has a legiti-

mate role to play.

My concern is when the IMF goes in and attempts to ask the Duma to make tough reforms, like imposing new taxes on people for the water that they drink, for the electricity, for the housing which in the past they got for free, if I were a Duma deputy, I would say to the IMF and the U.S. Government: Go pound sand. Why didn't you come to us when you were spending all of this money in our country? Why didn't you come to us when policies were being developed as to where the IMF were putting dollars? Why didn't you come to us when we suggested that the regions should be benefiting where they are making reforms? Why didn't you come to us all along? Do not come at the eleventh hour and expect us to do the right thing simply because Russia's back is against the wall.

In my opinion, that has been the failure of our Government, and I include the Congress and the White House. We have not done

enough to strengthen the institution of the Parliament in Washington.

I was in Moscow a year ago in September when this Congress would not approve IMF funding to let the most recent tranche at that time, and at the same time the Duma was opposed to the tranche of IMF funding. Why would the Duma be opposed to more money coming into Russia? Because the Duma deputies from all the factions look at this as a bailout of the corrupt policies of the Yeltsin government, of the cronies and the oligarchs who run the seven banks, the cronies who benefited from the billions of dollars that we put into Russia, and I would disagree that all of it is totally accounted for.

I would make the statement that there are some cases where we have not been able to account for even the taxpayer money going into Russia. That is why the Duma was opposed to the IMF

tranche.

I came up with a set of eight principles. This follows up on Mr. Frank's suggestion that if we have some ideas, bring them forward. These ideas are two years ago, Mr. Secretary. Let me read them to you in summary form and ask which ones you disagree with.

Number one: to establish a joint U.S.-Russian legislative oversight commission to monitor every dime of Western money going into Russia. Not to dictate where it goes, but to make sure it is

going to where it is supposed to go.

Focus Russian resources on programs like housing that will help develop a Russian middle class; to make Western resources available to reform-minded regional governments instead of running everything through the central government in Moscow. Deny corrupt Moscow-based institutions access to any further Western resources.

Number five, reform the International Monetary Fund was a suggestion to me by George Soros the week I left for Moscow. He said the one thing that needs to be done is to put pressure on the IMF to establish an international blue ribbon task force to make recommendations on how to deal with an emerging economy like Russia's

And number six, Mr. Secretary, the Duma leaders agreed to this, and listen to this, to put the horse in front of the cart, make reforms precede and not follow the resources. So something the IMF couldn't get Russia to do, that our Government couldn't get it to do, the Duma agreed to because we were tying it into these other changes focusing on the regions, making sure focusing on programs that create middle classes, to make sure there was an oversight process where the Duma could monitor inside of Russia where the dollars were going.

The last two were to develop a joint action plan to engage CEOs of American companies with Russian enterprises and a mentoring

relationship, some of which is being done now.

And the last one was to bring over 15,000 young Russian students within three years to have them attend undergrad and graduate degree programs at American business, finance and economic schools with the stipulation they must go back to Russia to live to help create the next generation of free market leaders in Russia.

We presented this plan to the President, and the White House told Speaker Gingrich, "we don't support it," and so Speaker Gingrich, to his fault, was not willing to stand up and have the Con-

gress vote on it, yet the Duma agreed to it.

My question, Mr. Chairman, if we are ever going to get Russia straightened out, we have to understand that Russia lives under a constitution, and as much as I want Yeltsin to succeed, and I did all the way through, you have to engage the parliamentary bodies, the Duma and the Federation Council, because if you don't, you will never have the reforms codified that you and the IMF feel are so necessary.

Mr. SUMMERS. Let me just say, Congressman Weldon, how much we appreciate the work that you have done for a number of years with the Duma, and I think you are right in your central point that engaging with any country, you have to engage with the whole of its government and not just its president; and that should be, and

I think will be, a priority policy going forward.

There is obviously a balance that has to be struck, just as foreign governments in dealing with our country, there is a role for them in dealing with Congress, and there is a role for them in dealing with the Executive Branch, and a balance has to be struck. But I think there is no question that our approaches, going forward in Russia, will have to increasingly be from the ground up, and that is a theme that, if you like, connects Congressman Inslee's concern with micro-enterprise lending, some of the concerns that were expressed about making assistance felt directly by the people.

And I think it also goes to your suggestion for a political strategy in terms of a greater degree of engagement with the Duma. Of course, we are at a particularly complex moment in Russia's political calendar right now, and that is something the United States needs to be mindful of as it sets policy toward Russia, but I think that the central point of your eight principles, the need to engage more deeply with Russian society and not simply from the top

down, is entirely correct.

Chairman LEACH. I thank you, Mr. Weldon, for your extremely

thoughtful contribution.

Just in conclusion, let me say that from the American perspective, the principal issue isn't who lost Russia, but how we can help save Russian democracy; and I believe it would be an exaggeration to suggest that Russia is an economic Vietnam, but it would not be to note that any sense of history requires that the United States take all credible steps to ensure that the Cold War isn't revisited.

In this context, corruption problems have a capacity to destabilize Russia and, therefore, the international political system. Issues of corruption and public service ethics have a National Security Adviser dimension. In this sense, our committee's basic jurisdiction is over banking, and banks are intermediaries for good or for evil, and it is a challenge to all of us to ensure that financial systems are designed to serve people and not insiders, and that is an extraordinary circumstance that will reflect on, I believe, the future of not only U.S.-Russia relations, but much of Western stability.

Anyway, we thank you very much for your testimony, Mr. Secretary, and we wish you well. And I would say I am particularly supportive of your last theme, and that is to begin from the bottom up, which is implicitly looking at the concerns of people first, rec-

ognizing that governments are to be accountable to people and if governments aren't accountable to people, other governments ought to be, and this Government ought to lead the way.

Thank you very much.

Mr. Summers. Mr. Chairman, Ranking Member LaFalce, thank you very much for having provided me with this opportunity for discussing both the crucial issues involved in U.S.-Russia policy and the crucial issues involved in making sure that the United States takes an adequately vigorous approach to financial crime. We in the Administration look forward to consulting with Members of this committee and other Members of Congress on these very important issues as we go forward.

Chairman LEACH. Thank you, Mr. Secretary. The committee will now ask that the second panel come forward, and I will introduce

them

Our second panel is composed of the Honorable James Woolsey, who is the former Director of the Central Intelligence Agency; Mr. Fritz Ermarth, who is the former CIA Chief Russian Analyst and National Security Council official; Mr. Paul Saunders, who is Director of the Nixon Center; and Mr. Vladimir Brovkin, who is a Professor at the American University Transnational Crime and Corruption Center.

We will begin in the order of introductions and begin with Direc-

tor Woolsey. Mr. Woolsey, please proceed.

Mr. Frank. Mr. Chairman, could you ask people who are doing business to clear the room. I think we are going to have trouble hearing. There are various conversations going on.

Chairman LEACH. The Chair would ask that there be order and that it is disconcerting for conversations to take place when our speakers are proceeding.

Director Woolsey.

STATEMENT OF HON. R. JAMES WOOLSEY, SHEA & GARDNER, FORMER DIRECTOR, CENTRAL INTELLIGENCE AGENCY

Mr. WOOLSEY. Thank you, Mr. Chairman. If it is all right, I would submit this three-page statement and then just speak infor-

mally from it for a few minutes, not reading it.

Chairman LEACH. Without objection, and I will say I am somewhat disappointed, because I considered it to be an exceptional three-page statement, but please proceed as you see it fit, and your full statement will be placed in the record.

Mr. Woolsey. Thank you, Mr. Chairman.

It is an honor to be asked to testify today on this important subject. I should begin by ensuring that you realize that my detailed knowledge of this particular issue—that is, Russian money laundering—is dated, is limited in scope and was highly classified at the time I was working on it several years ago, because of the sources and methods that we used in learning about it.

My involvement arose because during 1993, when I was Director of Central Intelligence, some very able CIA analysts came to me with an excellent briefing on some aspects of Russian organized crime. I moved promptly to ensure that very senior officials at Justice, the FBI, the National Security Council and elsewhere in the Government received this briefing. I commissioned a special Na-

tional Intelligence Estimate on Russian organized crime that had limited circulation because of the sensitivity of the sources and methods. I also put the issue on the agenda of some of our meetings with our allies at very senior levels working on this issue; and I think that through this, the U.S. intelligence community and the CIA in particular, performed a very valuable service in putting the issue squarely before those in our country and in some of our allies' governments who needed to know about it in order to take appropriate action.

I believe that this is one of the most important issues facing the United States, that is, the issue of large corruption in Russia, of which money laundering is one aspect, really for three reasons.

First, organized crime and corruption together have the potential to destabilize the Russian state and Russia can still destroy the United States within the 30-minute flight time of an ICBM. Thus, its political instability and the unpredictability of any who command and control its strategic systems are of course extremely important to us.

Second, there is the real possibility that Russian organized crime groups may become involved with the sale of technology or the material for weapons of mass destruction, and such sales could be profitable in the right quarters, for example in the Mideast, to terrorist groups or governments such as Iraq; and this, of course, is a major issue for the United States.

Third, Russian organized crime can use its resources to corrupt institutions in the United States, and the recent case involving the

Bank of New York may prove to be one such example.

I have been particularly concerned for some time, Mr. Chairman, at the inter-penetration of Russian organized crime, Russian intelligence and law enforcement, and Russian business. I sometimes illustrate this point with the following hypothetical: If you should chance to strike up a conversation with an articulate Englishspeaking Russian in, say, the restaurant of one of the luxury hotels along Lake Geneva, and he is wearing a \$3,000 suit and Gucci loafers and he tells you he is an executive of a Russian trading company and he wants to talk to you about a joint venture, he may be what he says he is. He may be a Russian intelligence officer under commercial cover. He may be part of a Russian organized crime group. But the really interesting possibility is that he may be all three, and that none of those three institutions have any problem with that arrangement.

In addition to the above points, I have said publicly, Mr. Chairman, that during the time we were working on this issue of organized crime in Russia, Mr. Louchansky and his company, Nordex,

were a focus of our attention.

I would point out that since the second week of January of 1995 I have been a private citizen. So let me turn now from what I know to what I just have judgments about, based on public sources.

I have no reason to dispute the Russian government's estimate that criminal syndicates now control around 40 percent of the Russian economy, and as you pointed out in your piece in the New York Times, Mr. Chairman, there are higher estimates as well. Former Interior Minister Kulikov said to me last week that the Duma has passed anticorruption legislation on five occasions that

has either been vetoed by President Yeltsin or sidetracked by him

and his staff in some fashion.

The heart of the matter seems to me to be the difficulty that we have today in finding an institution or group of individuals with whom we can work on a long-term basis. I might contrast the current Russian situation with that in Italy some years ago, when organized crime was an extremely serious matter. But by working with Italian magistrates, who by law and by custom are the "untouchables," in a sense, in the Italian system, we were able to help those magistrates make a substantial dent in the problem of organized crime in Italy.

In Russia, there are individuals with whom from time to time we can work, but there does not seem to be a critical mass at the national level of honest magistrates of this sort, or any other arrangement which gives us a partner on a long-term basis. Perhaps the presidential election in Russia will bring some developments that will be positive; I hope so. But it is important for us to do what

we can, even if we operate alone.

Let me conclude with the following point. I have been asked frequently, since the story began to break a few weeks ago concerning money laundering through the Bank of New York, whether during my tenure I detected any lack of willingness at the senior levels of the U.S. Government to hear information about this subject. My answer to that specific question is, no, I detected no such lack of willingness as of January, 1995; but during the last several years, as a policy matter now, we have seen that to an extraordinary degree the United States has become identified with President Yeltsin and his senior people, the circulating list of senior people, and we have been quite generous financially, particularly through the IMF, with sending funds to Russia, and we have pushed for increased tax collections and tight budgets.

Each of these approaches at one time or another had some defensible aspects to it, but if you step back from them and look at the overall pattern, it is very easy to see, as Congressman Weldon has pointed out, why ordinary Russians who saw us just a few years ago in very idealized terms have turned sour on the United States. In their eyes, we are the supporters of those who have stolen much of their national patrimony, through a highly corrupt privatization process particularly, and at the same time we are the ones who insist that the ordinary people of Russia bend their backs even harder. We are seen, in short, by average Russians as supporting the

system and the individuals who are exploiting them.

To them, America won the Cold War and then helped to give them a capitalist economic system that is modeled not on Silicon Valley, but on the Chicago liquor market of the 1920's. Something is badly wrong here, but the roots of the problem don't lie solely in our knowledge about, or our approach toward dealing with, Russian organized crime. There are deeper, I think fundamental, issues in the approach toward Russia that we have, perhaps in a fit of absent-mindedness, adopted as American policy.

I conclude with one final point, Mr. Chairman. Congressman Weldon was kind enough earlier this year to have me and former Secretary of Defense Rumsfeld and several others join him and other Members of the House in Moscow, meeting with some mem-

bers of the Russian Duma, and I became familiar then with the

program which he described a few minutes ago.

I think that his statement, and some of the questions by Congressman Inslee, as well as your closing remarks and some of the things that Secretary Summers said, could point the direction toward a rather middle way between the current policy and the withdrawal from engagement with Russia. In pursuit of such a withdrawal, some have even proposed cutting Nunn-Lugar funds, which I think would be extremely shortsighted.

I would characterize Congressman Weldon's overall approach as a form of "tough love" in dealing with Russia. It has often been said that the Morrill Act, establishing land grant colleges, and mortgage interest deductability may be two of the most important things that the Congress has ever done in terms of building an educated middle class, and a homeowning middle class, in the

United States.

Many of the analogs that exist to those types of measures and others in Congressman Weldon's program seem to me to present a positive approach. Perhaps not every detail ought to be implemented precisely the way it is drafted now, but I believe if those in the Administration who have fostered the approach that I believe has not succeeded and has brought us to this point, as well as those in the Congress who are proposing more or less a complete withdrawal from dealing with Russia, would get together and focus on some of the points and issues that Congressman Weldon and others here have raised, I think there is a way out of this. It will not be easy, but it does present the possibility of a positive approach toward engagement with the Russian people in way that we have not been engaged to date.

Thank you, Mr. Chairman.

[The prepared statement of Hon. R. James Woolsey can be found on page 246 in the appendix.]

Mr. LEACH. Thank you, Mr. Woolsey.

Mr. Ermarth.

STATEMENT OF FRITZ W. ERMARTH, FORMER CIA CHIEF RUSSIAN ANALYST, NATIONAL SECURITY COUNCIL OFFICIAL

Mr. Ermarth. Mr. Chairman, I am deeply grateful to you and the other Members of the committee for offering me the oppor-

tunity to testify today on this extremely important agenda.

Staff asked me to say just a word about my background. I retired a year ago from a 35-year career in serving the national security, twenty of it working for CIA, and in those years I was a national intelligence officer for the U.S.S.R., now Russia. I was the Chairman of the National Intelligence Council, which prepares national intelligence estimates. I had two tours on the NSC staff, one under President Carter, one under President Reagan, and I also served in private industry.

Throughout that period, I was primarily focused on things having to do with the Soviet Union one way or another, and of course, I continued my keen interest in Russian affairs after the collapse of

the Soviet Union.

I would like to focus my testimony on the larger context of Russian developments that have posed the challenge before this com-

mittee, the challenge of organized crime and its various threatening practices like money laundering. We can probably need to have little doubt that our law enforcement agencies and regulators will come to grip with this challenge. This committee will no doubt help in that endeavor, but we must keep the most important issues in the forefront, as the Chairman has done in his public statements and in his very gracious and, I thought, very timely statement in the Russian language to the Russian people here today.

We must consider how our country's future security and wellbeing will be threatened if, once again, Russia fails in its historic mission to find a way to an authentic, stable democracy in a just.

prosperous society with a market economy.

My bottom line is that Russia is not lost. That is a strongman statement, as a matter of fact; we ought to ban it from the debate from now on since everybody's attention has been got anyhow. Russia is stuck, stuck in a swamp, between the Soviet past and several alternative future possibilities, some of them bright and some of them ominously dark.

The larger purpose of these hearings in this committee and in other committees at the Congress and in the debate now finally taking place in our political arena and in our press is to understand Russia's condition and prospects better and to inform better American policies for encouraging the brighter prospects of democ-

racy and Russian capitalism.

The threat from Russian organized crime springs from two fundamental and interrelated realities: first, the grave weakness of the rule of law in Russia and, second, the perversions of what we

have called "economic reform."

The Communist system was itself a kind of structured lawlessness. The Soviet Union had lots of laws. They were really tools in the hands of those who wielded power to use, abuse or ignore, and they left plenty of room for ordinary crime, organized crime and official crime or what I called authorized crime. And these possibilities of course expanded massively and rapidly with the collapse of the Soviet order.

The collapse of Communist rule gave free rein to these phenomena in a completely new setting. Now, that new setting, which we have labeled The Emerging Capitalist Economy of Russia is something for which I have not found a good definition. It has important features of democracy and capitalism, but it is not authentic democracy or complete democracy, and certainly not authentic capitalism. Focusing on the business and economic side, I would use the term "crony capitalism" without capitalism or at least much capitalism.

By "capitalism," we mean investment for the building of wealth; that is not what was going on there. We see a lack of firm property rights and good corporate governance. We see a system that is more about the distribution and especially the concentration of wealth than it is about investment and the creation of wealth, and above all, we see a system that is about the extraction and the ex-

patriation of wealth.

We have used the term "capital flight" here. I think we have got to have another term for most of this because capital flight ain't what it is. It is the flight of loot rather than the flight of capital in many cases. That is not just the criminal loot, but the plundered wealth out of the natural resource base. It isn't the same as a businessman in Brazil making a profit on a business and then sending that money abroad, because it isn't safe or profitable at home.

Now, this came about in large measure because of the manner in which the reformers of the post-Communist regime tried to create capitalism amidst the wreckage of the Soviet order. As one analyst I have read put it, they proceeded in good Communist fashion to create a new capitalist class. By basically appointing them, relying largely on privileged insider relationships, vast resources and enterprises were placed into private hands, often the old Communist hands, at less than fire sale prices. Enterprises were sold off at less than the cash value of their annual revenues. Export and import privileges were handed out to cronies like the sports funds. Even the church profited from this, alas.

Thus, the process of privatization was, from the outset, a rip-off at the expense of the state and the society. This, along with the destruction, the unnecessary destruction of people's savings through inflation in the early 1990's deeply blighted the public's view of capitalism from the outset. The reformers took a course certain to alienate society. They almost deliberately ignored the task of building public understanding and support, a theme to which Congressman Weldon spoke when he referred to the importance of engaging

the Duma.

Dimitri Simes, known I am sure to all of you who follow Russian affairs, tells a story of how on his last trip to Moscow, former President Nixon visited with President Yeltsin and urged President Yeltsin and the reform team to pay more attention to building public and Duma support, at least a dialogue in the face of mounting opposition. President Yeltsin said, "Well, that is not what we are hearing from Washington. We are told we ought to just ignore them, the Duma and the opposition." This was in 1993. So the political—or naivete is not too good a word for it, but whatever it is

on our part started very early.

Now, this style might have worked out had the new owners, however privileged and unfair their access to this wealth, had they proceeded to manage their new wealth as real capitalists, as real entrepreneurs, by investing, building and creating as our robber barons did, so-called; but far too often they did not do this. Lacking confidence that their new wealth could be profitably invested in Russia, even if they could hold on to it and not knowing in most cases how to turn resources into new wealth through investment and entrepreneurship, they all too often simply extracted it, stripped it, plundered it out of Russia and sent it abroad where it could be safe and productive, with little work by themselves other than financial and other kinds of bureaucratic machinations.

In this matter, a country rich in natural resources and productive potential saw its state and its society impoverished. The society and domestic economy reacted with various coping strategies—barter, trade, moonlighting work. The state had its coping strategies like not paying its bills and then very creative financing called the short-term capital bond market at high interest rates which aptly turned into a no-lose casino that eventually had to go bust

despite the lavish spending of the IMF to keep it up.

What we have seen here is not so much organized crime as authorized crime, intertwined with corrupt government and politics at all levels. It has been abetted and has abetted itself by organized crime with its money laundering, its protection rackets and the like.

The fundamental misdemeanor of Western, including American, policy was that it bought into this phony, crony capitalism too uncritically and for too long, and against obvious evidence you could have shut down all of Mr. Woolsey's colleagues on this front and it still would have been obvious. Intelligence brought its own very special contribution sources and methods of a sensitive nature, but you didn't need intelligence to see this. You needed an absence of intelligence—small "i"—to ignore it, but the government wasn't alone. The mainstream media, the mainstream foreign policy establishment up and down Mass Avenue ignored it as well. The protests of Western and Russian observers who knew what was going on went unheeded.

One of the sad consequences of IMF lending, while aiming to stabilize and grow the economy, it actually lubricated, legitimized this plundering; at least that was the way a lot of Russians viewed the political meaning of IMF lending. I think it was more a perversion, than diversion, of IMF lending. Although I think there was some

diversion, especially in July-August 1998.

If one includes the period of the late 1980's, when much of this activity was begun under the aegis of the CPSU and the KGB, the representatives of the Soviet state itself, one might guess from \$200 to \$500 billion of "capital flight," "capital loot," has left Rus-

sia

Now, some of it derives from crime. Some of it was completely legitimate, although it was trying to escape taxes, but most of it was in this gray zone derived from phony, crony, insider access to natural and other resources. Now, some of it comes out to be laundered, because it needs to be disguised, but a lot of it just gets deposited, just comes out where it is safe and productive and it doesn't stay in Cyprus. It goes to the biggest, most productive, most successful economy in the world, the United States of America.

Here, it goes in several directions. Some stays and takes a nap, as I say, waiting for future opportunities. Some goes back to Russia for business, crime, for politics. A lot of it gets invested in portfolios and real estate and businesses, and I am sure that some of it goes

into political contributions.

Now, that might seem like an inflammatory statement, but I can make it with confidence for three reasons. First, the logic of the situation. That is what this kind of money does. It is bipartisan. It won't go to just one side of the aisle, but that doesn't make sense. These people don't care about the issues or the values or the poli-

tics. They care about influence.

The second reason, I think, I can make this statement is because there are some examples in the press over the years; and third, because FBI people who follow Russian organized crime in this country have said it is so, it goes on. They don't know quite what to do about it if it doesn't involve direct violation of law, but they have told me that it does.

I would assign even greater weight, however, to a more general problem or threat. Money on this scale acquires friends, and those friends have leverage. How much leverage and with what effects on Government policies, I do not know, but that is a proper subject for

inquiry by this committee.

Did Americans heavily invested in the GKO market, this casino, this no-lose casino that eventually became a plundering of the Russian state budget for the benefit of Russia and Western speculators—vast profits extracted, vast losses risked—did the stakeholders in that enterprise have influence over U.S. Government policy to encourage IMF lending last summer? Mr. Soros and others have strongly implied exactly that.

Let me state that the picture, Mr. Chairman, that I have painted here is deliberately unfair, because it doesn't afford enough attention to the positive. There is real capitalism and democracy in Russia. There are decent businesses, honest policemen, clean politi-

cians.

Back to our first point, Russia is stuck, not lost. If the Russians can somehow get through these elections, the crisis of terrorism, create a somewhat stable and legitimate government, I believe there is a possibility that a real window for reform will reopen, that it could be done right. Certainly it can be done better. I hope that we shall be ready with supportive policies that are more perceptive, more honest and more constructive than they have been in the past. At least we have got to quit committing the errors of the past.

Thank you, Mr. Chairman.

[The prepared statement of Fritz W. Ermarth can be found on page 249 in the appendix.]

Chairman LEACH. Thank you.

Mr. Saunders.

STATEMENT OF PAUL J. SAUNDERS, DIRECTOR, THE NIXON CENTER

Mr. SAUNDERS. Thank you very much, Mr. Chairman. Thank you also to the Ranking Member and other Members of the committee

for the opportunity to be here today.

Before I start, I wanted to make two minor bureaucratic points. First, my written testimony was prepared jointly with Dimitri Simes, the President of The Nixon Center, who unfortunately was unable to be here today; and second, that despite our respective positions at The Nixon Center, our testimony does not represent an institutional position by the center as an entity and expresses solely our private views. Moreover, to the extent that I drift from the testimony, I am expressing my views alone.

I will discuss my prepared remarks only very briefly, because I would like to address some of the issues that came up in the dis-

cussion this morning in a little greater detail.

I think from the discussion this morning, it is clear that the Clinton Administration has been aware of the scope and scale of Russia's corruption problem for some time, and that, for a variety of reasons, it has chosen either not to act or to take limited, ineffective action.

In my view, this is a result of the Administration's overall approach toward Russia and its division of Russian politicians into good" and "bad." This was a gross oversimplification of the situation in Russia. It led to the Parliament being put into "bad" the category with some of the consequences that Mr. Weldon outlined earlier.

It also allowed the Administration to ignore the inappropriate or questionable actions of the so-called "good people" sequences that we have heard about today. with con-

Turning to the question of who lost Russia, I don't think that it is an appropriate debate. Secretary of State Madeline Albright said last week that it was "arrogant to argue that we could have lost Russia, because only Russia could lose Russia." I agree wholeheartedly with that sentiment; but I would take it one step farther and say that is it arrogant not only to say that we could lose Russia, but also to pursue the policy that we have pursued in recent years, believing that we know better than Russia's government and people what budget deficit level they should have, what inflation level is appropriate, or which specific people should be part of any given Russian government. That is one of the major problems of our policy toward Russia. There was a sense that we somehow knew more than the Russians did, that we could come up with the right answer for Russia out of the dizzying array of economic possibilities in the world.

This led us to focus on macro-economic issues, the budget deficit,

inflation rate, and others I mentioned earlier.

These policies were advanced at the expense of other priorities that would have been much more desirable in the long term, such

as the rule of law.

I believe that if the Administration had pressured Russia and President Yeltsin more heavily on the rule of law, rather than on these economic issues, which ended up spoiling relations between the Russian executive and legislative branches and prevented the passage of legislation that would have encouraged investment and limited opportunities for corruption in Russia, we would be in a much better position than we are today.

On that point, it is essential in thinking about Russia to decide what our priorities really are. Whether Russia's budget deficit is 3 percent or 4 percent or 5 percent is not going to keep anybody awake at night in Washington, but if there is a return to some kind of authoritarian government, or if there is chaos in Russia resulting from popular frustration with corruption and other problems,

I think a lot of us could be awake at night.

I would like to make one final point about the debate over our policy toward Russia. The Administration and its defenders have frequently tried to cast opponents to their policy as "cold warriors" opposed to engagement with Russia. I don't think that is really the

correct way to frame the argument.

There are many ways to engage with Russia that will allow us to have a very productive and mutually beneficial relationship. If we give more attention to the things that really matter in Russia, such as creating a rule of law system, we will be much better served in the long run.

Thank you again.

[The prepared statement of Paul J. Saunders can be found on page 251 in the appendix.]

Chairman LEACH. Thank you, Mr. Saunders.

Professor Broykin.

STATEMENT OF PROF. VLADIMIR BROVKIN, PROFESSOR, AMERICAN UNIVERSITY TRANSNATIONAL CRIME AND COR-RUPTION CENTER, ACCOMPANIED BY PROF. LOUISE SHEL-

Mr. Brovkin. Thank you very much for the opportunity to speak before this committee. I also should say that I am particularly honored to be here, as I am a Russian-American. I spent half of my life in Leningrad, U.S.S.R., and the other half in the United States, having been educated in this country, but devoting my professional life to the study of Russia; and I am particularly grateful to my colleague and friend, Louise Shelley, the Director of the Transnational Crime and Corruption Center, with whom we have been working for the last two years on the problem of organized crime and corruption in Russia.

The written part of our remarks has been developed by the three of us-the two Directors and I, Keith Henderson and Louise Shelley. I will summarize briefly our major points, and also as we go along, give a couple of examples about the issues that we have de-

veloped in these remarks.

First of all, I should say that in the two years that we have been working on this project, actually funded in large part by a Department of Justice grant, we have come in contact with many, many Russians-journalists, politicians, prosecutors, street cops-and we have developed very good relations with many of them. In July 1998, we held a money laundering conference at the Federation Council in Moscow which was extremely useful and very revealing in terms of the processes and mechanisms of how money laundering works; and a lot of debate was going on about the formulation of the money laundering law in Russia, which still hasn't been passed. It also showed that the term "money laundering" is understood in quite a variety of ways and certainly very different from what we understand here in the United States, which also needs to be addressed in a future discussion.

We have just returned from Moscow, where we had a conference on corruption, sponsored by us and our partners in Russia with the Institute of State Law and the Russian Academy of Sciences, and I am not going to spend time summarizing it. It is all going to be on our Website. But what I would say is, I was struck with the degree of openness, the degree of frankness when the Russian prosecutors and officials were talking about their problems in front of Americans. This was totally inconceivable five or six years ago, let

alone in the Soviet period.

Moreover, what I also think you all will be pleased to hear is, the kinds of proposals they have developed are very much in the American spirit. They were talking about the conflict of interest law that they would like to introduce, about the statement of income for the relatives of civil servants, about the ethical code of behavior for the civil servants and many, many other interesting initiatives. So it is one more time to emphasize that when we do speak about corruption and organized crime in Russia, that should not mean that there are no serious attempts made by many honest

Russians to combat this problem.

But now to our comments, and essentially what we are arguing in this paper, in this presentation, is that the scandals that have been filling the pages of the world press recently are a wake-up call that reveal several fundamental problems that have been plaguing the Russian and American financial communities. It should be a wake-up call to the Congress, to the White House, to multilateral institutions such as the IMF and the World Bank, financial institu-

tions and regulators, and the public at large.

We do have extensive analysis of the mechanisms of the phenomenon of money laundering and capital flight, and in a nutshell, we are convinced that it is not just a Russian problem. It is not just a Russian organized crime issue, because respectable American and multinational companies, financial institutions in many countries—in U.S., Swiss, Russian, United Kingdom, Cyprus, and many other offshore zones—have been involved in this, and therefore, if money was flowing through all these places, it is not just a Russian problem. There is a serious problem on this side. Some of my Russian colleagues tell us, "You"—meaning Americans—"benefit from this; you make all the money and we lose all the money." So this, of course, is something that should be of concern to this committee, that Russia is losing capital it badly needs, that is, of course, leaving Russia for a variety of reasons.

What we have done in our TraCCC Institute is reconstruct some of the models of illicit capital flight and try to develop typologies to distinguish what is a capital flight, as opposed to theft of natural resources, as opposed to illicit proceeds that would be criminal

under one system and not criminal under another system.

We have a term, such as "skimming," which is double accounting, which is a part of the resources are exported, and if the revenue stays in the West, if they had to pay taxes, it would be totally legitimate parking of your capital abroad. If they have done that, then there is no crime of any kind; but if they not paid taxes to the Russian authorities, then it is tax evasion. But again, it depends on which law and in which country the money is parked.

We are also developing typologies of how front companies, or what the British call "shell companies" operate, and that concerns mostly the Russian export sector. And that, of course, directly involves money laundering, but again it depends which laws have been broken and in which country and whether that would qualify

as money laundering or not.

Our estimate is that of the total figure, \$15 billion, that is leaving Russia, probably about a third is what you could call hard-core criminal proceeds; the rest of it is either semi-legitimate or simply money parked abroad since the ruble is undesirable currency.

We believe, and we do state in this statement, that these processes represent a national security threat to the United States, to the financial stability of the Free World and also to Russia, and of course, many other countries such as Mexico, Indonesia, and Brazil. We do think that it is essential to rethink the financial structure and the national security aspects of it; and it is my term that I add, that we need to think about containing the threat of

global organized crime with the same seriousness as we thought about containing communism, because in today's world the transnational organized crime networks represent just about an equal danger to the financial stability of the United States and the

world as did the Communist threat, if not more so.

We also believe that if left unchecked, these processes of corruption and organized crime will lead to serious social damage to Russia and CIS countries and many other developing countries, because dirty money feeds the caucus of criminal networks involved in a number of activities we studied, such as nuclear and weapons smuggling, narcotics trade, and trafficking in human beings, especially exploitation of women and children. So there is a component of human rights here that is extremely important.

As far as the loans are concerned, much has been said today about this, the IMF and the World Bank. We are convinced that new policies and procedures for dispensing and monitoring aid and loans must be developed. As Keith Henderson put it, "Know your donee" rules, conditionality, sanctions, independent audits and civil society monitoring and oversight mechanisms must be developed and enforced. For diplomatic and political reasons, government and multilateral companies may have to sometimes deal with corrupt public officials. However, they should not do so with a blind eye to

accountability.

And here I should add in view of the discussion this morning that I myself was in Russia, as a matter of fact, attending the money laundering conference in June 1998, exactly June 1998, and this is in regard to Congressman Weldon's comments. And that is that this is the time, if you recall, that Mr. Chubais, who was appointed as the negotiator on the Russian side with the IMF, and the way it was presented when finally the news broke that the IMF released the tranche was that the Duma would have to accept an anticrisis program. But nobody knew, and it was never publicized or said anywhere what exactly IMF wanted Russia to do. So the Duma perceived this as a kind of a hidden deal behind closed doors between Mr. Chubais and the American Government.

Now, to make their fears worse, Chubais appeared on national TV-and I saw it myself-and he said if the Duma does not pass an anticrisis program, the administration, meaning President Yeltsin, would find other means to implement the program which was, of course, a clear threat in regard to the Duma. Now, of course, the Duma would not be very happy with operating under

such conditions.

What we are suggesting is that there should be more transparency in the interest of the IMF and accountability in the way

that deals are concluded and adopted.

And finally, one more point on this subject that Secretary Larry Summers was talking about this morning, and that is that there is an open revolving door. Where is the money of the IMF? And when it goes into the budget, you would never know whether that is the budget or not. But let me give you an example of the situation at that time, June-July 1998.

Suppose that you know from the inside of the government that \$4 billion is coming to the Russian budget. Now, what does that piece of information mean? It means that immediately the GKO rates go up, because everybody knows the government will have more money. So that means that from 60 percent, in two weeks, the Russian GKO market rates went to 123 percent, which means that if you are buying up the GKO, you are making a lot of money in full confidence that the government will support the ruble, that is, will support its financial system.

In other words, what is happening is that the IMF money is coming into the budget and the state is giving it away essentially to privileged banks through the mechanism of high interest rates on

GKO.

In other words, you don't really need to siphon off or channel any of the IMF money on the side. You do it by buying GKO at 123 percent a year, and conversely, if you do know that the ruble is going to fall, you sell the GKO and that is how several of the Russian privileged banks made a lot of money in August.

Mr. LEACH. Thank you, Mr. Brovkin.

Can you summarize very quickly your statement? You are going on a little bit longer than the other panelists. Can you summarize?

Mr. BROVKIN. Yes.

Finally, I go to our recommendations in one minute. I think that it is essential to rethink the regulation of the financial market mechanisms as was spoken today, before. We believe it is essential to be more vigilant in addressing grand corruption and no looking the other way, regardless of how high ranking the government officials are. The lawyers, investment bankers, accountants, were involved in facilitating corruption in organized crime, and it must be subject to great scrutiny and appropriate sanctions.

We believe that it is essential to foster interagency cooperation both in drug-related and in non-drug-related money laundering between the intelligence community, law enforcement, political and

financial analysis between the United States and Russia.

We also believe that it essential not to politicize the issue of corruption in Russia, but rather present it in a way that the Russian people will be the beneficiaries if they have a clean government, if they have transparency and if they have banks that keep their

money rather than expropriate it every several years.

Next point, we believe that it is essential to restructure the Russian banking system. Much was talked about it this morning, to abolish the privileged banks that handle the state budget and are a source of corruption and money laundering. It is essential to work together with the Russian financial institutions in trying to implement the kind of ideas we heard this morning.

It is also important to bring money from the shadow economy into the real economy and institute a number of measures with international support that would make repatriation of Russian capital into Russia. If things go the way they do, Russia will have serious economic and political upheavals. The country cannot sustain

a loss of \$15 billion a year.

Russia needs to enact legislation and adopt effective enforcement strategies in the judicial and taxation sector. Great oversight is needed in the international loan policy. More attention must be paid to preventing diversion of money by corruption and organized crime. And finally, the tenth point, great attention must be paid to developing policies to seize and repatriate assets and to promote development in public policy goals.

Thank you.

[The prepared statement of Prof. Vladimir Brovkin can be found on page 255 in the appendix.]

Chairman LEACH. Thank you, Professor.

Let me turn first to Mr. Woolsey. In your statement you indicated that in 1993 you approached high levels of the Government, the IG and Justice Department, and so forth, about information your agency received related to corruption. Can you tell us, did this information that you relayed involve government officials and offi-

cial resources, Western or Russian?

Mr. Woolsey. This did not really focus on the senior individuals in the Russian government at that time, Mr. Chairman. It was basically, as I recall—and I haven't read it now in over five years—concentrated on how organized crime was working in Russia, what areas they were getting into, how successful some Russian organized crime groups had been, and it was basically sort of an introduction to the seriousness of the problem. But at that point in 1993-1994, I don't recall that any of our focus was that there were really any indications of corruption at very senior levels of the Russian government.

Chairman LEACH. You referenced in your testimony a concurrence with some of the statements of one of your successors, Mr.

Deutch, about the Louchansky-Nordex matter.

Mr. WOOLSEY. Yes.

Chairman LEACH. I wonder if you could provide the committee some perspective. Who was Mr. Louchansky? Who was Nordex? What is the relevance of this, particularly to Mr. Ermath's assertion that perhaps there are political monies that have entered into the American process.

Mr. WOOLSEY. Mr. Chairman, my recollection of the details of that analysis, as I say, are over five years old. I haven't read any

of that material since then.

At the time, the reason it was so highly classified was because of the sources and methods, and I am a bit afraid to start trying to speculate about what I remember from them and what might

still be classified or not.

I am sure the Intelligence Committees have copies of that estimate, and I would really prefer if in some executive session or in some way, hopefully with the cooperation of the Director of Central Intelligence, they, or I in some fashion, could go over this in executive session. I would need to refresh my recollection and also find out exactly what is classified in what way.

Chairman LEACH. Fair enough. Mr. ERMATH. Mr. Chairman.

Chairman LEACH. One second, Mr. Ermath.

One of the concerns as a committee is, we look at the problem of corruption abroad, how do you present shields to your own country and have those shields work? And Mr. Ermath has asserted that he believes that there may have been monies that have seeped into the American political process.

And I would like to ask you, Mr. Ermath, if you could elaborate

on that assertion.

Mr. Ermarth. The Louchansky case is one of the more prominent that I know about in the public domain. It has just been referred to in the press. In fact, most of the Louchansky story is in the public domain, because of press coverage in Europe and in the United States over the years.

He was one of those operations that was set up in business by the KGB in the late 1980's that semiprivatized himself after the collapse of the Soviet order. The political contribution arose in 1993 when he attended a fund-raiser in New York with an American friend, and the allegation was, he just wouldn't have been there if

he hadn't made a contribution.

Another case is Golden Ada, a company in San Francisco since dissolved and defunct, set up in the early 1990's to cut, polish and market Russian diamonds and other precious metals and stones, receiving hundreds of millions of dollars of diamonds and gold, platinum, which they just pocketed the proceeds; and they are known to have made political contributions in the San Francisco area.

I simply cite those as attention-getting public cases. I would rest more on the direct assertions admittedly in private settings by colleagues and the FBI who say, yes, it is happening at the Federal or at the State and local and probably at the Federal level as well, at least in the States where there is a substantial Russian business influence from offshore. There is no attempt here to impugn the honesty or patriotism of Russian-Americans who now live in this country in fairly substantial numbers, but it is money coming from offshore.

Chairman LEACH. Thank you. Does anyone else wish to comment

on this subject?

Mr. LaFalce.
Mr. LaFalce. Mr. Brovkin, I just want to find out a bit more about the Transnational Crime and Corruption Center. Are you affiliated with American University in some way?

Mr. Brovkin. Yes.

Mr. LAFALCE. When did it come into existence?

Mr. Brovkin. In the current form, it was founded in 1997. Before that it was a smaller program, a grant program funded by the MacArthur Foundation. But the founding person is right here; it is Louise Shelley. I joined the crew in the fall of 1997. Before that, I taught at Harvard University in the Russian Research Center.

Mr. LAFALCE. Well, either of you can respond to my questions. You made reference to the studies that you did which were enabled

by a Department of Justice grant.

Can you expand upon this Department of Justice grant, please? Mr. BROVKIN, Could I ask Louise Shelley to answer?

Mr. LAFALCE. Surely.

Chairman Leach. If you would introduce yourself for the record. Ms. Shelley. I am Professor Shelley of American University. I am the Director of the Center for the Study of Transnational Crime and Corruption. The reason Professor Brovkin has asked me to comment on this is that I was the principal investigator on these proposals before Professor Brovkin arrived on the scene, and we

have been running projects in Russia and now in Ukraine with Russian colleagues and Ukrainian colleagues—in four cities in Russia and one in Ukraine—to study problems of organized crime and corruption.

With them we have worked with members of the Russian Parliament and produced publications and seminars and training for

law enforcement.

Mr. LAFALCE. Can we focus in on the Department of Justice grant, Ms. Shelley?

Ms. Shelley. That is the Department of Justice grant.

We also have a second grant—

Mr. LAFALCE. You say that is. What is?

Ms. SHELLEY. We have two grants from the Department of Justice out of the Coordinator's Office administered by the Department of Justice on organized crime studies.

Mr. LAFALCE. Did they put out solicitations for these grants, re-

quests for proposals?

Ms. Shelley. Yes.

Mr. LAFALCE. When did they do this?

Ms. Shelley. When this project first started—it was in 1995—we received initial funding from the McArthur Foundation and some additional money from AID. That funding ran a total of a year. After that point, the FBI and the anti-corruption working group within the U.S. Embassy in Moscow began to participate in our programs and asked us to make a formal application for funding to the Coordinator's Office at the Department of State for assistance to the former Soviet Union for a full-scale program in Russia, at which point I developed such a proposal that went through appropriate committees, and it was then given to the Department of Justice to administer. So we have been receiving Department of Justice funding since 1997.

Mr. LAFALCE. 1997? How much is that for?

Ms. Shelley. In this year, our funding—we are still operating our 1998 money—is approximately \$300,000. We submitted all of

these reports with our testimony.

We also received funding—Dr. Brovkin and I wrote last year a proposal to international law enforcement at their request to study money laundering and front companies. That money from international law enforcement at the State Department was transferred to the Department of Justice to administer, and we started working on that this spring.

Mr. LAFALCE. I am just wondering to what extent the Justice Department was involved in investigating whatever money laundering problems may have been in existence in connection with Russia, or corruption problems, at the time of their request for proposals and whether your work was enabling to them in carrying out and en-

forcing the United States law?

Ms. Shelley. We would certainly hope so.

At other points, Professor Brovkin and I have given lectures in 1999, to the strike forces on organized crime to help them understand these issues. We have sat with prosecutors and tried to bring the results of our research to bear.

Mr. LAFALCE. And you work with officials from the Treasury Department? Did you work at all with officials from the national regu-

latory agencies, whether it is the Federal Reserve or the OCC or

the superintendent's office from the State of New York?

Ms. Shelley. We have met on just one occasion with the Department of the Treasury. We have also met with top officials at the World Bank on these issues in the last year. But we have not had other contact than those. Our contacts have been primarily with the Justice Department on these issues.

Mr. LAFALCE. Did your studies investigate the nature of the privatization process within Russia and the tremendous potential for

either good or bad or exploitation of that process?

Ms. Shelley. I have even testified before Congress many times on the misuse of privatization and the abuses that were committed in this process and gave lectures to the State Department and AID

on this issue already four years ago.

Mr. LAFALCE. Would you give me the list of each of the occasions that you testified before Congress and each of the United States or international financial institutional entities that you have spoken before on this subject, please?

Ms. Shelley. Yes.

[The information can be found on page 261 in the appendix.]

Mr. LAFALCE. Thank you.

Chairman LEACH. Thank you, Mr. LaFalce.

Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman.

I want to say to the witnesses that I regret not hearing your oral testimony. To the extent that you have submitted written state-

ments, I have read them in advance.

I simply wanted to ask all of you, in order, if you can respond as directly as possible about what is, in your judgment, the primary thing that we in the Congress, or the Government generally, can do to reduce money laundering activities from Russia that take place in this country, and including those that involve American financial institutions?

Could I start with you, Director Woolsey? Mr. WOOLSEY. Yes, Congressman Bereuter.

The money laundering itself is, from my point of view, a problem in two ways. One is what you mentioned, that it runs the risk with large deposits in this country of corrupting American institutions. And about that I have no specific learning or expertise. It is obviously a very important issue and important to this committee.

But from my background and perspective, one second very troubling aspect of it is that it is evidence of corruption in Russia which undermines the structure of the state. Sometimes it is hard to tell money that is simply being deposited here from money that is being laundered. And although capital flight is a problem from Russia, the real problem, in the second sense that I was describing, seems to me to be that the laundering of it is evidence that particularly the privatization process in Russia was so corruptly handled that individual Russians have lost confidence with the stability of their state and of our involvement with it.

I really think that the primary effort on that second problem ought to be best dealt with by a program something along the lines of what Congressman Weldon has proposed, which moves us in the direction of working with those honest institutions in Russia—and there are definitely some at the oblast and krai level—in the direction of working together with proper Russian financial institutions on mortgages for home-owning and the like, so that ordinary Russians see that American efforts are going to help them, rather than to being diverted into corrupt channels. That seems to me to be, again from the perspective of my background and interests and focus, a very, very major problem. It is the major difficulty that over the course of the last several years our policies have not fostered that.

So I guess I will close with those two points.

Mr. BEREUTER. Thank you.

Mr. Ermarth, would you comment on what is the most important thing we can do to stop money laundering in this country, whether

or not it involves American institutions?

Mr. ERMARTH. Two things, sir. First, the mandate of this committee directly to craft laws and regulations and institutional change that causes the regulation of our financial institutions to catch up with the globalization of everything. It is not just Russian money

laundering.

Second, to contribute to the larger debate in the Congress and in the public about Russian policy so that when and if a new window of opportunity for reform in Russia opens up we have the policies, the perspectives, the strategies ready to go, as it were, that can respond. Congressman Weldon has a list. Others have lists. In effect, it is an answer to Congressman Frank's question, what could we have done better?

The alternatives were there in the past: more honesty, more transparency, more rigorous and thoughtful conditionality. It does not necessarily mean tighter, but about things that really matter like law and order, the courts, the civil code. And, finally, not so close in identification with certain individuals and a certain clan of

politicians.

Mr. BEREUTER. Thank you.

Mr. Saunders, would you respond, if you wish?

Mr. SAUNDERS. I don't have anything to add. I endorse the comments of both of the previous witnesses.

Mr. BEREUTER. Let me then get Professor Brovkin an oppor-

tunity in my five-minute period.

Mr. Broykin. In addition to what has been said already, which I completely agree, I just simply want you to keep in mind when developing these transparency and honesty systems and legislation, to keep in mind that it is in the national interest of the United States to keep the goodwill of the Russian people which is now turning sour, and that Russian people, because of the failed reforms, increasingly perceive the United States as the country that is partly responsible or guilty of the misery that they are in. They identify misery with capitalism, capitalism with failed democracy.

I think it is extremely important to realize, before it is too late—and it could be too late at some time down the road—that you have got to change course and make sure that the Russian people understand that U.S. policy is for them, and not necessarily for whatever

political leader happens to be there at the top.

Mr. BEREUTER. I understand. That is good advice.

Thank you, Mr. Chairman.

Chairman LEACH. Thank you, Doug.

Mr. Frank.

Mr. FRANK. Mr. Brovkin, I, like Mr. Bereuter, have read the statements. I wasn't able to be here for them.

You made reference to a fund-raiser in 1992 that a Mr.

Louchansky gave money to. Did I hear that correctly?

Mr. ERMARTH. That is what has been reported.

Mr. FRANK. Whose fund-raiser? Who was the beneficiary?

Mr. ERMARTH. Democratic National Committee.

Mr. FRANK. In 1993?

Mr. ERMARTH. The man's name is spelled in a somewhat Frenchified, Frankified manner. L-O-U—

Mr. FRANK. Let's stick with Frenchified. You can give that off of

my minute. You can give that to the reporter off of my time. Mr. ERMARTH. If you do an Internet run, you will get it all.

Mr. Frank. Mr. Saunders, first, your criticisms of some of the kind of macro- and micro-economic policy I was pleased to hear, because I think what we get here are the common themes—to some extent these are not Russian-specific, but IMF-specific. There is an underlying problem that many of us have had with an IMF imposition, one of too much specificity and too much austerity. Professor Brovkin, you have summed what I have found to be the problem with that.

We get this identification, because very often we are simultaneously implementing IMF policies in newly democratizing countries, and we give people this notion that austerity and democracy go together and that paying more for your food and paying more

for necessities is somehow a consequence of democracy.

I would say, Mr. Chairman, I said this to Mr. Summers before, it has relevance to a piece of legislation that we are going to deal with. I believe morally there is nothing more important for us than to pass the legislation dealing with the heavily indebted poor countries. But I don't believe the votes are here in this House, nor should there be, to put that to the ESAF, to put that through the economic structural adjustment fund of the IMF for some of the kinds of reasons we have had here.

But back now, if I could, to Mr. Saunders. As I said, I appreciate that, because I did want to say that in context. It is a problem of our Treasury and IMF and other treasuries in general. Part of the problem is—and maybe we ought to look at this, Mr. Chairman. We ought to maybe get the State Department and open entities

into this.

The problem is that increasingly in the world today foreign policy is heavily influenced by the World Bank and the IMF—I think the Bank has been much better than the IMF—and they are run by treasuries. There is a structural problem. The political element, the people who appreciate democracy, the people who appreciate some of these kinds of considerations are literally out of that loop. We have only the treasuries to the IMF and other financial institutions, and I think that should be looked at.

Mr. Saunders, let me ask you just one question. You said that we made a mistake when we divided the Russians into the good guys and the bad guys. None of us have trouble thinking of good

guys who aren't such good guys, but I am wondering, who did we inappropriately characterize as bad guys to whom we should have been more neutral? Because I have a harder time coming up with

that list.

Mr. Saunders. I tried to answer that question earlier in my opening statement. I think one of the groups that was inappropriately characterized as "bad guys" was clearly the Russian Parliament. They obtained this label, "Communist dominated," which ended up in virtually every speech or piece of press reporting on Russian political developments. I think that had a very negative impact.

Mr. Frank. I think those two tie in, because that would be true of other parliaments in other countries, which is parliaments are necessarily, understandably, less inclined to raise food prices and

cut unemployment benefits and throw people out of work.

What we are really talking about is a conflict between financial orthodoxy and democracy. I guess those who have been unable to get the American Congress to do some of those things should not be surprised when the IMF is unable to get other parliaments to

do it.

The only other thing that I would have to say—and I must say, Mr. Saunders, in the statement, that I did read the statement, my guess is the State Department probably would be pointing with pride to your giving credit for successfully influencing Russian policy with regards to Bosnia, Kosovo, Iran, and I would throw in NATO. I was wondering before about where the tradeoff would come, because you can't obviously—one other area—and I was wondering if I read you correctly, because you also throw in here macro-economic policy.

I gather your tradeoff would have been more sort of stricter legal regularity and less concern with both macro- and micro-economic

policy, less fiscal regularity?

Mr. SAUNDERS. That is correct. I would also consider tradeoffs on some of the foreign policy issues, but that is probably not germane to this.

Mr. FRANK. Oh, yes, it is. Go ahead.

Mr. Saunders. I think if we had tried to work earlier and more cooperatively with Russia and Yugoslavia, we might not have ended up having to lean quite so hard on them toward the end.

Mr. Frank. I guess I didn't—I need more elaboration on that. I must say you could hear an enormous sigh of relief that almost raised the Capitol dome when the Russians threw in with us and helped bring about an end to the terrible time that we faced in Kosovo. Certainly any suggestion that that tradeoff should have been made we wouldn't argue. You are saying we could avoided that earlier on, but I would have to, since I have run out of time, close with just a skepticism about that without a chance to discuss it.

Chairman LEACH. Thank you.

Mr. Royce.

Mr. ROYCE. Mr. Woolsey, thanks for being here today.

Five-and-a-half years ago, you appeared before the International Relations Committee. At that time, I asked you about the extent of the former Soviet KGB involvement in organized criminal activity in Russia, which was then becoming evident. Today, that problem has mushroomed beyond Russia, becoming a transnational and

international issue.

The question that I would ask is, what is the extent of Russian internal security, electronics intelligence, and foreign intelligence agency operations against American banking interests, American banking and in business? One of the reasons that I ask that question is because a Russian external intelligence spokesman has said that they are focusing less on foreign ministries and defense and now more on foreign ministries of finance. If so, that means that the United States Treasury Department, the Federal Reserve, and the banking and financial systems are targets of Russian espionage.

My question is, how much does the FBI know about Russian intelligence against American banking and business and what is being done to alert those agencies and businesses to the problem, to help them counteract the problem and take countermeasures?

to help them counteract the problem and take countermeasures? The second question that I would ask is, if there were violations of U.S. and international law on the part of U.S. Government officials with regard to U.S. Inancial aid to Russia, what is the appropriate agency to investigate those violations? Would it be the General Accounting Office, the FBI, the Justice Department, the Federal Reserve? Which agencies would investigate the IMF?

Should international investigating and forensic auditing companies be used more aggressively to get to the bottom of the Russian corruption is another question, and how can we ensure against fu-

ture looting of U.S. assistance?

Mr. WOOLSEY. I will give a try to those, Congressman.

First of all, let me say I am four-and-a-half years out of date with respect to any classified information on this, so what you are really getting from me is essentially the reactions of a rather careful

newspaper reader.

Also, with respect to the law enforcement questions, of course, our responsibility out at the CIA was, whenever any indication of a violation of law by an American citizen might have come across the screen as a result of foreign intelligence collection, to refer that to the Department of Justice and then get as far away from it as possible. The CIA doesn't look into matters that might involve lawbreaking by Americans.

So for two reasons my knowledge is limited here.

I have spent some time over the course of the last several years on a panel with Arnaud de Borchgrave and Frank Ciluffo, who will be testifying next, at the Center for Strategic and International Studies where we have looked into both Russian organized crime

and cybercrime as well as a number of related issues.

My judgment is that, with respect to your first question, the implication is quite correct that there has come to be a good deal of focus by combined efforts of Russian intelligence and Russian organized crime interests on Western, and particularly American, financial institutions. But with respect to the scope as distinct from the direction, I don't have any specialized knowledge or judgment.

I think that, as far as violations of the law by international financial institutions are concerned, in the first instance, if American citizens have been involved in any such violations of law, that should immediately go to the Justice Department and presumably

the FBI.

The international financial institution itself in its official capacity presents, of course, a very complicated question. Most of these institutions have immunity from prosecution or lawsuits in the United States for one reason or another. I have been involved in arbitrations against the United Nations as an institution, and certainly we could handle something by arbitration there, because of the arbitration clause in the contract, but we could never have brought them into court.

I think I will have to stop at that and suggest that, with respect to what the FBI knows or the violations of law by American citizens, that you need more specialized counsel on those subjects than

my background is able to give you.

Mr. ROYCE. I thank you, Mr. Woolsey, Mr. Chairman.

Chairman LEACH. Mr. Royce.

Mr. Ryan.

Mr. RYAN. Thank you.

Dr. Brovkin, I was very taken by what you had said about the Russian people are losing faith in America and in American policy toward them, because their version of capitalism is this crony capitalism that we talk about.

Mr. Saunders, you mentioned that our American policy—our Federal Government's policy has been, pick the good guys, pick the bad guys, and stick with the good guys regardless of whether or not we

find out or determine that they are bad guys.

This leads me to a question for you, Mr. Ermarth. In a recent article, I think it was in *Insight* magazine this week, you said that you felt pressure to whitewash intelligence reports about corruption in Russia. And, further, career diplomats at the U.S. Embassy in Russia confirmed your statements; and the article discussed a top secret 1995 CIA report on Chernomyrdin and other Russian leaders that elaborated on their affiliation with corrupt activities and organized criminal figures.

How did the White House and the Vice President's office receive this report? What was the reaction to the allegations of corrupt ac-

tivities to the so-called good guys?

Mr. Ermarth. Mr. Congressman, I have never written anything for *Insight* magazine, so they must have been quoting me from something else.

Mr. RYAN. It was a quote-let me-it may have been from

that---

Mr. Ermarth.——in the national interests.

In the article that I did write, I alluded to a variety of problems we had in dealing with Russian organized crime, corruption and of-

ficial corruption, high-level kind of corruption.

There was some pressure because, in a variety of mostly subtle ways the people who made policy on Russia, the Administration made it clear they didn't want to hear much about that, at least allegations of high-level corruption.

I wasn't in the line of fire directly. I got most of this from the analysts who were. They came back from the meetings and told me about it because I was taking an interest in this almost as a case study in post-Cold War problems. We have had so many faces to

it, nuclear proliferation, almost—it was crime. It was KGB intelligence. It was politics. It was business. It was banking. It is foreign affairs, even, because it affected our diplomacy. A lot of these

people had Israeli citizenship and so forth.

So I was watching how this evolved. And the analysts had a lot of problems, because of the political distaste for what they had to say, partly because they couldn't bring all of the different pictures and pieces of the picture together, partly because economists didn't know how to deal with corruption and crime as an analytical problem. So there was a lot of problems.

It was in this context that a story arose and a report went down to the White House to Vice President Gore's office, and he came

back with the so-called barnyard epithet.

I will tell you, as an intelligence officer, you have got to make judgments about the truth or falsity of what you hear. I heard it from so many people that I think it is true. I never saw it, however. And now they can't find it.

Mr. RYAN. Are you saying-

Mr. ERMARTH. It is a bit of a symbol of the problem for which

there is a lot more-

Mr. WELDON. If the gentleman would yield, I would not necessarily put you in the position of stating that barnyard epithet, but would you characterize the tone of the barnyard epithet in terms of what it meant to the report?

Mr. ERMARTH. Yes. It was quite clearly dismissive of what was in the report. But there again, I just heard it so often that I believed it was true. But that was not the basis for my belief that

there was a resistance to this from policymakers.

Mr. RYAN. So what you saw in the intelligence community was a shift from the White House and policymakers from deep analysis, objective analysis to one of more agenda-driven analysis on intel-

ligence reports?

Mr. ERMARTH. I found that to be the case across the board. Remember, this was a period in which two contradictory things were happening. On the one hand, the topic, the agenda of intelligence was spreading out over a lot of issues, not anew, but new priorities, and all of them quite difficult and demanding of manpower in the field for collection and at home for analysis. At the same time, there was downsizing of the work force. And you throw on top of that the fact that Russia was kind of unfashionable in the early 1990's because it was redolent of the Cold War, and there were all of these other things to put people onto. Yes, there was a shrinkage of the resources for deep analysis. Some people pretended the inbox—

Mr. RYAN. I guess my final question, seeing that the red light is about to go on, is why—I would like to ask all of the panelists

this—why this shift in intelligence attitude?

It is understandable that we don't want to do things that drive nationalization in Russia, that we don't want to push them away from freedom and democracy and capitalism, that we want to go down the road. But it seems as though the attitude from the Administration has been one of receiving intelligence reports that are more preferable to the political agenda than receiving intelligence reports that are more factual or accurate. Why is that? I would just

like to see if anybody would care to answer that question, what your opinion would be.

Mr. WOOLSEY. Congressman, I will take a stab at that.

I have always said that the principal qualification of Director of Central Intelligence is that you don't want anyone on the job who wants too much to be liked, because you are always, if you are doing your job right, the skunk at the garden party. You are not a participant in the policy process directly. I think you should not be if you are doing the job right. You should not be making policy recommendations, because then the other players, State, Defense, and so forth, will believe that you are skewing what you estimate in the direction of supporting your own policies. You are the only person at the table who should, I think, have no stake in the policy outcome. Just call it like you see it. Sometimes you are right. Sometimes you are wrong.

During the first two years of the Administration when I was the DCI, we did have the phenomenon that Fritz describes of declining resources and a need to focus a great deal on the newer issues. But I felt one of the newer issues we were focusing on and, as I said in my testimony, I did not detect any lack of interest in it or subtle

signals to turn away from it, was Russian organized crime.

I would not say the same of some other questions. There were, for example, a number of times which I forwarded or made assessments about what was going on in Haiti, that I felt there was a great deal of body language in other parts of the Administration showing a not wanting to hear what the CIA had to say, or I had to say. I did not feel that way as of early January, 1995, about Russian organized crime.

But Fritz was in the agency longer than I. I have known him a long time and value his judgments and views very highly. I would certainly not dispute his judgments about what things looked like

during the entire time he was there.

Mr. ERMARTH. I would only add that while there were problems, and I described them in that article and tried to summarize, I think it is very important for people like the Members of this committee and other committees to understand that intelligence problems attending to all of this—and it had less to do, by the way, of organized crime where there were no political pressures than the high end, the authorized crime, the big shots who were corrupt and the notion that maybe these reforms were not all they were cranked up to be. That our leadership did have a problem with.

But this was secondary because, like I said earlier, the facts and very sophisticated interpretations of what was going on in Russia, the truth was amply in the public domain, in the Russian press, in Western analysis. In fact, I would say that after 1996 when he founded this little news service, David Johnson called—his product is Johnson's Russia List. If you are interested in Russia and you are prepared to spend half-an-hour a day and only read English, you have absolutely no excuse, from 1996, to be in the dark about any of this.

Mr. WOOLSEY. Mr. Chairman, could I add one more point? It is important to get the sequence of events straight here.

The privatization of the program with the vouchers was taking place, I think, for instance, in 1994. So that did result in a number

of institutions and old-line Communist managers of factories and the like being able to buy up people's vouchers very cheaply and to get control of things. That was understood and reported very

The now highly discredited loans-for-shares program, which Mr. Chubais operated, was really after that. I think it took place in 1995 or 1996. That probably began the time in which you began to see, at least from my reading of the press during the time after I left the Government, strong suspicions of involvement of very high-level people in what would be in this country corrupt behavior and was morally corrupt in Russia, even if it perhaps didn't violate the laws that were on the books.

So there is a time sequence here. I would say 1995-1996 was probably the period in which—again, from my reading of the press-it looks as if people's attention started to turn to high-level corruption and may well coincide with some of the reactions that

Fritz is describing.

Mr. RYAN. Any others wish to comment on that?

Mr. Brovkin. I would just say, in addition to what has been said, is that Secretary Summers referred this morning about a too fast or too slow approach. The fact is, it is not a matter of too slow or

too fast, but differently.

What we have just heard is exactly the process. They first vouch organizations, they then fake elections, and then the rise of the oligarchs who finance the ultimate selection campaign. Then the reports that some violations may have been committed during the elections campaign. The United States Administration looks the other way. Then there are more and more examples, both from the political and economics sphere, that the Administration looks the other way. As a result, things get bigger.

If companies make more and more money on GTOs, you look at the progress of the banks. It is public information on the Internet. You look from year to year after year how the twelve major Russian banks were expanding at the time when the economy was collapsing. That is amazing, that is an absolute miracle that Russian banks were expanding in 1996, 1997, 1998. How could they possibly be making so much money when the economy was shrinking? That is the question that needs to be answered by this committee.

Mr. RYAN. Very insightful, thank you.

Thank you, Mr. Chairman. Chairman LEACH. Mrs. Jones.

Mrs. Jones. Thank you, Mr. Chairman.

Would you pronounce your name for me, sir, in the burgundy jacket, please?

Mr. Brovkin. Professor Brovkin.

Mrs. JONES. Let's continue that. How could they grow? How could those banks grow when the economy was falling apart? Speculate for me.

Mr. Brovkin. Primarily due to the high-interest GTO market. GTO stands for government short-term obligation. It is a domestic debt. So the way it was functioning was that the Russian government had a deficit in the budget. They couldn't pay the wages. They couldn't pay the pensioners. They couldn't pay their soldiers. The reason they couldn't pay that was nothing was working.

So the correct approach, not the one we had this morning, would have been to start by getting Russian people to work. Even if it is not profitable, get them to work. Get small businesses going. I call it in one of my articles the same approach that was taken in Germany in 1946. You don't start with privatizing the banks. You start with getting local bakeries and local businesses going and making sure that the local mafia does not control them, that there is law enforcement, that there is observance at least of the Soviet laws.

None of that was done. Instead, the Administration encouraged Mr. Chubais and others to create the securities markets. How can

there be a securities market when there is no industry?

Mrs. Jones. Thank you. Let me ask another question. Thank

Now, this is, from your perspective, not being a part of the Ad-

ministration; is that correct?

Mr. Brovkin. That is correct.
Mrs. Jones. And not knowing all that the Administration knew; is that correct?

Mr. Brovkin. That is correct.

Mrs. Jones. So you sit here on this panel, based on your experience outside of a responsibility as administrator of a Government like the United States. And you are not alleging in your statement any wrongdoing, criminal wrongdoing on the part of the Administration based on this situation, correct?

Mr. Brovkin. No.

Mrs. JONES. Thank you. I want to ask someone else another question. Thank you very much.

It is kind of hard when you are a less senior person on the com-

mittee, you get way in the corner over here.

Mr. Ermarth, I want to ask you a question. Thanks.

You were saying there was a shift and a deep analysis, and that shift and deep analysis arose, am I correct, as a result of a lack of enough people or staffing to be able to do a deep analysis? Is that what you said?

Mr. ERMARTH. No. ma'am. That is not the only cause.

Mrs. JONES. But you did say that earlier?

Mr. Ermarth. It appeared in this article, "Why Did We Underachieve Out at the CIA?" I wrote a little article about that. That was one of the factors.

Mrs. JONES. So was it a minor or major factor?

Mr. Ermarth. This lack of deep analysis? It was a major factor in our-

Mrs. JONES. It was a lack of deep analysis that arose as a result of a lack of staff.

Mr. Ermarth. That was part of it. Also, it got unfashionable.

Mrs. JONES. Now, when you say "unfashionable," would you be

a little more clear with that for me, please?

Mr. Ermarth. The management of the agency in which I was a part for a good many years found, particularly in the 1980's, that a lot of our old products, big heavy analyses of what the Russian military forces, the Soviet military forces, they did not help the customer very much, the policymaker very much. He wanted more operational near term: What do I do tomorrow? How do I handle—

Mrs. JONES. When you say "he", would you be more clear on who "he" is?

Mr. ERMARTH. The customer for intelligence throughout the Ex-

ecutive Branch.

Mr. RYAN. If the gentlewoman would yield.

Mrs. Jones. I don't know if I want to, but I will.

Mr. Ryan. Thank you, Stephanie.

I just wanted to-because I brought this up with Mr. Ermarth's quote—I just want to read you a quote and see if you still agree. Mrs. JONES. Why don't you let me finish and then can you deal

with that? Go ahead.

Mr. Ermarth. So there was an effort made to encourage analysts in all areas, Latin America, Africa, Middle East and Russia, to write things that are more current, that have a more immediate

relevance to what the policymakers are doing.

OK, please the customer. So the business got more retail, if you will, to the point where sometimes we began to say, "Well, we are just Kentucky-fried intelligence." Where is the depth? There was a sacrifice there, because it takes a lot of deep investment to, for example, meet military intelligence requirements, make sure your maps are up to date, for example.

Mrs. Jones. But as a policymaker, you are an analyst. As a policymaker, sometimes you have to make that decision, where are

you going to put the most, the best of your troops, right?

Mr. ERMARTH. That is right.

Mrs. JONES. Sometimes you make the decision based on all that is in front of you at that juncture. As an analyst, not being the policymaker, you could not necessarily say that that was a bad decision to be made based on all of that you had in front of you in light of the fact that you didn't know everything? Yes or no?

Mr. ERMARTH. No. The analysts usually know more than the pol-

icymakers.

Mrs. Jones. That is because you are an analyst.

Mr. ERMARTH. I have been both.

Mrs. Jones. Based on what we are talking about, it was your opinion after the analysis that you knew more than the policymakers and that is why you make the statements that you made today.

Mr. ERMARTH. Yes.

Mrs. JONES. OK. I am done.

Mr. RYAN. I just wanted to clear this up, because it is a very worthwhile point. I think it goes beyond whether there were staffing cutbacks or something like that, the shift in intelligence. I just wanted to read one of your quotes and see if you could just confirm this.

That, "deep analysis-intelligence reports with regard to Russia deteriorated from deep analysis toward an agenda," where you described, "supportive of daily business, our policymakers did not want, and our intelligence analysts had little incentive to provide, a big picture of long-term assessment of Russian realities. They mainly wanted to get to the next Chernomyrdin meeting or the next quarrel about Russian missile dealings with Iran."

It sounds as if there was a shift in attitude for what you were

sending them. Is that correct?

Do you still agree with these quotes?

Mr. ERMARTH. I agree with them, but I would not say it is a shift in attitude. If you will, it is a shift in business style. It had con-

sequences, and they were costly.

And, by the way, management at the agency has recognized that and tried to counteract that within the resource constraints that they have. You can't have current intelligence that is meaningful unless you do deep analysis to back it up. That applies to very mundane things like maps and order of battle and economic data.

Mr. RYAN. Very fair point.

Mr. WOOLSEY. I have one sentence on this, if I may.

That tension existed—exists all the time. I agree with the concerns that Fritz expressed about the direction and the pressure. But in 1993, 1994, we felt that the work that we were doing on Russian organized crime was precisely a good example of the indepth, long-term analysis. This was a very fine piece of work by young analysts out of the agency that I took around to very senior people in the U.S. Government and in other governments, because it was so thorough and in-depth.

So it is not a simple picture, but I don't dispute what Fritz said

about what happened in 1995 and 1996.

Chairman LEACH. Thank you.

Mr. Lazio.

Mr. Lazio. Thank you, Mr. Chairman.

I think that we are left with a fairly sobering picture here of a strategic relationship, a bilateral, strategic relationship that has largely deteriorated since 1993, no progress really in terms of arms control, divestment estimates from \$100 billion to \$150 billion to maybe twice that amount in terms of net numbers. You have a political leap in Russia that seems to seek to undermine American interests, and then you have, as Professor Brovkin has noted, popular sentiment turning against America as the so-called reforms have had sort of a perverse impact on the quality of life and purchasing power for people.

I want to get back to sort of these turning points, because it seems as though around this 1993 point that we began this downward spiral, and it coincides to some extent—I would like to hear from the panelists—with the Chubais loans-for-shares program, and the relationship between the Treasury Department, the Administration, the Harvard Institute, and this privatization issue, how we went about it, bypassing public bidding proposals. And it seems as though the net result was a concentration of great wealth

in the hands of the few, a sort of economic oligarchy.

I want to begin with Professor Brovkin, if he could respond to that assessment and whether he agrees with that or not and respond to it and any of the other panelists that would like to add in.

Mr. Brovkin. Yes, I do agree with what you just said.

I should add that in the next issue of the journal Demokratizatsiya we are running—and we are showing the editors—we are running an article by Janine Wedel exactly on this subject, on the kind of nexus political between the Chubais clan, as she calls it, and several people in Washington, and the way they have shaped U.S. policy to Russia and designed the privatization

program which in many ways—it is not only her opinion, but mine and many, many other people believe set in motion the process of crooked privatization, the rise of the oligarchs, the rise of the organized crime and, of course, money laundering.

So, in many ways, the crucial decisions were indeed made in 1994, 1995, and the loans-for-shares scandal was the first actual scandal. It was the first time it became apparent that something

terribly wrong was happening.

I do believe and I do support the view that a large share of the responsibility lies with those on this side who either didn't understand—I grant them the benefit of the doubt. They just made a mistake or they knew that something was happening and they just looked the other way or, even worse, benefited from the kind of processes that went further.

Mr. LAZIO. Anybody else want to respond?

Mr. Woolsey. I will add, Congressman Lazio, I do think the loans-for-shares program was something of a tipping point. Clearly, many of the problems that Russia was facing in all of the ways that we were describing were incipient up until that point. But the extraordinary buy-off of the companies for very small amounts of money and the aggrandizement of some of these individuals through that loans-for-shares program was the point at which I think it all sort of came together, and it has been downhill ever since.

If there is no single event, there is no single thing that was absolutely decisive. But if you are looking for a point in which I think everybody who was watching this either said or should have said, this is all starting to go really bad now, it would have been—

Mr. LAZIO. Sort of a national pilfering.

Could you comment on the Harvard Management Company's

participation in that?

Mr. WOOLSEY. That all occurred after I left Government. I just read the newspapers on that. I don't really have any substantial views on that.

Mr. LAZIO. That raises some fairly extraordinary questions in

terms of insider dealings and who was profiting from this.

Let me ask you, if I can, Director, about Louchansky and his relationship with the DNC. And if there were Republicans involved,

I would like to hear about that as well.

Mr. WOOLSEY. The only thing that I can think that I can say publicly about this—and just about all I remember from this assessment of several years ago—is the sequence of events I believe was that Mr. Louchansky was invited to a fund-raiser in New York by an American citizen. He apparently had his picture taken with President Clinton. That picture appeared in a Russian publication. When we first saw it, we thought it was a forgery. But it turned out it was not.

Mr. LAZIO. There is much that we find out that we think is unbe-

lievable.

Mr. WOOLSEY. Lots of people get their hands shaken at fund-

raisers and apparently his was.

Then a couple of years later, even though there had been a good deal of attention paid to Mr. Louchansky at the top levels of the Government as a result of our reports, he was apparently invited

by the DNC to another fund-raiser in his own right, and then the State Department did not give him a visa. Somehow it had filtered through the system. I don't know exactly what happened. That was after I left the Government, but those are the bare facts as I believe them to be the case based on public reports and what we knew at the time. More than that, what money went from anyone to anyone, I don't know.

Mr. LAZIO. Does anybody have any information on this?

Mr. Ermarth. If you are interested in Mr. Louchansky, including, by the way, his denials of any wrongdoing, any organized crime, any smuggling, money laundering, just get one of your staffers to do a search on the Web and you will get more than you ever want to read about Mr. Louchansky.

Mr. LAZIO. Thank you, Mr. Chairman.

Chairman LEACH. Mr. LaFalce.

Mr. LAFALCE. I really can't address the specifics of any particular fund-raiser or any particular photo. It is just interesting to note that I have received invitations to fund-raisers for Governor Bush, Senator Dole. Somehow I got on some list. I can't begin to count the number of people that I have had my pictures taken with, with a handshake, and I am unaware of who they are. I just wanted to point that out. This is a fact of life, and the more prominent you become the more frequently this happens.

Mr. Woolsey, when did you leave the CIA?

Mr. WOOLSEY. The second week of January of 1995. Mr. LAFALCE. So you were there until January of 1995.

Mr. Ermarth, when did you leave the CIA? Mr. ERMARTH. I retired on October 1, 1998.

Mr. LAFALCE. OK. Now, in my prior life when I was Chairman of the Small Business Committee, I did a lot of things. For example, when I went to some of the Central European countries in January of 1990, I came back and we created legislatively the Central European Small Business Commission. The whole purpose of that was to develop a small business sector in those formerly centrally planned economies.

I think it was very successful for the funding that we were able to achieve. Unfortunately, OMB came in and said we were just going to have to eliminate that. That was very unfortunate, be-

cause I saw the importance of it.

I also saw what I thought was the most important phenomenon in the world at that time and that was the phenomenon of privatization and that we were in this critical juncture in the world where we would either do it right or do it wrong and we would have far reaching consequences on account of that. So I had hearings in my Small Business Committee, a number of them in early 1994.

I said it would be terrible if we measured the success of the privatization program by the number of privatizations similar to the area—savings and loan subsequent to FIREA. We measured the success of the approach to deal with this problem by the number of institutions that we closed, which was the worst possible measure. I said the success of privatization should be measured by the way in which societal wealth is being distributed and whether or not we were building up a small or medium-sized sector.

Were there any studies within CIA, any reports within CIA about the phenomenon of privatization, about the pitfalls of privatization, about the potential of privatization, either in the abstract or in the concrete? In the concrete more specifically with respect to Russia, either by the end of 1995 or—in your case, Mr. Woolsey—or, in your case, Mr. Ermarth, by the end of October of 1998?

Mr. WOOLSEY. Again, Congressman, I resigned in early January

of 1995.

Mr. LAFALCE. That is what I was referring to.

Mr. WOOLSEY. I recall more than one assessment, critical assessments of the way that the voucher privatization program had been going and the problems with it. I don't recall a single long study or detailed study of the sort that I described about the 1993 work

on Russian organized crime.

Mr. LAFALCE. The difficulty that I had was I couldn't get anybody to pay attention to the quality of privatization, and I am talking about with any international financial institution. I went to London to talk with the head of the European bank and reconstruction development about Russia and other programs and whether or not we were doing it right, and so forth. I was unaware the CIA really was that concerned at all.

Mr. WOOLSEY. I recall several items that the voucher program was not—items that said the voucher program was producing a much greater concentration of wealth. People's assets were being bought up very cheaply. It was not being spread around in society,

the ownership shares—

Mr. LAFALCE. I had testimony in my early 1994 hearings that privatization was the way for the wealth to be stolen from the State into the hands of either the patrons or no one was sure. This was not—and there was article after article. This was not some-

thing that was secret.

Mr. Woolsey. I think that we are starting to see that with respect to those vouchers in 1994 and by early 1995 when I left. And I think if I can just say, I think your concern about the procedures and the fairness and the quality is exactly on the mark. One of the things that has gone badly wrong here is that all of us in different professions have our blinders. Certainly, my profession of the law has its. But sometimes economists and financial people assume that a rule of law is going to apply and all they really need to do is look at the economics in some theoretical way.

That was, I think, the wrong approach in our attitude toward Russian privatization. I think that what you suggested about the quality of the privatization was exactly the approach that people

should have been focussed on.

Mr. LAFALCE. That is hindsight. I was wondering if at the time the CIA was making any reports on this to the Administration, to anybody else, with a call for action, with a call for remedial policy

and strategy, and so forth?

Mr. WOOLSEY. Reports to some extent I do recall. The Intelligence Committees would be able to tell you in more detail. I don't recall a single major detailed study, as I said, of the sort we had on Russian organized crime. But as far as a call to action, no, we would not have done that. We would not make a policy recommendation. We would not have done that.

Mr. LAFALCE. Mr. Ermarth.

Mr. ERMARTH. I had the same reaction in the early 1990's as you had, Mr. LaFalce. I don't recall a specific report on privatization, per se, but there were many reports on how the economic reforms were going, and they all contained observations, data assertions about the extent of privatization. Thirty percent of industry—

Mr. LAFALCE. I was wondering about the utility of the work that the CIA does, if I could just explain what I mean by that state-

ment.

It is one thing to come up with a fact. It is another thing to come up with an interpretation of those facts and recommendations based upon those interpretations. I am just wondering if you saw, knew what was going on, but you didn't pull it all together and press the case, make specific recommendations.

Mr. WOOLSEY. Recommendations we would have not done, would

not press the case, would not call for action.

Mr. LAFALCE. Was that inappropriate for CIA?

Mr. WOOLSEY. I believe so. That was my understanding with President Clinton, when I took the job, that I would not make policy recommendations. We resolutely refrained from making policy recommendations while I was there.

Mr. LAFALCE. What about some overall study, exposition of the

nature of the problem?

Mr. ERMARTH. I found the same problem you did. The quality of the privatization was not being assessed and challenged properly.

When they said, "OK, 40 percent are privatized," I would go around to the analyst and say, "Look, we know that privatization is a strange thing in Russia. Some state industries act like private ones." In other words, they are looking for new customers, they are looking for revenue, they are looking to improve their product.

On the other hand, some privatized ones are acting like state ones. They are looking for subsidies, they are looking for protection. Don't you go out and try to tell the difference, the quality of privatization, exactly as you put it, the quality of management and the

broader impact on the economy of that quality.

They said, "No, we haven't got the resources." You have got to do that almost door-to-door.

Mr. LAFALCE. Thank you, Mr. Chairman.

Chairman LEACH. Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman. I apologize first of all to the witnesses for not being here for your testimony. I had to

take care of some meetings in my office.

I have had a chance to go through some of the testimony, and I guess what I would ask is while Russia has progressed far less than any of us would like to have seen, it seems to me that it is hard to determine what would have been a more appropriate strategy going forward. Mr. Woolsey in his testimony states that if you are engaged in dealing with Russia at the time, both from Administration and IMF policy, at each instance you would probably have taken the steps. When you stand back you might say why are we doing this? But the problem—weren't we in a period, one, where you see the collapse of the Soviet Union; the new Russian federation under Yeltsin with a government that we don't know whether or not is going to survive for a day, a week, or a year just from

a force standpoint, let alone an economic standpoint. We don't know what direction they are going to go in. We have numerous strategic concerns, not to mention economic concerns. You go from that period forward to where you are trying to build some stability in the mid-1990's, and that carries you up to 1998 where you have a complete collapse, a near complete collapse of the Russian economy, just as we had seen in other emerging markets, and I would argue that there is not a lot of difference between the problems that we have seen in other emerging markets. Even if we could step back now and in hindsight say we would have done things differently, I am not sure that I see or have heard today what we would have done differently. I don't think anyone here has advocated that we would not have engaged the Russians and I don't think that the Administration has also explicitly advocated that ves we know that there is corruption, but that is the only choice we have. I don't know that I have seen anywhere where the Administration has explicitly said that corruption in Russia is acceptable in order to get to the end. Has anybody been able to document that?

Mr. WOOLSEY. No, I don't recall hearing an Administration witness say that, Congressman. I will try to deal with the question,

if you want.

Mr. BENTSEN. Sure.

Mr. Woolsey. I think it is unfair to look back with 20/20 hind-sight and engage in complete Monday morning quarterbacking and say that the Bush Administration in its last year or the Clinton Administration right at the beginning of the Administration should have done all of the things that some of us up here now are suggesting would have been good ideas. I don't think that is fair. Policy-making is an uncertain situation and this was a highly complicated and difficult set of circumstances that both the Bush Administration in its last year and the Clinton Administration, when

it came in, met.

I would say this. That by the time of the loans-for-shares program in 1995, there should have been, I think, a good deal more alarm bells going off than appeared to have gone off. And second, by around the time of 1996-1997, I think that a different approach somewhat along the line of what Congressman Weldon has suggested should have commended itself to many of the decision-makers involved. That would not have been a disengagement from Russia. It would have been far more focused on working with individual Russians, on monitoring the money and the like. Just a little over a year ago, the IMF granted over a \$22 billion loan to the Russian government on Mr. Chubais' assurances, and he later said publicly that he conned—the thrust was that he conned—the U.S. Government into moving this way. At some point in there, the 1996-1997-1998 timeframe, it seems to me, even as I try to avoid being hypercritical with 20/20 hindsight, that some different shift in emphasis in the way we engaged with Russia should have commended itself to people.

Mr. Bentsen. For the record, of the \$22 billion the outstanding IMF debt to Russia is not that high at this point in time. I think it is in the range of \$17 billion and the tranches were stopped over that period of time and in fact new IMF policy, as has been stated

today, is quite severe in terms of both the type of currency that is lent and how the funding is done.

Let me ask you this and particularly Mr. Saunders and Mr.

Brovkin.

I am a graduate of American University and so I am glad to see that you are here today, perhaps not well trained, but nonetheless, can you tell me of a similar situation in history where you have had a country that is trying to make the transition the same as Russia is? It seems to me that you cannot compare Russia with other former Eastern Bloc nations. There is not the history or the economic history as you would have, say in Poland, or the Czech Republic? Is it fairer to state that Russia in many respects went from almost a near feudal system into its experiment—failed experiment I would add—in Marxism and a centralist planned economy, and then is thrown into capitalism. Is there a similar situation in

economic history and are there any parallels?

Mr. Saunders. There is no question that the transformation underway now in Russia is historically unprecedented. I would return to a theme that I was discussing earlier, however, and add that precisely because it is a historically unprecedented transformation, it was remarkably arrogant of the United States to believe that we could go to Russia with a set of very specific policy prescriptions and recommendations, telling them what the budget deficit should be or the inflation level should be. In the context of this amazing transformation, I can't understand how people felt that we knew enough ourselves in this country to try to give that kind of advice. So I agree that it was an unprecedented situation, but I would say that it was all the more reason to be very cautious in our approach.

Mr. Bentsen. Do you not concur—some of my colleagues argue that the U.S. through the IMF was not requesting a sufficient level of conditionality in terms of making loans. You argue the reverse,

that the U.S. was trying to impose too much structure?

Mr. Saunders. I think the conditionality should have taken a different form. In the early 1990's, some people, including former President Richard Nixon, proposed that assistance to Russia be organized not through the IMF, but through G-7 precisely to avoid the problem of the IMF and financial bureaucrats coming up with these various economic targets and ignoring the broader political issues in Russia. There definitely should have been very strict conditionality, but it should have been conditionality based on the rule of law and the development of a legal system that would promote investment. This could have prevented much of the corruption and capital flight we now see.

Mr. Bentsen. Do you think that U.S. policy, which is fairly dominant in IMF activities I would argue with respect to Russia—has been silent with respect to establishing a rule of law or civil justice

system?

Mr. SAUNDERS. Certainly not. But, at the same time, the Administration has clearly given greater priority to privatization, for example, to privatizing 70 percent of enterprises or some other number, than it has given to getting laws through the Duma. And, because the Administration and the IMF were pushing President Yeltsin to implement these economic policies, he was not able to

work with the Duma to get other things. That is where our policy

fell apart.

Mr. Brovkin. Your question implies that since Russia had this unique historic situation, nothing could have been done and only in retrospect we could speculate what could have been done better. I want to remind you of a historical fact. In 1991 when communism collapsed, there was tremendous upsurge in entrepreneurship in Russia. Farmers were appearing. Small businesses set up. Instead of supporting the small businesses, and Russia had this experience in NEP, New Epidemic Policy, and I wrote a book about it, and I referred to Germany in 1946. Instead of that, there was this focus on achieving targets of privatization. That was the stated policy. Instead of supporting privatization, competition, rule of law and guarantee from local mafias so they don't grow up to become transnational mafias, none of this was done. Instead, there were targets on privatization and lectures here in Washington all over town how privatized Russian economy was, how great the capital society has been created. This was a wrong approach. Not too fast, not too slow, wrong approach.

Mr. BENTSEN. Thank you. Chairman LEACH. Mr. Weldon.

Mr. Weldon of Pennsylvania. Thank you, Mr. Chairman. I have two points that I want to make, and thank the witnesses for

their excellent testimony.

First of all here is the problem. If you are a Russian citizen who for seventy years was dominated by centrally controlled communism, you were looking forward to the day when communism was thrown off and a democracy would give you the benefits of

what we have in America. That day came and went.

I was in Moscow a year ago in January with the Duma at a conference on the Western nations to find out why more Western investment wasn't going into Russia, and I had to give the sad statistic, from 1991 until 1997, U.S. businesses invested \$10 billion in the Russian economy. A free democracy, a free market economy. During that same period of time, U.S. businesses invested \$350 billion in the Chinese economy.

For those that say that our policy should have been based strictly on dealing with President Yeltsin, because the Duma was dominated by Communists, they have to justify in my mind how they can go hog wild in dealing with the Chinese Communists, who never were elected. And these, the Communists in Russia, were

elected in free and fair elections.

Our problem with Russia has been for the past seven years we have been so preoccupied with the Clinton-Yeltsin relationship that anything that would disturb that relationship, anything that would cast a negative impression on our relationship with President Yeltsin or Russia in fact was denigrated, was denied or basically was cast aside, and that is not just in IMF funding. I did a floor speech a year ago where I documented seventeen violations of international arms control regimes by Russia. How many times did we impose the required sanctions? Zero. We had the evidence. In fact, Gordon Eyler had to resign his job. Why, because as the head of the non-proliferation center for the CIA, he made the mistake of telling Congress that Koptev's agency was working with the Ira-

nians on the Shahab 3 and the Shahab 4. What was his reward?

Forced out of his position.

Mr. Woolsey left the agency in January 1995 and did an outstanding job. At the end of that year, the CIA completed an intelligence report that he wasn't a part of, called NI9519, which understated the threat that was being caused by Russia proliferating technology around the world, and it was the Rumsfeld Commission two years later that caused the CIA to reverse itself and acknowledge that they made a fundamental mistake, they underestimated the Russian threat.

When I got that brief in the Intelligence Committee hearing on the day after it was released, I asked the CIA briefer, David Osias, "How can you make these conclusions that Russia is no greater a threat today than it was back in 1991." He said "That is our information. If you don't like it, that is the way it goes." Two years later the CIA reverses itself and says that they made a fundamental mistake. And vet we based much of our discussions with Russia on

strategic issues on that report.

Or look at the Russian fission program, which is a program run by the Department of Energy up through the beginning of this Administration. That program was ended in 1994. The material was shredded because it looked to the insecure relationship and the control of Russian fission material.

My position is that we were so preoccupied with bolstering up Boris Yeltsin that we didn't want anything to surface in any area that would undermine Yeltsin. Look at the letter that Bill Gertz revealed for the first time in his book "Betrayal", which just came out this summer.

For the first time, Mr. Chairman, the memo that Bill Clinton sent to Boris Yeltsin during the Presidential reelection in Russia, he is saying, "Don't worry, we will not let anything happen that undermines your leadership. We won't let anything happen to embarrass you." That was sent by our President to Boris Yeltsin the

year that Yeltsin was running for president.

My position, Mr. Chairman, is that this is a pattern that goes far beyond IMF funding. We didn't want to hear the bad news. That does not mean that we should withdraw from Russia. I support all of the Administration's initiatives, but you have to deal from a position of strength, consistency and candor and when you don't follow those three principles, Russians will not respect you, and I agree with Mr. Brovkin today, the Russian people don't respect us. And to be honest if I were sitting in their shoes, I would think the same thing. Why should I trust America?

You reinforce the corrupt administration. You saw the oligarch siphoning off this money that was supposed to reform the coal industry, and you denied when reality was occurring that we knew things were wrong, and now you want us to believe that you care

about our stability. We have a real problem on our hands.

Mr. Chairman, unlike some of my colleagues I do believe that we are at fault as a Nation. In fact, five years ago General Alexander Levitt testified before the Congress twice, and following his testimony, Alexey Yablokov, the leading Russian economist, testified before Congress twice, and five years ago they told this Congress that it was corrupt, the leaders were siphoning off money and that policies had to be changed, and we did nothing about it. That is our fault.

Chairman LEACH. Well, thank you very much, Mr. Weldon.

Let me just conclude by making one comment that is a little afield, but I think is very important. We have two representatives of the Central Intelligence Agency of the United States, former representatives. In America we sometimes argue that the CIA has done an inadequate job. We argue that it has been too intrusive or not intrusive enough. But when you contrast the CIA with the KGB, the contrast is rather severe. There is something that stands out today that I think is really important. We take for granted the fact that the United States intelligence community is basically as corruptionless and as conflict-of-interest-less of any institutions of any kind anywhere in the world. And if it were any other circumstance, this country would be in grave difficulty.

Of all the comparative lessons when we look at Russia today and we see the infiltration of former KGB into the financial system, into the economy, and we wonder what is unique about Russia, because there are other kleptocracies in the world, but one of the unique aspects of Russia today is: A, that it is so large and extraordinary; and B, it is a backward economy in many ways, but it is immensely sophisticated in many other ways, for example, intel-

ligence and military hardware.

So the combination of kleptocratic greed, coupled with centralized controls and bureaucratic expertise and coercion of a historical nature is something that the world has never seen before. So we are looking at a situation that is absolutely novel, as well as a situation that has precedents in other societies. But the combination of situations is novel.

So A, I want to thank two particular witnesses for their distinguished public service and I would like to thank three others for distinctive analysis, and thank you for your testimony today and

we will commence with the third panel.

Mr. Woolsey. Thank you, Mr. Chairman. Mr. Ermath. Thank you, Mr. Chairman.

Chairman LEACH. Our third and final panel will be composed of Mr. Yuri Shvets, who is a former KGB agent; Ms. Ann Williamson, who is an author of a forthcoming book entitled "Contagion: The Betrayal of Liberty; Russia and the United States in the 1990's"; Mr. Arnaud de Borchgrave, who is currently at the Center for Strategic and International Studies; and finally, Mr. Richard Palmer, who is a former CIA station chief.

We will begin in the order of introductions and let me just say I apologize partly on the lateness of the day, but all statements will be placed in the record and I would like you to do your best to not be as lengthy as possibly you might have intended. We will begin

with Mr. Shvets.

STATEMENT OF YURI SHVETS, CONSULTANT, FORMER KGB AGENT

Mr. Shvets. Thank you, Mr. Chairman and Members of the committee, for extending an invitation to appear before the distinguished committee. This is a unique experience and privilege for me to appear before a committee of the United States Congress.

Chairman LEACH. Excuse me, if I can ask you to bring the micro-

phone a little closer.

Mr. Shvets. From 1980 to 1990, I worked for the KGB intelligence service. Starting from 1988, the KGB intelligence service focused primarily on following domestic developments in the Soviet Union. It was also preparing for future market reforms in the Soviet Union. The number one priority of any KGB officer was to work on establishing new businesses or penetrating existing businesses, including the banks. I was a senior analyst, and my responsibility included analyzing the information provided by the field officers and composing reports to the top leadership of the country.

In September 1990, I resigned from the KGB intelligence service on political grounds. At that point it was clear to me and to many of my colleagues that the leadership of the KGB and the Soviet Communist Party were ruining the country. Later I published my book about my experience with the agency, which was published by Simon and Schuster in New York in 1995. The same year I was

granted political asylum in the United States.

Widescale infiltration of the Western financial system by Russian organized crime started right on the eve of collapse of the Soviet Union. The main players of the game were high ranking officials of the Soviet Communist Party, top KGB leadership and top bosses of the criminal world. They joined forces by the end of the 1980's on the initiative of the Communist Party, and this unique formation is called today by the Russian people the Russian mafia. The primary objective of this brotherhood was to accumulate maximum personal wealth and build safe havens abroad before Russia plummeted into financial chaos. There was little doubt among them that

the collapse was more likely than not in the near future.

The first full-scale money laundering in Russia to the best of my knowledge is associated with the All-Russia Exchange Bank. It was established in Moscow on April 24, 1991, but the concept of this operation had been formulated in the mid-1980's. The bank was established under the full KGB control and one was under its total operational control. As a front of the operation, the KGB used a 24year-old Russian citizen, Alexander Konanykhine, appointing him the president of the bank. The full corresponding account of the All-Russia Exchange Bank was opened in the Central European International Bank, Bupapest, Hungary, in November 1991. From November 1991 to May 1992, the bank channeled from Russia hundreds of millions of dollars which are still missing. The total amount of the theft is not clear yet. High ranking officials of law enforcement agencies speaking before the closed door in Russian Duma acknowledged the theft of \$300 million. The former president of the bank recently publicly acknowledged the theft of \$1 billion. It is remarkable that the money was being taken out of Russia during the first months of Boris Yeltsin assuming the presidency of independent Russia. The newly appointed democratic government, chaired by Yegor Gaydar, declared that the state reserves of hard currency were totally depleted and asked the West for humanitarian aid. At the same time humanitarian aid was coming in, the former KGB was taking hundreds of millions of U.S. dollars out of Russia. It is even more remarkable that the theft was committed by the former KGB in 1992, but after this date the Russian military prosecutor's office has been going out of its way to cover the theft up. Several governments and prime ministers and prosecutors were appointed and dismissed, but military prosecutors kept cover-

ing this crime up.

The Russian government went as far as misinforming the U.S. Administration on this case. It demonstrates better than any declarations of the Russian officials that the former KGB leadership is as powerful today as it was in the Soviet Union and is as well connected at the top Yeltsin regime and that this regime is corrupt.

I would add also that this bank, while executing this money laundering operation, contributed significantly to the Yeltsin elec-

toral campaign in 1992.

As a result, I am not very much optimistic when the Russian law enforcement agency pledges to cooperate with the American counterparts on investigating allegations of money laundering in the Bank of New York or other American financial institutions. When the All-Russia Exchange Bank completed money laundering operations, the president, Alexander Konanykhine, moved to the United States and was granted political asylum in this country. I believe it was a mistake. I believe granting him political asylum was a mistake. There are strong indications that Konanykhine was a willing accomplice of the KGB in the operation, in stealing the money from Russia and laundering the money through Western financial institutions.

A recent high-ranking delegation of the Russian law enforcement agency visited the United States and about two days ago they returned back to Moscow. Their position is there are no corroborating facts of Russian money laundering and the infiltration of Western

financial systems by Russian criminals.

I would respectfully direct attention of the distinguished Members of this committee to the All-Russia Exchange Bank case. This case has it all. Large scale money theft from Russia, money laundering through the international financial system, coverup and de-

ception of a foreign government.

As for the situation being discussed today on what to do next concerning Russian corruption and money laundering, I believe it is a complicated issue, but there is a solution, and it may not be as complicated and as difficult to achieve as it may seem. We have to realize that the so-called Russian "elite", the people who have the real money in Russia, have the real power. They keep their personal savings in the West. They steal in Russia, they transfer money to the West and this is where they build their safe havens. They realize that what they are doing right now in Russia sooner or later may break the country apart, and then they will flee the country and come over to the West and enjoy their life here.

It is my understanding and it is the understanding of an average Russian citizen, if the people are totally dependent on the West, the West has the right to tell them loud and clear that the West will not tolerate corruption, outrageous corruption and money laundering involving Western financial institutions. I believe that this message alone sent loud and clear to the Russian elite will make

a big difference. Thank you very much for your attention.
[The prepared statement of Yuri Shvets can be found on page

263 in the appendix.]

Chairman LEACH. Well, thank you, Mr. Shvets. Ms. Williamson.

STATEMENT OF ANNE WILLIAMSON, AUTHOR

Ms. WILLIAMSON. Before I begin my testimony, I want to take a moment to thank you, Chairman Leach, and Ranking Member La-Falce for the opportunity to share with the House Committee on Banking some of the things I have learned over eight years of watching our Russian assistance program unfold. Chairman Leach, I particularly want to commend your efforts to lead the Congress on this very timely investigation of the true nature and unhappy consequences of our Russian policies.

I should just like to add a few words about myself. I am the author of "Contagion: The Betrayal of Liberty; Russia and the United States in the 1990's", which will be available to committee Members and the American public in time for the Nation's Thanksgiving

holiday.

Chairman LEACH. Who is the publisher?

Ms. WILLIAMSON. They will find out in November. It is a surprise. Prior to beginning my work on the book, I covered just about all things Russian for a broad range of publications, including the Wall Street Journal, the New York Times, Mother Jones, Art and Antiques, Premiere, Film Comment and Spy Magazine. From the late 1980's until 1997, I maintained homes in both Moscow and the United States, and therefore I can say that for much of the last decade I had the privilege of being a witness to the dramatic history unfolding in Russia and the pleasure and excitement of sharing with the Russian people their remarkable land, language and culture, and it is with a profound gratitude to them and a deep respect for that noble, heroic and too-long suffering people that I speak to you today.

In the matter before us—many billions churning through Western banks, we should look at this as an opportunity, because it throws open a window on what sort of financial arrangements a country without property rights, a country without banks, a country without certainty of contract, a country without an accountable government or a leadership decent enough to be concerned with the national interest or its own citizens' well-being looks like. It is not a very pretty picture, but let there be no mistake, in Russia the West has truly been the author of our own misery. And there are two victims to this story: The first, U.S. taxpayers along with other Western taxpayers, and Russian citizens whose national legacy was stolen only to be squandered and/or invested in Western real estate and equities markets.

The failure to understand where communism ended and Russia began insured that the Clinton Administration's policies toward Russia would be riddled with error and ultimately ineffective. Two mistakes are key to understanding what went wrong and why. The first mistake was the West's perception of the elected Russian president, Boris Yeltsin; where American triumphalists saw a great democrat determined to destroy the Communist system for freedom's sake, Soviet history will record a usurper. A usurper's first task is to transform a thin layer of the self-interested rabble into a constituency. Western assistance, IMF lending and the targeted

division of national assets are what provided Boris Yeltsin the initial wherewithal to purchase his constituency of ex-Komsomol bank chiefs, who were given the freedom and the mechanisms to plunder their own country in tandem with the resurgent and more economically competent criminal class. The new elite learned everything about the confiscation of wealth, but nothing about its creation. Worse yet, this elite thrives in the condition of chaos and eschews the very stability for which the United States so fervently hopes, knowing full well as they do that stability will severely hamper their ability to obtain outrageous profits. Consequently, Yeltsin's reform government was and is doomed to sustain their parasitic political base composed of the banking oligarchy.

The second mistake lay in a profound misunderstanding of the Russian culture and in the Harvard Institute of International Development's advisers' disregard for the very basis of their own country's success; property rights. It was a very grave error. Private property is not only the most effective instrument of economic organization, it is also the organizational mechanism of an independent civil society. The protection of property, both of individuals and that of a nation, has justified the existence of and a popu-

lation's acceptance of the modern state and its public levies.

Without private property, Russians will never pay taxes nor will any other population that I know of in the world. Russian property rights are tricky. Property has never been distributed, but only confiscated and awarded on a cyclical basis. For the big players, property exists as it always has, where there is power. For the common man, the property right hasn't advanced much beyond custom, which prevents the taking of any man's shelter, clothes or tools so long as a continuous usage is demonstrable. An additional purely Slavic feature of the Russian's concept of property is the shared belief that each has a claim upon some part of the whole.

The whole is known as the votchina, or the estate, and was held by all members of a particular clan. This understanding of property still informs the culture; Westerners bemoan Moscow Mayor Yuri Lyuzhkov's retention of the system of the residential permit, or propiska, as an impediment to a more flexible labor force, but this policy is one of Lyuzhkov's most popular. Moscovites are well satisfied with a mayor who polices outsiders as they believe any propri-

etor of such a great estate as Moscow should.

The Russians' failure to accept the Roman concept of private property has compelled them to suffer the coercive powers of the state so that at the very least a civil order, if not a civil society, might be established and sustained. The hackneyed idea that Russians have some special longing for tyranny is a pernicious myth. Rather, they share the common human need for predictable event undergirded by civil and state institutions, and their difficult history is the result of their struggle to achieve both in the absence of private property.

We are running short on time and so I will just briefly add that the real problem with our privatization program was in its conception. It wasn't a bad idea, a share holding society. In fact it was rather good, because a share holding society would have addressed the central flaw in the Russian concept of property, which was that it was non-transferable. It is a very great shame that the Harvard

Institute of International Development, along with advisers from the multilateral institutions, thought that they could simply override this concept and target particular players with the property. It is a very great mistake to think that all of the injustice began with loans-for-shares. You simply need to examine closely the privatization program, voucher privatization, which American citizens paid for with \$325 million. It was a tremendous swindle and the Russians knew it. They knew it at the time and so did the advisers in Moscow. I spoke with them in real time. I have many interviews and quotes from these people, and this is something of a myth that they are attempting to create today by saying that the problems began with loans-for-shares. It simply isn't true.

Second, the idea of freezing prices in a monopolistic economy is simply mad. All that happened is that the monopoly producers raised prices without penalty. In turn, the Russian people were robbed of their national savings. That is why they had a 2500 percent inflation in 1992. By the time the property auctions began in 1993, the only money available to participate was criminal money and foreign money. In other words, the money coming into Russia, that is when it is laundered. It is going out as capital flight. It is going out as capital flight, because there are no banks, because no

rational person can possibly work within this system.

Today when we hear very much criticism about the national character and the nature of Russian business, I would remind everyone in this room if any of us were living in such a society with so many distortions and disincentives, we would behave in exactly the same way. There is nothing wrong with the character of the Russian people, their energy, their resourcefulness, their ability to produce, but they are extremely hampered by the government and by the lack of a judicial system and by the West continuing to fund

a criminal government.

Now since the party had the property, no individual Russian could ever be sure of anything upon which to build wealth. And let us not forget that the property right is the poor man's ticket into the game of wealth. The rich have their friends and money. The poor must rely upon the law. And it was in the absence of property. and it was access, the opportunity to seek opportunity and favor in which the Russians began to traffic. This is what colors their behavior and culture to this day. The connections achieved in turn became the most essential tools a human being could grasp, employ and over time in which he might trade. Where relationships, not laws, are used to define society's boundaries, attribute must be paid. Bribery, extortion and subterfuge have been the inevitable result. And what marks the Russian condition in particular is the scale of these activities, which is colossal, as is her wealth. Russia is a negotiated culture, the opposite of what an openly competitive productive market requires.

There was an alternative in Russia in 1992. A woman by the name of Larisa Piasheva was appointed privatization chief by Moscow Mayor Popov. She had devised a true free market program, an actual one based upon the principles of Werner Erhard, his reform in Germany. Essentially she was going to pursue Lenin's revolutionary dictum of property to the people, factory to the workers in a rapid and fearless plunge into the market which would have dis-

tributed property widely into Russia's many eager hands. Her program did not rely upon Western lending, but instead tailored itself to maximize direct Western investment with a particular emphasis on the development and the protection of property rights. After robbing the Russian people of the only capital they had to participate in the new market, the nation's household savings, America's advisers signed on with the brave young Russian reformers who had ginned up a development theory of big capitalism based on Karl Marx's mistaken edict that capitalism requires the accumulation of capital. The big capitalists would appear instantly, they said, and a broadly based market economy shortly thereafter. If only the pocket of preselected members of their own ex-Komsomol circle were properly stopped. Those who hankered for a public reputation were to secure the government purchases from which they would pass state assets to their brethren in the nascent business community happy in the knowledge that they too would be kicked back a significant cut of the swag. The U.S.-led West accommodated the reformers' cockeyed theory by designating a rapid and easily manipulated voucher privatization program that was really only a transfer of title. Voucher privatizations receipts were compounded by a grevious insult, unregulated voucher investment funds which the privatizers encouraged the uncertain Russian citizenry to patronize. Hundreds and hundreds of investment funds simply walked with their clients' vouchers, reselling them to domestic criminals, red directors, Western investment banks and international money launderers.

When the eighteen-month long bank voucher privatization that the bank represented was concluded in July 1994, the program whose very design left the controlling share-holding of any single enterprise in the hands of the state, had actually institutionalized the state as the determinant owner of all that had formerly belonged to the people. And that was the rationale for the loans-for-share program, that they had to break up the state ownership, yet the voucher privatization is what created it and institutionalized the state, because according to the Soviet Union constitution, the nation's assets belonged to all of the people undivided, not to the state. That was the legal arrangement that our program changed. Of course we then went on to establish a bond market. That was an initiative from the Bush Administration. Their yields were improbable. They drew all investment to bonds to the support of the

state just as Tsarism and communism had done previously.

Today when the Clinton Administration says that someone had to keep the Communists at bay, this too is a deceit. There were no Communists in Russia by late 1991, only nascent investment bankers looking to nail down a stake any which way. Communism had evaporated by late 1987, a year in which the Russian people were allowed to hold convertible currency. Overnight the power of money

replaced the power of ideology.

We also protected the banks, we allowed Russia to protect her banks and opened her producers to competition with the West. It should have been the other way around. Her industry should have been protected and banking should have had to suffer the competition of the West. At any rate after the loans-for-shares program, the predatory privatization continued. Directors stashed profits abroad, withheld employees' wages and after cash famine set in, used those wages, confiscated profits and state subsidies to buy the workers' shares from them. But until the Russian people decide how property is to be held and secured, their decision de jure, all of the destructive economic arrangements and cultural behaviors crowding Russian history will continue. Wealth will not be created without private property. Without transferable property legally secure to protect, no Russian will pay taxes. Without revenues, no Russian government can endure without falling back on what is every state's final reserve, coercion. The best way to understand Russia, the Russia we must cope with, is through her most common souvenir, the Matreshka doll, because each doll as you examine it is trapped within the larger one until finally the largest doll consumes them all. It is a perfect demonstration of Russia's universe.

[The prepared statement of Anne Williamson can be found on

page 275 in the appendix.]

Chairman LEACH. Thank you very much.

Mr. de Borchgrave.

STATEMENT OF ARNAUD DE BORCHGRAVE, DIRECTOR, THE GLOBAL ORGANIZED CRIME PROJECT, THE CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES

Mr. DE BORCHGRAVE. Thank you, Mr. Chairman, for the opportunity to assist you in trying to illuminate this critically important subject. I speak to you today as Director of the Global Organized Crime Project at the Center for Strategic and International Studies, which is chaired, as I think you know, by Judge William Webster, the former FBI director and director of central intelligence. Our project is divided into seven task forces for all matters of transnational crime. One of them is Russian organized crime, which is chaired by my Deputy Director behind me, Frank Cilluffo.

We published our first report on Russian Organized Crime and its Global Implications for U.S. National Security on September 29, 1997. Four days before its release, President Yeltsin told the upper house of parliament, known as the Federal Council, that "criminal elements have entered our political arena and are dictating our laws with the help of corrupt bureaucrats."

The Russian organized crime task force is in the process of completing a companion report updating the situation since the August 17, 1998 meltdown. The report will be released before the end of the year. The key findings of the 1997 report are still very relevant today. They are two years old. A few of them, and I quote: Left un-checked, Russia is in danger of becoming a criminal syndicalist state under the control of corrupt government bureaucrats, politicians, businessmen and criminals with which normal relations would be impossible.

Russian organized crime, ROC, constitutes a direct threat to the national security interests of the United States by fostering instability in a nuclear armed major power. Equally ominous is the challenge to national security and law enforcement posed by the transnational operations and alliances of ROC groups. Overall, some 200 large, sophisticated ROC groups are now operating in 58 countries, which is up from 29 countries four years ago according

to the FBI.

The processes of democratization and economic liberalization in Russia are being seriously undermined by ROC. ROC has extended its tentacles throughout Russia's economy, which confers an aura of legitimacy to myriad illicit activities, including the manipulation of Russia's banking system and financial markets.

In the absence of effective courts, a working judicial system, and consistent enforcement of established commercial and contract law. criminal elements have become de facto adjudicators. Protection rackets in effect have usurped the government's traditional legal

functions and safeguards.

So what was a threat two years ago is a reality today.

The CSIS report on ROC was quickly endorsed by FBI Director Louis Freeh, but just as quickly dismissed by high ranking Administration officials, even though the intelligence community was well

aware of the facts, as you have already heard today.

The genesis of the Global Organized Crime Project at CSIS goes back to 1994, when a wealthy friend of mine with high level contacts in Moscow was called by one of his contacts who said "Could you please take care of five Russians coming over to New York next week?" He said "no problem." He quickly discovered that what they really wanted was an introduction to his banker in Nassau in the Bahamas, where he also kept a house. Two days later he got a call from this banker saying, "Do you realize what your Russian friends wanted?" He said, "Yes, I assume that they wanted to open a bank account." He said, "Do you realize for how much?" He said, "Well, I thought it might be a few million. Why, what is the problem?"

And the Swiss banker said, "The amount was \$2.5 billion, which they wanted to put in untraceable accounts through a variety of offshore tax havens." Zurich turned down the business.

Three weeks later I was in the south of France on vacation sitting next to another Swiss banker based in Monte Carlo. I re-counted the anecdote and he said, "What a coincidence, I had a Russian walk in two days ago with no introductions who wanted to deposit \$400 million through six different countries as well."

1994, as you may recall, Mr. Chairman, was also the year the late Claire Sterling, a much honored investigative reporter, published a book titled "Thieves World," which documented chapter and verse on the global tentacles of ROC. Ms. Sterling had traveled the world, including several trips to Russia, to investigate the connections between Russian intelligence and security agencies, organized crime syndicates and the so-called oligarchs who plundered Russia systematically under the guise of various privatization schemes. There was no doubt in Ms. Sterling's mind that this lethal mix enjoyed the protection of the powers that be in the Kremlin. I also traveled extensively on behalf of CSIS's Global Organized Crime Project without using any of Ms. Sterling's contacts. We deliberately avoided duplication. From Buenos Aires to Berlin, from London to Lugano, from Bogota to Beirut, the pattern was identical-countless billions of dollars siphoned out of Russia that were laundered before buying commercial properties or being used to pay cash for lavish private residences in Europe's capitals and in the Mediterranean's luxury resorts, as well as to purchase yachts and private planes. I personally discovered scores of examples of properties ranging in price from \$5 million to \$75 million, paid for

by Russians in cash.

Little known outside the intelligence community is the fact that the clandestine stripping of Russia's assets began as early as 1985 and 1986 when key members of the Soviet Communist Party's Central Committee concluded that President Gorbachev's glasnost and perestroika policies would lead to the collapse of communism. This is when these Central Committee members turned to the KGB for assistance in moving abroad precious metals and stones and liquid assets. The KGB was the only organization familiar with Western conduits willing to handle this clandestine traffic.

When the Soviet empire began to implode in 1989, many of these Communist apparatchiks and their KGB associates became instant

businessmen.

I saw that the red light went on, so don't want to be longer than I am allowed to be.

Chairman LEACH. Mr. de Borchgrave, please continue if you like.

Your statement is excellent.

Mr. DE BORCHGRAVE. I was trying to respect the red light. I'm

sorry.

Russia's much touted instant market economics and democratic politics were little more than a sham, Mr. Chairman. In 1997 Prosecutor-General Yuri Skuratov ridiculed President Yeltsin's seven major crackdowns on organized crime and corruption as a Potemkin Village. "It is a charade", Mr. Skuratov said in an interview. There is neither the will at the top nor the resources to do much about it. After three years of investigative work, Mr. Skuratov started prosecuting the first of 780 top officials. Not for long. Skuratov was framed in a sex scandal by the security services earlier this year and then suspended by Mr. Yeltsin for poking around the Kremlin's immensely complicated financial structure. But the Russian parliament twice declined to endorse the suspension and Mr. Skuratov continues to speak out in interviews. He now says that \$3.9 billion of the IMF's \$4.8 billion loaned last year never reached Russia, but was sold by the Russian Central Bank directly to eighteen commercial banks controlled by the oligarchs.

You've heard Jim Woolsey this afternoon quoting former Deputy Prime Minister and former Interior Minister Anatoly Kulikov. He was at a ROC task force in Washington a week ago. He estimates that about half the Russian economy is controlled by shadow sys-

tems that run illegal operations.

Kulikov also estimates the amount of capital flight since 1992 is close to \$300 billion. Some 55 offshore secrecy jurisdictions from Vanuatu in the Pacific to island nations in the Carribean and a dozen countries from Bahrain to the Bahamas were eager to take in Russia's dirty laundry. In 1995 and 1996 about \$1 billion a month came into Cyprus from Russia and another \$1 billion a month went in and out of Israel. The money laundering activities uncovered recently by the FBI at the Bank of New York are not unusual. They have been duplicated by scores of banks the world over. Wealthy individuals have parked an estimated \$8 trillion in offshore tax shelters that guarantee secrecy. There are also approximately one million corporations anonymously chartered in these secrecy jurisdictions that sell naturalization and a new pass-

port for \$50,000. Dominica charges \$75,000, but that includes passports for a spouse and two children. This is not to say that this is the Russian organized crime trillions of dollars winding up in these places, but the facilities are extraordinary and widely used by tax dodgers all over the world.

Russians have been very bitter about how what they perceive as American capitalism made them poor. 40 percent of the population is now living below the poverty line of \$38 a month. Now they are bitter about being weak and this plays right into the hands of anti-

American ultra nationalists.

The totalitarian temptation, as we know, has existed in Russia for the past one-thousand years. It is now rearing its ugly head again after a decade-long taste of gangster capitalism. Last week Secretary of State Madeleine Albright called on President Yeltsin to make fighting corruption a top priority. "The problem is real, and must be taken seriously," said Mrs. Albright. Well, the problem has been real and glaringly obvious since 1991, and repeated warnings that it was undermining U.S. foreign policy objectives as well as diverting U.S. financial assistance and IMF loans were repeatedly dismissed as exaggerations.

It is hardly surprising, therefore, that Russian nationalists have convinced themselves that the United States, not content with its Cold War victory, was also bent on wrecking the Russian economy.

The Administration has invariably invoked the need to give priority to strategic arms control and economic reforms, rejecting the notion that the emergence of a criminal state was in direct contradiction with U.S. objectives. General Boris Gromov, Chairman of the Subcommittee on Arms Control and International Security of the Duma's Committee on International Affairs, said this week that the lamentable state of the Russian military was a direct result of Western indifference to the way the Kremlin robbed the armed forces of the resources needed to maintain cohesion. Yeltsin's so-called reforms, General Gromov said, have brought nothing to the majority of the Russian population but disappointment.

By way of conclusion, Saul Bellow once said that "a great deal of intelligence can be invested in ignorance when the need for illusion runs deep." The Administration's need for illusion in its Russian policies has been an evergreen commodity since the collapse

of the Soviet Union.

So where do we go from here? I think it is essential, Mr. Chairman, and very urgent to weave Russia, in close cooperation with the Duma, into an ever tighter web of mutual interest with the United States with a view to encouraging transparency, the rule of law and the emergence of a Russian middle class. A back-to-the-drawing-board blueprint is provided by Congressman Weldon's eight-point recommendations that have been partly incorporated in the 1989 Russian Economic Restoration and Justice Act.

Thank you, Mr. Chairman.

[The prepared statement of Arnaud de Borchgrave can be found on page 292 in the appendix.]

Chairman LEACH. Thank you, Mr. de Borchgrave.

Mr. Palmer.

STATEMENT OF RICHARD L. PALMER, PRESIDENT, CACHET INTERNATIONAL, INC., FORMER CIA STATION CHIEF

Mr. PALMER. Thank you, Mr. Chairman, and other honored Members of the committee.

First of all, I am very glad to be here today.

Chairman LEACH. Before you commence, could you give us one second of your background, your employment background.

Mr. PALMER. Very quickly, I spent 5½ years in the military, first as an infantry officer in Vietnam, then as an intelligence officer.

I then spent twenty years as a CIA operations officer, eleven years of that as a senior manager, eighteen years of that time was

verseas

I have nine years' experience in researching the subject of money laundering. I finished my career with a posting in the former Soviet Union. I then remained in the former Soviet Union for an additional three years, worked with a Russian bank for a while, and

also was a consultant on business and security.

I then returned to the United States, thinking that the research that I have been able to do during this period on Russian organized crime would be of great interest, and I must say that before appearing before this committee today, it has been somewhat disappointing. I am glad to see that someone is finally addressing the subject.

Mr. LEACH. Please proceed.

Mr. PALMER. I now work in asset recovery and due diligence pri-

marily in Russia.

I am particularly glad to be here today, because the BBC Moscow is carrying a story that I was removed from the witness list because I was the person who sent Matrokin down the street to the British. This is the former KGB officer who has recently written a book with a lot of details. I cannot discuss my CIA employment in detail, but I can tell you that the first time I ever heard or saw of Mr. Matrokin was in reading a local newspaper, and my closest contact to him is that I ordered his book over the Internet.

I also know nothing about Mr. Penkovsky.

This is a subject that presents serious threats to Western nations as well as involves the use of U.S. taxpayers' funds to continue the looting of Russia and its former republics. I feel reasonably well qualified on the subject as a result of my former Government service, personal research and professional duties. I devoted much of my time, energy and money to Central and Eastern Europe and the former Soviet Union in the last seven years, because I believe that the collapse of the Soviet system was an historic, revolutionary event and that the outcome would shape the course of history. Unfortunately, we have thus far squandered our opportunity to help shape the outcome of this event in the positive directions that benefit the majority of the people in this region rather than just a few persons at the top.

We have little time left to avoid the permanent denigration of the term democracy in this region and the return of totalitarian regimes which may not necessarily be Communist. This would lead to instability in a region that spans ten time zones and still re-

mains the second ranking nuclear power.

Several knowledgeable, respected speakers have preceded me today. Indeed, Mr. Chairman, your article in the September 10th issue of the *New York Times* lays out the issues very well. Therefore, I would still like to preface my comments by noting a few points I consider givens.

Russia is too important to us and to the world to simply abandon. Second, despite the incredible, severe obstacles and forces that confront them, there are honest and courageous Russian officials, law enforcement personnel and businessmen. Regrettably that cur-

rently represents a small minority.

Third, most Western bankers and businesspersons have been more interested in making usurious profits quickly than building long-term investments. They have also sought to obey neither the law, the spirit of the U.S. laws, nor the letter of the U.S. laws concerning money laundering in their recordkeeping. Further, U.S. laws regarding money laundering and the conduct of due diligence on customers who move large sums of money are inadequate.

We are willing to conduct stings against Mexican banks for money laundering for drug lords. We conduct classes not only in the U.S., but in foreign countries, to advise them about the U.S. laws on money laundering and how this can be avoided. On the other hand, the U.S. Government has not been particularly aggressive in looking at one of the major sources of laundered funds, Russia; and second, I have been told by several foreign countries that they have been, as they put it, "stiff-armed" by the U.S. Government when it comes to asking for our help in looking at the provenance of funds. This is something where we give the image that basically we are going after this for competitive advantage instead of actually trying to stop the looting of states.

And finally, the U.S. Government continued to seek only good news about events in Russia, strenuously overlooking even the most poignant cases of theft and criminal activity at the highest

levels. This is self-defeating and dangerous.

The purpose of my rather long and detailed written testimony is to document that the looting of the Russian state was part of an elaborate plan that was created in the mid-1980's. Further, current political leaders such as Prime Minister Vladimir Putin and President Boris Yeltsin continue this program. Any objective observer must be swayed by the multitude of published evidence of the corruption regarding President Yeltsin, his family members, and a circle of financial supporters.

The three appendices to my testimony are simply a small example of the documentation that are publicly available. One of those in Appendix A shows the documents on Mr. Borodin's Swiss bank account. Appendix B is a document that shows that Mr. Borodin bequeathed two apartments to members of the Russian government illegally. One was to the acting prosecutor who replaced Mr. Skuratov, and the other is to the chief military prosecutor for Russia. Apparently this is to ensure that there won't be any prosecution of the Yeltsin group.

We must move away from the personalization of Russian policy. We must be able to talk to all sides. Russia is too big for narrow relationships. We must stop the growing popular perception in Russia that the U.S. and democracy are simply allies of their own cor-

rupt society and government. We must move away from channelling our support solely to the most corrupt elements of the state. We need to recognize that the most corrupt elements include the most senior politicians, bankers, businessmen and even law enforcement officials of Russia. We must come to grips with the concept that the Russian government is riddled with corruption and there is no rule of law. To pretend otherwise is a recipe for disaster.

Large amounts of money encourage corruption. Russian organized crime is unique in that it is willing to spend up to 50 percent of its profits on corruption, including bribes to officials. That, if left unchecked, will corrode America's political, economic and legal system. Make no mistake about it, the traditional mafia hoodlums who steal cars, run prostitution rings and collect protection money comprise only about 10 to 15 percent of Russian organized crime. Russian officials, politicians, bankers, businessmen, industrial managers and even some law enforcement officials comprise the other 85 to 90 percent. Both components work together to subvert the law. Both engage in typical racketeering activities. Some just have better educations and dress better than others.

Regarding the amount of money that has been stolen from Russia, we must also include the cost of the Russian resources such as oil and copper in these calculations, which were sold at extremely undervalued prices to Russian organized crime intermediary firms. One frequently cited example is the fact that in 1990 one package of Marlboro cigarettes had the same free market cost as one ton of crude oil, about \$3. The only problem was to have the connections

to obtain a permit to obtain and sell the oil abroad.

Current Russian Prime Minister Vladimir Putin provided such permits as part of his duties when he worked for the former mayor of St. Petersburg before the latter was forced to flee to France when charged with wholesale corruption.

Both Interpol and the Russian Ministry of Interior estimated in 1998 that at least \$300 billion had been looted from Russia. The most optimistic estimates say \$1 to \$2 billion a month were removed, which would put the total between a very optimistic \$90 billion and a more reasonable \$180 billion. Other, more realistic estimates went as high as \$500 billion.

While no one knows for sure, consider the fact that Benex accounts allegedly moved up to \$10 billion through one series of accounts within one year, and that was certainly only one of these

accounts.

The key point to remember is that the exodus of this money from Russia is to the West and that it uses the Western banking system for these movements. Combining Russian organized crime members, as well as simply those who do not want to pay taxes, these billions exit Russia leaving it to the Western countries and the IMF to make up the difference. In other words, even if money laundering is not considered a crime in Russia or cannot be prosecuted in the West, we are still helping them avoid paying taxes. The difference is made up by our taxpayers in loans that will never be paid back. This means that what is considered good business for Western banks is forcing Western, particularly U.S. taxpayers, to continue to subsidize corrupt regimes and Russian organized crime.

The phenomenon of large-scale looting or kleptocracy is not and will not be restricted to Russia. We can expect that other autocratic states who encounter similar problems as they attempt to transition to free market society—Cuba, Vietnam, North Korea and even China—have already begun to register striking growth in organized crime groups, all with ties to the top of their governments. However, this model will also provide a preview of problems to come in countries such as Mexico when they begin to decentralize and privatize their resources.

How to solve these problems? We have to come up with a foreign policy that is bipartisan and has long-term goals. We have to decide what is manageable in Russia. Certainly, we cannot walk away; we must work with them. But we must also tie our aid not to one government, not to a group of politicians on either side, but to cooperation between the governments. We also have to tie our aid to discernible, measurable goals. That means before we allow more investment, we should have a Russian-U.S. investment treaty

to protect American investors.

The European Union was successful on this. Why not us? How can we encourage U.S. investors to invest when we don't even have

a treaty to protect their rights?

Second, we must make due diligence a requirement at several levels of our dealings with Russia in its former republics. The argument that effective due diligence is not possible in Russia is specious. It is being done every day and not just in a perfunctory manner. For example, USAID and assistance programs to businesses should include a mandatory section that confirms that this business and its principals have been investigated and found to have no ties to Russian organized crime. These investigations should be overseen and conducted by U.S. or Western firms which can be disciplined if they are found to be negligent or fraudulent in their work. Official Russian assurances or investigation by security firms with ties to Russian organized crime which comprise the majority cannot be taken seriously.

Effective due diligence will encourage that honest firms stay that way. It will reduce cash flows to corrupt or Russian-organized controlled firms. It will give honest businesspersons some incentive to either stay that way or become that way. This isn't pie in the sky.

It won't happen overnight, but we have to take a long view.

Western banks must insist on knowing the provenance of the money that they accept. Accepting billions of dollars from firms that don't exist or consist of a small office, telephone and computer are not acceptable. There should be strong penalties for failure to exercise due diligence by any Western bank, particularly in the U.S., because it is the largest banking system in the world.

And finally, banks must be held responsible for the actions of their employees. It strains credulity to listen to explanations that "we didn't notice that the billions of dollars were flowing through a bank, because of the actions of one or two corrupt employees."

Finally, think of the impression we make on other countries when many of our banks that we use here in the Washington area, for example, have the letters N.A. after the name. It means they are based in the Dutch Antilles to minimize taxes and maximize profits, or I recently read that the State of Colorado has passed a

law providing for offshore companies for foreigners. Apparently they want to join the ranks of Delaware and similar States that want to attract deposits by foreigners maintaining shell companies in the United States. At what cost?

I am hoping that this committee will be able to follow through

on their plans to introduce new legislation.

I want to thank you for your time, sir.

[The prepared statement of Richard L. Palmer can be found on page 306 in the appendix.]

Chairman LEACH. Thank you, Mr. Palmer.

Let me just begin, because you have something unique to the panel, in fact, unique virtually to any American, and that is, you have worked in a Russian bank. The impression that I have is that most Russian banks aren't deserving of the term of art "bank"; that is, that they aren't deposit-taking institutions that revolve funds to make loans to a community, that they are more simply money laundering platforms or places where government funds come in and high levels are siphoned off by commanders of the banks.

Now, is that a valid observation or is that a false image?

Mr. PALMER. I would say that that, based on my experience and

my research, is at least 85 to 90 percent correct, sir.

Chairman LEACH. The reason I want to press you a little bit on this, let us say you are an American bank, and a Russian bank comes and says, "We want to do business with you."

It would be inconceivable, if you are a thoughtful, reasonable American bank, that you would not know that that bank is not a traditional bank, that there is, by definition, a potential problem.

Is that valid or not?

Mr. PALMER. That is certainly my view, sir. The bank that I worked with, as many of them did, went bankrupt. It was a Russian-owned bank in Latvia, and one of the largest American brokerages deposited several million dollars with that bank one week before it went bankrupt.

Chairman LEACH. For what reason?

Mr. Palmer. Well, that is a question many people asked afterwards, because it was in the newspapers that the bank was in difficulty. The audit papers from one of the big six audit firms said that the bank was quite solid, but most people don't put much trust in that. But what I am saying is you could ask a taxi driver and learn that people were concerned about the bank.

Frankly, the thing that I have seen most often in American companies and firms that have been defrauded, from Russia, is that normally the Russian groups, or Eastern European groups in some cases, find someone in the American corporation that they can

work with.

Chairman LEACH. I am going to get to that in just one second. First, I want to ask a very specific question. One of the financial institutions that has come under a great deal of attention is one called Menatep, and I know Ms. Williamson is familiar with it. Is there anyone on this panel that doesn't almost instantly understand that this is an institution of doubtful integrity?

How would you describe it, Mr. Shvets?

Mr. Shvets. Yes, Mr. Chairman, Menatep was one of the largest Russian banks, the most heavily penetrated by the KGB, starting

with the former KGB Chairman, Ivanenko. There were different factions within the KGB before the collapse of the Soviet Union, after collapse of the Soviet Union. So Menatep apparently worked more closer with the faction of the KGB which supported Boris Yeltsin in his fight against so-called "Gigashipa" in August 1991, and it basically fits the pattern of the KGB-penetrated financial institution.

Besides----

Chairman LEACH. Finish your sentence, please.

Mr. SHVETS. This bank particularly, specifically was involved in, let us say, the American leg of the all-Russian exchange bank operation where the Russian exchange bank former President, together as a representative—actually he was then vice president of Menatep Bank—came to this country to work on establishment of a bank with initial capitalization of \$1.7 billion, and this mission was financed by Bank Menatep.

Chairman LEACH. Do you have any comments on Menatep, Ms.

Williamson?

Ms. WILLIAMSON. Well, it was known as a gangster bank in Moscow. And one thing about the KGB involvement, though, is that the CPSU banked at the Vnesheconomobank, which in the trade is known as V-Bank; and account number one belonged to CPSU, and it was actually KGB that handled the money transfers and so forth for the Communist Party under the Soviet Union. So their moving into Menatep was also a certain capturing of professionalism. But I do know that Income Bank employees used to complain vociferously, because they said there is no end to the money Menatep can get; they constantly were refilled, they told me.

Chairman LEACH. Yes, I know.

Mr. DE BORCHGRAVE. Mr. Chairman, just to show you how the old conduits continued to be useful to latter day Russia, you have read about the FIMACO in the Island of Jersey, where the Russian Central Bank transferred several billion dollars. That particular offshore bank in Jersey belongs to the now-called European Union Bank in Paris, which used to be the Banc Commerciale de Neu in Paris, which was used to move funds from the Soviet Union to the French Communist Party.

Chairman LEACH. One final question, and I turn to other questioners, particularly Mr. Palmer and Mr. Shvets, but the other two panelists may have knowledge, too: Do you believe that Russian organized crime and/or KGB has infiltrated personnel in aspects of

the American financial system?

Mr. PALMER. I would say absolutely.

Chairman LEACH. And can you give examples, if not of named institutions, of kinds of personnel? Do you mean in like management,

in computers? How do you mean?

Mr. PALMER. The British Service has published something in their newspapers about two years ago that they had found, "plants from the KGB, or moles," who were involved in providing information on currency exchange rates and bank operations.

Chairman LEACH. Are these in Moscow, London, New York?

Mr. PALMER. These are Russians who were brought into the banks, but these are also British citizens who are then hired by, now, the SVR to provide banking information. That this happens

is absolutely true. Banking and financial information is now one of the highest priorities of the SVR. The British have found some of

these people, they publicized it.

In the United States—I have been out of the Government since 1994, so I can't speak for the U.S. Government—but it seems to me it begs logic to think that they would avoid the largest banking system in the world.

I would also say, when you look at this case we are looking at in New York, you have a woman who was a teller in a bank, OK, first of all; and she met an American—and I know nothing about the case and I am not disparaging her, but in 1976 you didn't meet Americans on the street, strike up a long relationship with them and get them an exit permit to leave married. Mr. Shvets can

speak to that.

But someone goes out to the West and is recontacted perhaps. Suddenly they are moved from being a teller to a vice president of a bank to going to an offshore banking haven for Russia—Riga. In Latvia, the second largest industry is money laundering—and giving a class on money laundering. I would think in any bank the alarms would go off on that. What I am saying is these things must

be happening.

I can say this: Following my retirement, I still met a lot of people from the KGB who were quite willing to come up and tell me where they used to work, about their backgrounds, and they would tell me one of the first things they did was contact the agent they had sent to North America and Western Europe when they were spies and now recontacted them for business. That doesn't mean that these are necessarily on behalf of the KGB, now the SVR, but it can mean that this group that stole the money, that controls the money, has contacted people they used to work with, and now they have economic relations with them as well.

Chairman LEACH. Mr. Shvets, do you want to comment on this?

Mr. SHVETS. Mr. Chairman, as far as to my knowledge-

Chairman LEACH. This is an interesting contrast, a former CIA agent and a former KGB agent.

agent and a former NOD agent.

Mr. SHVETS. We have been knowing each other for quite a while. Chairman LEACH. I am not going to get into your background, please.

Mr. DE BORCHGRAVE. Neither side could have fought me, Mr.

Chairman.

Mr. SHVETS. Basically, minutes after collapse of the Soviet Union, the KGB made an attempt to directly penetrate the American banking system by establishing a KGB-controlled bank in the United States, and they sent their human asset, so-called human asset, to Washington, DC., and he was trying to negotiate the conditions for opening the bank here. Eventually, he was told that there would be no Russian bank on American soil in the foresee-able future. So this attempt was stopped.

However, for some time, I was following very interesting developments in the policy of the Russian embassy toward the Russian citizens living in the United States. The problem now that such countries as China, Israel have citizens in large quantities living in other countries, and the KGB perfectly knew that Chinese intelligence was working very closely with Chinese citizens living in

other countries, specifically in the United States, because, as Chinese, they were considered potential assets of the intelligence service.

The same was known about Mossad, Israel intelligence, and about a year ago the Russian embassy introduced special procedures for officially renewing foreign passports for Russian citizens living in the United States, and in order to renew this passport, each applicant should fill out the form which for me, as a former KGB agent, reminds me very much of the 1970's when the committee had files on all formal Russian citizens. In this document and this application, what is important again for me from a professional point of view, is that a Russian citizen living here as an American resident needs to show where they work, their employment, their telephone numbers and their street address.

Chairman LEACH. As well as their family in Russia.

Mr. SHVETS. And the whereabouts of their family in Russia.

So it was my experience, I take it for granted this information will be used by the KGB for operational needs. They can approach, first, this Russian in the United States who has an offer or demand, and they can put pressure on him or on her through their relatives living in Russia; and lots of Russians living here as residents, they were so scared by this new form that they decided not to fill it out even though they couldn't return to Russia to see their relatives anymore.

Chairman LEACH. Thank you.

Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman.

Let me just follow up on the Chairman, Mr. Shvets. I have to ask you, did you ever imagine in your wildest dreams that you would be testifying before the U.S. House of Representatives Banking

Committee as a former KGB agent?

Mr. SHVETS. It was absolutely incredible. I had a tour of duty in Washington, DC., in the mid-1980's, and I did visit the United States Congress when I worked here under cover as a *Tass* correspondent, but I never imagined that some day I would be testifying here before a committee of the U.S. Congress.

Mr. BENTSEN. This is an extraordinary time for everything that

has gone on.

Ms. Williamson, I haven't read any of your stuff and I want to apologize that there are not many of us here. I think they are all the Members who ever had a subscription to *Spy Magazine* who are left here today, but are you—in your testimony, are you asserting that perhaps the United States backed the wrong force in Yeltsin and, in fact, we should have walked away from Yeltsin some time ago?

Ms. WILLIAMSON. Well, yes. I think we certainly got far too close to him as a personal relationship and put too many hopes on this

man

You know, in 1991, we went along with the idea that what was triumphing was democracy, but in fact what was happening was that Boris Yeltsin had chosen to seize power and the obstacle in his way was a man named Mikhail Gorbachev and an entity, the U.S.S.R.; and a group of them decided, we are in the U.S.S.R. and will take power and take assets of the U.S.S.R. So there was this

misunderstanding of the two sides, though the Russians, particularly Mr. Yeltsin, were very clever at leading this notion along

amongst Western participants in this drama.

Mr. Bentsen. So you are asserting that while there was an attempted coup d'etat with respect to Mikhail Gorbachev and then Yeltsin and his backers seized the parliamentary building, that that was really subterfuge, that this was all a coup d'etat, nonetheless, that was a transfer of power to oust Gorbachev; and whether it was the military or the old Communist regime, that Yeltsin was one and the same.

Ms. WILLIAMSON. No, no.

Mr. Bentsen. Or were there two coups d'état going on simulta-

neously?

Ms. WILLIAMSON. It is my understanding Yeltsin was aware of the intent, that there would be an attempt against Gorbachev and the participants, but there are so many strange things about those days. I am still not entirely convinced whether Mr. Gorbachev knew about it or not. Why wasn't Mr. Yeltsin arrested that morn-

ing?

Just lots of anomalies in this story, but I don't necessarily believe at all that Mr. Yeltsin was part of that, but he exploited the situation brilliantly; and then after Mr. Gorbachev's return from Four Oaks and the new day dawned, they moved very quickly to get him completely out of the way, and part of what led to that momentum was, Westerners flooded into Moscow and actors who really wanted to move this forward from Harvard University became involved, and they worked with the media to create this image and to move the situation along. And that is a separate effort, I am saying, from what occurred in August of 1991.

Mr. Bentsen. I don't know about Harvard, but let me ask, but then you had subsequent elections in Russia, this newly constituted Russian Federation, and you had elections, you had the Presidential election, you had the Duma election, you have effectively a split government, I guess, now with the Communist-controlled Duma versus Yeltsin's being in the opposition, or vice versa.

Those elections, you felt—were those substantial elections, were those rigged elections, or—your observation. And is Russia a demo-

cratic country today? Would it be a democratic country?

Ms. Williamson. I do not believe the constitution of the Russian Federation passed the qualifications to be truly accepted by the electorate. There was not a majority of the electorate that passed it. The elections are dubious.

But, yes, they do have elections. And I will tell you, sir, that the Russian people vote in great numbers. I have witnessed them. They are a population that likes to vote, that likes to make their opinion known and select their leaders, that is true.

Mr. BENTSEN. My time is up, but I have another question. I have been waiting—and I am also late for a meeting I have got to make a presentation at, but I do want to ask two things very quickly.

Mr. de Borchgrave, in your testimony, you cite comments by Mr. Skuratov that he has continued to say that \$3.9 billion of the IMF \$4.8 billion loan, made last year subsequent to August, never reached the Russian shores, never reached the borders of Russia, that that money was siphoned off.

Mr. DE BORCHGRAVE. It was sold directly, Congressman, to eighteen banks that were on their list of favorites by the Russian Central Bank; and Mr. Skuratov has given six interviews, to my knowledge, in the past fifteen days.

Mr. BENTSEN. And this is contrary to what the IMF has told—certainly contrary to what the Secretary of the Treasury told us

this morning.

Mr. DE BORCHGRAVE. That is correct, sir.

Mr. Bentsen. And contrary to what the IMF has publicly stated and what Price Waterhouse and others have found.

Mr. DE BORCHGRAVE. That is correct.

Mr. BENTSEN. Have you reviewed the evidence or has Mr. Skuratov provide any evidence to your committee?

Mr. DE BORCHGRAVE. No. Mr. Skuratov, last time I saw him was about a year ago. What I am referring to now is the interviews he

has been giving in Moscow.

Mr. Bentsen. I only say that because I would be interested in it. I, like the Chairman, have been supportive of the IMF when we think they are doing a right job. I, you may know, raised objections with respect to our ongoing loan facility with Indonesia vis-a-vis the East Timor situation. I don't think that is a credit we should want to underwrite under these circumstances, and I would find the same to be true if, in fact, there is credible evidence which can be produced that would indicate that IMF funds are being siphoned off. And I would encourage you, if you have the ability to bring that forward, because no one else seems to have brought that forward.

Mr. DE BORCHGRAVE. What I would respectfully suggest, Congressman, is that a staffer from this committee or several staffers

go to Moscow and talk to Mr. Skuratov on or off the record.

Mr. Bentsen. I defer to the Chairman, since he controls the

pursestrings of the staff.

Finally, let me just restate, Mr. Palmer, you are saying that all of this comes down—a vast majority of what is going on, this sort of organized corruption, Russian-style crony capitalism, if you will, the origin of it really goes back to the Communist Party under the old Soviet Union back in the late 1980's and early 1990's when they foresaw the breakup; am I interpreting your comments correctly?

Mr. PALMER. Absolutely correct, Congressman.

Mr. Bentsen. This is not happenstance or coincidental or what happens, as we have seen in other countries, where you go break up and decentralize and oligarchs appear without basic structures in place. This was a planned event, in many respects?

Mr. PALMER. Exactly right, sir, and I tried to document that in

my testimony.

Mr. BENTSEN. Thank you, Mr. Chairman.

Chairman LEACH. Thank you.

Mr. Lazio.

Mr. LAZIO. Thank you, Mr. Chairman. I welcome the panel.

I would like to begin with a question for you, Mr. Shvets, and I want to thank you for your testimony, and I was interested in your testimony concerning the KGB attempt to set up a bank here in the States, and I am wondering what subsequently happened in terms of a strategy. Were there human resources, KGB resources,

that were used to infiltrate U.S. banks subsequent to that? Is that

your knowledge of part of the strategy?

Mr. SHVETS. It is my understanding that attempts of establishing a KGB-controlled financial institution on American soil is not in the cards anymore, because they were refused this opportunity in 1994—1993, I am sorry. So from this point on, their attempts, they concentrate—focus their attempts on penetrating Western financial institutions through the countries of the Third World.

It is easier to penetrate a banking institution in the Caribbean, for instance, even though there are other problems. It is very difficult to launder \$10 billion through a bank in Costa Rica, because

the whole budget of the country is \$9 billion.

Mr. LAZIO. I can understand that.

Mr. SHVETS. On the other hand, they are working on it.

The last information I got was that in April this year several Ambassadors of small Central American countries in Moscow were approached by—from what they describe to me, they were people connected with intelligence service and organized crime, and the offer was that—the message, the Russian message, was that there is a huge amount of IMF money stashed in European banks and this money is being handled by a small Russian financial company. This Russian company would finance any commercial project, any business project of this small Central American country with the understanding that the small country gets 10 percent, and 90 percent goes to Russia. And the total amount of loan they were considering lending this way was around half-a-billion dollars.

Several Ambassadors were approached and their governments took this offer very seriously, so seriously that the finance minister of Guatemala went to Moscow to conduct specific negotiations.

Mr. LAZIO. Let me follow up on that. If anyone else has any other information, I would like for them to join in. But my question is, subsequent to any possible KGB placement, was there any attempt, do you think—you know, this is to the rest of the panel—for there to be organized crime placement? And I noted when you talked about organized crime and KGB, you mentioned them in the same breath in terms of this approach.

Is there any infiltration of organized crime in U.S. banks? How broad is it? Do you think they were placement in key banks? Is that part of an enterprise that reaches, I am sure, to all parts of

the world?

Mr. Shvets. I think that American law enforcement agencies should focus their attention on the banks that have Russian-speaking employees in the areas with a concentration of Russian-speaking population. I don't want to change Russian citizens living in United States; however, I do know that Russian organized crime groups living in such areas as New York, New Jersey and California and Florida, they keep an eye on Russian-speaking citizens who have their jobs with financial institutions in this country.

Mr. LAZIO. Mr. Palmer.

Mr. PALMER. I would just like to add one thing to this. The Russian's organized crime, this society lives by corruption. They are excellent at corrupting. They also, organized crime, inherited a lot of former KGB officers, unemployed, so you see a lot of the techniques used. If you are a small business, you might have someone come

up and say, "We are your new partner, we want 50 percent of your bottling plant or store or whatever." If you are a bank, it works a

little differently.

I have looked at eleven major cases of U.S. firms who were defrauded by Russian organized crime. These are firms, I am sure the technique is the same, and it would make sense to you. They find someone in the institution who isn't adverse to making more money. I will give you an example.

There is a major U.S. firm. They started a project with Russia. They never looked to see who they were doing business with. It was such a great deal, they had to hurry and get it done before they lost it. Four years down the road they found out they were

short \$32 million.

Mr. LAZIO. They lost it?

Mr. PALMER. Yes. So they said, "Well, actually this is serious money. We have to look at it." So what they found was it was a vice president who had pushed this thing the whole time, and we were able to trace in the neighborhood of \$2 million had gone to

a Caribbean island and appeared to be his.

The company approached him and said, "Look, the money is missing", and he said, "I can't tell you anything about it." They said, "Well, we would like you to leave." He said, "Well, gee, I would like to go, but you know I have a contract. I would like more money." Basically to get him to leave without a scandal they had to almost double his golden parachute. It cost them \$32 million.

What I am saying is, they find people within the organization that work. It is not just Russians. They can find anyone in the bank who can help them move the money. I think you may be look-

ing at an example of that right now.

Mr. LAZIO. Could I ask just one question? I am sorry. I just want to know if anyone here at the panel can tell me anything about

Bruce Rappaport.

Mr. De Borchgrave. I have known Bruce Rappaport since I was based in Geneva, when I was Chief Foreign Correspondent of Newsweek Magazine for seventeen years. I had opted to live in Geneva, base myself there, and that is how I got to know Mr. Rappaport. And what I know is that he was always involved in the days of the Cold War on business with the Soviet Union. That is all I know about him.

Mr. LAZIO. Do you know anything about his involvement with the

Bank of New York?

Mr. DE BORCHGRAVE. No, sir.

Ms. WILLIAMSON. Representative Lazio, I would add that they were rather open about this. I interviewed Yuri Kovalovki in early autumn 1991; and he is a well-known gentleman with the KGB until just several days ago, Mr. Shvets has informed me. But at any rate, there was a lot of talk about reorganizing the KGB at that time, and they split the agency into a domestic and an external service—so forth, so on—but we were discovering that—and he was very frank.

He said, "We are going to use our agents for economic purposes, for economic development"; and I said, "Well, gee, wouldn't that be more appropriate for someone in the finance ministry or other

areas?" "Oh, no, these people, that is what our job is going to be is economic development."

It was quite clear what he meant. So you could get this informa-

tion very early.

Mr. SHVETS. If I may add, Congressman, after collapse of the Soviet Union the Russian government had problems paying salaries, even to intelligence service employees. So what Mr. Primakov did, when he was appointed director of the Russian intelligence service, he allowed intelligence services employees to do private business on the basis of information, intelligence information, and intelligence contacts that they had, so basically to make their own living using their official positions; and that is exactly what happened. They went out, using different compromising materials, intelligence information, and they penetrated a huge amount of businesses. This is not all of them. If you have a successful Russian business, they give them three or four months-which have business with foreign partners, they give this company three or four months to see how it works. If the company looks successful, two visitors from the Russian intelligence service visit the boss of this company, and they offer a deal, if you don't want to have problem, if instead you want to be helped, we want two positions in the administration of your company, second from the top, and we want—this is a subject of negotiation—from 30 up to 60 percent of profit of this company, and I was told that in most cases this offer is accepted.

Mr. LAZIO. Official extortion. Thank you very much, Mr. Chair-

man.

Chairman LEACH. Thank you, Mr. Lazio.

Mr. Royce.

Mr. ROYCE. Yes.

Mr. de Borchgrave, in your capacity as director of the global organized crime project, how would you evaluate the Administration's policy toward senior level reformers in the Russian government and reformers outside the government? Have these reformers received the support that they needed to implement actual changes; and absent United States support, were their efforts doomed to fail? In other words, were we the only ones that could have affected this?

And the second question I would ask you is, to what degree has the IMF policy of distributing funds without any condition for loans aggravated the problem of capital flight? Are there specific legal or economic reforms that would address the capital flight problem and provide incentives for Russians to keep their money in the country or are the problems so deeply rooted that nothing short of financial—just complete, fundamental cultural change could remedy this situation?

Mr. DE BORCHGRAVE. Well, sir, to pick up again on what I said at the end of my testimony, where do we go from here? I said, as I recall, we should weave Russia, in close cooperation with the Duma, into a very tight web of mutual interest with the United States with a view to encouraging transparency, the rule of law and the emergence of a Russian middle class.

I don't think it is too late for that. We have to just get on with it; and clearly we have to bypass the family in the Kremlin, and

that can be done in my judgment. As for the reformers that you asked me about, there were no reformers.

Mr. ROYCE. Back to the issue of IMF distribution of funds without conditions on those funds and whether or not that aggravated

capital flight.

Mr. DE BORCHGRAVE. Of course, it did, Congressman. And clearly, new rules and regulations are required; and that is, I assume,

the assignment of the Banking Committee.

Mr. ROYCE. Let me ask another question to any of the witnesses, and that is, several of you today noted that corruption is now kind of an inherent part of the system there, and the Russian Duma has passed anti-money laundering legislation, I think, twice; somebody said five times. President Yeltsin has vetoed it each time, which suggests lack of commitment to addressing the problem created by the thriving criminal element in Russia.

What are the prospects for meaningful anti-money laundering legislation being enacted now? I mean, has the attitude changed

there in the executive branch?

Mr. DE BORCHGRAVE. I go back, sir, to what happened with PDD 42—I believe the number was number 42—in 1995, President Clinton decided to crack down severely on money laundering centers the world over, and if we could not persuade them to curtail these activities, we would then take them out of the American financial loop. The problem with that PDD is that there is no such animal as the American financial loop. There is a seamless global electronic web in which money can be laundered through six different countries in one day.

Mr. ROYCE. And what about the prospects now—for any of the panelists—of getting the Russian president to change his attitude

about constantly vetoing these bills passed by the Duma?

Ms. Williamson. I would just say you could probably get that legislation signed, but it doesn't mean it is going to be enforced.

Mr. ROYCE. Only a month ago he vetoed it, right?

Ms. WILLIAMSON. Right. But again, even as a PR move, he might do that, but it isn't relevant to whether it will be enforced. And another element to the capital flight as well as the looting, the state-sponsored looting of Russia, is the draconian taxation which the IMF encourages and asked the Duma to raise taxes even further, and if these taxes were imposed upon our population, we would have similar problems, quite frankly.

So, again, I go back instead to of lots of forms and regulations; let us get serious about the property rights and taxation and ra-

tional economics.

Mr. ROYCE. I see.

Yuri.

Mr. SHVETS. The problem right now in Russia is that the system, legal system and law enforcement practice, is such that it is impossible to do successful business following the law. If you strictly follow the law, if you pay all taxes, if you pay all import, export dues, you are broke. So basically any successful businessman has just committed a sort of crime.

So, if you even pass the law, it will again be up to a bureaucrat in a law enforcement agency to make a decision. This businessman

will be prosecuted, and this one will not be prosecuted; and again, you have a problem of corruption.

So I don't think that—even if the legislation is passed, I don't

think that it will be a solution.

Mr. ROYCE. I see. OK. Thank you.

Yes.

Mr. PALMER. I would think the chances are still rather slim, because the Yeltsin family is still very concerned about maintaining their economic, financial support coming into the elections, where they hope to put up their own candidate; and they are worried

about their futures.

But I agree with everyone here. If they passed it, it would never be enforced anyhow. I have lived in these countries and seen that their laws have no relationship to what the courts do. Unfortunately, it is a fact that most judges can be bought. I mentioned in my testimony that a company has a decision by the Russian supreme court, and in two years hasn't been able to enforce it, regarding one building, and the courts have no effect.

On the other hand, it would be effective, at least if we had some document, through which we could say, "Aha, at least to us it looks

like money laundering in Russia."

Mr. ROYCE. Let me make a point and that is, from my stand-point—I understand the points you have made, but from my stand-point, for the Duma, if the Duma wanted to do an investigation, at least if there was a law on the books, they would have the right to access the information. But currently they cannot trace money laundering, because there isn't even a law to point to, because it has been repeatedly vetoed; and that is why I raised the point. But would you concur with my analysis on that point?

Mr. PALMER. I think it is absolutely an essential first step, and I couldn't agree more, sir. I think it is absolutely critical that we press for this. What type of success we will have is another matter.

Mr. ROYCE. I understand your wider point on the front in terms of the rule of law being inoperable. Well, thank you again.

Chairman LEACH. Thank you, Mr. Royce.

Mr. Weldon, do you want—

Mr. Weldon of Pennsylvania. I just think the testimony from all three panels has reinforced the notion that we can't impose requirements on Russia unless we have a viable process that works within Russia. We have not done enough, I think, to solidify the nature of democratic institutions in Russia. We have been so preoccupied with bolstering up what is now a floundering presidency that we have ignored the institution of parliament, which could to some degree have the ability to provide a check and balance inside of Russia, and therefore, I think that should be a top priority.

In closing, I would just like to ask if they could give us some of their own views on, one, are the major potential candidates for succeeding Yeltsin, namely, Luzhkov, Primakov, Putin? Do they have any ties to corruption that perhaps Yeltsin and Chernomyrdin have

had?

Number two, who is really running Russia today? I am firmly convinced it is not Yeltsin. Is it Tatyana? Is it Barazovsky? Who is in charge?

And number three, do the tentacles of the corruption effort invade MINATOM, the Ministry of Atomic Energy and the nuclear stockpile of Russia, and are they also intertwined with the Ministry of Defense and agencies like Rosvooruzheniye who does the arms marketing for much of Russia's conventional arms?

Chairman LEACH. I apologize to my colleague. This is a treatise he is asking for, and I am going to ask for all of this to be summed

up in about a minute-and-a-half. We have a timing constraint.

Mr. Weldon of Pennsylvania. If they can put it in the record, also.

Chairman LEACH. Those are tremendous questions. Mr. DE BORCHGRAVE. Very quickly, Congressman.

Chairman LEACH. I know you will speak for the panel.

Mr. DE BORCHGRAVE. I can't, because I have learned from long experience, as you know, Mr. Chairman, that political forecasting has made astrology look respectable in recent years. But I would say they are all connected in one way or another with the people we consider bad guys.

The Luzhkov-Primakov combination, no question that they won't be much of a change from what we see today. The only one that I think is totally clean is Mr. Yavlinsky of the Yabloko party.

Chairman LEACH. You have 30 seconds.

Mr. PALMER. There is credible evidence that Mayor Luzhkov is head of one of the largest crime families in Russia. If we look at Mr. Putin, he, as I showed in my testimony, was part and parcel of looting the state; and he was involved in it for years, and then he was involved with Navatex.

Mr. Primakov oversaw the use of the KGB to move the money out of the country, rebuffed attempts by the Duma to investigate it and then later said, oh, well, maybe we should form a committee to see where it went. I really don't see any honest faces on the hori-

zon.

Chairman LEACH. Let me conclude then with a comment.

Mr. Shvets concluded his original testimony in terms of arguing what we might do with the observation that if we strengthened our money laundering laws, that would be a great service to Russia, because strengthening laws in the West becomes a deterrent for Russians to bring their money out. In addition, it serves as a basis for future prosecutions by future governments, or even conceivably by current prosecutors.

Now, I stress this because money laundering might seem to many as a modest legal dilemma, but underlining, money laundering is someone's accumulation of resources that may involve a very spectacular criminal activity, and so from money laundering you get a lens to see things. You also get the prospect of looking at

other laws that might be violated.

And finally, let me just observe that in terms of kleptocracy, we had a modest model on the world stage fifteen years ago in the Philippines where Ferdinand Marcos and his wife appeared to garner a fortune in the several billion and possibly larger range. Upon their demise, the government of the Philippines had a basis to be claim in some circumstances, and Western governments were willing to assist, including the Swiss. And I only stress this because, from a Russian perspective, I would go back to the point, if they

are going to allow capital to leave the country, they ought to make very strict restrictions that it only go into Western financial institutions that may come under Western law, and there must be an end placed to these money center havens that are created for one singular purpose, and that is for illegal funds to be deposited and no other purpose that I can gather, other than lack of regulation and avoidance of scrutiny.

And, therefore, it is incumbent upon the United States to lead in cracking down on money laundering as a technique to crack down on much more significant crime, and crime that has enormous implications for the national interest of the United States and world

security.

Let me thank all of you for your extraordinary testimony and I appreciate it very much. The hearing is adjourned, and we will meet tomorrow with another series of panelists.

[Whereupon, at 5 p.m., the hearing adjourned.]

RUSSIAN MONEY LAUNDERING

WEDNESDAY, SEPTEMBER 22, 1999

U.S. HOUSE OF REPRESENTATIVES, COMMITTEE ON BANKING AND FINANCIAL SERVICES,

Washington, DC.

The committee met, pursuant to call, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. James A. Leach,

[chairman of the committee], presiding.

Present: Chairman Leach; Representatives McCollum, Roukema, Bereuter, Lazio, King, Royce, Metcalf, Barr, Kelly, Cook, P. Ryan of Wisconsin, Biggert, Terry, Green, LaFalce, Vento, Waters, C. Maloney of New York, Bentsen, J. Maloney of Connecticut, Sherman, Lee, Goode, Inslee, Moore, Gonzalez, S. Jones of Ohio,

Capuano and Forbes.

Chairman Leach. The hearing will come to order for a second day of hearings on this precise subject, but fourth or fifth day of hearings in the last year-and-a-half on Russia. And I would like to just address a couple of philosophical issues that may seem a little out of sorts in the context of specific actions of specific individuals or companies. When you think about it, for most of this century the world has been engaged in a battle between communism and capitalism. That battle has been put aside, if not the West having largely prevailed, although there is some question now, the Cold War being over, whether the peace has been won.

But it strikes me the new great antagonism in the world today is between capital systems that operate under the rule of law and those that operate outside the rule of law, and what you have here as we look at Russia is a society in which free markets are developing, but they are developing in such a way that there is a lawlessness. In fact, as one of our witnesses yesterday indicated, law ap-

plies to the poor and contacts apply for the rich.

Interestingly, philosophically in communism there are two great flaws in Marxist philosophy. One was the view that history was based on a march in which individuals weren't necessarily accountable, because historical forces were the dominant forces, and you have a class struggle, both of which I always thought had virtually no basis in reality of either history or philosophy. Although ironically in the circumstances developing in Russia today, we have un-Marxist elements that are tied to these theories; that is, you have a new class that has been put in power that is a class that has never existed in world society in a like manner before, and this new political power class has now come to control instruments of economics. I don't believe personally that any society can long

stand in which very few control all the wealth and the very many

have virtually no opportunity.

And so by a virtual accountability sense, there is real question of whether democracy can hold in this kind of circumstance, and I believe that we in the West have an obligation to cease standing up for governments in power and start standing for people and their plights, and that what we should be doing in the West, led by the United States, is identifying with the Russian people, not with their leaders.

In this regard, when it comes to international finance, I don't think you can walk away in Russia. On the other hand, when you look at any institution like the IMF, which give large macro-economic adjustment programs to central banks that are not perfectly accountable, and which, it appears, have been leading in social theft, one of the questions is, "Is it justified for the United States to support IMF lending to Russia at this time?" I think this is very dubious.

aubious.

On the other hand, there is a second great institution of international finance called the World Bank, which is what might be described at the micro level instead of the macro level of economics, and I personally think we ought to be giving emphasis to World Bank assistance to Russian people, perhaps having World Bank contract out with Western banks or community-oriented financial institutions instead of state-controlled, monopolistic enterprises so that money can flow for economic development for the sake of the Russian people.

In any regard, today we have a series of witnesses who will talk about the issue of crime in Russia and the issue of money laundering, and one example of significance from an American banking perspective of the possibility that will reveal, shed light on how funds from Russia come into the Western banking system, whether they be perfectly legally from a Russian or American perspective or

with some questions as to their propriety.

[The prepared statement of Hon. James A. Leach can be found

on page 347 in the appendix.]

At this point, let me turn to Mr. LaFalce for any opening com-

ments he might have.

Mr. Lafalce. Thank you very much, Mr. Chairman. I think these hearings are extremely important. About a decade or so ago, it became obvious to the world that we were witnessing a great moment in history, a moment when a transition would take place, a transition from Communist states, with centrally planned economies, to something else. Some people, they thought they knew what that something else would be, but nobody really knew for sure. Many people say, "Well, we are going to go from communism to capitalism." That is much too simplistic; but, of course, there are difficulties with both.

I am often fond of reading encyclicals of Pope John Paul II, and he will condemn the evils of communism and give solace to us of the United States saying, "Aha, we are right." But he will also condemn the potential evils of the capitalistic system, too, which ought to make us stand up and say, "Well, now, wait a minute, you know, you have to be careful. If you are going to have a capitalist econ-

omy, you have to have certain rules and regulations that are fair, that are enforceable," and so forth.

And whatever your political system, whatever your economic system, there is something that must always be central, and that is not something in the abstract. It is not a bunch of figures, budget deficits, budget surpluses, GNP growth, GDP, whatever it might be. The most important concern of all individuals should be the condition of the human being, the condition of the human being within the United States, the condition of the human being in Russia, condition of the human being in Mexico, and so forth.

And so whatever policies we adopt as a Nation, our first question should be how will this affect people in our own country, and because things, what we do, have ramifications elsewhere, how will it affect people elsewhere. We are especially obligated to ask that question, how does it affect people elsewhere, when we take action within multilateral institutions, whether that is the IMF, the World Bank, European Bank for Reconstruction and Development,

InterAmerican Development Bank, you name it.

I don't think that we have had before us on all occasions the centrality of human beings and their condition in the actions we have taken. I think also that we have so glorified capitalism that we have not been mindful enough of its problems, and we clearly have not been mindful enough of the problems that can so easily come about in making a transition from one type of system to another, the transition from communism to a basically capitalist economy. That is why I was so concerned going way back to the early 1990's, introduced legislation that was passed that created the Central European Small Business Commission, so that we could help develop a small business sector in these formerly Communist states. It did excellent work, in my judgment, but then we couldn't get it reauthorized and reappropriated. That is why I was so concerned.

I thought the most important phenomenon taking place circa 1993, 1994, 1995 to 1996 was the phenomena of privatization. We were witnessing privatization on a scale and in a manner that had been unknown to the world, and we would either do it right, or we would let this golden opportunity slip through our hands. In large part we let a tremendous amount of opportunity slip through our hands, we being a lot of people, World Bank, the private consultants, United States, European Bank for Reconstruction and Development, and so forth, and so much of the privatization went then to the benefit of a relatively small handful of individuals, either legally or illegally. That is one of the difficulties is so much of this

was done under the color of law.

So what do we do? Well, we do what we can right now, learn from what we did or didn't do right and wrong; examine our laws, most especially our money laundering laws, to see if the laws are good, if the laws are being enforced, and if they are not being enforced, why not, and if they are good, but could be better, how so. Then, of course, we have individuals such as the Justice Department which look at criminal issues, and we have to be careful to what extent Congress works compatibly with criminal investigators so that nothing we do serves to be or proves to be counterproductive, and I am always mindful of that. Anything we do I

want or the Chairman wants to be productive rather than counter-

productive.

So some of those are my initial thoughts. This is an important hearing. I look forward to hearing from you, Mr. Robinson, and all of the witnesses scheduled today and those witnesses that will be brought in the future.

Chairman LEACH. Mrs. Roukema.

Mrs. ROUKEMA. Thank you, Mr. Chairman. I will limit my introductory remarks here and just express my regrets to everyone that I couldn't be here for most of the hearing yesterday. I heard the third panel, but as you know, we were experiencing Hurricane Floyd disaster in two of my counties in northern New Jersey and I had to meet with the Director of FEMA, James Witt, who had flown in early yesterday morning, and the Governor of the State in order to assess the damage and set up lines of communication and organization to deal with the flooding problems. I am happy to say

that things seem to be under control.

I will however be reviewing the testimony of yesterday. I want to express my extreme appreciation, Mr. Chairman, for the fact that you are taking up these subjects; not only the foreign policy components, but also and most central to our committee are the questions of money laundering. As you know, I have held some money laundering hearings, way back in April, and have proposed legislation, the Bulk Cash Smuggling Act. I believe these hearing expose what is being done in terms of money laundering, and what should be done in the United States as well as what should be criminalized and how we should have the law enforcement community react.

But more importantly than that is the fact, Mr. Chairman, that you introduced just this week, yesterday, and I am very happy to be a co-sponsor of that legislation, the Foreign Money Laundering Deterrence and Anticorruption Act. Mr. Chairman, there is great need for this legislation. I think the need for stricter money laundering laws is is being demonstrated clearly by these hearings. Certainly my questioning today will focus on whether or not we have learned enough from this particular tragic experience with Russia and the Bank of New York to determine whether the legislation, based on this experience, will be sufficient and comprehen-

sive enough.

I think we are going to learn some excellent things today. I pledge, Mr. Chairman, that with the full knowledge of these committee hearings that we can, and should, all move together, hopefully in a bipartisan basis, to expedite the movement toward enacting money laundering legislation this year. I certainly look forward to what we can learn from our panelists today to help us achieve that purpose. Thank you, Mr. Chairman.

[The prepared statement of Hon. Marge Roukema can be found

on page 356 in the appendix.]

Chairman LEACH. Well, thank you, Mrs. Roukema.

Mr. Vento.

Mr. VENTO. Thanks, Mr. Chairman. I don't have a prepared statement. I want to again recognize the importance of this series of hearings with this new focus on the transactions of cash flow from the Soviet Union and from other countries I suppose it could

be expanded to. We are obviously looking at this and I think in sort of a myopic way when we look only at the financial institutions here and perhaps not looking at what happens in bond markets or what happens in other equity markets that are taking place if we

really want to follow the entire flow of the capital.

Mr. Chairman, I heard in some of the comments of yourself and some of my colleagues there was debate over the IMF, whether we are going to look at simply the market-oriented forces of the conditions and requirements that the IMF attempts to personify in providing some of the key loans that are made upon which many other loans and financial arrangements depend, looking upon that and whether or not we are going to look at what the human condition is, and of course we hear this from our friends.

Of course, I have been advocating or attempting to look at the human rights questions broadly insofar as they affect countries with regard to Asia and certainly with the World Bank and its sister institution. That sister institution, that is what its primary focus is, but invariably the other 180 nations that are members of the International Monetary Fund don't always take kindly to the

U.S. view of culture and various rights of individuals.

And so I think we have to be aware of that phenomenon and what the limits are, but I think it could come to and should come to an agreement. I don't think that a sustainable free-market economy is sustainable based on an undemocratic or grave social injustices that are embedded in some of the member countries that we are attempting to deal with that have severe financial problems and need sort of the financial architecture and the keystone posi-

tion that the IMF puts in place in those instances.

Mr. Chairman, furthermore, of course, as we look at our own institutions and how they can indirectly help a nation such as Russia that is emerging and has an evolving market system, one that obviously has come without the institutional memory from a centrally controlled economy, with all the other adjectives that are added to its demerits, in looking at how we can assist, there has to obviously be the will and the recognition within the country of the necessity of the actions that we may take. And doing these, as I said, in a myopic way just within the United States simply transfers, as has often been pointed out, these activities to other banks, to other financial entities globally.

So I don't know the answer. I appreciate that some are risking putting forth solutions very quickly, including yourself, Mr. Chairman, and I think that it is a positive effort that is being made. We obviously need to learn many of the aspects of this and whether or not we can achieve agreement with the other financial entities and policymakers on an international basis, including, I think—and Curt Weldon's comments were, I think, well placed—in not relying simply on the one personality or one leader in Russia, but relying on and trying to establish better relations with other government

and state institutions, including the Duma, in Russia.

Mr. Chairman, I am pleased to see our former colleague Senator DeConcini is present. I wanted to put you in New Mexico for a minute, Dennis, but I know that he has maintained in this and obviously is working and representing some of the witness/clients that are present today.

Mr. Chairman, thank you.

Chairman LEACH. Thank you, Bruce.

Does anyone else seek recognition?

Mr. Lazio.

Mr. LAZIO. Thank you, Mr. Chairman. Just briefly I just want to make two remarks. First of all is again to emphasize the fact that it is important for us to make some assessment about American complicity in the crisis in Russia. Everything ranging from the dramatic increase in poverty from about two million people to sixty million Russians living in poverty, a tremendous health crisis that is occurring now that is unseen in even some Third World countries, a dramatic increase in alcoholism among Russian males, the diplomacy between America and Russia that can at best be characterized as chilling, an economy that is now roughly the size of Denmark, and how this all happened and whether Russia will look back upon this and say America could have done better and needs to do better.

I want to make a personal remark about Tom Renyi, who is testifying today, the CEO. They are obviously in a difficult position, but I think it is extraordinarily graceful of him, frankly, as a CEO to be here and to answer these questions, and I think it shows great leadership at the CEO level for an important institution in New

York.

Chairman LEACH. Thank you very much.

Mrs. Kelly.

Mrs. Kelly. Mr. Chairman, I have a statement, but in the interest of time I would like to have unanimous consent to insert it in the record.

Chairman Leach. Without objection, so ordered.

Mrs. KELLY. Thank you.

Chairman LEACH. Mr. King.

Mr. KING. Thank you, Mr. Chairman. I don't have any formal opening statement. I just want to commend you for initiating these hearings. They certainly go to the heart of the issues that could have both criminal and foreign policy implications. So I look for-

ward to listening to the testimony here today.

I regret I could not be at the hearing yesterday. I was at the U.N. for the opening of the session, but certainly from what I have read and from what I have seen in going over the testimony, it seems to have been a very productive hearing, and along those lines, I want to commend you also for the legislation you have introduced. I intended going on as a co-sponsor yesterday, but I was not here.

I look forward to the testimony today, and again, these do go to the heart of very, very significant issues which have criminal and foreign policy implications, and I commend you for having the ini-

tiative to bring this forward.

Chairman LEACH. Thank you, Mr. King.

Mr. Ryan.

Mr. RYAN. Thank you, Mr. Chairman. This issue is something that I think we are going to learn quite a bit about. We have a lot to learn, but as we look at these things, as we look at the newspaper accounts and the testimony from the witnesses, it seems to me that the problem with our policy toward Russia is not so much

a coddling and coping with organized crime units at the highest level in Russia with respect to our U.S. Administration's policy as much as it is a high-stakes crap shoot policy of picking the only route we think that is safe for Russian policy in supporting the Yeltsin administration and going to the point of denying and not wanting to know any other information.

I think we are finding, and we are going to find, that our Russian policy is basically that as we heard from the testimony of oth-

ers

The concern that I have—and the pleasure that it is to see that we have several members of the Duma here with us today, which I would like to welcome on behalf of Curt Weldon, who I know is not here, is this. It is my concern that the people in Russia think that Western capitalism is cronyism. The people in Russia think that Western capitalism is those who have the assets and the power are the ones who survive, but I would like to send a message to the people of Russia, and I think Congress should send a message to the people of Russia that that is not what we see as demo-

cratic capitalism.

What we see as democratic capitalism is this: You are bound only by your God-given talents and your own effort. That is what capitalism is. Capitalism is an asset. It is not cronyism. Capitalism is liberalization of the market and everybody having a stake in society and moving forward based on the core premise of the rule of law. That is what capitalism is. That is what we believe capitalism is, so that when you go to your bank, you know that your money is safe. That is something that people don't enjoy in Russia today. It is very foreign to us here in America. We know our money is safe in the bank, but they don't realize that their money is safe in the bank in Russia.

So it is a message that I think is very important for Congress to send to the people of Russia is that we want to see real capitalism flourish in Russia. That is what these hearings hopefully will come about. Hopefully we will have a shift in American policy on behalf of the people in Russia, on behalf of real capitalism and the rule of law, and hopefully that is the good that will come out from all of the bad things we are going to be hearing over the next cou-

ple of months.

Thank you, Mr. Chairman.

Chairman LEACH. Thank you, Mr. Ryan.

If there are no further opening statements, let me welcome—excuse me, the gentleman from Washington.

Mr. METCALF. Thank you very much, Mr. Chairman.

Money was allocated for relief of people in these vast transactions. I am deeply concerned about the apparent problems of money laundering. Eight months ago I was in Russia, and we met with people that were in need, and I now thank the Chairman very much for holding these hearings and saying if wrongdoing or corruption or personal gain has been involved in this scenario, then dramatic action is absolutely essential.

Thank you, Mr. Chairman.

Chairman LEACH. Thank you, Mr. Metcalf.

If there are no further opening statements, let me welcome to our committee, I think for the first time, James Robinson. Mr. Robin-

son is a Michigander. He is a former United States Attorney, and he is currently the Assistant Attorney General in the Criminal Division of the Department of Justice.

Mr. Robinson, please proceed.

STATEMENT OF HON. JAMES K. ROBINSON, ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE

Mr. ROBINSON. Chairman Leach, Ranking Minority Member La-Falce and Members of the committee, I want to thank you for this opportunity to discuss the nature and scope of the threat posed by Russian organized crime groups and the steps the Department of

Justice is taking to combat that threat.

In preparing for my testimony today, I have prepared a written overview of the problem of organized crime in the United States emanating from the former Soviet Union. I have also discussed some of the measures law enforcement has been engaged in to combat international organized crime in general and Russian organized crime in particular. I have given a copy of these written remarks to the committee, and to expedite the proceedings.

Chairman LEACH. Without objection, your full statement will be

placed in the record.

Mr. ROBINSON. I will summarize some of the key points and then answer the questions the committee Members may have to the best

of my ability.

Before I do so, I would like to take this opportunity, however, to express the appreciation of law enforcement for the assistance provided to it by this committee over the years and as recently as this week in assisting law enforcement in providing it with the tools we need to combat money laundering. Making efforts to assure that crime does not pay and being able to identify and prosecute illegal activities through the money laundering statutes is among the most effective ways of combatting criminal activities and deterring criminal conduct.

As stated in the Chairman's letter inviting me to be here today, I know that much of what you are interested in involves recent allegations that appeared in the press involving possible Russian money laundering at the Bank of New York. However, it would potentially prejudice the criminal inquiry currently under way to discuss that investigation in great detail or what has been uncovered so far, and I obviously have limited ability to do that. I can, however, give you a general idea about the investigation, how it has been structured, and I will be happy to do that.

The inquiry into suspicious transactions at the Bank of New York is being conducted by agents of the Federal Bureau of Investigation's New York field office, and with prosecutors from the United States Attorney's Office for the Southern District of New York. Analysts from the Federal Reserve Bank of New York and the Internal Revenue Service are also working with this investiga-

tive group.

This has been and will continue to be an exceedingly complex investigation. The volume of transactions passing through a major United States bank on any single day is simply staggering, and money laundering investigations necessarily involve painstaking

research of these many transactions. Significant investigative resources have been and will continue to be expended in an effort to ensure that we uncover the entire story and bring any merited

criminal charges for violations of United States law.

Last week as part of this inquiry, I and other prosecutors and agents met with a team of Russian law enforcement officials in Washington. We discussed ways we could cooperate consistent with applicable law and our respective law enforcement policies and practices, and we agreed on improved procedures to secure nec-

essary assistance in conducting this investigation.

I should also note that except possibly in terms of volume and number of transactions, this matter has many of the same characteristics as numerous other cases we encounter with some regularity. I regret that I will be unable to discuss those matters in greater detail at this time because of the severe limitations and restrictions that prevent us from commenting in public on pending criminal investigations. We are also sensitive to a number of policy considerations, a sensitivity which I know is shared by Members of this committee, which make us extremely reluctant to make public comments on a case even in situations where we might arguably be able to do so should we choose.

Among those policies is the need to protect the identity and safety of witnesses. Premature disclosure of an investigation can cause subjects of that investigation to destroy or alter or manufacture evidence and could deter witnesses from coming forward. Also of very serious concern to those of us in this country is the need to prevent unfair damage to reputations that would result if we were to prematurely accuse people of committing crimes that may never

be charged.

I have a few other remarks that I would be happy to finish. Chairman LEACH. The red light doesn't apply to you. You are free to proceed at some length, Mr. Robinson.

Mr. ROBINSON. Thank you.

I would also like to make the point that in complex, fast-moving matters such as this one, there is a very real danger that any comment that I might make on day one of a matter could be rendered inaccurate by new evidence discovered on day two, and that is another reason for great circumspection with regard to comments on

an ongoing investigation.

With respect to the general problem of Russian organized crime, I note by way of background, that since the fall of the Soviet Union, Russian criminal groups have become more open, more organized and more powerful, and have a more powerful influence on Russian society. Of particular interest to today's discussion is the role that Russian organized crime groups may be playing in the massive outflow of capital from the former Soviet Union. Clearly billions of dollars are flowing out of Russia to foreign bank accounts. These outflows resist comprehensive analysis. Some of the activities may result from Russian individuals and businesses sending their legitimate assets abroad for safekeeping. Some could involve Russians conducting business with Western companies and paying for Western goods. Neither of these activities are per se illegal under United States law; however, the activities could involve violations of Russian currency, tax or other laws.

We believe that Russian organized crime groups are using Western financial institutions to launder the proceeds of their own illegal activities in Russia. We further believe that Russian organized crime groups assist Russian businesses and individuals in moving assets out of Russia in a manner that attempts to evade the scrutiny of Russian law enforcement and tax officials. Because the United States does not want to become the world's repository of foreign criminal proceeds, we must continue to combat Russian money laundering and Russian organized crime activities generally.

Our strategy in attacking Russian organized crime is embedded in the President's comprehensive International Crime Control Strategy issued in May of 1998, a copy of which I am sure many of you have seen. It has designated international organized crime as a national security threat and directed United States law enforcement, diplomatic and intelligence agencies to intensify their

international organized crime efforts.

Additionally, the Department and other law enforcement agencies are significantly expanding our presence in other countries and building new relationships with foreign governments. At the same time, we are continuing aggressively to investigate and prosecute Russian organized crime activity that we discover in the United

States.

As of December 1998, the FBI alone had approximately 260 pending investigations targeting Russian and Eastern European criminal enterprises. Our work in this area has already scored notable successes, including indictments and convictions of significant Russian organized crime figures. Our prosecutions of Russian organized crime cases are handled by United States attorneys around the country, in particular through the twenty-four organized crime strike forces. These cases are coordinated through the Criminial Division, which also coordinates contacts with foreign authorities to obtain evidence and to extradite fugitives from abroad. The strike force model has worked extraordinarily well in combatting LCN activities in this country, and the close network of strike forces is well-suited to combat emerging forms of international crime such as Russian organized crime.

I can say just as a footnote that a great deal has changed since twenty years ago when I was the United States Attorney for the Eastern District of Michigan. In those days it would have been, frankly, quite unusual for United States attorneys in this country and even members of the Criminal Division at Main Justice to have had the involvement to the extent that we have in international criminal activities of all kinds in the narcotics area and

many other areas.

We feel we are making significant progress in dealing with Russian organized crime and other international organized crime groups; however, some of the law and some of the resources we use to wage this effort, particularly in the area of money laundering, I think need to keep up with the developments and the techniques of international crimes being used by criminals. With the addition of some new legislative provisions of the type that the Chairman has introduced and some proposals that we have as well, we think that the fight against organized crime can be significantly enhanced.

For example, under current U.S. law, in order to prove a charge of money laundering, we must allege and prove that one of the specified unlawful activities listed in the money laundering statute gave rise to the illegal proceeds, but only a very limited number of foreign offenses now qualify as specified unlawful activities, and I am delighted that the legislation that has been introduced—and we are in the process of looking at that—introduced by the Chairman, addresses those issues.

Thus, the legislative provisions contained in these various proposals and some that will be shortly submitted to Congress by the Administration as the Money Laundering Act of 1999 would add additional foreign crimes such as fraud to the list of permissible specified unlawful activities for U.S. money laundering charges. Other provisions in the Money Laundering Act of 1999 would make it easier for Federal prosecutors to gain access to foreign business records and enhance our ability to prosecute money transmitters who knowingly accept criminal proceeds.

We look forward to working with this committee on these important improvements to our money laundering statutes, and again, we appreciate the fine work of this committee in assisting law enforcement as we move into the 21st Century where we will increasingly need to address issues of international organized crime. Thank you very much, and I will be happy to try to answer any

questions.

[The prepared statement of Hon. James K. Robinson can be

found on page 359 in the appendix.]

Chairman LEACH. Thank you, Mr. Robinson, and I would also point out to members of the panel that Mr. Robinson has a very impressive opening statement that he has submitted for the record that is of a more general nature rather than a specific case nature,

but I think is very, very helpful.

Let me in terms of opening comments say that, as you know, we are looking at a particular case, and when you have cases, there are sometimes back-biting that occurs, and the British Government, for example, the Financial Times has reported, actually went to the White House with concerns that our law enforcement authorities were moving too slowly after information that it had provided to precipitate the case. We have an article in a major publication yesterday indicating that the British National Crimes Squad, as well as the Department of State, believe in the New York bank case that movement has been slow.

And so the question I have is not so much a criticism, but can you assure this committee that all requisite efforts of the United States Government will be marshalled on serious money launder-

ing cases of this nature?

Mr. ROBINSON. I can assure the committee that that is the case. The Federal Bureau of Investigation has very close working relationships, as do members of the Department of Justice, with our foreign counterparts. As you know, in an investigation of an international money laundering case, that is very important to have close relationships with and to secure information from a whole host of other countries, and I can assure you that we are working closely with our international partners in addressing these matters. It is being done rigorously and effectively, and I think, as you point

out, from time to time there are tensions between different agencies of government, and we need to continue to work hard to see to it that those don't get in the way of doing an effective, expeditious job.

Chairman LEACH. Fair enough.

Now, yesterday another major reporting agency from the press indicated that Swiss authorities have expressed a desire to help the United States in the case under review today, but that to help the United States, a formal request has to be made to Swiss authorities, and such a request has not been made. Is that something the

Department is prepared to address?

Mr. ROBINSON. I can address it in this way, and that is to assure you that there has been contact and will continue to be contact with foreign countries, including the Swiss and the Russians and other countries with whom we need to work. As the Chairman knows all too well, in order to successfully investigate a money laundering case, one needs to identify the source of the money and where it went, and to the extent these are international transactions, we need the assistance of our international partners. We have outlined in the submitted testimony the procedures that are available. One of the reasons for the meeting with the group from Russia was to make sure that the lines of communication were open there, and we are continuing to do that with other countries as well.

Chairman LEACH. That was my final question. You met last week with Russian counterparts to discuss issues of this nature and others, but how would you characterize the level of cooperation with U.S. law enforcement, and in particular, was this case raised, and did the Russians have any information that they wanted to

share with you?

Mr. Robinson. We had a general discussion. It was very productive in terms of trying to clearly understand the different legal systems we have in our two countries, the money laundering statutes here, the statutes that are available, the investigative techniques that are available, and the agents and the prosecutors did meet to gether and tried to identify the kinds of information that needed to be shared. And this is obviously the kind of thing we try to do in any one of these investigations, and I know that we developed a point of contact that we hope will facilitate the exchange of the kind of information that is necessary to conduct a thorough and successful investigation.

Chairman Leach. I appreciate that. I just want to conclude with this observation: Historically we have always thought the United States was the leading country in concerns for issues like money laundering and international financial institution issues related to bank regulatory enforcement. In this case, it appears that British authorities have been ahead of us, and I want to thank and compliment the British in this regard. In this case, based on one newspaper article, for the first time, to my knowledge, instead of us going to the Swiss and asking for them to be more forthcoming,

they have been more forthcoming than we have.

And second, the Swiss authorities, from a law enforcement perspective, appear to have done a more politically-sensitive and more comprehensive law enforcement effort with regard to high officials in Russia than the United States. And I would just simply express to you, first, that it is good news where Britain is today. It is good news how far Switzerland has come, and in a very competitive sense I hope American standards are not going to be second best. And so I would argue as strongly as I can that this is a very significant area of endeavor, and I would hope the Department of Justice would indicate to its subsidiary organizations, the Federal Bureau of Investigation and U.S. Attorneys, that this is an issue of true national significance in a national interest way as well as in a law enforcement way, and this issue be prioritized, and I would just want to make it clear from a congressional perspective that I think that is the way we all feel.

Mr. ROBINSON. I couldn't agree more, and I would only indicate on the subject of news accounts with regard to activities back and forth, with no disrespect to any members of the press who are here,

we can't believe everything we read in the newspapers.

Chairman LEACH. Fair enough.

Mr. LaFalce.

Mr. LAFALCE. Thank you very much.

Mr. Robinson, I would like to get a better understanding of the enforcement mechanism that exists within the United States and internationally to deal with what we consider to be money laundering and with what other countries might consider to be money laundering, because obviously we are dealing with an international phenomenon, an international phenomenon that on the one hand crosses national boundaries, on the other hand, in the era of the Internet, knows no national boundaries, because you have transfers

virtually at the speed of light or the press of a button.

So I would like to look at the bodies of law, but mainly the structure that exists within the United States and internationally. Tell me about FinCEN. Tell me about the role of the Justice Department and the FBI. Tell me about the interrelationship or coordinating mechanisms you have with them and with the Federal Reserve and the OCC and with the State bank superintendents, most especially the superintendent of banks for the State of New York, although there are others, and because of the international nature of it, what coordinating enforcement mechanisms exist internationally.

Mr. ROBINSON. I think it is clear that it is more important than ever before that there be the kind of coordination that you are identifying. There are many actors. Obviously the regulatory regime that exists to try to identify suspicious activities brings those to the attention of law enforcement, to coordinate all of the actors in the law enforcement agencies of the Treasury Department, as well as the Justice Department and other components that are crit-

ical.

Because I don't want to take anything away from what I know will be an announcement tomorrow by the Attorney General and the Secretary of the Treasury with regard to the new money laundering strategy, I hope you won't mind if I don't go into the kind of detail that I expect will come out tomorrow in connection with this, but I can tell you that the Justice Department, the Criminal Division, has been working very closely with law enforcement in the Treasury Department, the Federal Bureau of Investigation, the

United States Attorneys' offices in developing this money laundering strategy that will be unveiled in some detail and comes as a result of the work of this committee encouraging this activity to occur. And I think that it will be an effective means of coordinating the various components, and I think the assistance provided by this committee and the statutes that you have been shepherding through will continue to assist us in that regard.

Mr. LAFALCE. That is it?

Mr. ROBINSON. Well, as I say, I don't want to get ahead of my interference with regard to the strategy which I think is comprehensive and discusses many of these areas, and I don't want to be getting ahead of my boss, the Attorney General of the United States, and the Secretary of the Treasury with regard to these matters. I know there was some discussion by Secretary Summers yesterday with regard to this, and this will be discussed in detail tomorrow.

Mr. LAFALCE. This is a preview of coming attractions.

Mr. ROBINSON. Yes, indeed.

Mr. LAFALCE. All right. We will be there tomorrow.

Let me go on. Does your office or does any United States office have a handle on the extent to which organized crime or criminality was involved in the various privatization efforts within Russia?

Mr. ROBINSON. I would think that that kind of information as to internal activities within Russia itself would be less likely, except in an indirect way, to come to the attention of U.S. law enforcement, whose primary responsibility, obviously, is the investigation and prosecution of violation of United States laws. We, as well as many others, are privy to a wide variety of intelligence information concerning much of this activity, but with regard to the internal relations of privatization in Russia, I wouldn't be the best person, I suppose, to give you that detailed analysis.

We certainly see money flows, and as I indicated in my opening remarks and in the testimony that we filed, the extent to which these flows violate Russian laws is a subject that will require us to go and try to deal with our counterparts within Russia and to address some of the issues that are contemplated by the Chairman's legislation with regard to expanding the number of specified unlawful activities that are contained within the money laundering

statutes.

Mr. LAFALCE. Thank you.

Chairman LEACH. Mr. McCollum.

Mr. McCollum. Thank you, Mr. Chairman.

Mr. Robinson, it has been reported to us that yesterday was the first time the FBI contacted the Swiss Attorney General regarding the case that involves the IMF and the possibility of money laundering via the Bank of New York, and so forth. Is that true?

Mr. ROBINSON. I think the answer is no. There are contacts throughout—we have constant contacts, frankly, with our partners in other countries, including the Swiss, and while I don't want to

get involved in the specifics.

Mr. McCollum. I don't want you to either, but are you prepared to assure us that that assertion to us is not true, that there were earlier contacts and have been earlier contacts? You don't have to go into details. I just want to know was yesterday the first time

or not that the FBI or the Department of Justice has been in contact by the Swiss on this matter. Have there been any earlier contacts?

Mr. ROBINSON. My understanding is there have been earlier contacts, but just to make absolutely sure that did occur, I will double-

check.

Mr. McCollum. Please do.

Mr. ROBINSON, I will correct the record if I am mistaken.

Mr. McCollum. Thank you.

To your knowledge, does Russia have a truly independent judici-

arv?

Mr. ROBINSON. I would say that the issue of the challenge for Russia with regard to the rule of law and the independence of its judiciary is a serious challenge. One of the things we do within the Criminal Division is to have a program of providing assistance for training prosecutors and police agencies. There have been discussions and I think needs to be continuing work with Russia with regard to their achievement of a rule of law. That would, I think, make an enormous difference to many of the issues that we are talking about here today.

So my short answer, I guess, to your question would be I think there is a serious question as to the independence of the judiciary and the strength of the rule of the law. They are emerging and the Russians are working hard, I know, on these issues and on their

constitution.

Mr. McCollum. Do the Russian law enforcement agencies have an effective program to combat internal corruption such as we have

in our law enforcement agencies?

Mr. ROBINSON. I certainly wouldn't indicate, based upon my knowledge, that it would be anything comparable to the kinds of thorough programs that we have here, and it is important that those be developed, I think.

Mr. McCollum. We have a very effective program with the Colombian National Police in Colombia where we have all the drug problems to theft. Their police officers, they have been very cooperative with us on this level, and that ability has been demonstrated that we, the United States, can, with the cooperation of a foreign government, do that sort of work, help them do that work.

Is the level of relationship between United States Department of

Justice and our program that you just mentioned in working with the Russians, is it up to the same par with that we have with regard to the Colombian National Police? Are we working with them to-have we established relationships to help them vet their police,

or are they less cooperative them than the Colombians?

Mr. ROBINSON. To the best of my knowledge, we have not been involved in this vetted unit concept. I will double-check. But I think we need to make the extraordinary expertise we have in this country available, and I think that there have been discussions on this subject and that there needs to continue to be discussions. Before I took this job, I was the dean of a law school for five years and had a number of members I know of my faculty there, some who speak Russian who were involved in training programs for Russian prosecutors and judges. And I think that that kind of cooperative effort is one of the very important things that we can do

in this country.

Mr. McCollum. It strikes me, Mr. Robinson, not only do we need cooperation, we need to have some force here when it deals with the International Monetary Fund, the loans we have made, however our future relationships are with Russia, to make sure that they are willing to do this kind of detailed vetting that we have with relationship to Colombia, in that example I gave you, because that is the only way I think they are going to come around to issues like the money laundering and the corruption in this country.

At the same time I am asking this series of questions, I am curious to know what your assessment is, what the Justice Department's assessment is of the extent of the Russian mob penetration of the Russian banking system? Do you have an assessment? Is there one at the Justice Department? How widespread, in other

words, is the mob in control of Russia's banking system?

Mr. ROBINSON. I think there are concerns. There have been some assessments done, but obviously our investigations are largely domestic, and I think much of the information that exists on this subject is in the intelligence community and other places. And our investigations, we don't have jurisdiction to investigate crimes within Russia itself. We have major concerns about it, some of which I

identified in my written testimony.

Mr. McCollum. If I can, Mr. Robinson, I happen to sit on the House Intelligence Committee, and I know that there is a sharing of information that goes on, if there is an ascii, and we need cooperation between the FBI and the CIA and intelligence units. So I certainly hope and pray that you do have, you may not be able to reveal to us those details today, but you do have that information, and that in the process of assessing that, that you get to the bottom to the degree to which we can of where that corruption is, and that we as an Administration with the Attorney General taking a lead on this, along with the Secretary of the Treasury, make some commitment to really get tough in our negotiations when we deal with our friends, and they are, I think, our friends. At least some of the leadership over there wants to be. But we have got to change the way they operate, we can't do it alone. Obviously we need their cooperation.

But we also can't do it, and they can't do it if we don't show them somewhat of the way and tell them that we aren't going to be able to have the kind of economic relations that are desirous that we have had up to this point in the future, if they are not going to

shape up their system and get rid of this corruption.

So I am very concerned that Justice is not carrying on as strong a policy role in this as it should. Even though I know the hand is out, it seems to me the carrot stick needs to be there, Mr. Robin-

son.

Mr. ROBINSON. I think that one of the things that PDD-42 and the International Crime Control Strategy makes clear is that we need to have this kind of close working relationship between the intelligence community, the State Department, and the Justice Department. We need to gather the kind of information you are talking about and make our assessments.

And I would certainly agree that we do have a serious concern on the issue of the extent to which Russian organized crime groups are involved in the Russian banking system. I think it does present serious problems and things that we need to take a careful look at.

Mr. McCollum. Thank you. Thank you, Mr. Chairman.

Chairman LEACH. Thank you. Mr. Vento.

Mr. Vento. Thanks, Mr. Chairman. Mr. Robinson, thanks for your testimony. I have looked over the summary of the legislation that you have proposed. It didn't quite ask what the Chairman has done, so I think we might want to try and reconcile some of that.

You noticed in my opening comments that I alluded to the fact that we are dealing sometimes with bonds or with other types of instruments. Do you feel that, in fact, those disposal of assets in those particular circumstances, whether it goes to bonds, annunities, real estate, do we actually track those as closely as we do in terms of bank activities?

Mr. ROBINSON. I am not sure we have the regulatory mechanisms to do in the same way, and that is why I think it is important to address those mechanisms, and I share the concerns that

you have mentioned about the need to do that.

Mr. VENTO. I expect a lot of it gets back to some sort of a wire transfer to a bank, at least in terms of our nation, I don't know globally if that is true. But the concern is that in the work that you do, do you find that on occasions that if you are trying to trace money that it actually goes in those directions?

Mr. ROBINSON. Absolutely. And I think the better capacity law enforcement has to try to identify those things the better able we

will be able to do an effective job.

Mr. VENTO. One of the issues, of course, is that we are concerned that the specter of the IMF and World Bank that has been brought up and what happens to the assets or resources that go into them. There have been the discussion of tax evasion if various countries—obviously, the focus of the tension today is Russia—capital flight.

Of course what you are talking about very often are assets and resources through banks that result in criminal activity. I notice in the convictions that you have had here, some is under the Hobbs Act, which is sort of a shakedown of immigrants and of transporting prostitutes from abroad, and going through some of these, some of these are just not identified as just money laundering and this Armenia issue that you raised.

But in tracking what you are working here on is pretty much the illegally attained, you don't really make, there is no tracking of

IMF dollars? Is that a specific role that you have?

Mr. ROBINSON. A specific role of tracking IMF dollars?

Mr. VENTO. Yes.

Mr. ROBINSON. Once they get to the Russia, you mean.

Mr. VENTO. However you do it. I understand that, you know, that dollars never get over there. According to the Secretary of Treasury, they are just sitting in Washington, and I understand that, so you have to—so I know you cannot do that, but I think that—is there any specific role that you have in terms of indirectly trying to determine—IMF dollars basically leverage a lot of other things that go on in these nations in terms of credit. Is there any role or

monitoring role that we have, either as a nation or internationally

in terms of monitoring these dollars?

Mr. ROBINSON. Well, obviously from a law enforcement perspective, before we begin to open a criminal investigation, we need a predicate, and so we are not out there searching around. But I do think that the regulatory agencies and others, through the suspicious activity reports and other mechanisms, do provide early warnings for those activities that ought to be looked at by law enforcement. And I think that is the kind of thing that we ought to do and then investigate those thoroughly.

Mr. VENTO. You know, you have some other issues that are going on here. The capital flight is one, where assets are being taken out of the country and deposited. I mean, these are concerns, because if we, through our national policy are trying to support the IMF to put dollars into Russia or other countries, we would like that those resources to stay there insofar as possible to better the economic and market goals that we have, to market oriented goals and some

social goals that some of us might have.

So we are concerned about issues of tax evasion, whether individuals are not paying taxes in Russia or doing things which bar it—which touch on evasion, but really with the laws you are looking at pretty illegal activities within the United States, not necessarily

in Russia; is that correct?

Mr. ROBINSON. I think to a large extent. There are a few specified unlawful activities that involve foreign offenses as well, but I think that the kind of work that is being done by the committee to address the issue of expanding the number of specified unlawful activities that would be included in the money laundering statute would give tools to law enforcement that would enable us to really go after these things in a significant way and help us, and that is

why our proposals address that.

I know the Chairman's proposals address it as well. And we are looking forward to working with the committee to try to improve these to the point where we can address these kinds of issues. We are working in a very different world these days with regard to the amount of activity that the Justice Department is engaged in that has international implications. And this is one of a number of examples, and I think these statutes, which are intended to accommodate these changing dynamics, will be of great assistance to law enforcement.

Mr. VENTO. I mean it does involve monitoring, as we pointed out yesterday in testimony, that Russia exports both as an example as a country \$80 billion worth of exports, so there is a lot of transactions that take place, and short of having financial entities across the board helping us with that and feeding us back the information there isn't much hope—I mean we can't begin to be the police force and law enforcement for Russia, can we?

Mr. ROBINSON. No, I think we have enough to handle here, but we certainly need to interact with the consequences that occur there that affect the United States both directly and indirectly.

Mr. VENTO. It is sort of frustrating, I think it is like playing catch with a kid that can't catch the ball, and he doesn't throw it back to you, you know, it is kind of hard to do. And so I mean we really need cooperation in order to accomplish this end. And I think

while we are concerned with illegal assets and illegal activities here that there has to be an integrated policy with other nations and banks.

I mean if we are willing to superimpose these requirements on us and others are not-for instance, picking on someone like the French, they tend to pick on us, so I shall pick on them—if they don't cooperate, then it obviously dissipates in a different direction. And even in the money laundering activity-or the capital flight, we are probably only talking about 20 percent of the export dollars, so it is not-there is still some good that comes out of what happens here. It is a question of whether we are moving in the right direction, I think, here, not whether or not the system is perfect. Mr. ROBINSON. True.

Mr. VENTO. Thank you, Mr. Chairman.

Chairman LEACH. Thank you.

Mrs. Roukema.

Mrs. ROUKEMA. Thank you, Mr. Chairman.

In many ways, our questions have overlapped here. Certainly the questions I have heard from my colleagues are central to the questions I have. But let me-hopefully without prejudicing or compromising your investigation, let me ask the questions the way they have come to my mind. You heard me indicate in my opening statement that the Chairman has introduced legislation and, of course, the Treasury is going to have recommendations for legislation tomorrow.

But I am wondering, based on your experience and knowledge of the international problem here, and unfortunately I don't think we are going to find in the end that it is limited to Russia, there may be a more worldwide problem than we currently understand.

The legislation that you know of, based on your experience thus far, what do you think is most central to the need for criminal reforms? Are we closing the loopholes effectively in the legislation as you know it?

Mr. ROBINSON. Well, I haven't had an opportunity to study the Chairman's proposals that were offered up I think yesterday. But I think that those are the kinds of things that we need to-

Mrs. ROUKEMA. Aside from that, excuse me, aside from the Chairman's legislation, then what do you think we should focus on as the top priorities for closing the loopholes based on your own experience?

Mr. ROBINSON. We have a variety of proposals. I think one of those would be the extent to which in the money laundering area the specified unlawful activities are broadened. It seems to me that

would be a significant assistance to us in law enforcement.

I have tried in my written testimony to discuss a variety of those questions. But among the proposals would be to expand the list of money laundering, predicate crimes, to include a variety of things, including public corruption against foreign governments. And I think these would increase the availability of money laundering enforcement tools to law enforcement; also broadening the definition of a financial institution to include foreign banks, closing a loophole that might exist there involving criminally derived funds, laundered through foreign banks doing business in other countries.

Mrs. ROUKEMA. You mean new definitions on that?

Mr. ROBINSON. Yes.

Mrs. ROUKEMA. And also what are those, the banks that are able to get funds only from private payments and not include deposits

from their own local citizens; is that right?

Mr. ROBINSON. I think those kinds of issues are things that we certainly need to address. Also toughening penalties for violations of the International Emergency Economic Powers Act, the IEEPA. There are a variety of specific things that we have discussed and I think we will be continuing to discuss in terms of making these kinds of improvements.

Mrs. ROUKEMA. Well, I would appreciate anything else that you could submit to us for the record with specificity, not only about our legislation, but based on your experience in various investigations as to how we close those loopholes, if you have anything be-

yond your testimony.

Mr. ROBINSON. We would be delighted to do that.

Mrs. ROUKEMA. But it is also brought to my attention by staff that in an Administration briefing recently for staff, there was an indication that the most significant feature in the new strategy regarding money laundering is an agreement between the AG and the Secretary of the Treasury to have their agencies work together to combat money laundering.

That seems to be so elementary. Is there something more specific that you are talking about as to how you work together and cooperate with specificity that is not permissive or required under the law

now?

Mr. ROBINSON. I don't want to get ahead of the interference again. But the answer is, yes, I think those details will be discussed tomorrow when this strategy is discussed by the Attorney General and the Secretary of the Treasury.

Mrs. ROUKEMA. Evidently it was not clear to some staff persons, and just on the basis of the way they presented it to me, that raised a question in my mind as well. So we will be looking at that.

Mr. ROBINSON. Good.

Mrs. ROUKEMA. All right. Thank you, Mr. Chairman.

Mr. ROBINSON. Thank you.

Chairman LEACH. Thank you very much.

Ms. Waters.

Ms. WATERS. Thank you very much.

Mr. Robinson, I have been reviewing your statement, and I am particularly concerned about the laundering of drug money.

Mr. ROBINSON. Yes.

Ms. Waters. Coming from the Justice Department, you are aware of our mandatory minimum laws and the fact that the prisons are filling up with young people from inner cities, mostly minorities, who for 5 grams of crack cocaine can get a mandatory—a minimum of five years in prison, and the judge does not have any discretion.

When I look at the laundering of drug money by our own domestic banks, and I have reviewed the 105 or so prosecutions over the past few years, I see that the fines have been given for some of these banks, one fine as high as \$25 million for American Express International. I saw that Confia bank was on the list. That was one of the banks that was identified in the Casablanca operation. That

was a known drug money laundering bank that was under pur-

chase at the time by Citibank.

We have "know your customer laws" that are basically ignored by our own domestic banks. There are some reference to private banking, nothing about concentration accounts, and no one has ever lost a bank charter for laundering drug money. At the same time we give long sentences to low-level street dealers. Without the ability to realize the profits there would be no drug trafficking. They couldn't spend the money. It just wouldn't happen.

What are you prepared to recommend? What get tough laws are you recommending for banks, and do you include in that the loss of a charter for banks that are convicted for the laundering of drug

money?

Mr. ROBINSON. I share the concerns that you have about the need for effective prosecution, not only of individuals who commit crimes, but financial institutions that commit crimes. I know that this has been a subject of discussion. And I had the opportunity to review and saw your testimony actually yesterday on this topic. I think that you raise very legitimate points, and I think law enforcement needs continuous improvement in this area.

As you know, in the submissions that we have given to you by one of my deputies and others concerning the work of the Department over the past ten years in this area, there has been a good deal of work, but that doesn't suggest that simply because there have been 105 foreign and domestic banks and financial institutions that have either been convicted of money laundering or penal-

Ms. WATERS. Excuse me, I don't want you to go any further.

Mr. ROBINSON. Yes.

Ms. WATERS. That is the cost of doing business these days.

Mr. ROBINSON, I understand.

Ms. WATERS. If you can keep doing business and you get fined and you are making money, you will pay the fine. Are you prepared for us to take away the charters of banks who launder drug money?

Mr. ROBINSON. I think in appropriate circumstances that if people are engaged in criminal activity at that level, the forfeiture laws and others ought to be considered. I guess the short answer is getting tough in this area is appropriate.

Ms. WATERS. Are you prepared to recommend the loss of a charter under any circumstances where the laundering of drug money

is involved?

Mr. ROBINSON. I think yes under appropriate circumstances. The answer ought to be yes.

Ms. WATERS. Can you describe what kind of circumstance you

think would be appropriate to snatch a charter?

Mr. ROBINSON. I think if you had a financial institution engaged in knowledgeable money laundering at the highest levels of the corporation, that that was their business to engage in, that you didn't have a situation in which there were mechanisms in place to prevent this, where you have corporate compliance programs to see to it—we do encounter situations in which people, because of the tremendous economic advantages, get involved in this activity and hide their activity from other people and the institutions. That

doesn't mean that the institution shouldn't pay, but I think we

have to look at these cases on a case-by-case basis.

And in an appropriate case, it seems to me, it would be appropriate to have the ultimate capital punishment for a financial institution with regard to that. I think it depends on the specific case.

Ms. WATERS. Are you involved at all with the ongoing investiga-

tion of Citibank?

Mr. ROBINSON. I am familiar with it, yes.

Ms. Waters. But it is still ongoing? It has not been concluded vet?

Mr. ROBINSON. I obviously can't comment on the specifics of the

investigation, however.

Ms. WATERS. I just ask. Is it still ongoing?

Mr. ROBINSON. I think it wouldn't be appropriate to say anything other than there has been no conclusion as I understand it and the specific answer to the question, let me double-check and get back to you.

Ms. WATERS. Thank you.

Chairman LEACH. Mr. Lazio.

Mr. LAZIO. Thank you, Mr. Chairman.

I just want to get, if I can, some understanding of the structure that is being used from a law enforcement point of view. Is it a task force that has been assembled, an interagency task force on the money laundering issue?

Mr. ROBINSON. Are you talking about a particular case or—

Mr. LAZIO. I will refer particularly to the Russian case.

Mr. ROBINSON. The Bank of New York case, or whatever you

want to call it? As I indicated-

Mr. LAZIO. I presume it is broader than just Bank of New York. Mr. ROBINSON. Yes. As I indicated in my opening remarks and in the testimony that was submitted, the matter is being handled by the United States Attorney's Office for the Southern District of New York working with agents with the FBI field office in New York in conjunction with agents from the IRS and other regulatory agencies in coordination with the Organized Crime Racketeering Section of the Criminal Division at the Justice Department.

To the extent that additional resources are deemed to be necessary, those resources, I think, will be assigned if that answers

your question.

Mr. LAZIO. Not completely. In other words, is it a collaboration right now in sort of an institutionalized way with Treasury? Is there a collaboration in some type of institutionalized way with our intelligence services?

Mr. ROBINSON, Yes.

Mr. LAZIO. In this task force?

Mr. ROBINSON. Yes, the answer is yes.

Mr. LAZIO. And Treasury has FinCEN organization. Is that di-

rectly involved as a representative of—

Mr. ROBINSON. What I wouldn't want to do is describe in great detail, in any more specifics than I have in the testimony, the specific configuration of the investigation.

Mr. LAZIO. I am interested in whether FinCEN has been proactive and has been effective from a law enforcement standpoint and whether it is frankly worthy of additional scrutiny, and so I

will ask you this directly. How would you characterize up until today, because I understand there will be an announcement tomorrow, how would you characterize FinCEN's role in money launder-

ing in general and in this particular case in particular?

Mr. ROBINSON. Well, let me add, sir, that FinCEN is a very important tool and I think it does a very effective job and works cooperatively with the rest of Federal law enforcement. And I think it has a very important role in money laundering investigations, and the continued cooperation between all of these resources in the Federal Government will be essential to do an effective job.

And I think they have been effectively engaged. Their resources are well-known to the rest of the law enforcement, and I think that obviously under the topic of continuous improvement, there always needs to be continuous improvement. But I think there has been good cooperation between Treasury and Justice with regard to

these matters.

Mr. LAZIO. Yesterday we heard testimony from Fritz Ermarth, who is a former CIA official who headed the Russian—I guess chief Russian analyst. And he testified as to almost a culture, and that is my word, I don't think it was his, but a reference to the pressure not to pass on bad news to superiors, that intelligence would be gathered, but there would be a sense that people at the upper ends just did not want to hear it, because they were pursuing a strategy that was an announcement to some of this bad news.

Have you had any experience with that? Had you heard of other people in American law enforcement who have expressed a concern

about that?

Mr. Robinson. I have not, although I did see some of the hearings last night. The Justice Department thrives on bad news. We are supposed to investigate it and so the extent to which we can get information indicative of the possibility of criminal activity, that is part of our job to look for that information, make a determination as to whether the predicates are there for the possible violation of United States law and conduct a thorough investigation.

Mr. LAZIO. OK. You also know, and I say this as a former prosecutor myself, not everything that is uncovered ends up being criminal. There is essential information that sometimes needs to be passed on so that policymakers can make informed decisions.

Mr. ROBINSON. True.

Mr. LAZIO. So my question is to you, did you ever experience or hear of anybody who ever experienced a disinclination to pass on information to higher-ups, because it didn't fit in with the strategy that was being pursued from a political standpoint?

Mr. ROBINSON. I haven't, but obviously my period of most recent involvement in this topic is about fourteen months since my ap-

pointment to this position last June.

Mr. LAZIO. Thank you very much, Mr. Chairman.

Chairman LEACH. Thank you.

Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman.

Mr. Robinson, in your testimony, you talk about, on page 7, you talk about the increasing frequency of suspicious financial transactions. And you talk about prosecutions under Sections 1956 and

57 of Title XVIII, and 5324 Title XXXI, and on the following page, you list the charges that have been brought. It shows an increase in fiscal years 1996 through 1998.

How does this compare to the previous three years? Has there been a pretty substantial step-up in the number of charges

brought, and is this both domestic and international related?

Mr. ROBINSON. These would include all prosecutions under these sections. And I will be glad to get the information on the years preceding. But I would anticipate that we will see this number increase as we go forward.

Mr. BENTSEN. So the various U.S. Attorneys out in the field have been stepping up their activity based on the data that you showed

here at least in the last three years.

Mr. ROBINSON. I think that is true. And my understanding is that these numbers have been relatively consistent over the last five or six years. But we will double-check the specific figures.

Mr. BENTSEN. That would be helpful. Later on in your testimony, you reference the International Crime Control Act of 1998, a package of more than 50 new legislative measures to help us fight international crime and implement the objectives of the international crime control strategy.

Now, apparently that passed the Senate, but was never taken up

by the House in the last Congress, according to your testimony.

Mr. ROBINSON. My understanding is that is correct.

Mr. Bentsen. Was it ever taken up by the Judiciary Committee in the House, do you know?

Mr. ROBINSON. Pieces of it have, as I understand, but not the en-

tire package.

Mr. Bentsen. Otherwise the Senate acted, but the House did not act. Would this be a helpful measure for U.S. Attorneys in the field and for the Justice Department and the international efforts to combat money laundering and organized crime infiltration of the Nation's financial system?

Mr. ROBINSON. We believe it would be. Mr. BENTSEN. There have been questions raised, and certainly raised to me primarily from the media, and there have been a number of reports in the media that the Bank of New York is endemic of a situation where high levels in the Clinton Administration have turned a blind eye toward organized crime and corruption in Russia for furtherance of other goals, and some have said in the case of the Bank of New York, the blame lays at the doorstep of the Vice President, because of being the point person on U.S. relations with Russia.

My question to you would be, what is the standard operating procedure involving an ongoing criminal investigation within the Justice Department and notification? From testimony given yesterday by Secretary Summers, the Treasury policy officials were notified in April of this year, although, if I recall correctly, FinCEN officials at Treasury were engaged with the FBI and with Justice and the U.S. Attorney's Office in the Southern District of New York on this,

as you would expect.

But, would it be appropriate or inappropriate, in your opinion, for this to be an issue to be taken up to the high levels of the Administration so it could be used in negotiations, say, with a Russian prime minister, of concern within the Administration with respect to corruption, or would an ongoing criminal investigation be something that we would prefer to keep under wraps until a decision can be made whether or not to bring charges or pursue a prosecution?

Mr. ROBINSON. Well, we start with the proposition that we prefer to keep criminal investigations confidential for some of the reasons I identified in my opening remarks and I articulated in the written statement that I made. In addition, there are specific legal constraints with regard to sharing information, particularly grand jury information under rule 6(e) of the Federal Rules of Criminal Procedure. There are specific prohibitions on the sharing of grand jury information.

information.

Having said that, increasingly these days and at the point that probably didn't exist, certainly didn't exist when I was a United States Attorney twenty years ago, because of the internationalization of criminal activities and the extent to which the Justice Department comes across information in the course of our efforts, there are situations in which we could come across information that is so important to the national security or foreign relations of the United States that it would be deemed appropriate to provide limited information, and so we have a process within the Department to try to flag that kind of information.

Each United States Attorney's office was advised and has been reminded that, if during the course of investigations information comes to their attention of this type, we have to have a careful process of determining under what circumstances it rises to a level where it is appropriate, that it affects national security, that there

ought to be notification to policymakers.

So we would raise the matter up to the Attorney General, and a determination would be made as to the extent to which it would be necessary to share that information. So that is the process that is utilized, and it is a careful, I think, process that is designed to protect the integrity of the investigation while still not sitting on something that could affect the vital national security interests of

the United States.

Mr. Bentsen. With the Chairman's indulgence, based upon that, as a former U.S. Attorney and a high-level Justice Department official now, would it be in your opinion productive or counterproductive for information regarding an ongoing investigation to be divulged in international contacts; that is, for our negotiators with the Russians to bring up that, oh, by the way, we are investigating potential money laundering activities through a certain U.S. bank, we think this is a problem that you should be aware of and you should be addressing, or would that be counterproductive or productive to your ongoing criminal investigation?

Mr. Robinson. Well, obviously, I wouldn't want to comment on the specifics or even a hypothetical basis. Let me say the answer this way, obviously—to the extent, we conclude through this process that there is information vital to the national security interests that needs to be shared with people that are engaged in carrying out that policy on behalf of the United States, the point at which those policymakers, based upon a much larger role and responsibility for foreign relations and other things, determine how to use it

is something that I think that they would have to determine. Obviously, we would prefer that any disclosures be only as necessary so that we can continue to protect the equities that I outlined in my written testimony and stated here.

Mr. BENTSEN. Thank you. Thank you, Mr. Chairman. Chairman LEACH. Thank you.

Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

Part of our responsibility—

Chairman LEACH. Could you hold just a second, Ed. Do you want a parliamentary inquiry?

Ms. WATERS. I would like to submit my statement for the record. Chairman Leach. Mrs. Waters has a unanimous consent to submit her statement. Without objection, so ordered.

Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

One of our responsibilities here is to get at the facts. And one of the witnesses that we heard yesterday passed on the following observation: he says officials of one of our closest allies told him last spring that they are now monitoring their local Russian organized crime problem very closely. And they say, further, 80 percent of the funds through Russian organized crime entering their country first come into the United States; that they are laundered through the U.S.; and of those funds from the U.S., they say 60 percent arrive from the City of Boston. However, when they ask U.S. police to provide information on the ownership of those accounts, it takes six to eight months to receive sketchy data.

Further, the Russians close and change those accounts every six months. However, our allies are being assured that Boston has no

Russian organized crime problem.

Now, he says he will give us the names of policemen there that are willing to indicate differently. This is the question that we have been bringing up now. The Chairman held a hearing in June of 1996 where we brought up this same set of issues, and I guess part of the concern that we have is not what Justice is going to do tomorrow, when you lay out a new program; the question is, what has been done over the last couple of years over a problem which is very serious?

We have Duma members that come to us and in our offices and tell us, it is time for the legislature and the Duma to begin to work together on this information, because there is not enough being done in their administration or in our Administration in terms of

investigating money laundering.

The Russian delegation that was just here last week that met with you, they met with the Justice Department, returned to Moscow and said that they had not been shown any evidence that there was a legal problem with the Bank of New York.

Now, is this what we call cooperation? I mean I would just like

your response on that.

Mr. ROBINSON. Well, we do require their cooperation, and there were meetings and there will continue to be meetings, not only with this group, but with other countries. We have mutual legal assistance treaties that have been outlined in my written testimony.

In the Office of International Affairs in the Criminal Division, we have people who work on a daily basis with our partners throughout the world. The FBI, DEA, and other law enforcement agencies have legal attachés. One of the things we are obviously expanding, because of the growth of international crime is the need to have people in place dealing with these different laws and different systems in creating the kind of relationships where the shared information can occur to have mutual assistance between our two countries.

We obviously have to do it with some care with regard to what you share under what circumstances, what guarantees do you have that by sharing the information it is not going to be inappropriately used, and that means building the kinds of partnerships. And I think that the meeting that we had last week was helpful, the relationships the FBI legatts have throughout the world. There are, as I indicated in the testimony, I think, 32 or 33 countries in which we have FBI legatts. And that needs to continue to improve.

Mr. ROYCE. Be mindful of the fact it is the Duma that has passed a series of laws to make money laundering a crime in Russia, all right? Those have been vetoed by their administration. They are trying to get a signature on a law to make it a crime in Russia. They come here and meet with you to investigate this issue of money laundering with respect to these funds that went through the Bank of New York.

They then return and have to say, "Well, we have been given no evidence, no information." I am just reporting to you, because we are hearing from delegations, from the Russian Duma, that indicate they are very upset with the amount of money laundering that has occurred in their country that has gone out of their country. They suspect a lot of it is going through banks here in the United States and then into the Caribbean, and so forth.

And they are trying to get to the bottom of this. We are trying to get a signature, I assume, from President Boris Yeltsin of Russia on a bill to in fact make this a crime, and it would just be helpful if there was some cooperation with the Duma members. And they are telling us they are not getting that cooperation from more than

one member of the Duma by the way.

Mr. ROBINSON. I think that the cooperative relationship between U.S. law enforcement and Russian law enforcement is there. I think that there is a good relationship. I think the meetings we had were productive, and I think there will be further meetings between law enforcement, to law enforcement with regard to sensitive

information, and that exchange needs to occur.

We also made the point during the meetings that we thought it was very important for the money laundering statute in Russia to come into place. And we had a discussion about that, had a copy and translated it, the veto message. And we are taking a careful look at that and urged them and made the point that we felt that money laundering statutes are critical here and would be very, very helpful and important in Russia as well.

Mr. ROYCE. It would be nice with all the aid we have given Russia if we would have at least leveraged that signature on that bill instead of the continued vetoes that we have gotten out of the Rus-

sian administration. But I thank you for your testimony.

Mr. ROBINSON, I agree with you.

Mr. ROYCE. Thank you, Mr. Chairman. Chairman LEACH. Thank you.

The gentlelady, please.

Ms. LEE. Thank you, Mr. Chairman.

Mr. Robinson, you indicate this in your testimony, that there are very limited foreign offenses under the money laundering statute, you mentioned on page 4 trafficking in narcotics, murder, kidnapping, robbery, extortion, destruction of property by means of explosives and fraud against a foreign bank, OK. Because they are very limited offenses, is it safe for us to assume that there are or have been other instances of money laundering from other countries, other than Russia, that for whatever reason has not been exposed nor investigated, because of the lack of statutory requirements, is this really just the tip of the iceberg?

Mr. ROBINSON. This problem is not a problem that is limited to the situation that we are talking about here today with Russia. We see it with other countries. We see it in a whole host of situations in our narcotics investigations and the like. So the topic of international money laundering is a topic that spans the globe and will continue to be a subject that we have very serious concern for law

Ms. LEE, But how do you decide when to prosecute and when not to prosecute, given the very minimal statutory authority that you

do have?

Mr. ROBINSON. Well, obviously, we are bound by the statutes that exist, and so to the extent that we have specific credible evidence that we can find a violation of United States law as it currently is configured, and understanding that our standard in the United States is to convict people beyond a reasonable doubt, we conduct those investigations and where we have the evidence, we bring the charges.

Ms. LEE. Can you, just for my own information, indicate where there have been other instances of money laundering that would-I won't say rise to the level of this investigation, but would be a

serious investigation that you have conducted or-

Mr. ROBINSON. Why don't I do this, rather than try to talk off the top of my head on this, is try to get back with specific information for you to supplement my testimony.

Ms. LEE. OK, thank you very much.

Thank you, Mr. Chairman. Thank you. I yield back the balance of my time.

Chairman Leach. Mrs. Jones.

Mrs. JONES. Thank you, Mr. Chairman.

Mr. Robinson, I did not arrive at the time you began your testimony. Would you repeat for me what your current position is, please?

Mr. ROBINSON. I am the Assistant Attorney General for the Criminal Division of the Justice Department. I was appointed last year and took office June 22nd of 1998.

Mrs. Jones. To whom do you report, sir? Mr. ROBINSON. I report to-

Mrs. JONES. Directly report?

Mr. ROBINSON. I report to the Attorney General of the United States through the Deputy Attorney General of the United States. Mrs. JONES. Who is your deputy?

Mr. ROBINSON. Eric Holder.

Mrs. JONES. I just wanted to understand the relationship. And

prior to serving in this position, what did you do?

Mr. ROBINSON. I have been a lawyer for 30-some years. I was a partner in a major law firm in Detroit where I headed the litigation department for many years. I was the United States Attorney for the Eastern District of Michigan in the Carter Administration. And for five years immediately before assuming my current position, I was the dean and a professor of law at Wayne State University Law School in Detroit, Michigan.

Mrs. JONES. Close to Ohio?

Mr. ROBINSON. Yes.

Mrs. Jones. OK. My background and experience is a former DA and a former judge. I sat here listening to the testimony yesterday, and I am sure you heard it over the television. It is very easy to sit here and speculate about what testimony is admissible or what isn't in a courtroom or to speculate and say hearsay, but you can't use that in a trial in a courtroom. Is that a fair statement, sir?

Mr. ROBINSON. As it turns out, my principal area of scholarly attention is evidence and so I taught evidence for many years, and I have written a couple of books about it. And there is no doubt that there is a difference between hearsay, rumor, speculation, in-

nuendo and what you can get into court.

Mrs. Jones. For representatives of the Duma to go back to Russia and publicly say that they have not had cooperation from law enforcement in the United States when they come over to complain makes for great television stories, doesn't it?

Mr. ROBINSON. I am not sure how the press plays it.

Mrs. JONES. Or the press. Mr. ROBINSON. I don't know.

Mrs. Jones. Now, yesterday we also heard testimony that privatization of Russian banks cause the flow of funds from Russia to other countries, therefore, the United States should be responsible for the money laundering dilemmas in Russia as a result of pushing for privatization.

Have you found any evidence of that particular fact that would cause us to proceed with money laundering claims in this country?

Mr. ROBINSON. Well, let me separate out a couple of things. I have seen the information that these privatization issues have resulted in a fair amount of capital flight out of Russia, some of which, as I indicated in my testimony, may be perfectly legitimate, and not a violation of any United States laws, some of which may constitute money laundering within the meaning of our statutes and each, of course, would require a very careful analysis of the transaction, identifying the source, determining whether the source was based upon a specified unlawful activity. This is a careful process that has to be built together before obviously anyone can be charged with violating Federal criminal law.

Mrs. JONES. Just for the fact that money flows from Russia out to other countries does not necessarily mean it is as a result of any

criminal activity?

Mr. ROBINSON. Certainly not necessarily a violation of United States criminal laws; whether it might or might not violate Russian laws is another matter. If it was to be sent out, for example, to evade Russian taxes or otherwise, but that is speculation.

Mrs. Jones. Would it be fair to say that a good analyst or investigator, even if he had the feeling that the higher-ups thought that some information should be one way or the other, but if he or she was doing their job, they are obligated to provide good news and bad news?

Mr. ROBINSON. I would assume that every manager wants all the information whether it is good or bad. I certainly do in my job, and

I would assume others want all the information as well.

Mrs. Jones. And the bad news is the news that could sting you in the behind in a courtroom if you didn't have it once you got to a courtroom on a particular case or analysis; is that a fair statement?

Mr. ROBINSON. In a courtroom or before a congressional hearing

or wherever.

Mrs. Jones. Finally, Mr. Robinson, is it a fair statement to say that in the course of being a criminal—excuse me, an Assistant U.S. Attorney or an assistant U.S. Attorney General, you provide not only civil, but also criminal advice to agencies in the United States; is that correct?

Mr. ROBINSON. Certainly the Justice Department.

Mrs. Jones. The Justice Department does. And there comes a time at some point wherein you may be providing civil advice to an agency and someone in the Criminal Division would be providing criminal advice, and at some point it may be required that in order to be giving good advice civilly, some information may have to be provided criminally that would not necessarily impair an investigation?

Mr. Robinson. It sounds possible in the abstract, yes.

Mrs. JONES. In fact, in reality, it could well happen as well?

Mr. ROBINSON. Sure.

Mrs. Jones. Thank you very much, Mr. Chairman.

Chairman LEACH. Thank you, Judge Jones.

Mr. Capuano?

Mr. FORBES. Mr. Forbes.

Chairman LEACH. Mr. Forbes. Excuse me, I am looking the wrong way, I apologize.

Mr. FORBES. Thank you, Mr. Chairman.

Thank you, Mr. Robinson, for your patience and for being here today. I think your information has been extremely informative, and as the newest Member of the Banking Committee and a Member from New York, I can tell you that I have great interest in this issue. And thank you again.

Is it correct for me to assume, based on what I have heard here this morning in your statements and your responses, that the efforts by organized crime in various foreign nations, Russia and other nations, that the laundering of money in the United States

is pervasive?

Mr. ROBINSON. I think that is fair to say. We may not be the most pervasive, but certainly it is a serious problem that requires law enforcement attention and regulatory attention, I think.

Mr. FORBES. May I also assume that given your testimony, that the limited number of offenses that would qualify under the money laundering statute somewhat tie the hands of the Department of Justice to get at this problem?

Mr. ROBINSON. I think there is no question, but that we could use some expansion of the statute specifically with regard to the specified unlawful activity predicates within the money laundering

statute, yes.

Mr. FORBES. The revelation, the recent revelations on one financial institution, its unfortunate involvement with money laundering, only really suggested—you can correct me if I am wrong, but I got the sense and I don't think you have had a chance to complete your statement—but, when my colleague Ms. Waters mentioned ways of getting financial institutions to perhaps be more aggressive in their oversight of money laundering, were you about to mention that there were 105 financial institutions that in one manner or another had been involved, albeit not of their own knowledge, but it came to light that they were involved or their personnel were involved unwittingly in money laundering?

Mr. ROBINSON. Yes, we have submitted some information with regard to that. Some may be mentioned in the attachments to my

testimony, yes.

Mr. Forbes. So it is about 105 institutions though?

Mr. ROBINSON. We are talking about investigations and prosecutions over the last ten years, I think is what the matter related to. There were earlier hearings on this subject and one of my deputies, Mary Lee Warren, who supervises, among others, the Asset Forfeiture and Money Laundering Section within the Criminal Division and also the Narcotics Section, testified here, and then following that there was a submission of some additional information. We would be happy to make it available to you as well.

Mr. FORBES. Thank you. Is it your sense that the financial institutions take a more passive role toward the money laundering

problem, or are they taking a more aggressive role?

Mr. ROBINSON. I think hearings like this are causing everybody to devote a greater degree of attention to these matters. And I think that that will ultimately inure to the benefit of law enforcement as we can identify situations that warrant a careful scrutiny.

Mr. Forbes. I guess more to the point, and perhaps some of this will come to light tomorrow when there is an announcement by the Attorney General and by the Treasury Secretary, but generally, as I understand it, beyond the statutory requirements that banks have in looking for suspicious transactions, has there been an effort in the last month or so, or a couple of months, particularly with the latest revelations, to get more aggressive and get the banks to be more aggressive in their approach to this problem?

Mr. ROBINSON. I would like to think that everyday we get a little more aggressive, but I wouldn't limit it to the last month or so, but the efforts in this area have been increasing over a period of time and I expect will continue to increase as we have a greater appre-

ciation for this problem.

Mr. FORBES. And finally, if I may, has the Department approached the Hill in trying to get these money laundering statutes

adjusted so that your hands are no longer tied in the manner I

think that you suggested?

Mr. ROBINSON. There have been proposals and this committee, I might say, has been very helpful to law enforcement in assisting us to make improvements in the statutory tools that are available to law enforcement.

Mr. FORBES. The Department itself has made those recommenda-

tions?

Mr. ROBINSON. We have. Mr. FORBES. Thank you. Thank you, Mr. Chairman.

Chairman LEACH. Thank you, Michael, and let me extend a formal welcome to you on the committee, and we are grateful for your contribution.

Mr. FORBES, Thank you. Thank you very much.

Chairman LEACH. Mr. Goode.

Mr. GOODE. Thank you, Mr. Chairman.

In your statement, you said organized crime in Russia covered a wide array of activities. Just ballpark percentagewise, how much is

protection rackets protecting people would you say?

Mr. ROBINSON. I would be reluctant to put a percentage. It has been identified as a very serious issue, I think, in Russia. There has been a lot written about this. There has been a fair amount of the classified information, which you can't talk about, but there has been a fair amount of discussion about this problem in Russia, and I think it is a serious problem.

Mr. GOODE. Would it be fair to say that it is far greater now than

it was when the Communists ruled Russia in the 1960's?

Mr. ROBINSON. That is my impression. I don't offer myself up as an expert on those particular matters, but it is obviously something we are spending a lot of time on. But that is certainly my impression.

Mr. GOODE. To jump to a tangent area, the tax. What kind of

taxes does a business person pay in Russia now?

Mr. ROBINSON, I would have to double-check.

Mr. GOODE. Do you have any income factor? Mr. ROBINSON. I do know there is a very substantial amount of evasion of taxes. My understanding is that the rate of taxation is reasonably high, and there are substantial incentives as a result for people to either engage in transactions that avoid the scrutiny of the taxing authorities in Russia or simply to try to avoid taxes altogether. I know it is a serious problem that has been recognized in Russia itself that needs to be addressed.

Mr. GOODE. Do they usually now focus more on sales tax type

taxes or income type taxes?

Mr. ROBINSON. I would be reluctant to offer an assessment without getting back, because I don't think I have gone into the detail of what their tax system is at this juncture. But we would be glad to try to do that for you.

Mr. GOODE. Well, do the criminal elements help those businesses that pay protection to avoid taxes? Is it a twofold thing? In other words, I am going to protect you from some bad guys, but I am also going to help you in avoiding paying your share to the government?

Mr. Robinson. I would not at all be surprised by that, but as I say, our concentration here, and there are others who would probably be in a better position to offer the right answers to your questions, is domestic law enforcement violations here. Many of those things that are happening there, we are seeing the consequences on our shores and in the Justice Department, our primary attention is the violation of U.S. laws.

Mr. GOODE. Well, with regard to the United States and the influence here, are the organized criminal elements trying to work with established criminal elements in this country or are they trying to

set up something apart from?

Mr. ROBINSON. We see a little of both, actually. We have seen some cooperation between some of these groups and traditional organized crime groups in this country and some independent activities as well.

Mr. GOODE. All right. And I yield back, Mr. Chairman.

Chairman LEACH. Thank you, Mr. Goode.

Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman.

Mr. Robinson, I was reviewing your testimony here, including your references to the current money laundering statutes and what you see as their limited applicability to international cases such as the ones that we are talking about here today involving Russian organized crime and money laundering. Are there any offenses, any provisions of the U.S. criminal Code that would, other than the money laundering statutes, that might be able to be used by our prosecutors for offences involving money that is diverted or fraudulently used; that is, that goes through the IMF, other than simply the money laundering statutes?

Mr. Robinson. Well, there is certainly the fraud statutes—bank fraud statues, and variety that could be looked at in the context of specific facts. So money laundering is one of the tools, but there may be other fraud statutes that could be utilized, conspiracy and fraud statutes that could be utilized depending on the facts development.

oped.

Mr. BARR. Because I know if we look at problems with misuse of Federal funds domestically, I know there are ways to directly attack funds that are misused or not used in accordance with statutory provisions on grants and so forth that go through domestic agencies and are used domestically, certainly.

Mr. ROBINSON. And also, as I am sure you know from your prior work in the criminal justice area, that the interstate transportation stolen property statute and others might also provide a vehicle for

being used in appropriate circumstances.

Mr. BARR. Are attorneys at the Department, or in particularly U.S. Attorneys' offices that might have jurisdiction over these particular type of offenses, are they looking at those statutes and the possibility of bringing cases? In other words, being imaginative, using current Federal statues while we are waiting, and hopefully we can adjust some of these statutes to put more teeth in them as you have recommended, as others have recommended—rather than just wait for that to happen, are your prosecutors right now, as we speak, looking at different ways that they might be able to get at this if there are, as we certainly suspect, millions and millions of

taxpayer dollars that have been diverted from legitimate uses provided by Congress and intended by the President, or are we just sitting back and sort of waiting for new statutes?

Mr. ROBINSON. I think you are exactly right, imaginative examination of all of those statutes is going on. We would expect that to go on. I am sure you would expect that from your experience.

and we expect it here as well.

Mr. BARR. We certainly hope so. One area that is of concern to a number of us is you have indicated these cases are very, very complex. Even among money laundering cases, these are more complex, because of the international institutions involved and the international nature of them generally. Does the Department have training programs in place now for equipping prosecutors and agents with the tools they need to level the playing field with regard to these criminal enterprises or do you need to develop some additional or new training programs in light of the complexities of these cases?

Mr. ROBINSON. I think we need to continue to do that. We have those programs in place. We have international coordinators now in the U.S. Attorneys' offices. As I said earlier before you were here, there has been a sea change since I was the United States Attorney in Detroit twenty years ago to the kinds of issues that are being confronted in these days by our prosecutors throughout the Federal system, and I think we need to do continuous work in getting our Assistant United States Attorneys and Federal prosecutors, as well as the investigators, fully trained with regard to the new technology that is being used and new activities that are oc-

curring really internationally these days.

Mr. BARR. Thank you. I would urge you to move forward on that as quickly as possible and also to really push these prosecutions, because there is an awful lot of money at stake here for the Amer-

ican people.

Mr. ROBINSON. Thank you.

Chairman LEACH. Thank you, Mr. Barr.

Well, let me just conclude with two questions. One I am not sure you will be able to answer and the second may be rhetorical. First, is the Justice Department looking into the possible diversion of IMF funds in any of the cases it has under review?

Mr. ROBINSON. The entire matter of the investigation, there aren't any limitations on it. The investigation is going to be done thoroughly and carefully and carried to wherever it may go without

any limitations at all.

Chairman LEACH. Second, and this may be rhetorical, have you been in close consultation with Justice authorities and legal authorities and banking authorities in the Cayman Islands and re-

ceived good cooperation from them in your investigation?

Mr. ROBINSON. I think the answer is yes, that there has been. This is going to be increasingly important for us to engage in, particularly in places where we have concerns about offshore financial institutions that are putting money beyond our reach. That is a challenge for us, and we need to continue to follow up on it.

Chairman LEACH. I raise this for the following reason, just so that you understand. A few months back, the Federal Reserve of the United States intervened and helped assist an American incorporated institution called Long-Term Capital Management, involving funds, however, that were chartered in the Cayman Islands. And I asked the Chairman of the Federal Reserve Board if he had of course consulted with the Cayman monetary authorities before making this decision to save Cayman funds, and this was a rhetori-

cal question, which of course he had not.

But the point I would raise is that we have developed a system in the world where some countries establish laws that are designed to defend the lawless. And so one of the great questions we have as a country is how do we disincentivize people using those countries, and I would like to make it very clear if the Justice Department does not get full cooperation from countries like the Caymans, clearly the Congress is going to have to move in directions to disincentivize that kind of country from being utilized. And I believe that that is something we ought to be looking at seriously, and I would be looking at constructive advice from the Justice Department in that vein.

Well, let me just conclude by noting that sitting behind you is Mr. Mark Richard, who is a longtime Justice Department employee who is moving on to a new assignment. We want to wish him well in his new assignment as we wish you well in your current assign-

ment. Thank you very much.

Mr. ROBINSON. Let me just say as a footnote to that, Mark is going to be in Brussels, still with the Criminal Division, and I think it is symptomatic of the fact of the required reach of our international law enforcement efforts that Mark will be working with the European Union and working with our offices abroad in trying to deal with the very complexities of the kinds of things we have been talking about at this hearing.

Chairman LEACH. Well, thank you very much, Mr. Robinson.

Mr. ROBINSON. Thank you.

Chairman LEACH. I would like to ask now our second panel, which is also a one-person panel, to come forward. Our second witness today is Mr. Yuri Shchekochikhin, who is a member of the Russian Duma and an editor of the Moscow paper called Novaya Gazeta. We welcome Mr. Shchekochikhin who is violating two normal precedents of the Congress; that is, we normally do not invite foreign witnesses and particularly foreign government witnesses. We are particularly appreciative that you have agreed to come, and normally we do not invite members of the press as witnesses. You happen to be a member of the first and fourth estates in terms of an American term of art.

Mr. Shchekochikhin's newspaper has been a leading reporter of certain issues of corruption in Russia, and for that reason we wanted to invite his perspective before the panel. Mr. Shchekochikhin is joined by an interpreter, and we invite him to proceed as he sees

fit. Welcome.

STATEMENT OF YURI SHCHEKOCHIKHIN, MEMBER OF THE RUSSIAN DUMA, EDITOR OF MOSCOW NEWSPAPER, "NOVAYA GAZETA"

Mr. Shchekochikhin. Thank you, Mr. Chairman, and Mr. Chairman, Members of Congress, my English is not good enough for so serious a report, and I ask Natasha to help me to translate.

Chairman LEACH. Of course.

Mr. Shchekochikhin. Mr. Chairman, I would like to thank you for this invitation to participate in the hearings, which I am sure will play a major role in our joint struggle against corruption and in Russian-American relations. Although, both yesterday and today, I felt as if I were at a meeting of the Russian Ministry of the Interior. I heard the same names and the same numbers, almost as if I were at home.

I am a member of the Committee on Security and a member of the Committee on Struggle with Corruption, and I represent the Yabloko faction in the Duma. At the same time, I am Deputy Editor of the newspaper Novaya Gazeta, New Gazette. It is a weekly which has a circulation of about half-a-million. Unfortunately, the investigations we do are sometimes more effective than the investigations done by the government. At least three Vice Premiers had to resign after publications in our newspaper. However, the new ones who came were no better than the old ones, but that is our life today.

Yes, it is our life where corruption has become the main stumbling block to development in our society. The public is firmly aware of the concept, "the family" now, and by that we mean not only the president and his immediate family, but the people sur-

rounding him.

As the leader of our faction, Grigory Yavlinsky said "You can see the same thing only in Indonesia." A day doesn't go by that our press does not mention the name of the dark genius, Boris Berezovsky. The President of Sibneyts, Raymond Mabrovich, who is called head treasurer of the family. By the way, it was our newspaper that has found criminal action, and based on this case, he should be in prison right now and not in the Kremlin.

Another hero of our times, the President of the bank Unicom, Ashor Ygadzon, who managed to steal about a million dollars from an organization Rosvooruzheniye, Ross Armaments, but this was the man who organized the provocation against Skuratov, the Attorney General, and another ten or dozen names which defined the

life in our country.

I am sorry that I could not prepare a written statement for these hearings, but there were reasons for this. Right before my trip to Washington, 24 hours before the trip, I returned from Dagestan, where there are new Caucasus wars taking place. Local residents openly called this war a money war, and even the eagles of the mountains know the name Bidirovsky. There I had occasion again to be convinced that corruption is not only an evil, but it also leads to the loss of life of innocent people and bloodshed, but these are

all our problems.

I am thinking about something else, why today money laundering in Russia has become such an important issue here in the United States. The constant publications and the press here and releases remind me of a bombing attack. All of this happened a long time ago. America knew about this. Why only today? I want to warn you about coming to conclusions about the money laundering situation in the Bank of New York. Maybe these are international organizations, maybe ours. Don't forget that Russia is still a wealthy country. Two hundred years ago, our historian

Karamzine, when he saw fellow Russians in Paris, and this Russian asked him, "Well, what is happening in Russia?" He responded, "They are stealing." During those 200 years, they haven't managed to steal everything, and because of that, the \$1.5 billion

that is leaving Russia, more often than not, it is our money.

There are American traces for this money. Five years ago we had the history of Mr. Stroiyev. An American mass media called him one of the best businessmen in Russia. Newsweek had a photograph of him on its first page. He was a member of the Moscow government, and at the same time President of the firm Perestroika. He stole everything that he could. And bought everything that he needed or wanted in America. He ran away from Russia two days before my article about him appeared, and now he is leading a calm life in Atlanta, and he is afraid to return to Russia.

I also researched the history of oil. The money received for the

I also researched the history of oil. The money received for the sale of this was supposed to go to the Republic of Komi. The Republic received only about \$1 million. The other \$11 million turned up in pockets of various officials. When in Copenhagen, I found a list of these officials and of the money that was lost, and at that time

huge sums were transferred to the U.S.

The Committee for Fighting Corruption and my fellow members in the Duma raised the question of raising a criminal issue about this, and this case was given to the procurer of the small town Solikamsk, and the official there in charge of the investigation has no money to travel anywhere to investigate this issue. And the information I had, the bills, are still lying in my safe at home, because it seems that nobody was interested in this.

The truth of the matter is that the local governor has ties to the president's family. As I was told in Copenhagen, one of the oil companies, Tabakiev, was sold at auction offshore in the Virgin Islands. The son-in-law of President Yeltsin, Aleksandr Uchinko, was

involved in these dark dealings.

There is another American connection, the city of Monroeville in Pennsylvania, that one of the founders of the firm Alletta, who was buying Russian nuclear technology, he is a member of the ministry named ADAMAT, and the account for this company, and possibly the Minister itself, is in a PNC Bank in Pennsylvania. Much has been written and said about this, but even though the premiers in

Russia have been changing, the ministers still stay.

Now, about credits. We took an interest in the expenses or in foreign credits, and among those receiving them were now defunct banks, Menatep, Imperial, Inkombank, Dacca bank, and what was even more surprising to us, \$400 million are to be spent in aid to Mongolia, Tunisia, Cuba and Vietnam, and so forth, Algeria. We are not rich enough these days to be able to do this. And the most interesting thing, or maybe interesting for my American colleagues, each third item in the credits is titled "consulting." Could it be that during those last two years, all of this consulting done for our officials has not taught them anything? But who are these consultants?

A few years ago, with my American colleagues, we studied the question of where the credits for supporting small business disappeared to. It turned out that they were in several books which remained in the Russian Embassy, but more than that, I was told

that money which is given by the West is not only stolen by our officials, but is also going into the pockets of these numerous consultants, including those from the USA for expensive Moscow hotels, for travel with family and friends to Moscow, and so forth, and I want to stress and repeat that I know this from my American friends.

I am very grateful that yesterday I heard in this hall that the state Duma still exists, but America is a strange country. It only knows symbols. Gorbachev is a symbol of Perestroika. Yeltsin is a

symbol of democracy. Chubais is a symbol of privatization.

The conclusions of the commission of which were about the reasons for the default of August, which were created by a decision of the federal council, it gave the names openly of Kadiyevka, Dubenya, Chubais as the authors or the executors of this financial crash. More than that, in this conclusion, Chubais is accused of giving out certain interested to financial groups, both ours and foreign, the timetable for the financial crash that was to come. There is a different opinion of Chubais in different parts of society, and including my colleagues, the members of the democratic faction Yabloko.

But even during the non-official visits of Chubais to Washington, he is received by the highest officials of the U.S. Administration. There is a double bookkeeping, both here and there. I think that the decision of the U.S., that was not well thought out, and an inadequate evaluation of the current situation in Russia leads to the fact that the higher officials in Russia feel that they can do whatever they wish, their hands are not tied. This happened in the fall of 1993 when the American Administration in practical terms approved of the dissolution of parliament, no matter how I personally felt about the parliament at that time.

I remember a conversation I had with a high-level government official in Washington. He said what Russia has to do in parliament is turn off all the water supplies so they would be forced to leave, and I asked him, would he advise that to his own President, to cut off the water supply in the Senate or Congress? And this leads to what we are talking about here and even more than

here, in Moscow.

From time to time I hear from our officials, well, what is this, somebody received \$10,000 or \$100,000 for a book that has not been published yet. Is that money? And I am reminded of our teachers, our doctors, our soldiers who are fighting in the Caucasus, and our officers whose salary is 22 rubles a day, which is enough to buy a pack of cigarettes.

Thank you very much.

Chairman LEACH. Well, thank you very much, Mr. Shchekochikhin, and let me stress in terms of symbols, I think the Shchekochikhin symbol will be straight talk. Your issue of book

publishing is not novel to Russia.

Let me ask a question just about reactions in your country. You have a few Russians today who have bought major real estate in the United States, in Pebble Beach and Palm Beach. What do Russians think of this? Are they offended or do they think this is right and proper?

Mr. Shchekochikhin. You know, we can't say today that everyone who buys real estate is a bandit or a criminal, but I think we have to go not from private property to crime, but from facts which take place in Russia and then go to the real estate. And unfortunately, the cooperation between our special services is very bad, no matter what is said here or contrary to what is said here.

Chairman LEACH. What are the best estimates of the capital flight from Russia? And can you give us your assessment of why so much investment from Russians has fled Russia? Is it the economic stability, the political instability, the absence of legal protections in property? Why have Russians lost confidence in their own country and determined to allow so much capital to go abroad?

Mr. Shchekochikhin. That is a very important question. When President DeGaulle, when he came to power in France said, I ask the French to put their money in French banks and I promise that not one centime will be lost—unfortunately we have no one to say something like that. And of course, lack of trust in the government is the first or the foremost reason. In spite of the efforts of the Yabloko faction to change the tax laws, nothing is happening. If one were to pay all taxes, then there wouldn't be any business at all. It is safer to hold the money in the West. Unfortunately, foreign banks are not working in Russia. There are many reasons. It is like the thousand and one nights.

Chairman LEACH. One final question. What role do you see being played by what are called offshore banks, banks in Antigua and Cyprus, and is there any reason why the Duma could not pass a law that disallowed capital flight to countries that didn't have well-

regulated banking systems?

Mr. Shchekochikhin. Yes. The Duma could pass a law about that, but what will happen after that? With the dissolution of the Soviet Union and with the formation of new countries with which we do not have normal boundaries, with this enormous amount of joint enterprises or firms, the money will flow out. I am not even talking about the direct carrying out of cash money.

About five years ago I saw someone in Washington who carried out \$3 million in cash. I asked him, "How did you manage to do that?" And his eyes became very sad, and he said, "I had \$5 mil-

ion."

Chairman LEACH. Thank you, sir.

Mrs. Maloney.

Mrs. Maloney. Welcome, Mr. Shchekochikhin, and thank you for joining us here today. In this country, money laundering is enforced by our bank regulators, the Treasury, through FinCEN, the Justice Department, the FBI and many other agencies. Could you comment on the level of commitment to combat money laundering in your own country, what are the agencies combatting money laundering, and do they have a strong political and popular support?

Mr. Shchekochikhin. There is a presidential veto on the law that is about money laundering. This law is not perfect, but it is this kind of law that is not perfect in many other countries, too, but you need some sort of basis or foundation. Then, second, there was a commission formed to deal with money laundering, with rep-

resentatives from several agencies, but this is a very complicated

question and not only in Russia.

In this very room yesterday, I heard from a colleague of yours that I know that American banks launder money, but not a single bank lost its licensing during this time. And of course we need cooperation between our financial organs, exchange of information with each other, trust in each other. That is the most important thing.

Mrs. Maloney. Could you elaborate? You said there was a law that passed that was vetoed by the president. You said there was

legislation with a presidential veto. Could you clarify?

Mr. Shchekochikhin. You know, it would be easier for the president to explain this.

Mrs. MALONEY. But he did veto the legislation.

Mr. Shchekochikhin. Yes, he vetoed a law which was passed by the Duma. Right now, a committee is working on this.

Mrs. MALONEY. What was the reason he gave when he vetoed the

Duma's legislation on money laundering?

Mr. Shchekochikhin. Well, first, because the law was not perfect and there is one thing in the law that you can take issue with, and our colleagues from the Communist Party and we argued with them about this.

Mrs. Maloney. What was the point they took issue with?

Mr. Shchekochikhin. OK. The terminology used was "unlawful income" rather than "criminal income," because unlawful is a much more embracing or wider embracing term. You could take some grandmother who is selling flowers at a metro stop, but this gave the president a reason to veto this law.

Mrs. Maloney. Well, Mr. Chairman, I want to compliment you on calling this hearing and for the legislation that you introduced yesterday, and I have reviewed it and I look forward to working with you to enact it in this Congress, even though it is not perfect.

It is a step in the right direction, and I support it.

Chairman LEACH. Thank you very much. And I want to make it very clear that this hearing is not designed to investigate Russian Bablashisks.

Mrs. Roukema.

Mrs. ROUKEMA. All right. Thank you, Mr. Chairman.

I do want to ask a question for clarification. I believe you said that foreign banks are not active in Russia. Did you indicate that? But does that mean that only U.S. banks are active in Russia. Or did I misunderstand you?

Mr. Shchekochikhin. No, no, you misunderstood. There are

Mrs. ROUKEMA. No foreign banks?

Mr. Shchekochikhin. There are no foreign banks in Russia. You said that America welcomes a number of foreign banks in Russia. That was said here yesterday in these chambers.

Mrs. ROUKEMA. Oh, I see.

Mr. Shchekochikhin. But I think that active Russian banks—and the Western banks in Russia probably, that is equal to zero right now.

Mrs. ROUKEMA. But there are still some American banks active

in Russia or have been up until now?

Mr. Shchekochikhin. No, I think that American banks are act-

ing or active with Russian money in the U.S.

Mrs. ROUKEMA. We will come back to that, but let me ask this question. At the beginning of your testimony today you made this statement: "I want to warn you about coming to conclusions about the Bank of New York," but you didn't state your warnings about the conclusions. Can you comment on that subject?

Mr. SHCHEKOCHIKHIN. I read the American press about this scandal. The same facts are repeated, and I don't see any proof, but I read that this scandal involves money from the IMF and that somehow this is linked to whether aid should be given to Russia. and I am afraid when criminal questions are taken over by political questions, and that is why I would not rush to conclusions. Maybe those, the commentators are correct, but maybe not.

Mrs. ROUKEMA. I hope you would feel confident at this point in time. I am confident that the investigation through the criminal justice system is being properly handled. It will have due process under the laws of our country. Let me go on and ask you this. One of our people yesterday on the panel made this statement: "Russia

is too important to abandon."

A question I have for you is how and when can we restore our

economic and foreign policy ties to Russia in your opinion?

Mr. SHCHEKOCHIKHIN. Well, right now there is the hope for America and Russia, it is gone. What I am saying is what people feel over there.

Mrs. ROUKEMA. Yes, yes.

Mr. SHCHEKOCHIKHIN. Maybe it will come back. I hope that this will happen. Who will make the first step? I came to Washington right after the bombings in Belgrade and I tried to explain to the high officials and the Administration in the U.S. The experience from Vietnam, from Afghanistan, from Iraq, it all turns out to be something other than what it was supposed to be. It is a very complex question, and this really had an impact on the relations between Russia and the U.S., and I was told that I don't understand anything in foreign policy.

Mrs. ROUKEMA. I thank you for your response.

Chairman LEACH. Thank you.

Mr. Bereuter.

Mr. Bereuter. Thank you, Mr. Chairman.

Mr. Shchekochikhin, thank you very much for your testimony. I heard your story about someone in this Administration suggesting the water should be shut off on the Duma. They have the same attitude in some places about the Congress shutting off the lights and the water. They love democracy in the abstract, but when it comes to the inconvenient appendage called the Congress, which is tenacious and inquisitive, it creates a lot of problems for those people who prefer an elected absolute monarch.

Having commiserated with you as a parliamentarian on that, I would like to ask you what you meant when you said there is dou-

ble bookkeeping in both places.

Mr. Shchekochikhin. Well, it is a double moral standard. It is

not a financial category right now.

Mr. BEREUTER. We have had people come before us and in other sessions, Russian economists from outside of the government and institutes, who have suggested that the West should provide no more financial assistance to the central government, but should, in fact, provide multilateral and bilateral assistance to building democracy by working with people at the local level and by pushing for a rule of law. They have also gone on to say that since the debt of the Russian government seems so hopelessly large, a better solution would be to forgive the Soviet debt which falls on Russia today. That would five the Russians some hope for actually meeting debt requirements which, in turn, could cause a positive effect upon performance.

Now, it is easy for an American to embrace that possibility, if it is a good one, because most of the Soviet debt is held by German banks. What is your reaction to: One, shutting off aid to the central government?; and, second, sending it out to governors and local groups that are doing their job—focusing on democracy and rule of

law?

Mr. Shchekochikhin. You know, I am not an economist. I am in the Security and Corruption Committees, and I am not as intelligent as the economists, but I am afraid of the words "give money for democracy." Because then what happens is that democracy is being built on only one small part of the territory for one person. I think we have to try to get joint projects, joint technologies where a year from now you could actually feel or see the results, what is happening.

I am sure that Russia does not need any more consultants from the U.S. or from Germany on how to build democracy. The world

is small. We have to work together.

Mr. BEREUTER. Mr. Shchekochikhin, I want to fit in one more question if I may on my time. What is your best judgment about the extent to which Russian organized crime has succeeded in gain-

ing control or ownership of Russian banks?

Mr. Shchekochikhin. You know, I heard a colleague talk here today of the hearings, and for many years I have been trying to find the Russian mafia in America. A lot has been written about it and a lot is being said about it, and there is only one criminal case against Yaponchik, and I am getting tired of all of these mysterious figures, the Russian mafia, because I see the same thing in Russia also. Organized crime is actually being suppressed by the officials in the administration. It is the officials who are getting the money.

These are new processes. I have been studying this issue of all of these criminals for twenty years, you can believe me, and that is what is frightening, and today the organized crime is turning to

narcotics and things like that.

Mr. BEREUTER. Thank you, Mr. Chairman.

Chairman LEACH. Thank you. Just to clarify what you are saying, is there is an increase in public corruption as contrasted with traditional criminal activities?

Mr. Shchekochikhin. Yes, that is correct.

Chairman LEACH. Thank you.

Mr. Barr

Mr. BARR. During the course of the last two years in our country, we have investigated extensive use of illegal foreign money into the President's reelection campaign, including large amounts of money

coming in from Communist China and other countries in the Far East. Are you aware of any evidence that any money from Russia, including from organized crime elements, has been funneled into any political or election campaigns of public officials here in this country?

Mr. Shchekochikhin. No, ours—they won't give money for that. Mr. Barr. They are somewhat unique then. Do you have any evidence, I know you touched on this very briefly, but could you indicate if you have any further evidence that the money that is being accumulated by organized crime in Russia is being used to traffic in armaments with groups outside of Russia, groups inside Russia, or other countries?

Mr. Shchekochikhin. Yes. A lot has been said and written about this. Criminal cases were begun—again several generals who had ties with these bandits, with bandits. But, you know, the armaments market is traditional for organized crime and for high-level

officials who are linked to that.

You especially see this in the Caucasus. Right now you had this case with this invasion of Dugestan and there was an international brigade in Dugestan at that time. I myself saw people who were killed who were from the Sudan, and they had the newest kind of armaments, which the Russian army doesn't have. Almost every one of them has this English sniper rifle, Magna, whereas in the territory of Dugestan there are only two of those. And so, as you can see, it is a very big market.

Mr. BARR. Any evidence that that market includes biological or

chemical weapons?

Mr. Shchekochikhin. There is some, a little bit written about this, and especially the younger investigators are looking into this. But those conflicts that I had looked into, I did not see any evidence of this or I would have written about it.

Mr. BARR. Is there any evidence that the trafficking of armaments, or the funding of sales of armaments, extends to terrorist

nations such as Iraq or Libya?

Mr. Shchekochikhin. Well, you know, I am convinced that those attacks on Dugestan were funded by Arabic countries, and everyone knows about this, and a lot of money—big money, is going. You know, the main purpose there is to establish Islamic Fundamentalism, or even worse, on Dugestan territory. And so a lot of money has been given for this, and I think that this whole Caucasian business is, it is not only a Russian affair, it should be international, or it is international. Because there are a lot of links there with countries that are traditionally supported by the USA.

Mr. BARR. Thank you.

Chairman LEACH. Thank you very much, Mr. Barr. And let me

thank you, Mr. Shchekochikhin.

I would also like to extend personal thanks to the interpreter who represents the Library of Congress, and I think she has reflected very well on herself and the Library and we appreciate very much your being able to do this today. And I might ask that you introduce your name for the record if you would.

The INTERPRETER. Natalia Montviloff. Thank you.

Chairman LEACH. Thank you. Thank you, Mr. Shchekochikhin. Thank you.

Our third panel is—we welcome Thomas A. Renyi. Mr. Renyi is Chairman of the Board and the Chief Executive Officer of the Bank of New York.

And your full statement will be placed in the record. And you may proceed as you see fit and read the full statement or parts as

you prefer.

STATEMENT OF THOMAS A. RENYI, CHAIRMAN AND CEO, BANK OF NEW YORK

Mr. RENYI. Thank you, Mr. Chairman. Mr. Chairman, Members of the committee, my name is Tom Renyi, and I am Chairman of the Board and Chief Executive Officer of the Bank of New York.

I appreciate the opportunity to testify before the House Banking Committee on behalf of the Bank of New York. Our bank was founded in 1784 by Alexander Hamilton. Our business today focuses on the global financial services sector, and we are one of the leading correspondent banks for commercial banks around the world. We provide corporate and retail services in our home market, as well as a variety of other trust and investment services.

The Bank of New York has consistently enjoyed a reputation for prudence and responsibility while producing amongst the highest earnings in our industry for our shareholders. I have been dismayed by suggestions in the press that the Bank of New York was somehow actively involved in the reported Russian money laundering scandals. Let me said the record straight, no charges have been filed against the Bank of New York, no relevant authorities have asserted that the bank is engaged in money laundering or violated any other law. No customer of the bank, nor the bank itself has lost money as a result of the activities in question.

During the past year, we have worked closely with all of the ongoing investigations. We have provided thousands of documents and millions of electronic bits of information, and these investigations are not yet complete. They remain highly confidential, and as you can understand, there are limits to what we can disclose prior

to their completion.

Mr. Chairman, in my written statement I have provided detailed information on the six specific topics raised in your letter inviting me to appear today. I would like to use this limited time available to me now to discuss several basic questions: What events actually took place, how did they take place, what have we done as a result of these events, and the subsequent inquiry. And, finally, Mr. Chairman, I would like to suggest policy issues that the committee may wish to consider.

Press accounts have tended to ignore the Bank of New York's cooperation with the investigating agencies both here and abroad. And although, Mr. Chairman, there are limits as to what I can say again about these investigations, let me try and describe what I

can.

The bank learned of these investigations a year ago in September of 1998, and when we requested the U.S. Attorney's permission to close the accounts, we were asked to keep the accounts open, to advise no one, other than our bank regulators, and to take no action that would compromise the investigations. We did all of these things.

This was our commitment then, and it remains our commitment now to cooperate fully with all law enforcement agencies. Now when opened, the accounts were quite normal. The principal accounts were opened at a New York City branch of the bank by Peter Berlin, a New Jersey resident, who became a U.S. citizen in 1996 and who represented himself as operating small businesses in the New York metropolitan area.

The accounts were referred to us by an officer of the bank, Lucy Edwards, Mr. Berlin's wife. The initial history of these accounts were unremarkable and account activity was consistent with a

modest business.

However, the volume of funds moving through these accounts increased to levels well beyond what would have been expected for businesses of this kind. And when bank employees noticed the increase in volume, questions were raised within the bank both about Mr. Berlin and his companies. But the questions were not pursued with sufficient vigor or follow-through and the questioners relied too heavily on the fact that Mr. Berlin was married to a well-regarded bank officer, Ms. Edwards, who again originally referred the accounts.

Allowing these accounts to remain open and active without sufficient questioning was a lapse on the part of the bank, and I have taken personal responsibility for implementing remedial actions, which I will describe later in my testimony. But let me turn, Mr. Chairman, to the Bank of New York's business dealings in Russia. The bank has done business in Russia since 1922. And with the collapse of the Soviet Union in 1991, a new banking system began to emerge in Russia. And we, as many of the nation's leading commercial and investment banks, were asked to aid in the development of their banking system.

The role we chose was similar to what we do in many other countries and more limited than what many other banks chose. In our case, correspondent banking and securities processing activities, bank-to-bank business that generates stable predictable fees with relatively low risk in capital exposure was what we chose. To correct any misimpressions, I want to underscore the fact that Bank of New York has no branches or bank subsidiaries in Russia, just a small five-person office that performs administrative functions.

When we open correspondent relationships, we are selective. We do business only with banks that meet the high standards in their particular marketplace. We require documentation from them as to the legality and the creditworthiness of their businesses and we review their capital adequacy and their reputation in the local mar-

ketplace.

But having a correspondent relationship with a bank, Mr. Chairman, does not give us nor any bank much direct knowledge about that correspondent's customer accounts. This results from the opaque nature of the electronic global payment system. Information regarding the sender and receiver of funds consists little more than sums, account numbers and digital information regarding the bank identified.

The system is excellent at tracking funds' flows within its electronic pathways, but the system is not very good at identifying who controls the origination or destination accounts, how they may have come by the money or what they plan to do with it. So we share that frustration that all of the authorities who are our partners in

these ongoing investigations have regarding these accounts.

In the last five weeks, we have examined vast amounts of data, but we do not have all of the answers that we want and we don't know when or if we will. Working with outside auditors, we have reviewed the program we employ for identifying and reporting suspicious activity, and we have identified several areas of our improvements and have implemented already most of the changes.

We have formed——

Chairman LEACH. Mr. Renyi, if I can interrupt you for just a second.

Mr. RENYI. I'm sorry, Mr. Chairman.

Chairman LEACH. I apologize, we are interrupted by a vote on the floor, maybe several votes, and it strikes me that it might be better to recess in the middle of your testimony than just before you finish so that you have a better chance to give a flow.

Mr. RENYI. Fine, Mr. Chairman.

Chairman LEACH. So what I would suggest is that the hearing recess pending the several votes, and then we will return to your testimony. And you can proceed as you see fit at that time.

Mr. RENYI. Very well.

Chairman LEACH. So the hearing will be in recess pending the vote.

Mr. RENYI. Thank you.

[Recess.]

Chairman LEACH. The hearing will reconvene.

When we recessed for a series of votes, Mr. Renyi was in the middle of his testimony, and I would like him to proceed.

Mr. RENYI. Thank you, Mr. Chairman.

Prior to the vote, I had summarized much of the activities that were taking place in the Bank of New York that is subject to our investigation and, most importantly, what we did about them, what we are doing about those activities, those investigations.

I was at the point where I would like to really discuss and offer some public policy commentary and being that one of the central issues, one of the central questions that are coming before this sub-committee is the possible misuse of international funds transfer system, which we feel is a truly important issue that affects clearly

all of the banking system here in the U.S.

It is an issue that has two components, the granting of access to the global payment system and the monitoring of activity taking place within the system. Mr. Chairman, if Congress concludes that the access to the payment system should be tightened, I would urge strongly that this be done through a process of international cooperation, otherwise, if we restrict access in any one country, we may simply drive would-be wrongdoers to less stringent points of entry into the system.

The U.S. dollars, the unquestioned currency of choice of payments, for payments moving through the global system, any policy action that reduces the importance and attractiveness of the U.S. dollar for world trade would place the United States at a competi-

tive disadvantage.

As we look at monitoring activity within the payment system, we should as well determine how U.S. foreign policy should address il-

licit business activity that uses this payment system.

Today, an agency of the U.S. Treasury, the Office of Foreign Access Control provides enforcement against academically embargoed countries. Should that approach be applied to money laundering? Should it be applied to capital flight? Could it be done without hindering legitimate trade flows? And if we choose to step up surveillance activities, can we do so with appropriate respect for our fellow citizens' right to privacy?

Mr. Chairman, you have expressed a policy concern about the role of U.S. banks in establishing correspondent relationships in Russia and other emerging countries where there are clear concerns for corruption. Let us be careful that if Western banks redline Russian banks, the emergence of a modern capitalistic econ-

omy in Russia will probably be impossible.

In conclusion, I believe that these are legitimate and important issues that touch on the central themes of these hearings. Yet the broader considerations should not obscure the essential responsibility that we and all the participants in the global system have in ensuring its appropriate use. When any financial institution provides access to the system or facilitates its use, it must do everything it can to prevent illicit activity from taking place as a result. And if illicit activity does take place, it must detect it and bring it promptly to the attention of appropriate authorities. This is our responsibility and on behalf of the Bank of New York, I reaffirm that responsibility today.

Thank you, Mr. Chairman.

[The prepared statement of Thomas A. Renyi can be found on page 381 in the appendix.]

Chairman LEACH. Thank you very much, Mr. Renyi.

Let me say that there is an element of awkwardness in all of this hearing in that we have before us today one of the most reputable banks in the world and a bank with an enormous history, in fact, as stated in your initial comments, the oldest bank in the United States founded by the man many of us considered to be our greatest Secretary of the Treasury, Alexander Hamilton.

The fact that it is such a great bank and such a reputable bank makes the questions at stake rather large, because if our best and strongest are part of a system in which money can be laundered, whether it be through fault or not fault of the bank, is very dif-

ficult.

So let me just begin by saying, can you give us a sense of the magnitude of funds that you believe have come from Russia through your bank?

Mr. RENYI. I am sorry, I didn't hear you. What is the source?

Chairman LEACH. The magnitude of funds that would be considered in a traditional way. You know, press accounts are in the \$10 billion figure; you indicated to me privately perhaps less than that.

Mr. Renyl. Somewhat less than that. We are in the process of our own investigation, which really started five weeks ago when the leak first occurred in the press, and as you can imagine, this is a very, very complex, very complex situation to review, and there

are literally thousands of pages of documents, thousands of credits

and debits flowing in these accounts.

What we have been able to determine is that the central accounts in question here that were controlled seemingly by Mr. Berlin moved \$7.5 billion over the past three years, roughly three and one-quarter years, roughly even throughout the course of those $3\frac{1}{2}$ - $3\frac{1}{4}$ years. So the magnitude is very substantial under virtually any type of measurement.

Chairman LEACH. So these are the accounts controlled by this one individual? How many Russian banks are correspondents that

you work with?

Mr. Renyi. Today, Mr. Chairman, we have roughly 160 banks that we work with. That represents approximately 10 percent of

the universe in Russia today.

Chairman LEACH. Yesterday a former CIA station chief indicated that his judgment was about 85 percent of the Russian banks are fraudulent, and the figures are a given kind of magnitude that have been talked about for some time, and that Russian banks in many cases are considered money laundering platforms.

Do you have figures on dollar volume of Russian bank funds run

through your bank?

Mr. RENYI. We do, Mr. Chairman. Obviously through the course of this examination, we have literally pored over every type of statistic that we can to develop a sense of dimension to this issue within our own organization. I think it gives some degree of dimension as well to the issue overall through the U.S. banking system.

With regard to our banks, our correspondent banks in Russia, we looked at specifically a timeframe of last July and last August, which coincides with the IMF payment last year, to determine what volumes were flowing through our accounts. And at that time it was \$3.7 billion per day.

Chairman LEACH. \$2.7 billion per day?

Mr. RENYI. \$3.7 billion per day on average and a fairly tight range, \$3.2 to \$3.8 billion.

Chairman LEACH. How would this relate to say three months

earlier and three months later?

Mr. Renyi. It appeared to be very, very similar. There was a slight runup since the early part of 1998, but it has stayed very stable around that \$3.7 billion. I might add that represents less than 1.5 percent of all of the dollars that we clear for all of our correspondents, which is about \$600 billion.

Chairman LEACH. Of these amounts, how many would have had any origin in let us say from offshore banks, or are these directly

from Russia?

Mr. RENYI. This would all be from Russia.

Chairman LEACH. Directly?

Mr. RENYI. These are all Russian.

Chairman Leach. Using no intermediaries?

Mr. Renyi. Russian domiciled organizations, yes, Mr. Chairman. Chairman Leach. Now you have an offshore subsidiary, is that correct, in the Caymans?

Mr. RENYI. We have both a branch and a subsidiary trust com-

pany.

Chairman LEACH. For what reason would you have a branch in

the Caymans?

Mr. Renyi. The Caymans branch is a funding vehicle for the bank overall. It is similar to virtually every Cayman branch that any U.S. bank would have. It strictly offers an ability for us to be able to quote different rates than what we have here in the U.S. The Cayman branch that we have is under the jurisdiction of the Federal Reserve.

Chairman LEACH. Now, today's Wall Street Journal reports that investigators were reviewing two accounts at your Cayman branch that are beneficially owned by Leonid Dyachenko, who is married to President Yeltsin's daughter and close political adviser Tatyana.

The article suggests that the Cayman accounts were opened in the names of two offshore companies, the ownership of which appears to be a bit unclear, and the deposits into the account came from two companies owned by Mr. Dyachenko and incorporated in the Caymans. These two companies are in turn reported to be affiliated with the Russian company that published President Yeltsin's memoirs.

Can you tell us, first, is it true that the Bank of New York main-

tains accounts for Mr. Dyachenko in the Cayman Islands?

Mr. Renyi. As you can imagine, Mr. Chairman, this is an exceptionally sensitive issue. Because it is very much under the purview of the ongoing investigation, we by policy do not discuss relationships with any of our clients. That is a policy that is shared by virtually every bank that I am aware of, compounded by the issue surrounding the investigation. Obviously given the commentary today in today's press, what I can say is to confirm the fact that those two accounts do exist at the Bank of New York, that Cayman Island branch. Again, as any deposits that may be, any accounts in the Cayman Island branch is under the supervision and jurisdiction of the Federal Reserve, just as every branch in the United States is.

Chairman LEACH. Jurisdiction implies regulatory.

Mr. RENYI. Regulatory review.

Chairman Leach. But that is different than legal jurisdiction.

Mr. RENYI. I am implying the regulatory review.

Chairman LEACH. I think that is a distinction that is of some profoundness.

Did you make inquiries to determine who the beneficial owners were when these deposits were made? Did you know that at the time?

Mr. RENYI. That, Mr. Chairman, I am again quite sensitive to, and I am not sure I am in a position to respond to that, again, given the ongoing investigation.

Chairman LEACH. This is just a question for the bank, to the

bank's knowledge.

Mr. RENYI. In terms of the bank's own actions, yes, we did. We asked and went through, to the best of my knowledge, and I have reviewed that, the typical routines that we have for know your customer, which includes an identification of the beneficial owner and source of proceeds.

Chairman LEACH. Do you maintain accounts, to your knowledge,

for any other members of President Yeltsin's inner circle?

Mr. RENYI. To my knowledge, no. And I might add, we have tried to do as thorough an investigation over the course of the five weeks

to try and identify any of those accounts.

Chairman LEACH. Is there anything unique about Russian bank correspondent relationships with your bank; that is, relative to other countries? Do you charge different fees? Do they have dif-

ferent patterns of activity?

Mr. RENYI. The style and the character of the business that we do with our Russian correspondents are very, very similar to what we do elsewhere in the country and elsewhere in the world, especially as it relates to other emerging or developing countries. In those types of countries, our correspondent banking business tends very much to be in the deposit side of the dollar clearing, in providing cash management services with a very modest level of credit exposure, and that does exist, that profile, that character is very, very similar-in Russia-similar to everyone else.

In terms of the fees, we did also investigate. Again given the press reports that would indicate that significant amounts of profitability were gained from our Russian business, I looked very specifically at fee comparisons as to what we have been able to charge, what we charge for our Russian correspondent banking business and elsewhere around the world and where we have found, with the exception of Europe, which is the most competitive portion of the world, Eastern Europe, generally in Russia, in particular, had the next lowest rate fee, rate of fees that we were charging.

I asked why, and the immediate response is the competitive atmosphere, given the fact that we are not the only organization that has similar banking relationships, correspondent banking relation-

ships and dollar clearing accounts.

Chairman LEACH. Let me be clear about this. You just go to the numbers, because numbers can be numbing. We had \$7.5 billion cleared through one account, and \$3.5 billion a day through just general correspondent relationships with Russian banks?

Mr. RENYI. Yes.

Chairman LEACH. To your knowledge, is this typical of other

banks in New York, or are you different?

Mr. RENYI. I believe it is typical, Mr. Chairman. The \$7.5 billion that I referred to was a cumulative number over three years. The average volume per day was approximately \$6 million. I think there is a need to compare that and characterize that in the context of our overall clearing, which I indicated was about \$600 billion a day for all of our correspondent banking relationships.

Mr. LAFALCE. Can I interject for one second, are you comparing

\$6 million to \$6 billion per day?

Mr. RENYI. In terms of the dollar clearing that we do, yes.

Mr. LAFALCE. I wasn't sure that I got the Ms and the Bs

straight. Thank you.

Mr. RENYI. There were three, three figures, three statistics that, Mr. Chairman, I think you were discussing, and that is the daily flow within the principal accounts of the so-called Berlin accounts, all of our correspondent banking within Russia and then our entire dollar clearing business enterprisewide, and that is \$6 million for the Berlin accounts, \$3.7 billion per day with regard to the Russian banking correspondents, and \$600 billion enterprisewide. We are

the second largest dollar clearing organization in the U.S.

Chairman LEACH. As a financial company that is central to this worldwide movement of capital, what is your personal sense over the last three or four years of how Russia is behaving? Do you have a view that we have a problem in this great country of Russia, or is this something that the bank is neutral about?

Mr. RENYI. Well, I suspect, Mr. Chairman, that just given the na-

ture of the proceedings and what I heard last night on television of yesterday's proceedings and clearly seeing this firsthand myself this morning, it is not an uncomplex issue. There are a lot of other very countervailing forces here. Clearly there is an intention since 1991 to bring Russia west, if you will, to effectively provide for

them to offer to them a Westernized capital markets.

We also have, I think, as an intention from a government-to-government view to certainly support Russia in its view to democracy, what we have found in every other country that the strength of a democracy, the strength of an economy is based on its banking system, and, thus, when we were asked when we saw opportunities clearly as a commercial bank in the U.S. dealing with offshore components to be able to conduct business and then encouraged by numerous governmental agencies to be supportive with regard to the development of a capital market, we saw great opportunity, therefore—and encouragement, and therefore we have been active as many banks, as very many commercial banks as well as investment banks within that Russian market.

At the very same time, we clearly have been seeing the growing pains that exist within Russia as it has been in virtually every emerging country. Every developing country has gone through similar phases, if you will. The degree of volatility within the Russian economy, Russian banking system may be somewhat unique.

I am not sure I am the best person to respond to that.

Chairman LEACH. Let me just conclude with one kind of tying the numbers. You have indicated a figure for Russian banks, you have indicated a figure for the Berlin associated companies. Are there other Russian companies or individuals that you have figures for?

Mr. RENYI. No, that is by far and away the statistics—there is, I don't believe, any relevant statistics, I think, relative to the issue on the table today.

Chairman LEACH. Thank you.

Mr. LaFalce.

Mr. LAFALCE. Thank you very much.

Let me make sure I have a correct, accurate grasp of the statistics. When you were referring to \$6 million per day, you were referring to one account, the Berlin account; is that correct?

Mr. RENYI. To be very clear, it is several accounts, but it is es-

sentially operated by one individual.

Mr. LAFALCE. About how many different accounts operate?

Mr. RENYI. Approximately I believe there were eight in total. I think there were probably three or four active at any one time.

Mr. LAFALCE. I see. Are these bunched together in any computer's mind or any—

Mr. RENYI. Yes.

Mr. LAFALCE. You would review those?

Mr. RENYI. Absolutely, they were clustered to a point where we

had one individual overlooking all of them.

Mr. LAFALCE. So we can look at the \$6 million. And then the next data is \$3.7 billion per day, is that correct, and that was for all Russian accounts?

Mr. RENYI. All Russian correspondent bank accounts.

Mr. LaFalce. Correspondent bank accounts, yes.

Mr. RENYI. Yes.

Mr. LAFALCE. And then the third figure was \$600 billion per day, and that was for all correspondent bank accounts; is that correct?

Mr. RENYI. That is correct, sir.

Mr. LAFALCE. OK. Was there anything that in retrospect should have raised a red flag either to you or someone working under you or to the Federal regulator responsible for the Federal Reserve Board.

Mr. RENYI. There certainly were flags that were raised not necessarily unfortunately to my level personally or to the regulators, but that there were individuals who supervised the account on a day-to-day basis who did see a marked increase in volume over what was originally reported to be or represented to be expected to

go through those accounts.

Those individuals who did raise the questions unfortunately raised them without really much vigor, without much follow-through, without raising it up through their own chain of command within their own organization. Our own investigation would indicate that those individuals took comfort in the fact that those accounts, particular accounts, were referred to by a very well regarded bank officer, who happened to be Mr. Berlin's wife.

Unfortunately, I can't get into the psyche of those individuals and in the minds of those particular individuals, but they did not

see the obvious conflict that we might see in hindsight.

Mr. LAFALCE. All right, thank you. The Federal Reserve Board has the legal regulatory authority over the Bank of New York?

Mr. RENYI. That is correct, sir.

Mr. LAFALCE. Now, A: what does that authority consist of with respect to accounts like this, and what is the nature of their periodic examinations of accounts such as this, most especially with respect to the money laundering laws? It is my understanding that the law enforcement officials criminally rely in large part on the regulatory authority's examinations to detect whether there is some criminal violation of the money laundering laws.

Can you expound upon that?

Mr. ŘENYI. Congressman, it probably is a very appropriate question. I suspect that even a better person to respond to that would be some Federal Reserve officers. However, from my perspective, as someone who is regulated by the Federal Reserve, my experience has been is that they would come in and review, in a very thorough manner, I might add, the process upon which we organize and manage our own organization. In certain areas such as credit extension, they take an even further and more detailed review of our accounts.

One of the very basic components of a Federal Reserve exam is reviewing the nature of the oversight process we have not only in anti-money laundering or in Know Your Customer, but as well every other facet of our management approach to the bank. So they are very much intent on looking at our management team and looking at the organization.

Mr. LAFALCE. So their examination is more of system than ac-

count examination?

Mr. RENYI. That is correct. It is much more systemic, much more process-oriented reviewing the reports that I might see, other members of our management team might see.

Mr. LAFALCE. One of the difficulties is if criminal enforcers are reliant upon that examination, a systems evaluation is probably the least likely to discover some type of wrongdoing, I would think.

Mr. RENYI. It would certainly discover if there was anything that was truly systemic or endemic in the organization. There would be no question, I think, that the Federal Reserve and any regulator, whether it is the Fed or OCC or even our own State banking regulators in New York, would look at the situation to determine is there a systemic issue. If it is a case where there is an isolated issue with regard to a set of accounts, they may or may not pick that up. That is something clearly our own internal auditors should also pick up.

Mr. LAFALCE. Let me ask you two more questions, if I might try to ask them at the same time. On the one hand, we hold dear to the principle that all individuals are presumed innocent until proven guilty. On the other hand, you have to file Suspicious Activity Reports, and I am wondering how you draw the line, you know, where is the gray area, what do you do. That is the first question.

where is the gray area, what do you do. That is the first question. The second question is this: I know that there are bankers groups that get together to discuss the appropriate use of derivatives, and so forth. Is there a group of bankers that gets together to discuss the approach that banks will take domestically and internationally with respect to money laundering? And the reason I ask this question is because if some banks are very, very rigorous, they just might not get the business, and so some other banks might be less rigorous and obtain the business. There could be a competition for laxity, both domestically and internationally, and I am just wondering if within the banking community there is any coordinating mechanism, group of CEOs, and so forth, that gets together to discuss this. If everybody has to live by the same rules, it is great. If somebody doesn't have to live or doesn't live by those rules, they have an unbelievably unfair competitive advantage.

Those are two questions I would like you to answer.

Mr. Renyi. Let me answer the first, and that is with regard to any cooperative efforts. Personally I am not aware of any efforts at a chief executive or an executive management level, and I really don't have—no, I can't identify a particular group within the U.S. or certainly extraterritorial, outside the U.S., that meets specifically on any money laundering issues. I think it would be a very good suggestion. It may or may not exist, and I would suggest that possibly some of our compliance officers within our organization who are attending these—we do have it, a local-level New York clearinghouse, we do have committees that look specifically at these issues.

Within the first question, with regard to SAR, and I think your point is with regard to privacy, specifically the regulations surrounding the Suspicious Activity Report filings require absolute privacy, absolute confidentiality for, I think, the very specific reason you are intimating here in that there could be a guilty-until-proven-innocent view toward any accounts we might file an SAR on. To that extent we are under strict guidance not to reveal filings of SARs, and I suspect for that very specific reason.

Mr. LAFALCE. Not to reveal to whom? Mr. RENYI. Not to reveal to the public.

Mr. LAFALCE. My question is whether you reveal them to the public. You do file them. You are mandated to file them. Who do you file them with, and how do you make the judgment as to whether to file or not? If I go to, you know, three different caseworkers, and I ask in my district how many cases do you have, I find out each of them has a different measurement as to what constitutes a case. Some might say a phone call does, somebody else might say it is not a case unless I have to work on it for at least a week or so, and I am just wondering what goes on in your bank's mind in determining whether or not to file a Suspicious Activity Report report, and is there any commonality that is enforced by the regulators on this issue?

Mr. Renyi. Well, Congressman, I don't believe that there is, and I don't know the regulations precisely, but I know what we do and how we do it, which leads me to believe that there is not necessarily a preset criteria of review that each bank must follow in order to file an SAR. I say that because we have filed many, many hundreds of SARs over the past year or two. Most recently, obviously, given the incredible oversight that the press reports and this investigation has created, we are filing many, many more for simply the reason that we see that a particular account may have received a debit or a credit from a name that we see in the press.

and to err on the cautiousness side, we would file an SAR.

Mr. LAFALCE. Thank you.

Chairman LEACH. Mrs. Roukema.

Mrs. Roukema. Mr. Chairman, you indicated in your introduction that you had an element of awkwardness here because of the status of the bank. I have another element of awkwardness here, which I only learned about last night, and that is that Mr. Renyi is a constituent of mine. I learned that last night. This makes questioning a little awkward, but I think we can speak frankly and directly in the interest of getting full information so that we can do our job and that you can do your job. I recognize that the bank is under investigation, but no charges, as you quite correctly pointed out, have been made.

But it seems to me, with all due respect, I do have to point out you just ended your discussion with Mr. LaFalce with respect to the Suspicious Activity Reports, and I don't know exactly how this fits in, but it seems to me that it should have been caught earlier, because it was over a period of years, involving billions of dollars, and with the fact that Mr. Berlin and Lucy Edwards, and officer of the bank, were married. It would seem to me that there should have been some understanding of the potential for the conflict of interest. Can you tell me either how you dealt with that and why

you dismissed the need for the SARs to be filed and how you now would apply it in view of the experience and the new knowledge that you have in understanding?

And then I want to go on to the global payment system.

Mr. RENYI. There are really, Congresswoman Roukema, there are two issues I think you raised in that question, and that is, one, the filing of an SAR, and then the conflict of interest. The SAR, to begin with, during the course of those three years of activity within those Berlin accounts, there is no question that people at a lower level, people who are looking over the operations of that account, raised issues, raised questions as to the validity or the rationale as to why the volume, vis-a-vis an export/import company or a tour company, of which he variously over a period of time identified himself as, why that volume would exist. So that we do see people in our organization, again retrospectively, who have identified an issue, but not sufficient follow-through, and I think that is where clearly the awkwardness, the embarrassment on our part, mine in particular, as to why those individuals saw fit not to report that up the chain of command which ultimately would have resulted in an SAR, it did not get up to a level which was the compliance officer in those particular areas, and that is, I think, the awkward question here, why an SAR was not filed.

Mrs. ROUKEMA. How can we reform that system in this legislation that we are dealing with? I am an enthusiastic co-sponsor, but I am not quite sure anything in this legislation will deal with tar-

geting that responsibility.

Mr. Renyi. That is very much of an internal issue, Congress-woman. I don't think I saw in the brief read of the legislation proposed elements that deal directly with that. Having said that, I do think it is very much incumbent upon the organization itself not only to have the process which we do, but the culture of being inquisitive, of questioning, of ensuring that every question that has to be asked is asked, and that no assumptions are made. The fact that people made an assumption that a well-regarded officer of the bank referred these accounts, gave an ability of that individual to be less concerned, that should not happen.

Mrs. ROUKEMA. I think this bears more review and study by those of us on the committee, but let me get to what you have quite

correctly pointed out very well.

I believe, although I am not quite sure, that I understand the specifics of your recommendations about not only the nature of the global payment system, but the increasing complexity of it. I think you called it the opaque nature of it.

Mr. RENYI. Yes.

Mrs. ROUKEMA. And of course the huge daily volumes are increasing. I am not sure, have you given us some specific recommendations as to how we can deal with this legislatively, or is

it just through regulatory authority?

Mr. Renyi. I have not offered what I would call great specifics or a great detailed recommendation with regard to the global payment system. Its characteristics of being huge, complex, immediate and instantaneous in its style for some very explicit reasons, because of its size, because of the cost of errors, the high cost of errors, the need for straight-through automatic processing also offers

it this opaqueness that I referred to in my remarks and in my testimony whereby the information that is obtained from the global payment system in terms of the remitter and beneficiary of payments is quite abbreviated, very much in the form of digital code rather than more, in layman's terms, identifiers, words describing who owns the account, where is that money going to.

There are some very good reasons for that to happen, because as one puts words, sentences in direction and instructions as to where moneys go, there is the greater opportunity for error, and therefore, again, in an effort to ensure that there is a greater level of straight-through processing or automation, there has been this re-

duction of information that one might see as usable.

Having said that, I think the core of my recommendation here for the committee and the Congress to consider is access to the payment system, because once access is granted, once an individual has an ability to enter into the payment system, it is easily lost track of because of the nature of the system.

Mrs. ROUKEMA. So you mean controlling the access?

Mr. RENYI. Controlling the access, having greater, maybe more

stringent requirements in terms of access to the system.

Mrs. Roukema. I think the Chairman's bill does go into some of that. I don't know if it is as comprehensive as we might want to make it, given what happened here, but we do begin to—and maybe it is as much as we can do in that respect—make a lot more unlawful about falsification of identity in transactions with the banks. We will look at that again. Thank you very much. I appreciate your assistance here.

Chairman LEACH. Thank you, Marge.

Mrs. Maloney.

Mrs. Maloney. Thank you, Mr. Chairman.

The Bank of New York case troubles me for a number of reasons. As we all know, the bank has played a ground-breaking role in the history of American finance. For over two centuries New Yorkers have entrusted the bank with their life savings. This is not a bank whose culture would be expected to lead itself into the center of a major scandal. The fact that such an incident would occur at such a respected bank is frightening to me. We have to wonder if this case is simply the tip of the iceberg.

While the guilt or the innocence of the parties involved is far from determined, it would appear that insiders in the bank were able to avoid detection until foreign investigators tipped off our Government. In other words, our money laundering laws would appear to break down when confronted with insider dealing. Would you agree with that, that our laws are not sufficient now, and they

break down with insider dealing?

Mr. Renyi. Well, Congresswoman, I would say that virtually any law, virtually any regulation that would be imposed on any financial institution is at risk if there is, in fact, inside assistance. It is awfully difficult to deal with many of these issues in any way, but when there is the possibility, and I must be very careful here not to imply that there exists in our case here, but if that were to take place, it makes it even doubly difficult to deal with.

Mrs. MALONEY. To what extent was your institution's anti-money laundering policy reviewed by the Federal bank regulators? You

testified earlier that they were looking at the systemic rather than actual transactions, but was there regular oversight, and was your

bank ever cited as insufficient?

Mr. RENYI. There has been regular oversight. The Bank of New York has never been cited for inadequate anti-money laundering or Know Your Customers policies. It should be obvious to everyone that given the intense reporting with regard to this particular issue, that regulators have redoubled their efforts in terms of reviewing our systems internally, and I am confident that we will do well here.

Mrs. Maloney. Chairman Leach, as we know, as has been cited earlier, is proposing legislation that would require financial institutions that open U.S. accounts to identify the beneficial owners of the accounts. It would also prohibit U.S. banks from opening correspondent accounts with so-called brass banks that are not subject to comprehensive home country supervision. How would these requirements impact upon your bank's operations on a day-to-day basis?

Mr. Renyi. Well, I think, Congresswoman, to respond succinctly, quite little, because our business is not to do business with these brass-plate blanks in these offshore areas. So greater scrutiny, greater restrictions or requirements in terms of review of these particular banks would have certainly no negative impact, and I

would welcome the opportunity to comply with those.

Mrs. MALONEY. The requirement to identify the beneficial owners of the accounts, would that impact on your day-to-day operations

at all?

Mr. RENYI. That may. I would need to know clearly a bit more of the detail as in virtually every piece of legislation that would impact the banking system. It depends upon the application, the evenness of the application, which then goes to other banks possibly outside the U.S. banking system, and certainly our ability to comply with those.

Mrs. Maloney. To what extent do you believe money laundering is taking place in the United States banks, and what can be done to prevent bank officers from facilitating laundering? You testified that the two provisions I mentioned in the Chairman's proposed legislation have little impact, but what would you suggest should

be done, and how extensive do you think?

Mr. Renyi. When I say little impact, I really mean, Congresswoman, that it would not negatively impact the Bank of New York; not the fact that it wouldn't be effective, but it would not pose a problem for us to be able to comply generically with that approach.

But I think your question with regard to the presence or the size of money laundering, that is an exceedingly difficult question, of course, to respond to. I think one of the issues that I sense is being debated here and that I offered as a possible public policy issue is the definition of money laundering, the distinction between money laundering and capital flight, some of which is, in fact, illegal, some of which has no restrictions by the host country. There is also the issue of being able to discern through the information that we would normally receive in the global payment system moneys that are sent to support legitimate business transactions or to support business transactions that are structured in the way to avoid local

law, local taxes. That is a very difficult thing to distinguish in the

best of circumstances.

So the issue of money laundering, and I go back, obviously, to our experience with these particular sets of accounts, given the vast amounts of data that we have reviewed, it is very difficult to determine which might be money laundering, which might be capital flight, which might be legitimate business transactions, and I suspect it might very well be some of each.

Mrs. MALONEY. My time is up. Thank you. Chairman LEACH. Thank you, Ms. Maloney.

Mr. Bereuter.

Mr. Bereuter. Thank you, Mr. Chairman.

Mr. Renyi, thank you. I heard your entire testimony and the Chairman's questions from the side, if I wasn't here directly. I will

ask as many questions as I can here.

First of all, as I understand it, if a bank processes a transaction knowing that it is designed to conceal or disguise the nature of the proceeds, the bank could be charged criminally or have their charter revoked. Did anyone at the management level in your bank know of Russian money laundering through your bank?

Mr. RENYI. Absolutely not, Mr. Bereuter.

Mr. BEREUTER. Thank you.

Now, Barclays Bank announced last week that it is closing a substantial number of its accounts to Russian corporate customers out of concern that it cannot verify where funds are coming or going to. Has the Bank of New York considered scaling back its presence in Russia in light of the recent allegations of possible misuse of

Russian-related accounts at the bank?

Mr. Renyi. Well, Congressman, I think again you can imagine the amount of review and oversight that is taking place within our own organization, throughout our organization with regard to these types of accounts. These types of corresponding relationships, it does not simply focus on Eastern Europe by any means. Having said that, clearly we are taking a second look, another look at each and every one of our relationships to ensure that they do comply with the highest levels of compliance, not only with anti-money laundering, but Know Your Customer requirements.

Mr. BEREUTER. Thank you.

Earlier, I think you gave a statistic of \$3.7 billion from Russian correspondent banks on a daily basis. Now, that would not include corporate customers or other accounts coming from Russia or from

Russian citizens; is that correct?

Mr. RENYI. We do not have corporate accounts in Russia. Any deposit relationship that we have, which I referred to the \$3.7 billion, are strictly from the banking system. It is our policy only to do business on correspondent banking business with regard to credit and deposit-taking.

Mr. BEREUTER. Thank you.

Do you have correspondent banking relationships with entities

domiciled in Antigua, Cyprus, and/or the Cayman Islands?

Mr. Renyi. With regard to Antigua, I believe we have one relationship. It is a relatively dormant one, very little transactions flowing through it. Cayman Islands, I am not quite sure. I do not

believe we do. Cyprus, I believe we do, but I am not—I don't have the precise figures. I will be happy to come back with those.

Mr. BEREUTER. Thank you.

Has Mr. Bruce Rappaport assisted the Bank of New York in the past in developing clients or other business relationships in Russia

or in Antigua?

Mr. Renyi. I understand the source of that question, given the press reports, but I can say that there has not been any involvement by Mr. Rappaport with regard to our Russian efforts. I think it was—as it was reported in the press—he assisted us in establishing our presence in Russia. That, in fact, was simply us being able to sublet some of his space that his bank, the Inter-Maritime Bank, has in Moscow for a one-year period. It does not go beyond that.

Mr. Bereuter. You mentioned him in your statement.

Mr. RENYI. I did.

Mr. BEREUTER. You also mentioned his Ambassadorial role from

Antigua to Russia and so on.

You had a little discussion before based on Mr. LaFalce's question related to the Suspicious Activity Reports, the SARs. Were any SAR reports or potential reports suppressed by management in your bank?

Mr. RENYI. Absolutely not, sir.

Mr. Bereuter. If you had a deposit of, say, in excess of \$5 million in currency coming to your bank, would it automatically or likely generate an SAR?

Mr. RENYI. \$5 million in currency?

Mr. BEREUTER. Currency.

Mr. RENYI. Clearly would, absolutely. In fact, there is a regulation of deposits of \$10,000 or more in currency, a report must be filed.

Mr. BEREUTER. Thank you.

I want to understand a little bit more about the relationship on Russian correspondent banks. Has the bank assisted any Russian banks in attempting to open representative offices in the U.S.?

Have any applications been successful?

Mr. RENYI. We have, in fact, provided letters of recommendation to certain of our correspondent banks in Russia to open offices in the U.S. This has been part of the overall process of bringing the Russian banking system to the West to be able to allow them to conduct business along Western-styled banking. In some instances we have made those representations, but, again, only to those banks with whom we do business with and that we are comfortable with.

Mr. Bereuter. But some would have been successful as far as

you know?

Mr. Renyi. I believe some of them may have been successful. I

don't know the specifics.

Mr. BEREUTER. I have one more question related to correspondent banks, if I may proceed.

Chairman LEACH. Please go right ahead.

Mr. BEREUTER. Thank you.

I would like to understand what kind of advantages or privileges of services go along with being a correspondent bank to the New York bank, especially, of course, those related to Russian correspondent banks. What privileges or services do they have by vir-

tue of their correspondent status go through your bank?

Mr. Renyi. As a correspondent, the typical correspondent banking services that we offer certainly include dollar clearing, a principal service and really the heart of our correspondent banking business. In certain instances, we also might provide short-term credit on an overnight basis. We might very well provide foreign exchange transactions as well and possibly certain securities servicing arrangements with that. In terms of privilege, we view it as a privilege for them that they can list the Bank of New York as a correspondent, because it is, in fact, I think, a very rare, very privileged view that they can, in fact, use us as a correspondent, effectively access to the banking system, and again speaks to the diligence we do on a continuing basis.

Mr. BEREUTER. Thank you. Thank you, Mr. Chairman. Chairman LEACH. Thank you.

Mr. Forbes.

Mr. FORBES. Mr. Renyi, again, thank you for being here today, and I particularly appreciate that in your capacity you have taken full responsibility for straightening out the situation that led to the unfortunate revelations. And I think all of us were shocked that this undertaking was transpiring at the Bank of New York, certainly a venerable institution, well respected not just nationally, but internationally.

But let me just say that I learned today that more than I ever realized that money laundering is extremely widespread in this country, and that it is affecting far too many, and one is too many,

but far too many of our financial institutions.

Since these revelations, have you heard from some of your colleagues across the country as they have maybe taken a long, hard look at their internal systems and lamented that perhaps they could be as vulnerable as the Bank of New York was, and do you have any sense in a way of validating what I think many of us have grown to understand, money laundering is a very, very wide-

spread, serious problem in this country?

Mr. Renyi. Well, it certainly has piqued everyone's interest, Mr. Forbes. I think there is no question, and I can say universally without exception, every one of my counterparts that I have come into contact with over the last five weeks have said that this has clearly initiated a review internally. So if there is anything good that can come out of this particular issue, that of Bank of New York being the poster child for money laundering, unfairly I hope, certainly believe, then the fact that there is much more greater intention of looking at intensive review of internal operations throughout every bank in the country.

Mr. FORBES. Well, certainly an institution like the Bank of New York, I have no doubt that perhaps this certainly caused you and all of your officials to step back for a moment. I noticed in your testimony, as you said, it is very difficult to identify, you know, origination and destination of accounts, and I know that the domestic banking community has wanted very much to partner with emerging nations and particularly nations like Russia which are trying to be more democratic and get more marketplace—free-market en-

terprises going, and particularly reforming the banking industry there. But has there been consideration by your bank to suspend any business with Russia or any transactions that would come from Russia?

And just to add to that, and I know that is perhaps a pretty dramatic consideration, but I think you made clear also that it is very difficult, for example, to track and review transactions that come from some preset identifiers like Cuba and Havana and Baghdad and Iraq, and I think the larger question is do financial institutions in the wake of what has happened at Bank of New York and others seriously consider that maybe there are some places where we just

don't accept transactions?

Mr. Renyi. At first—the last question in terms of is there an effort to seriously consider refusing transactions from certain countries? The short answer is yes. I think that it is a matter of what is the risk and can we really accept that risk. And I think it is clear, given the circumstances here, that may very well be areas that that is an unacceptable risk under any circumstances, and I don't mean in terms of profitability or awards, but simply risk to the organization, reputational risk, which is clearly what we have here to deal with at the Bank of New York.

Mr. Forbes. On another approach here, you know, Congress has this talent for when we see some kind of problem like we have seen with the Bank of New York and money laundering, that, you know, we want to go back in and rewrite some laws and make sure we are tougher on those laws. And I embrace those efforts, but it is hard not to think that maybe a good deal of this was tragic human oversight as far as the supervisors go and certainly outright criminality on others' part. But did the system break down, Mr. Renyi?

Do you think the system broke down?

Mr. RENYI. Congressman, my view at this juncture and time is it is a preliminary review, given the fact that the investigation continues not only externally, but internally, that systems were in place. They did not necessarily break down, but their implementation was far less than perfect. Clearly the implementation was flawed. It allows us an opportunity, though, to enhance the systems, to be able to do what we can to take out the personal element in the oversight. I think that generally is an approach that we continue to follow in getting enhanced systems with artificial intelligence, behavioral analysis, so that we are taking the human element out of it. We are also attempting to take the relationship element out of it so that no one in the future has the ability to rely on any one other member of the organization for comfort as to the validity of a transaction or an account; the establishment of an anti-money laundering committee, of very senior people throughout the organization that has a mandate far broader and independent than ever before, certainly in our organization and, I suspect, anywhere else.

Mr. FORBES. Thank you, sir.

Chairman LEACH. Thank you, Mr. Forbes.

Mr Lazio

Mr. LAZIO. Hello, Mr. Renyi, nice to see you again. I wanted to ask you—I would like to clarify a few points, if I heard you cor-

rectly testify that the Bank of New York had no Russian corporate accounts. Was that accurate?

Mr. RENYI. Banking accounts where we either extend credit or

accept deposits.

Mr. LAZIO. OK. Wire transfer account.

Mr. Renyi. We would not have a wire transfer account. What we would have would be the ADR-DR sponsorship relationships, which are an administrative function. It is a processing function where we do not accept deposits or extend credit.

Mr. LAZIO. Of these nine accounts, I understand it that they

were controlled or in the name of Peter Berlin?

Mr. RENYI. Yes.

Mr. LAZIO. How would you characterize those accounts?

Mr. Renyl. Those are U.S. domestic accounts. They are companies that are incorporated here in the U.S. We would view those as domestic accounts, and, in fact, when they were opened, they were opened by a Russian national who subsequently became naturalized as a U.S. citizen. The business may be transaction-oriented in an offshore, but it would be viewed as a domestic U.S. company.

Mr. LAZIO. Now, let me ask you, is it possible for somebody, for an accountholder who has got a wire transfer account, to execute a wire transfer with a terminal off premises of the Bank of New York without the knowledge or assistance of a Bank of New York

employee?

Mr. Renyl. We do have that service. It is a service that we, as well as—and we have checked this—virtually every other bank provides this particular type of service, which is a software-based service where we provide software for installation on personal computers, on-site locations which an individual can in fact initiate and execute transactions of wiring moneys out of their account, out of the bank to other accounts.

Mr. Lazio. Without the knowledge of the bank contemporaneous? Mr. Renyi. Contemporaneous. What is done is clearly a due diligence as it relates to who we are giving that service, offering that service to, so that there is a criteria that we use providing for whether that service is, in fact, appropriate for that individual or that corporation. Once that is taken care of, once we have satisfied ourselves, then that is done outside the bank without necessarily Bank of New York personnel intervention. There is oversight as we see the volumes, and as we said, we are instituting systems which will then have an oversight of those accounts to determine whether, based on certain parameters, certain criteria, that will trigger a specific oversight for that account.

Mr. LAZIO. So there is sort of an historical review that occurs on

accounts, whether it is wire transfer accounts?

Mr. RENYI. That is correct.

Mr. LAZIO. And could you just sort of describe briefly for me, if it is your own knowledge, what the due diligence principles might be for such an account?

Mr. RENYI. Knowing what business the individual is conducting, the volumes, the amounts of, the volumes that that individual would, in fact, be utilizing the service for.

Mr. LAZIO. That request would be up front.

Mr. RENYI. That would be up front before the installation is made.

Mr. LAZIO. Does a bank require documentation up front as well? Mr. RENYI. Certainly all those reports would be noted, the documentation in terms of certificates of incorporation, the legality of that.

Mr. LAZIO. Might you ask for documentation establishing whether a corporation or the entity is properly licensed in a particular State?

Mr. RENYI. If required, if we know that a license is required, then we would request that.

Mr. LAZIO. And is there a system, internal system, in check?

Mr. RENYI. Again, there is tremendous reliance on the individual and the relationship manager who was initiating that relationship to deal with that.

Mr. LAZIO. Now, this is an account, Torfinex?

Mr. RENYI. Yes.

Mr. LAZIO. Do you know if the bank followed that type of protocol

on that case?

Mr. RENYI. Well, that is certainly part of the investigations that we are going through right now. So I am really not sure I am at liberty to talk specifically about that particular account that is sub-

ject to investigation.

Mr. LAZIO. Let me ask you this last question if I can, because this is a question that was raised yesterday involving Bruce Rappaport, who has a very interesting background, and I am just wondering if you can tell me what the present and historical relationship of Mr. Rappaport might be with the Bank of New York; and if I could briefly follow on to that, if there has been a relationship. To the best of your knowledge, has there been any attempt by Mr. Rappaport to influence the hiring and placement of Bank of New York employees?

Mr. RENYI. Let me address the latter question first in that there has been no evidence, no instance of influence that Mr. Rappaport has had over not only the bank hiring people, but also business

transactions.

Mr. LAZIO. Could you answer the first question?

Mr. RENYI. Our initial relationship with Mr. Rappaport was as he was a substantial owner of bank shares quite a few years ago. It is now, we believe, less than 1.3 percent, possibly lower in terms of relationship. At this juncture our principal relationship with Mr. Rappaport is as a shared owner of a bank in Switzerland where we have a 28 percent interest. He has the remainder.

Mr. LAZIO. What is the name of that bank?

Mr. RENYI. BNY Inter-Maritime Bank.

Mr. LAZIO. Thank you very much.

Chairman LEACH. Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman.

Mr. Renyi, according to reports, and I think these figures have been gone into earlier, upward of \$7.5 billion may have flowed through nine suspicious accounts at the Bank of New York over a three-year period beginning in 1996. Let us assume on the conservative side that it is \$7.5 billion and not more than that. How much would the bank have earned in various commissions, points, interest income of any sort for that \$7.5 billion flowing through its accounts?

Mr. RENYI. We would have—the fees, the gross fees associated with that would probably be about \$500,000 per annum.

Mr. LAZIO. What about interest on any of that money that was

parked for any length of time?

Mr. RENYI. To the best of my understanding is that this was not

an interest-bearing account.

Mr. BARR. So \$7.5 billion would have resulted only in one-half-a-million dollars total?

Mr. RENYI. Of gross revenue, yes, sir.

Mr. LAZIO. Per year.

Mr. Renyl. Per year, out of a total of fee revenues. This would be fee revenues, Congressman, and last year our fee revenues was approximately \$2.5 billion. It is a relatively modest account.

Mr. BARR. I am sorry, what?

Mr. RENYI. Relatively modest account, \$500,000 in fees against a total fee revenue of the bank of about \$2.5 billion.

Mr. BARR. That is not inconsequential certainly.

Mr. Renyi. It is not inconsequential in its absolute terms.

Mr. BARR. Has there been any discussion at all with any Federal officials of immunity for the bank, any agreement not to prosecute any potential cases here for either committing illegal acts or failing to take steps to prevent illegal acts, such as failure to file SARs?

Mr. RENYI. I am not aware of any immunity offer to the Bank

of New York in its investigation.

Mr. BARR. OK. Apparently, at least two individuals, Lucy Edwards and Natasha Kokolovsky, have been terminated by the bank; is that correct?

Mr. RENYI. One of them has, Lucy Edwards, and Natasha

Kokolovsky---

Mr. BARR. Has been suspended?

Mr. RENYI. Is on a paid leave of absence.

Mr. BARR. Has she been suspended? Was that at her request, or

did the bank take that action?

Mr. Renyi. The bank took that action when the accounts in question were closed and the investigators asked that we secure files, and we felt it was in everyone's best interest that that take place.

Mr. BARR. Why was Ms. Edwards dismissed?

Mr. Renyi. When we were able to do our own private investigation, we reviewed her personal files and discovered paperwork that gave us evidence that she misrepresented the bank in a number of instances. Most particularly, we found out after the fact that she actually had signing authority on one or several of the accounts. In order for a staff member to have signing authority of an account—other than their own personal account—requires the approval of the chairman of the board. We have an annual code of conduct questionnaire that must be filled out with an affiliation report. Those affiliation reports that would have required her to disclose that were never filled out properly, did not disclose that. That is clear evidence, and a clear case for termination as violations of our code of conduct.

Mr. BARR. She is married to a Russian businessman who con-

trolled nine accounts at Bank of New York; is that correct?

Mr. RENYI. That is correct.

Mr. BARR. And how long a period did that relationship exist be-

fore the bank finally terminated Ms. Edwards?

Mr. Renyi. Well, I believe we were not quite sure, Congressman, when they were married. I believe it would have been 1992, 1994, somewhere in that timeframe. So when she obviously married, right up to the point of termination.

Mr. Barr. Are either of these individuals, Lucy Edwards or Natasha Kokolovsky, under investigation by Federal authorities?

Mr. RENYI. I believe I would have to say it is not something I can respond to.

Mr. BARR. Do you know? I mean, do you know whether or not

they are—

Mr. RENYI. I do know whether there has been contact between themselves and Federal investigators.

Mr. BARR. There has been contact? Mr. RENYI. There has been contact.

Mr. BARR. With regard to the questions that has already come up in several instances here today regarding SARs and the requirement that the Bank of New York has, as other financial institutions, to file SARs under circumstances either laid out in the statutes and then the forms with which, I presume, all of your bank officers, including the names we mentioned today, are familiar?

Mr. ŘENYI. Yes.

Mr. BARR. Was there anything in these series of transactions that we have been talking about here with Benex, for example,

that wasn't suspicious?

Mr. RENYI. The nature of these accounts, again through preliminary review since the last five weeks—the accounts, while large in amount, did not in and of itself pose a reason for suspicion in terms of either significant increases or changes in the flow through the accounts, it didn't necessarily warrant that, but that happened to be the judgment of an individual who followed those accounts on a day-to-day basis.

Mr. BARR. Who is that?

 ${
m Mr.}$ Renyl. An individual in our service area, individuals in our service area.

Mr. BARR. Do you know their names?

Mr. RENYI. Yes, sir.

Mr. BARR. I mean, you have gone back and looked at these, and you are saying that—I think there is just an initial round of Federal subpoenas produced over 3,500 pages of transactions for just one of these accounts with Benex involving huge sums of money—and you are saying that there was nothing suspicious about these transactions?

Mr. Renyi. No. I shouldn't—if I said that, I misstated myself. Clearly in retrospect, after review of all of those transactions over the three-year period of time, no question there was something suspicious about it, and this—in fact, we filed a Suspicious Activity

Report.

Mr. BARR. After this had already come to your attention?

Mr. RENYI. That is correct, during the course.

Mr. BARR. By the authorities?

Mr. RENYI. During the course of the three years of that, we did

not file an SAR.

Mr. BARR. Now, are you satisfied that, in the words of, I think, our colleagues from the other side of aisle from New York, that this was just a tragic human error?

Mr. RENYI. I believe that it appears to be, again, given my re-

views today, an element of poor judgment.

Mr. BARR. Why would these employees be terminated then if people were just involved in a series of tragic human errors? You certainly wouldn't terminate people for that reason, would you?

Mr. RENYI. The people that were terminated were terminated for reasons having nothing to do with the conduct of the account, Con-

gressman.

Mr. BARR. Nothing to do with the conduct of any of these accounts, even the Benex accounts?

Mr. RENYI. That is correct.

If I can restate with regard to Ms. Edwards, Ms. Edwards was terminated by us because of violations of the code of conduct surrounding the fact that she did not advise us that she was a signer for these accounts. She did not have any day-to-day activity or involvement in these particular accounts.

Mr. BARR. So it wouldn't really be accurate to say that she was not fired for any reason connected at all with the Benex accounts;

there is a connection there, is there not?

Mr. RENYI. There is a connection there to the extent she was a signer.

Mr. BARR. Through her and through her husband.

Mr. RENYI. And did not reveal that.

Mr. BARR. And through her husband there was a connection obviously.

Mr. RENYI. Yes, but that isn't necessarily grounds for termi-

nation.

Mr. BARR. But it certainly is grounds in retrospect for some rather significant suspicions.

Mr. RENYI. Correct. That is not to be debated.

Mr. BARR. I just have a general question. Would you say that any of the following are secondary to earning fees or making profits for the Bank: One, protecting our Nation's security, is that secondary?

Mr. RENYI. Absolutely not.

Mr. BARR. Compliance with our criminal laws?

Mr. RENYI. Absolutely not.

Mr. BARR. And protecting taxpayer funds?

Mr. RENYI. Absolutely not. Mr. BARR. Thank you.

Thank you, Mr. Chairman. Chairman LEACH. Thank you.

Mr. Rovce.

Mr. ROYCE. Thank you, Mr. Chairman.

Mr. Renyi, in your statement you describe how certain procedures that the Bank of New York follows to ensure due diligence. Basically, I guess, one of those procedures is reviewing financial statements and other regulatory filings.

Mr. RENYI. Yes, sir.

Mr. ROYCE. Reported yesterday is a story about the Bank of New York's efforts to help a Russian bank sell shares to investors and the way this aggressive pursuit was undertaken, but what is unusual in the story is that at the same time that your bank was doing that, Inkombank, the Russian bank, was undergoing its own review, and the financial status was being challenged in Russia, and Russian bank regulators that were investigating the bank had found that it had violated numerous rules, including inflating its income. In fact, the report recommended curtailing the bank's operations, and the bank has since been declared insolvent. And what is unusual here is, I think, the question, why would you pursue under these circumstances this particular customer, and why would you help it win regulatory approval in the United States to sell its stock in the U.S. as American Depositary Receipts in 1996?

Mr. RENYI. Well, Congressman, the response is somewhat of a lengthy one, because I need to go into just a little bit the nature of the depositary receipt service that we offer, very easily confused and misinterpreted, against the investment banking opportunity where an investment bank would, in fact, sell securities or underwrite securities. In our case and in the case of any depositary receipt sponsor, what we provide is what I would call the plumbing associated with the capital market transaction, where we are the individual that provides information, provides the recordkeeping for the legal transfer and registry of ownership of those securities. We in no way underwrite, sell, or issue securities on behalf of any of our clients that we are depositary receipt sponsor for.

Mr. ROYCE. Let me ask you another question. You stated in your testimony that since the Bank of New York has been conducting its own investigations, a vast amount of data has been examined, but, quote, it is simply not possible for this data to identify the source or legality of any individual transfer of funds once a bank grants a customer access to its payment system. It is extremely difficult to track the flow of funds or to stop a transaction before it happens.

Are there any steps that the Bank of New York has taken to remedy this situation, or is it a foregone conclusion that we cannot

track the flow of funds under any circumstances?

Mr. RENYI. The issue, Congressman, I believe, is a systemic one. It really lends itself to a discussion of the characteristics of the payment system, not necessarily what the Bank of New York or any other bank can or cannot do. What we are looking at is a system which requires a tremendous amount of volume and speed and automation, which, in order to ensure it takes place and it takes place flawlessly, there is a significant amount of automation, and therefore, the data that is provided in that system tends to be abbreviated. Therefore, what I was recommending in my testimony is that the Bank of New York, as well as all of the members of the payment system as supported by Congress, to ensure that access to the system is really where the point of control exists, access to the system, so that we must be much, much more diligent with regard to ensuring who we do business with.

Mr. ROYCE. Well, thank you very much for your testimony.

Mr. Chairman, thank you.

Chairman LEACH. Well, thank you, Mr. Royce.

To continue for a moment, does the Russian Central Bank have an account at your bank?

Mr. RENYI. They opened an account, Mr. Chairman, in November

of last year.

Chairman LEACH. Nothing before then?

Mr. RENYI. Nothing before then.

Chairman LEACH. Do you have any sense that, as you know, we are looking at this IMF issue in a particular timeframe, and you referenced it earlier.

Mr. RENYI. Yes.

Chairman LEACH. The Central Bank might have given deposits to any of your correspondent banks; is that a possibility in your

system?

Mr. Renyi. I would suspect that it could very well be a possibility. That is a reason why I intensely looked at the volumes going through those accounts for that timeframe. There was a press article which indicated that several days after the IMF funding, billions of dollars flowed through the Bank of New York. To the absolute best of my knowledge and review, that did not take place. The numbers that I mentioned to you really were in support of that in the context that \$640 million, I understand, was the IMF advance at that point in time. The moneys flowing through the account of \$3.7 billion may or may not have gone through any of those accounts. It really would be again virtually impossible to tell. There is no identifier with regard to IMF or any other type of governmental moneys.

Chairman LEACH. So all you know is that a number of Russian banks had deposits at your bank, they had flows of funds that were very large, but that they weren't terrifically out of proportion, but they were slightly higher than the previous three months and

slightly higher than the three months after.

Mr. RENYI. There was a continuation of that. Chairman LEACH. Continuation, so approximately the same thing?

Mr. RENYI. Yes.

Chairman LEACH. Part of this gets a little bit—and I wonder if you could comment on this, to the definition of a bank. That is, we use the word "bank." We all have in mind a bank in our hometown, but it appears that increasingly Russian banks, as a few other societies in the developing world, are individually controlled, possibly money laundering centers. Because something is called a bank doesn't necessarily mean it is a bank in our description of the term, and so of the banks that you have relationships with, would you call these traditional banks, or would you say some of them weren't? You had this issue of Menatep which was closed and another Russian bank that was closed, and what I am getting at is there any difference between the company Berlin controlled and each of these individual banks, and do you have a judgment on that?

Mr. RENYI. Mr. Chairman, I haven't looked at every single one of the roughly 160 banks that we do business with today. That

clearly is a process that is under way, however.

In the traditional sense of a bank that I think generally the population here would consider of a retail branch, retail bank, clearly

there would have to be a number of those banks that would not be viewed as purely Russian retail banks, but what I would more commonly describe as business banks, banks that are institutional banks, banks that principally did business with other Russian companies acting as their commercial bank.

Chairman LEACH. Did you ever do security services for any of these banks? For example, it strikes me—I visualize moneys coming into your bank. I don't visualize them going out. That is, as they go out, do they go to other banks, do you buy securities for

these?

Mr. RENYI. We would be—the sources of those funds clearly would come from those banks' clients. Moneys—dollar funding, any dollar assets that those banks would have would be in our bank as well as other correspondent banks that those banks might have.

The flow out of those accounts could be for the purchase of goods, for importation into Russia; it could be the purchase of securities. In that fashion it could have gone to an investment bank, a broker dealer, where maybe securities may have been bought. Some of those moneys can flow to overnight investments.

Chairman LEACH. You don't buy securities. Mr. RENYI. We are not a broker-dealer, no, sir.

Chairman LEACH. Do you have a sense—I mean, you are an expert in the banking system, and there are allegations that an increasing number of banks in Russia are controlled by organized

criminal elements. Do you have a sense for that or not?

Mr. Renyi. I really don't, Mr. Chairman. Our diligence today, certainly over the past several years, not only incorporates on-site visitations to these banks, but also visitations to the Central Bank and the authorities there to get, as best we can, a line, if you will, as to the reputation, the local reputation, of those banks, of those entities. If, in fact, during the course of those conversations that type of conversation might have come up, clearly I would not necessarily be privy to it, but I feel comfortable that those relationship managers in the Eastern European area would have done something about it and closed the accounts.

Chairman LEACH. Thank you very much. Does anyone else have any further questions?

Yes, Mr. Lazio.

Mr. LAZIO. I just wanted to ask this question, because I was speaking to a representative of a global financial services company who gave me the vignette that they once had one former New York City police officer as their security, and now they have an entire division, including recruitment of former CIA and former FBI officials. I am just wondering if that is an experience that has been parallel to the Bank of New York, what your security system looked like when you inherited the helm and what it looks like now, with an eye to your suggestion as to what lessons can we draw from this.

Mr. RENYI. Clearly, Congressman, one of the lessons we have learned is to look at the staffing in those particular areas for whatever talent we can get not only from law enforcement, but also from the regulatory and compliance area. So there is clearly an intent on our part to recruit those people that we think can be of great help to us with hands-on experience in precisely those areas,

and that is a difference from historical terms, where clearly we are looking at-for bankers, in large part, we are now looking for people in the infrastructure of our organization to preclude things from happening as they may have happened here.

Mr. LAZIO. From 1996 to 1998 when a lot of this account activity

occurred, what was the security infrastructure at the bank?

Mr. RENYI. We have a unit for physical security, physical and data security as well.
Mr. LAZIO. That is systemwide?

Mr. RENYI. Enterprisewide, enterprisewide, made up of individuals formerly from law enforcement, principally in the New York City metropolitan area.

Mr. LAZIO. You have since augmented that. Have you since en-

hanced that division?

Mr. RENYI. We have not from a physical security point of view. We have augmented it from a data security point of view. Our attention is certainly going to go to the physical security side as well, principally in terms of liaison with law enforcement on a day-to-

day basis.

Mr. LAZIO. Obviously there is significant concern in a sort of borderless society, especially on the economics, and it becomes increasingly difficult to regulate within borders and at the same time to have confidence in our financial systems. It is going to require a good amount of proactive engagement, voluntarily, on the part of our Nation's best financial institutions. I hope you take leadership on that.

Mr. RENYI. I certainly endorse that.

Mr. LAZIO. Thank you. Chairman LEACH. Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman. Just one guick follow-up question.

When we were talking previously about SARs, I think you indi-

cated the bank had filed an SAR?

Mr. RENYI. On these particular accounts, yes, we did. Mr. BARR. Yes. And do you have that with you?

Mr. RENYI. I do not.

Mr. BARR. Could you provide a copy to the Chairman, please?

Mr. RENYI. Certainly.

Mr. BARR. Within the next week?

Mr. RENYI. Absolutely.

Mr. BARR. OK, thank you.

Chairman Leach. Well, let me just conclude with one observation that has nothing to do with the Bank of New York, or probably not, but it strikes me in the world where you have many societies in which people in public life control—they have disproportionate influence in the commercial and financial system, that if one does a favor for someone of this nature, financial institutions can be benefited in other ways. Or if one does not, one can be negatively impacted, and there is an implicit kind of reward-punishment syndrome that can occur with public officials and their accounts abroad. That becomes a very competitive circumstance, I would assume, as well.

It just seems fairly obvious that if one is seeking the right to have a distribution channel of one kind or another in a given country, it would be helpful to have the account of the President of that country. This is something that is a very worrisome phenomenon, I would assume. I don't know if your case, you have all of five employees in Russia, so you have not been seeking a larger presence, although you do have accounts in a large number of Russian banks.

The only thing I would add to this is the magnitude of these dollars is really stunning. International currency flows are of a volume that make even those of us who deal in Federal Government spending difficult to comprehend. You have currency flows that almost equal on a daily basis the totality of the United States budget for a year, and you have flows that come in and out of banks that are of extraordinary proportions. But, nonetheless, when you look at the issues of millions and billions applying to single individuals, it does seem to be something that our system is going to have to pay attention to.

I am struck with the likelihood that Mr. Renyi has described the Bank of New York as a possible poster boy, but there is a strong possibility that other institutions have similar kinds of accounts, and that this is an issue that does take serious review. And I am struck also with the observation of Mr. Renyi that if our country moves in a given direction without bringing along the international community, there can be difficulties, and we are all going to have

to be looking at these issues with great care.

But I would say that what Bank of New York has become part of a transmission built for is something that goes beyond the banking matter, and when we look at the Russian issue and the future of Russian society, we are looking at a vital interest of the United States of America. So it means we are obligated to look at this as more than an individual institution issue, as more than a United States banking issue, but in the largest measure of the national interest of the United States and how it intertwines with the best interests of the Russian people. And that is why we have insisted that your bank appear, not out of any reason to be pointing disproportionate fingers at a particular American bank, but out of the symbolism that these are stunningly significant world events that have become centered in a financial system and then back down into a particular institution.

I appreciate the difficulty of your testimony, and thank you for

your appearance.

Mr. RENYI. Thank you, Mr. Chairman. Chairman LEACH. Thank you, Mr. Renyi.

Our next witness is Ms. Anne Vitale, the Managing Director and Deputy General Counsel of Republic National Bank of New York. Ms. Vitale.

STATEMENT OF ANNE T. VITALE, MANAGING DIRECTOR AND DEPUTY GENERAL COUNSEL, REPUBLIC NATIONAL BANK OF NEW YORK

Ms. VITALE. Chairman Leach, Members, on behalf of Republic National Bank of New York, I would like to thank you for inviting me to appear today. As Chairman Leach said, I am Managing Director and Deputy General Counsel of Republic, where I have been employed for nine years. As part of my duties at Republic, I am responsible for the development of Republic's global anti-money laun-

dering policy. Prior to joining Republic, I served as an Assistant United States Attorney in the Southern District of New York, where I prosecuted money laundering, narcotics and organized crime cases.

Republic supports the efforts you have made in discussing how financial institutions can protect themselves from attempts to launder money through the use of the international wire transfer pay-

ment system.

Republic is committed to making every effort to ensure that its banks around the world are not being used for illegitimate purposes. I am here to share with you the policies and procedures that Republic has developed in order to achieve that goal with respect to international wire transfer activity.

Before a correspondent account is opened at Republic, Republic obtains information about the foreign bank, which is detailed in a seven-page questionnaire, a copy of which has been provided to the

committee.

The information that Republic obtains includes the names of the owners and managers of the bank, its asset size, the identity of the bank's regulatory supervisor, and a description of the procedures

the foreign bank uses to know their customers.

Republic began the process of designing systems to monitor activity through its correspondent bank in late 1997. In substance, Republic's system filters out certain transactions and captures patterns of transactions which meet or exceed selected thresholds. We then apply the combined judgment of members of the Know Your Customer Committee to determine whether the activity may be suspicious.

Republic is proud of its initiative in developing its wire transfer monitoring system for correspondent banking. We believe that it is unmatched in the industry. As stated in a letter that Republic's chairman received from the FBI, Republic's wire transfer monitoring system was found to be "highly effective in detecting wire

transfer patterns indicating possible illegal activity."

The FBI letter is attached also.

There are basically two types of wire transfers through correspondent bank accounts. The first type of wire transfer is a bankto-bank transfer in which a foreign bank is making or receiving a payment for its own account, for example, to settle a foreign ex-

change transaction.

There are approximately 92,000 bank-to-bank wire transfers totaling \$306 billion in the average month at Republic. Republic's examination of bank-to-bank transfers has not over the course of fifteen months resulted in uncovering any significant pattern of activity that was suggestive to us of suspicious activity. For this reason, Republic now excludes bank-to-bank transfers from its monitoring program.

I should add that I have had conversations with Federal agencies asking them if they had any suggestions for our system with regard to bank-to-bank transfers, and everyone came up with the same answer, that they did not know how to monitor that or how to create a system that would detect a pattern for those transfers.

The second and more critical type of wire transfer activity is a third-party transaction in which the foreign bank is making or receiving a payment for the benefit of one of its customers.

There are approximately 58,000 third-party customer wire transfers totaling \$65 billion in an average month at Republic, and Republic has focused on these third-party wire transfers in its mon-

itoring program.

Commonly, the role of a bank in the United States is an intermediary one. There is commonly five parties to a wire transfer: an originator, an originating bank, an intermediary bank, a beneficiary bank, and a beneficiary. In most of the cases, Republic is an intermediary bank. It does not have the account of either the originator or the beneficiary. Nonetheless, when the flow of funds between an originator and a beneficiary is significant in terms of numbers and in terms of transfers, Republic seeks to capture that data.

In order to produce a report that was manageable in size and quantity of information, Republic set thresholds for the type of activity that is to be captured. After trying various approaches, Republic designed a system to capture the following data: A same originator to the same beneficiary three times a month, five times a month, whatever the number is—and I must say that none of these numbers have any special magic to them, and we vary the numbers from month-to-month—but we are looking for more than one, more than two, sometimes more than three transactions between the same originator and the same beneficiary and the aggregate amount of the dollar transfer in one month being over \$500,000.

We also fluctuate the dollar amount. Sometimes we will go as low as \$100,000; sometimes we will raise it higher. We are still fiddling with the system, and what we have found and what we are concerned about is what I testified to here today, is not a blueprint for individuals who want to circumvent a system. So we use varying dollar amounts as well as various figures to what constitutes

a pattern. But we are focusing on patterns.

Other type of pattern we focus on is the same originator to ten or more or sometimes less than ten beneficiaries or vice versa, different originators to the same beneficiary, with a substantial dollar amount that is somewhere in the neighborhood of \$500,000.

Indeed, Republic, as I said, varies the amounts as it continues to monitor, and sometimes we will look at an account and put abso-

lutely no thresholds in whatsoever.

Once a pattern is identified, Republic checks databases to see if there is any information about the originator or beneficiary that would support the legitimacy of the amounts and the pattern of the wire transfer. For instance, if Republic discovered information that established that an originator was a publicly traded company having business activities consistent with the amounts and geography of the transfer, Republic would document this information and take no further action.

We access Lexis-Nexis, we access the Web to try and find out information about the originator and the beneficiary that appears on wire transfers since neither of these entities are Republic's own customers. If Republic has not been able to discover anything about the originator or beneficiary that does have a significant pattern that would justify the activity and the volume, Republic contacts the originator or beneficiary bank who is our customer and inquires about the purpose of the transfer.

This has been a process of educating our correspondent banks that we need to know information as to the purpose of the transfer

that would make us comfortable with the wire transfer.

I want to stress the decision of the Know Your Customer Committee, which I am the chairperson of, is by no means infallible, but it is our best efforts that we are putting forward to make a determination based on the information that we are receiving either as a result of public databases or information from our correspondent banks.

In August of 1998, the programming generated a monthly report for wire transfer activity through our correspondent banks, and that particular activity took place in the month of July of 1998. This report identified the accounts of Republic correspondent banks which had patterns of activity and met the thresholds similar to

the ones that I described.

In August of 1998, as a result of its wire transfer monitoring, and this was the first full month of transfers that we had received from the new system, Republic discovered that substantial amounts of funds were being transferred from one particular originator to four beneficiaries. From the information supplied in the wire transfer message, it appeared that the originator was a corporation which had an account at a Russian bank. The Russian bank had an account at Republic, and the four beneficiaries had accounts at three other United States banks located in New York City. One of the four beneficiaries was Benex, which had an account at Bank of New York. In one month the total amount of wire transfers from the common originator to the four beneficiaries was approximately \$22 million.

Republic was unable to determine any particulars about the one originator and the four beneficiaries other than that information on the wire transfers indicated that one beneficiary, Benex, was located in Queens. After sending an investigator to this address, Republic was unable to confirm that Benex was, in fact, located there. Republic informed the FBI and other appropriate authorities about the wire transfer activity that I have described, and we made that notification both telephonically with the FBI and FinCEN and in

writing by filing an SAR.

Since August 1998, Republic has continued to monitor for patterns of significant activity that may be suspicious. It has reviewed the patterns that are identified by its systems and documents its determinations resulting from its reviews. If Republic is able to obtain information that seems to justify the wire transfer activity, it takes no action. If Republic is not able to obtain such information,

it reports the transactions to the appropriate authorities.

In some instances, Republic will cease processing transactions that appear suspicious by informing the correspondent bank that it will no longer process such transactions. At other times Republic has ceased processing transactions with certain offshore havens. In yet other instances, Republic has terminated its relationship with specific correspondent banks.

The decisions, as I said, of the Know Your Customer Committee are by no means infallible. They are based, as I said, on the results of the committee's best efforts to detect, report and prevent proceeds from suspicious activities from passing through our banks.

We report, I report, to a public responsibility committee of the board of directors, and in addition to reporting to our general counsel, to the chairman of the board. The public responsibility committee has taken an active role in reviewing Republic's wire transfer monitoring system and its relationships with its correspondent banks. That committee is chaired by William Rogers, former Attor-

ney General and Secretary of State for the United States.

In addition to the procedures in effect in the correspondent banking department, Republic has policies and procedures in effect in each area of business. We have a written global corporate Know Your Customer policy, which was codified in 1992, and which has been updated regularly since that time, and that provides the basic framework for our anti-money laundering efforts. I have submitted that also to this committee.

I hope that I have conveyed to you the importance that Republic places on its anti-money laundering efforts. In the course of my nine years at Republic, senior management has been committed to prevent the use of its banks as a vehicle to launder the proceeds

of illegal activity.

The Chairman Mr. Schlein and his predecessor Mr. Weiner, have been staunch supporters of implementing the Know Your Customer policy in all departments in all locations. Indeed, their commitment reflects the views of Republic's principal shareholder, Mr. Edmond Safra, who has repeatedly encouraged our efforts and stressed the

need for ongoing training in this area.

Two years ago, at his initiative, Republic convened a two-day anti-money laundering seminar in which we called in outside experts, former Government officials from the United States, and a former magistrate from Luxemburg, a former serious frauds prosecutor from the United Kingdom, and we brought in 170 of our senior private banking officers from all Republic locations. Annually we hold training classes for all our officers in all our locations. Adherence to Know Your Customer policy and anti-money laundering programs and procedures is audited, and adherence to these policies is a condition of employment.

Finally, Republic has a policy of cooperating fully with our regulators, and I should say the OCC, which regulates Republic, has been kept abreast and has encouraged our efforts in wire transfer monitoring, and they have looked at both our correspondent bank-

ing before this system was in place as well as after.

We also cooperate with law enforcement, and I hope, as you can judge by my presence here today, with Congress.

Thank you.

[The prepared statement of Anne T. Vitale can be found on page 405 in the appendix.]

Chairman LEACH. Thank you, Ms. Vitale.

Let me just begin by asking, as you may know, several of us introduced legislation yesterday that would require banks opening or maintaining accounts for foreign entities to identify and maintain

a record of the identity of each person having a beneficial owner-

ship in the account.

Does this seem like a reasonable approach? Would it involve costly new efforts on your behalf, or do you do something rather similar today?

Ms. VITALE. We do that now.

Chairman LEACH. Does this appear to you to be common sense?

Ms. VITALE. Yes.

Chairman LEACH. It is my understanding that many banks do this, but some don't, and it seems like it is a fairly reasonable thing to require as a universal requirement. You are suggesting that that does make sense?

Ms. VITALE. I agree with that.

Chairman LEACH. Second, you have correspondent banks. Do you have many in Russia?

Ms. VITALE. Yes, we do.

Chairman LEACH. How many?

Ms. VITALE. About 150.

Chairman LEACH. How do you look at these banks? Are they good banks? Are these accounts or banks? These are banks?

Ms. VITALE. These are banks, and we have about 150 accounts

of those banks.

Chairman LEACH. How do you monitor those?

Ms. VITALE. Well, first thing, if you look at the seven-page profile, that profile is a Know Your Customer profile. We get detailed information on each bank. As I said, what we do before we open it, and for Russia, I have to sign off on them. The business manager, the head of the Russia and NIS region, has to sign off on it, and for Russia NIS I have to sign off on it.

Once again, I am not infallible, and neither is our banker or any institution, but we have a process in place that I think shows that we are being duly diligent about knowing who these banks are. We visit them every year, and we monitor the activity through our

bank, and that is what is new.

We started to monitor since—well, we tried monitoring starting in late 1997, but until we developed a program that we have, the reports of this activity were too voluminous to monitor. So we had to form a system that would identify suspicious activity in terms of volumes and in terms of patterns, and that is what we look on,

and we look at it on a monthly basis.

We have meetings once a week to review the activity in our correspondent banks. Every month my department gets a report. We give the report of the activity that filters out the non-patterns and the bank-to-bank activity, and we review those, and we have weekly meetings that go on sometimes for two or three hours each week to review the activity. The correspondent banking department has its own compliance officer, who then is in charge of getting information about some of the patterns that we see, talking to our correspondent banks if she is unable to get information, and reporting back that information to the committee.

Chairman LEACH. A previous witness indicated that they had given a hard review in a given period of time regarding a particular IMF loan. Have you looked at this period of time? Is there any-

thing unusual about it to you?

Ms. VITALE. Yes. We have not seen IMF transfers of any significant amount at all going through. One of the things with our wire transfer report is to search for names appearing in the press. Now I have a staff member who puts in the names appearing in the press to see whether the wire has gone through Republic with that name on it. We have not seen substantial IMF transfers. What we have seen is very, very minimal.

Chairman LEACH. What do you define as an IMF transfer?

Ms. VITALE. We ran just recently the International Monetary Fund, and they were a party maybe on 3,000 transfers.

Chairman LEACH. It has their name attached to it?

Ms. VITALE. Yes.

Chairman LEACH. OK.

Mr. LaFalce.

Mr. LAFALCE. Thank you, Mr. Chairman.

Ms. Vitale, you gave a very impressive presentation, and it would appear that Republic is doing, based on your testimony in any event, quite an excellent job.

Let me ask you this: You are regulated by the OCC.

Ms. VITALE. Yes.

Mr. LAFALCE. The Bank of New York is regulated by the Federal Reserve.

Do you believe there is much of a difference in the regulation, the oversight and guidance with respect to enforcement of our

money laundering laws?

Ms. VITALE. Most of my contact has been with the OCC. We have a resident examiner. The OCC has a policy of having resident examiners in the large commercial banks, and they have been very proactive. Our resident examiner, I know, is a member of the OCC's national money laundering group. I have worked very closely with him.

Since we are also regulated by the Fed, because we are a bank holding company, we also have Fed examiners come in to review the holding company and the non-bank subsidiaries. I have not interacted directly with those examiners, but I know Rick Small, and I know the Fed has had a very conscientious approach to money laundering as well, but I am just not as familiar with them.

Mr. LAFALCE. Nor am I, but this is certainly something that I am sure our committee will be pursuing. We want to make sure there is rigorous enforcement through regulation and oversight and

investigation.

Ms. VITALE. The OCC has been rigorous.

Mr. LAFALCE. That is what I have heard. That is what I have heard.

Now, tell me this. You seem to have some excellent systems in place. Did you devise those, or did the OCC give guidance that systems should be devised and we recommend the following at all?

What other banks have systems somewhat similar to yours that you are aware of? Were you here also for my questioning of Mr. Renvi?

Renyr:

Ms. VITALE. Yes, I was.

Mr. LAFALCE. Then I would reiterate some of those questions I asked him to you, too, to refresh your recollection. Are there any groups of banks that get together to discuss money laundering and

ways in which they can combat money laundering activities? Is there a section of the American Bar Association and their banking law experts, a special subsection on money laundering that comes up with this? Does the OCC or Federal Reserve or superintendent of banks of New York have seminars saying to banks, you know, look at three reports per day in excess of \$500,000 with the same name; 10 reports if they have different names in excess, and so forth, and so forth?

What is going on out there, and what should go on out there?

Ms. VITALE. The OCC knows about our system, and when I said about trying to develop the criteria that I wanted to see the results of, I checked with our resident examiner, and one of the things that was suggested was a variance report, track each bank's volume month to month, and when you see a variance, that will show you something. That is a very valid tool when you are looking at individual accounts of individuals or even of corporations.

We tried it. It did not work. The nature of correspondent banking is just so broad that there are so many variables for activity. We had a pattern, and we were looking at any variation over 35 per-

cent. It did not work.

Mr. LAFALCE. Because of the time constraints, about how many

Suspicious Activity Reports would you file in a year?

Ms. VITALE. On correspondent banking? We have done 25 since we put this program in place.

Mr. LAFALCE. Which is how long a period of time?

Ms. VITALE. Since August of 1998. And these are significant. Mr. LAFALCE. OK. Now, do you know what is happening, how ef-

ficacious is this? What has happened to those?

Ms. VITALE. That is why you are having the hearings.
Mr. LAFALCE. We have this one hearing, OK. You were filing

Suspicious Activity Reports before August of 1998.

Ms. VITALE. Definitely. But on correspondent banking, as a result of our wire transfer monitoring, it was August of 1998 that started it. But yes, we were filing, and we file regularly when we see violations. But most of those times it is in an account that is a Republic customer directly. Through correspondent banking, the originator or the beneficiary is not an account at Republic in most cases.

But do you want me to answer your question?

Mr. LaFalce. Surely.

Ms. VITALE. There are working groups. The Department of Treasury does have a bank working group that gets together and talks about issues regarding the Bank Secrecy Act. The clearinghouse in New York has working groups. Republic is a member, along with other banks, in other working groups of compliance officers, so there are meetings and discussions.

Mr. LAFALCE. Let me just ask you this. I remember meeting with a group of physicians once, and it was a rather long lunch. We discussed many issues. All of a sudden they forgot I was there and started talking about themselves. All of a sudden you heard about

this malpractice case and that malpractice case went on.

When you get together at these group meetings, do you become aware that maybe certain banks are not doing what they should be doing in order to detect violations of our anti-money laundering laws?

Ms. VITALE. I think different banks have different commitments

to it.

Mr. LAFALCE. Is there a reason why one would have a lesser commitment to it? Could it be profitable to have a lesser commitment to it?

Ms. VITALE. Well, I know the system we put in costs money. It probably costs \$500,000, and maybe even upward of that. You need

to have senior management sign off on a system like that.

Mr. LAFALCE. All right. That is half-a-million dollars in the total scheme of things, but could there be some enhanced business opportunities because of a laxer approach to enforcement?

Ms. VITALE. I am sure there is a range of responses and a range

of reasons for it.

Mr. LAFALCE. OK. I am searching for it. If you could ever help

me with that.

If I can just have one last question. When the IMF is going to give assistance to any country in the world, we are aware of the privatizations that take place, too, and the huge amounts of money that are transferred at such periods of time.

Is there any mechanism for enhanced oversight and surveillance of, say, privatization transactions and the flow of money from such

transactions?

Ms. VITALE. When we look at the correspondent banking activity, we don't know what is the reason behind the transaction. We know a beneficiary, we know an originator, we know an originating bank, and we know a beneficiary bank. We can go and look at databases and see what we will learn about either the originator or beneficiary who we don't know. If there are articles, if there is a business news article about someone being privatized, then we learn about it. But there is no way of capturing that until you go behind the wire transfer.

You have to first know which wire transfers to look at, and because there are so many of them, the only way you could do that is if you capture patterns, in my opinion. Once you capture a pattern, you have to then find the answer or some information about

who the ultimate beneficiary and originator is.

Mr. LAFALCE. Thank you.

Chairman LEACH. Ms. Vitale, we have votes on the floor, so what I would like to do is recess pending the vote. The hearing is recessed pending the two votes.

[Recess.]

Chairman LEACH. The hearing will reconvene. It has been a long day, but I have just several more questions. There is much interest in the issue of profitability and so you take the correspondent relations, 150 banks. We have a correspondent relationship say with Russia and others around the world. How profitable is one of those relationships per bank? I mean is it a million dollars a year?

Ms. VITALE. Per bank?

Chairman LEACH. Yes. Is it less?

Ms. VITALE. I am not the right person to talk to in terms of numbers and profitability. That is one area that I don't have to worry

about. But no decision is made by Republic in this area on the basis of profitability. It is nowhere near a million a bank, I know that. Most of what I have seen has been maybe \$5,000 a year per

bank, some banks may be \$20,000.

Chairman LEACH. As you may recall, there is a recent article in the New Yorker Magazine, actually, several years ago, a journalist by the name of Albert Friedman, he described your bank's role as shipments of dollars to Russia, and the article contained allegations that a large share of these funds were funded through imperfect Russian banks used to finance activities in perfect Russia institutions.

Are you familiar with this article? Does it carry legitimacy?

Ms. VITALE. Mr. Chairman, that was in January of 1996. In February of 1996. New Yorker Magazine issued a two-page response, it contained six letters from the Department of Justice, from the Manhattan DA's office, from the OCC, from New York State banking, FinCEN, and I forget the sixth one. At that time Congressman Schumer had them placed in the Congressional Record, so they are a matter of public record. Each of the agencies said that they were not only aware of the bank note shipments that were made public, but that there was nothing illegal about them, and that the information in that article was not accurate. When this article was reprinted in Paris, Republic sued and obtained a judgment for defamation on that article.

Chairman LEACH. So you are suggesting that sometimes the

press does not get the story right?

Ms. VITALE. Yes.

Chairman LEACH. Paris has some very interesting defamation laws. Anyone in the public life somehow identifies with the judgments against journalists. Anyway, it has been publicly reported that your bank was responsible for the initial reports suggesting that there was an account that involved the Bank of New York that should be looked at; is that valid?

Ms. VITALE. Well, we filed an SAR and before checking whether I could say that, I ran it by the Department of Justice in New York and the FBI, because as you know, there is a criminal sanction against divulging whether you filed an SAR. But they said, yes, it was already on the record, on the public record.

Republic filed, as I mentioned in my testimony, because it saw one originator sending, I think it was over \$20 million in one month to four beneficiaries, one of which was Benex, and we could not find anything on the public record about Benex that would justify that sum of money or about any of the others in the wire transfers that we reviewed.

Chairman LEACH. I appreciate that. And it certainly appears in this case that your bank's diligence in this matter has been relevant. I think it shows the import of these SARs in certain cir-

cumstances.

Well, thank you. I have no further questions.

Ms. VITALE. Mr. Chairman, I read your bill. If I may, there isin the provisions you make an exemption for foreign entities for different jurisdictions, and I just want you to be aware of what I am saying, some offshore banks being incorporated in one of the areas that you have as an exemption, and that is the Republic of Palau,

so I would suggest you may want to look at that.

Chairman Leach. Well, thank you. I believe it is very constructive advice. And I might ask that you feel free to write us a more defined piece as well, if you have on this bill. We are certainly appreciative of that. In this matter, your bank is clearly to be commended.

Ms. VITALE. Thank you.

Chairman LEACH. Thank you very much.

Our last witness today is Karen von Gerhke-Thompson of the First Columbia Company, Inc.

And, Ms. Thompson, we welcome you, and please proceed.

STATEMENT OF KARON von GERHKE-THOMPSON, VICE PRESIDENT, FIRST COLUMBIA COMPANY, INC.

Ms. VON GERHKE-THOMPSON. Thank you, sir. Mr. Chairman, please kindly permit me to express how extraordinarily grateful I am for the opportunity to appear before you today. This is a unique, first time experience for me. I have not had the privilege of appearing before a committee of the United States Congress, so

I thank the Chairman for this opportunity.

The gravity of the significance of this hearing, an inquiry into Russian money laundering operations that may have tainted—or may have been tainted by, contingent upon one's perspective—U.S. banking and international financial institutions, cannot be sufficiently underscored. The past five years of my life have been consumed with who knew what when, relative to how all-persuasive and how high corruption reached in Russia and its former satellite republics, and why who knew what when was not reported to ap-

propriate legislative and judicial oversight committees. I have been asked to give a brief summary of my background. I am by profession a stockowner and Vice President of First Columbia Company, Inc., a company established in the District of Columbia in 1954. The First Columbia Company provides consultant services in international marketing, strategic alliance formation and government affairs to a host of U.S. Fortune 500 companies, primarily in the defense industry, energy and environmental services sector. Our clients in the defense industry sector include ITT Defense International/ITT Gilfillan, the former Westinghouse Electronics Systems Group International, Boeing/Argo Electronic Systems Group, Raytheon Corporation, and AT&T Ocean Systems. Other clients include, among others, Morrison-Knudsen International, Westinghouse Environmental Services Technology Divisions, Chemfix Technologies, Inc., National Environmental Control, Separation and Recovery Systems, Coastal Oil Corporation and Frank E. Basil, Inc.

Concurrently, I was a business partner of the late U.S. Attorney John M. Mitchell, Chairman of Global Research International, and a principal in the firm of Murphy and Associates, Inc., founded by Admiral Daniel J. Murphy, U.S. Navy Retired and former Chief of

Staff to then-Vice President Bush.

My first fifteen years in Washington representing some of America's finest corporate good citizens was both promising and lucrative. To borrow my much often-used quote from Sir Winston

Churchill: "Washington is ever the city at your feet, or at your throat." I think most of us who have lived in Washington have experienced this at one time or another, at least most of the people

I know have experienced it at one point.

Since my involvement with the Central Intelligence Agency and my efforts to bring the issues of Russian money laundering operations to the attention of appropriate oversight committees, Washington has been ever a city at my throat. And my career has been dormant.

Admiral Murphy warned me "never volunteer"; how sorely I regret that I did not heed his advice. In April of 1993, I volunteered my services as an unpaid intelligence asset to the CIA on a CIA operation to penetrate what the CIA, FBI and Department of Justice knew was a KGB money laundering operation that had tentacles that reached into the Kremlin to Boris Yeltsin. The target of the operation was Alexandre Konanykhine, the U.S. Vice President of Menatep Bank and President of Greatis USA, a public relations and advertising firm that he alleged represented Menatep Bank, the European Union Bank and Greatis Russia, among others.

Konanykhine alleged that he controlled \$1.7 billion in assets held by Menatep Bank, that he wanted to move out of Russia and Eastern European countries into the U.S., Latin America and the Caribbean. He alleged that Menatep Bank wanted to establish an offshore bank in Latin America and/or the Caribbean to protect its clients' assets and investment portfolios and to establish a bank with an initial capitalization of \$1 billion U.S. dollars, to obtain 100 naturalized passports for preferred clients of Menatep who allegedly held individual assets and investment and portfolios of \$100 million, 25 passports for employees of Menatep Bank and 15 diplomatic passports for very, very special clients of Menatep Bank at any cost.

This project was brought to me by Carter Cornick, Eugene Propper and Jonathan Ginsberg of the Washington, DC. based law firm of Ginsberg, Feldman and Bress. Cornick, Propper and Ginsberg wanted my help in assisting them in accessing officials who could facilitate a favorable negotiation climate for the establishment of a bank and expedite the procurement of the passports.

The \$1.7 billion Konanykhine wanted to move out of Russia raised a red flag with me, no pun intended. Russia was in the early phase of its transition from a command economy to a free market economy. We had a pending \$4 billion appropriation bill to provide

financial aid to Russia to assist them in their transition.

I telephoned a contact I had at the CIA who served as the director of the Soviet Eastern division. His telephone call was returned to me by a Mr. Z—and I am identifying these individuals by the initial of their last name to protect their identities—who informed me that the CIA was extremely interested in obtaining intelligence on and monitoring the activities of Konanykhine and Khodorkovsky, President of Menatep Bank.

Mr. Z informed me that I would be contacted by a Mr. V. On the same day, I received a telephone call from Mr. V. He informed me that the CIA believed that they were engaged in an elaborate money laundering scheme to launder billions of dollars stolen by

members of the KGB and high-level government officials.

The operation was abruptly ended in September of 1993 when Konanykhine telephoned his Washington associate Elena Cidorchuk-Heinz-Volevok from Turkey to instruct her to terminate the contract with First Columbia Company, Inc., and to cut off all further communications with us. She cited Konanykhine's decision to terminate the contract was based on his belief that I was a

phoney.

In April of 1994, I was advised by two CIA intelligence officers that the operation had been compromised by convicted spy Aldrich Ames. Mr. V corroborated that I had been compromised on the operation. He personally had routed the traffic on the operation to Ames who was responsible for monitoring money laundering operations at the CNC—the CIA's Counter Narcotics Center. An FBI report submitted to the Senate Select Committee on Intelligence confirmed that Ames and Konanykhine were in Turkey in September of 1993 at the same time, in the same location, and at the precise time that Konanykhine telephoned his assistant from Turkey to terminate the contract with First Columbia Company, Inc.

A Senate Select Committee report on the damage assessment of Ames' espionage activities also confirms that Ames was in Turkey in September of 1993, where he attended an international counternarcotics convention and where, according to a Statement of Fact, he turned over to the KGB classified cables and documents he had downloaded from the CIA's mainframe computer onto his personal

laptop computer.

This operation was not reported to Congressional Oversight Committees as mandated under the National Security Act of 1947. When it was not reported, it signaled me that it was a "policy" versus an "intelligence" failure, as is so often the case when senior executives fail to report significant failed intelligence or law enforcement operations.

From my first date of contact with the Agency in April of 1993 through September of 1993, I worked with Mr. V on a daily basis. It was evident to me, as would later be confirmed by Mr. Z, that the CIA knew who Konanykhine and Khodorkovsky were and

where their money laundering trail led.

Konanykhine was a known KGB asset running a KGB money laundering operation with stolen funds that were passed through Khodorkovsky of Menatep Bank as a KGB-controlled front firm.

Konanykhine is on the top of Russia's most wanted list. He is INS' highest profile case and the FBI's biggest quid pro quo with the Russian Military Procuratura. Konanykhine was a KGB asset conducting a KGB money laundering operation out of the Willard Hotel in downtown Washington, DC. The money was being laundered through Menatep Bank that is also alleged to be KGB-owned and controlled, as is Menatep's wholly-owned subsidiary, Yukos Oil. Khodorkovsky of Menatep Bank is the subject of the investigation into the Bank of New York's involvement in facilitating the laundering of an estimated \$10 billion, although I understand those estimates range between \$10 billion and \$7.2 million. Some of the \$10 billion is believed to be money loaned to Russia by the IMF.

Khodorkovsky and Konanykhine were also the subject of an investigation by the Federal Reserve Board of Governors for their in-

volvement in establishment of the European Union Bank in Antigua, one of eight Russian banks in Antigua alleged to have been

established for money laundering purposes.

Here is a man who conducted not one, but two money laundering operations out of the Willard Hotel directly across the street from the Office of the President of the United States: the KGB money laundering operation, and the European Union Bank, both of which were undertaken by Konanykhine on behalf of Khodorkovsky of Menatep Bank. The CIA, FBI, and the Department of Justice were knowledgeable of the KGB operation and the Federal Reserve Board was knowledgeable of the European Union Bank. Surely all were knowledgeable of Khodorkovsky's involvement with the Bank of New York.

Here is a man who first came to the United States as a member of Yeltsin's first official meeting with President Bush, a man who alleges he financed 50 percent of Yeltsin's presidential campaign, who Yeltsin then rewarded with a dacha previously owned by Mikhail Gorbachev, and who Yeltsin allegedly authorized his then-Chief of Security, General Korzackov, who I understand at the time was a colonel, to assign a Kremlin security deal for Konanykhine's personal safety and protection. Here is a man who was conducting a KGB money laundering operation with tentacles that reached to Boris Yeltsin that was penetrated by the CIA, the President's foreign intelligence operational arm, that was compromised by Aldrich Ames, and no one told the Administration and no one reported it to appropriate Congressional Oversight Committees.

I cannot remember the author, but I do remember reading a quote cited by an author who is quoted by a senior State Department official commenting half in jest: "There are no policy failures; there are only intelligence failures and policy successes." There is no jest here. The operation was a foreign policy failure, a see no evil-at-any-cost, don't-fail-under-my-watch foreign policy of appeasement, that in no small measure helped fuel the collapse of

free market reforms in Russia.

Russia was hemorrhaging dollars at estimates as high as \$2.5 billion per month. The Yeltsin Administration and his new oligarchs were bleeding the economy to near death. No tourniquet was offered to stop the hemorrhaging. To the contrary, the Clinton Administration was pouring billions upon billions of dollars into Russia that only fueled the hemorrhaging. We knew it in 1993. We

may have known it earlier.

We watched it. We did nothing to stop it. We aided it and abetted the corruption by fueling it with billions and billions of dollars in foreign aid and international monetary loans. I am not a lawyer, nor do I want to be one or, for that matter, be near one. I have had my fill of attorneys. But, I would venture to guess that to knowingly aid and abet corruption may be tantamount to being a co-conspirator.

Exposing the failure of the operation would have undoubtedly proved to have been politically unpalatable to both the Yeltsin and Clinton Administrations and to the Central Intelligence Agency.

I understand my time is up, Mr. Chairman. And I thank you. [The prepared statement of Karon von Gerhke-Thompson can be found on page 451 in the appendix.]

Chairman LEACH. Well, thank you very much.

Ms. VON GERHKE-THOMPSON. You are the only one left to ask

questions, sir.

Chairman LEACH. Let me just thank you for your testimony. You have gone through a very unique thing in your life, and it is something that the committee respects. It is always difficult to piece together circumstances from one individual's story. In fact, I am reminded of a novel of, oh, 30- or 40-years standing, called "The Alexander Quartet," which is the same story told four different times from four different persons' perspectives, and the kind of perspective you bring is important, because it indicates a perspective of an American citizen not involved in a process, getting caught up in something of some interest.

And I thank you very much for presenting it to the committee.

I have no questions.

Ms. von Gerhke-Thompson. Thank you, sir. Chairman Leach. Thank you. The hearing is adjourned. [Whereupon, at 5:00 p.m., the hearing was adjourned.]



APPENDIX

July 21, 1999



CURRENCY

Committee on Banking and Financial Services

Iames A. Leach, Chairman

For Immediate Release: Tuesday, September 21, 1999 Contact: David Runkel or Andrew Parmentier (202) 226-0471

Opening Statement
Of Representative James A. Leach
Chairman, Committee on Banking and Financial Services
Hearing on Russian Money Laundering

The Committee meets today for its fifth hearing on international financial issues this year and the third on Russia and corruption over the last twelve months. The hearings today and tomorrow will be followed this fall by others dealing specifically with western financial assistance strategy, including the International Monetary Fund (IMF), regulatory issues attendant to preventing financial crimes, the depth of the crime and corruption problem in Russia, Russian use of off-shore financial institutions and the intertwining of those institutions with US and other Western banks, the role of public and private US advisors in Russia's transition to free markets, the role of the US intelligence community in monitoring Russia's Central Bank and other monetary and banking matters, as well as other concerns.

Today we will begin with an examination of recent allegations that corrupt Russian groups and individuals have infiltrated Western financial institutions.

In this regard, we invited several witnesses who, according to various reports, have material knowledge of these matters, but who have declined to appear voluntarily before the Committee, including: Natasha Kagalovsky, former head of the Eastern European Division, Bank of New York; Lucy Edwards, formerly with the London office of the Bank of New York; Bruce Rappaport, Chairman and CEO of Bank of New York Inter-Maritime; Mikhail Khodorkovsky, Russian oil industry executive; as well as the Chairmen of several Western money center bank.

As the hearing process continues it will be my intention to seek witness subpoenas, where appropriate.

We also invited Carla del Ponte, the former chief Swiss prosecutor. She could not come because she took up new functions at the Hague yesterday, but she sent us a fulsome statement outlining a new aggressive Swiss policy toward the scourge of money laundering which involves a hard look at Russlan corruption. I invite the Committee's attention to her statement.

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I also invite the Committee's attention to a letter from the Honorable Yuri Skuratov, the Prosecutor General of Russia who also was invited to testify. Mr. Skuratov notes that he is "unfortunately" unable to come this week, but observes that he is "deeply convinced that the forthcoming hearings will allow to develop valuable recommendations to the financial and law enforcement structure of Russia and USA in counteracting to infiltration of dirty money into our financial systems."

Mr. Skuratov has offered his personal cooperation with the Committee's work. Significantly, three days after receiving the Committee's invitation his apartment in Moscow was ransacked.

It is my intention that the first of our subsequent Committee hearings on Russia will focus on Western assistance strategy for Russia and the possible diversion or misappropriation of those funds. Last month, Mr. LaFalec and I commissioned a GAO study to examine the effectiveness of the 590 billion in Western assistance for Russia, particularly in light of problems of corruption and the power of the so-called oligarchs. But recent developments warrant an additional in-depth investigation of allegations of diversion or misuse of Western assistance.

In this context, I would advise in the strongest possible terms that the Department of the Treasury insist on a full and complete audit of the relationship between the Central Bank of Russia and the IMF, particularly the activities of the CBR in the foreign exchange and treasury markets in the period July-August 1998. Failure to do so would undercut any remaining credibility of international financial institutions dealing with Russia. Likewise, I will request this week a full GAO audit of US bilateral assistance to Russia, as well as a review of multi-lateral assistance efforts.

The global payment system is opaque and anonymous by design, and has been made more so by the technological advances of the past decade. The same technology that has produced such great benefits for the financial services industry and the world economy as a whole has also made it enormously difficult to trace the proceeds of illegal activity once a criminal succeeds in gaining entry to the payment system. In an era where funds can be transferred among multiple accounts on multiple continents in the blink of an eye, the challenges faced by law enforcement agencies, regulators, and financial institutions in trying to track dirty money through the system are enormous.

In this regard, one of the issues brought forth by the recent reports of large money flows of questionable origin through western financial institutions is the legal obligation of US banks to report such activity to appropriate authorities. Under current law, depository institutions are required to file so-called "Suspicious Activity Reports" (SAR's) with the Treasury Department whenever they become aware of suspicious account activity or possible violations of law. According to press reports, it was the filing of a SAR by one of the banks that will be represented at these hearings, Republic National Bank of New York, that helped alert law enforcement authorities to the massive funds flows from Russia into other New York money center banks.

During debate on the financial modernization legislation that passed the House earlier this year, an amendment was offered that would have effectively eliminated the Suspicious Activity Reporting requirement. Several members of this Committee, including the Ranking Minority Member and Rep. McCollum, joined me in opposing the amendment, and it was defeated on a strong bipartisan vote. I believe that the decisive defeat of that amendment reflected a general consensus in the House of Representatives that banks must continue to be our first line of defense against criminal enterprises seeking to launder their illicit proceeds by entering them into the legitimate financial system.

By the same token, in our zeal to shut off the dirty money that flows all too freely through our financial institutions, we must be careful not to offend the legitimate privacy concerns that Americans have when it comes to their financial affairs. There is a difference between reviewing modest deposits American citizens place in depository institutions and multi-million dollar transactions of unknown foreign nationals from countries where the rule of law is not well established. The big picture is that law enforcement attention must be directed to activities of a growing new international criminal class, not traditional American small business enterprises.

As recent events demonstrate, where large money-center banks accept sizable deposits and wire transfers from overseas, particularly where those transactions originate in countries with minimal regulatory controls or high levels of private or public corruption, it is critically important that banks exercise due diligence in knowing who their customers are and whether their transactions are legitimate. To do otherwise risks making the western financial system complicit in the endemic corruption that has victimized so many peoples across the globe.

In short, the US must not only stand for the rule of law at home, but ensure that our financial institutions do not contribute to or facilitate corruption abroad.

Accordingly, I am today introducing legislation that would significantly increase the transparency of the international banking system and pierce the veil of secrecy that for too long has made it possible for institutions and individuals operating in largely unregulated off-shore jurisdictions to gain unfettered access to the U.S. financial system for purposes of legitimizing the proceeds of illegal activity. The legislation would, among other things:

- require a financial institution that opens or maintains a U.S. account for a foreign entity that is
 not publicly traded to identify, and maintain a record of the identity of, each direct or beneficial
 owner of the account and help banks in that process by making it a crime to misrepresent the
 true ownership of an account to a bank;
- (2) prohibit U.S. financial institutions from opening or maintaining correspondent accounts with so-called "brass plate" banks – most often in off-shore locations – that are not licensed to provide services in their home countries and are not subject to comprehensive home country supervision on a consolidated basis;
- (3) eliminate a significant gap in current US law by expanding the list of crimes committed on foreign soil that can serve as predicate offenses for money laundering prosecutions in the US, including the misappropriation of IMF funds; and
- (4) prioritize the issues of governmental corruption and insider self-dealing in the global fight against money laundering.
- (5) direct the US government to seek new international standards for money laundering, especially as it relates to governmental corruption.

It is self-evident that the old models for combating traditional criminal activity by "following the money" must be supplemented with new and innovative methods for addressing the increasingly endemic corruption and cronyism that have come to characterize an alarming number of nations around the world.

The legislation that I am introducing today is intended to supplement and reinforce current money laundering laws and is based on money laundering vulnerabilities identified in past hearings of this

Committee by law enforcement officials and recognized authorities on financial crime. I am confident that other constructive approaches will be offered by Members of this Committee and by the Administration.

Indeed, I understand that later this week, the Administration will unveil its long-overdue national money laundering strategy, which was mandated by legislation that originated in this Committee and was championed by our distinguished colleague from New York, Ms. Velazquez. It is certainly the hope and expectation of this Committee that the strategy will be a valuable source of guidance as we fulfill our legislative responsibilities in the critical areas that are the subject of this week's hearings.

Money laundering may seem like a relatively modest crime, but it is a window into greater crimes involving how illegal funds were accumulated in the first place. The allegations, for instance, that American and European banks have facilitated money laundering for Russian organized-crime figures underscore how intractable a problem corruption in Russia is and how vulnerable Western institutions are to the lure of servicing one of the world's most virulent deptocracies.

I first used the term kleptocracy in 1986 in relation to Ferdinand Marcos and the people of the Philippines. The goal of Congress in the Marcos investigation was to return looted money back to the Filipino people. Likewise, our aim in this case should be to shine the spotlight of accountability on the problem of corruption and endeavor to help return looted wealth to the Russian people.

Russia is hardly the first country to be victimized by a culture of corruption. The plundering of the Philippines under Marcos, the looting of Zaire by Mobutu and Indonesia's crony capitalism during the last years of Subarto stand as parallels. What sets Russia apart is the pervasiveness of politically tolerated corruption in a country of such sweeping geographic size and seminal geopolitical significance.

The Russian government estimates that criminal syndicates control 40 percent of the economy and perhaps half of the country's banking assets, though others put the figures higher. In any country where political stability is questionable and legal protections of property are unreliable, those who come to control wealth, legally or otherwise, can be expected to cast a "no confidence" vote with their savings and shift their capital to safe havens abroad. In Russia, theft has exceeded investment, resulting in a dramatic plunge – about 40 percent in the last decade – in economic activity and a disillusioned and impoverished society.

The question is how the West should respond to this crisis. The American people have a vested and humanitarian interest in helping the Russian people make a successful transition from communism to democracy. But, there is no credible way to suggest that taxpayers should support assistance to a government which allows insiders to recycle aid from the West in the form of laundered bank deposits, personal investments in the stock market or Pebble Beach real estate.

Russia, the land mass most similar to our own, has been kept back for most of this century because of the Big "C" — Communism — and has been dispirited for much of this decade because of the little "c" — corruption.

The struggle of the last half-century was to defeat the blasphemous social experiment called Communism. The challenge of the next 50 years will be to constrain the insidious societal cancer of corruption and misgovernment. The second struggle may well prove more difficult, because avarice is a more fundamental aspect of human nature than the Communist precept that people are subject to historical forces beyond the individual's control. Government in the Communist era lacked legitimacy because it ruled without the consent of the people. The new governing elite in Moscow has squandered the credibility it gained through democratic elections and effectively delegitimatized itself by failing to protect citizens from the self-serving greed of those in power.

Where should we begin? By enforcing our laws, issuing indictments if necessary. Such actions might prompt Russian prosecutors to do the same, calling Russia's new class of thieving oligarchs to account for domestic crimes more serious than international banking violations. We should also emphasize retrieving stolen assets for the Russian people.

For the Russians' part, instead of propelling the flight of capital through a banking system that increasingly serves merely as a platform for money laundering, they should establish community-oriented banks and credit unions. No nation, after all, can prosper if it lacks institutions where people can safely put their money and seek secure loans.

Russia would be well-advised in its own self-interest to seek the opening of branches of wellregulated Western banks in which people can trust that their savings will be turned into loans for local enterprises. In addition, Russian authorities may wish to consider imposing effective restrictions on the ability of their companies to use foreign banks or offshore corporate structures located in jurisdictions with inadequate financial regulatory systems. When western financial institutions are used as conduits for illegal commerce, the rule of law can ultimately be expected to prevail. But this expectation is not warranted when dealing with offshore financial jurisdictions designed as havens for rogues and thieves.

Parenthetically, to the extent that Russian parliamentarians or others purporting to speak for the Russian people accuse the Committee of overstating the problem of Russian crime and corruption to score political points against the Clinton Administration or denigrate the Russian people, we should keep in mind the following remark by President Yeltsin in a February 1997 speech: "The criminal world has openly challenged the state and launched into open competition with it."

From an American perspective the principal issue isn't who lost Russia, but how can we save Russian democracy. It would be an exaggeration to suggest that Russia is an economic Vietnam, but it would not be to note that any sense of history requires that the US should take all credible steps to ensure that the Cold War is not revisited. In this context, the question looms large: What should we now do in the wake of a decade of failed efforts?

Our policy makers have an obligation to ensure that the corrosive impact of foreign corruption is blocked from our shores. America may be as challenged today by the threat of a deterioration of values – galloping corruption – as it was yesterday by the menace of Marxist ideology.

During the Cold War, when national security was the central concern, secrecy was of paramount importance in protecting a country's citizens. Now that economic issues have become paramount, transparency holds the key to protecting individual citizens.

In the final measure, America's challenges are vastly more manageable than Russia's. All we have to do is show fidelity to time-honored values. What Russia must do is find a new set of values that fits its people and times.

The 21st century may be disproportionately more about economic policy and the intertwining of economics and politics in increasingly sophisticated markets. In this regard, US world leadership

relates to our policy toward Russia and our policy toward China. In both cases, relations are rocky, based in part upon the Kosovo war where Russia and China both felt they were unnecessarily embarrassed for different reasons and also because of corruption which has imploded Russian society and jeopardized the movement toward democracy in China.

Public service is about idealism, not self-enrichment. In Russia it appears there is a serious breakdown in public ethics which has led to the development of virtual anarchy stemming from a culture of corruption. When laws do not exist or are not enforced, governance becomes a black hole.

The Committee's goal is to advance the cause of accountability in Russia and in the international banking sector; to promote democracy and true free markets in Russia and to promote the return of illegally or improperly diverted funds to the Russian people.

Now I want to speak directly to the Russian people.

As Chairman of a Committee of Congress, I would like to emphasize that the American people believe that Russians are a great and heroic people. No people on the planet have undergone greater deprivation in this century than the Russian people, who were held back for decades by a dictatorial creed called communism and today are being deprived as a result of corruption.

The American people want to help the Russian people.

In this century, Americans and Russians together successfully fought the greatest war of our times, World War II, against the forces of fascism. Today we must ally to fight against corruption. We must fight for the rule of law, for the Russian people to hold their governmental leaders accountable.

This hearing is held to underscore the help Congress wants to give the Russian people and reformers in the Duma. We want money stolen from Russia by a new class of corrupted politicians and entrepreneurs returned to Russia for the benefit of the Russian people.

Corruption should be punished, not fed.

Bern, September 14, 1999

Statement to the Committee on Banking and Financial Services of the U.S. House of Representatives for the Hearing on Russian Money Laundering September 21 & 22, 1999

By Carla del Ponte Federal Prosecutor of the Swiss Confederation

Mister Chairman, Distinguished Members

It is a privilege to have an opportunity to contribute to your hearings on Russian Money Laundering. On behalf of the Government of Switzerland, I appreciate the opportunity to submit written testimony for inclusion in the record of these hearings on Russian organized crime and money laundering activities. These are issues that should concern the law enforcement authorities in global financial centers throughout the world.

I commend you for your timely efforts to bring leading US and international authorities together to collectively share our experiences and engage in discussing practical means to further develop international cooperation to fight international crime. In Switzerland, we are all aware that the scope and depth of the problem can only be tackled through an internationally coordinated and dedicated approach. The task is awesome but through continued dialogue and joint and cooperative enforcement efforts, we can make it much less attractive for criminal elements in Russia or elsewhere to use global financial markets to mask the illegal origins of funds.

In Switzerland, we have long shared your concerns over money laundering and have consistently worked to insure that our laws protect our financial system from abuse. We consider it our responsibility to ensure that our place in the international financial system is not corrupted nor utilized for legitimizing the profits of illegal activities. Generating huge profits through illegal activities is only beneficial if those profits can be used for other purposes. For example, a mountain of cash, regardless of the currency, has no benefit unless it can be applied to other investments or to other purchases. If nations are vigilant and work aggressively to prevent their financial institutions from becoming a mechanism for funneling illegal proceeds back into the commercial mainstream, we will not only succeed in combating money laundering, but we will discourage people from engaging in large-scale criminal acts.

This explains the early priority that the Swiss authorities have given to the fight against money laundering. This priority has been visible on three fronts: strengthening of the Swiss criminal code; enhanced regulation of Swiss financial institutions; and, increased cooperation with international enforcement efforts.

In the mid 1980s, when global law enforcement authorities began to appreciate the significance of money laundering to organized criminal enterprises, Switzerland made an assessment of the adequacy of its laws. Unfortunately, like many countries, the Swiss criminal code did not sufficiently address the threat presented by money laundering. As a result, Switzerland developed more specific criminal statutes to target this burgeoning phenomenon. Therefore, after drafting a preliminary amendment of its Criminal Code in 1986, Switzerland has implemented several statutes and regulations and taken other administrative actions that are specifically designed to combat money laundering through direct enforcement, domestically and through greater cooperation with international investigations and prosecutions.

In the process of creating these new enforcement mechanisms, reference was made to existing US law and collaborative discussions were held with our US counterparts. Furthermore, the recommendations of the Financial Action Task Force on Money Laundering (FATF) were fully implemented. The process of amending the Swiss criminal code has been an evolving one. The first step was realized in 1990 punishing the laundering of the proceeds of crime, wherever the crime may have been perpetrated. It also established the obligation of due diligence with regard to customer identification. In 1994 additional provisions were introduced addressing specifically organized crime and the confiscation of assets. In 1997 the Swiss Money Laundering Act was enacted, extending to all professional financial intermediaries the obligations which already applied to the banking sector. Consequently, in July 1998, the Swiss Federal Banking Commission adapted its guidelines concerning the prevention and combating of money laundering. For its own part, the Swiss banking sector had already taken substantial steps to combat money laundering. Thus, since 1977, the Swiss banking sector has been obligated to "know their clients" under the provisions of the Convention on Due Diligence.

As a result of the efforts of the Swiss law enforcement authorities and the Swiss banking sector, Switzerland is considered a model among nations in terms of the steps it has taken to combat illicit financial transactions, and has been so recognized by the US law enforcement authorities. Over the past 15 years, the US bank regulatory approach to combating money laundering has gradually moved closer to the Swiss model by moving away from burdensome and questionably valuable transaction reports to a system of obligating banks to have a greater understanding of their customers ordinary transaction flows and to report occurrences that are out of the ordinary to the appropriate officials. We applaud the United States for this transition and hope that in time there is greater uniformity in the standards that apply to financial

institutions throughout the world in connection with anti-money laundering efforts.

However, national legislation alone cannot address problems which go beyond national boundaries. The emerging global economy and its assorted tools of instant electronic communication have created new opportunities for legitimate economic pursuits and at the same time provided channels for illegal purposes. As a result, we must remain vigilant to emerging criminal practices and while we evaluate and adapt our domestic laws, we must do the same on the international level as well, to maintain the appropriate level of international collaboration in the face of such efforts.

Since 1959, Switzerland has actively participated in European initiatives to combat international crime. Switzerland was an early signatory to both the European Convention on Mutual Assistance in Criminal Matters, the European Convention on Extradition and the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime. Also, after concluding several bilateral agreements with the United States to ensure cooperation in criminal matters, in 1973, Switzerland amended its statutes and introduced the Federal Act on International Mutual Assistance in Criminal Matters which went into effect on January 1, 1983. This act is significant because it allows Switzerland to provide assistance in international criminal enforcement matters, without the existence of a formal treaty.

The 1983 Act and its underlying expression of a clearly defined political will was put to a major test in 1986 in connection with the Philippine government's prosecution of the Marcos case. Switzerland did not hesitate to honor the request of the Philippine government to freeze funds allegedly taken illegally by Mr. Marcos and members of his family and deposited in their names in Swiss banks. In that case and in view of the evident legitimacy of the matter, the Swiss Constitution provided the basis for cooperation despite the absence of a formal treaty between Switzerland and the Philippines. A similar reasoning was applied when the government of the Republic of Congo sought help in tracing the assets of former president Mobutu. In that case, Switzerland was the only country to reply favorably to Congo's request.

In addition, our investigation into the financial dealings of the brother of former President Salinas of Mexico, led to the freezing of over USD100 million in assets. International co-operation with the United States and Mexico, including 110 witness interrogations, was instrumental in the effective proceeding of this case. It is now up to the Geneva prosecuting magistrates to bring it to its conclusion.

These circumstances demonstrate a long-standing willingness to engage with our international partners and have prepared us to confront the current and future challenges such as organized crime of Russian origin.

As early as 1994, Russia and Switzerland concluded agreements on mutual judicial assistance and police co-operation. These instruments were complemented in April 1998 by a memorandum between the Office of the Attorney General of Switzerland and the Office of the Prosecutor-General of the Russian Federation aimed at strengthening co-operation against organised crime and money laundering within existing national legal frameworks. Switzerland and Ukraine signed a similar memorandum in April 1999. The two latter documents are designed to facilitate the exchange of information concerning organised crime and money laundering. Ukraine has also ratified most of the Council of Europe conventions concerning international mutual assistance in criminal matters.

In 1998 Switzerland prosecuted Mr. A. Mikhaïlov, a well-known Russian citizen, alleging that he was a member of a criminal organisation. The case took place in the Geneva criminal court and set a precedent in Europe for the number of letters rogatory issued by the court. In the course of the proceedings against Mikhaïlov, the investigating judge in Geneva issued 21 letters rogatory to foreign states in the space of a little less than two years. During the same period, eight letters rogatory were addressed to Switzerland concerning this matter. However, the case did not result in Mr. Mikhaïlov's conviction, in particular because the intensity of international co-operation was insufficient.

In the same year, the Geneva cantonal authorities followed up a request for judicial assistance by the Ukrainian authorities, which led to the indictment of Mr. P. Lasarenko, former prime minister of Ukraine, on charges of money laundering.

In November 1998, the Office of the Attorney General of Switzerland received a request for judicial assistance from its Russian counterpart concerning suspicions of corruption of high-level officials of the Russian central government. Switzerland agreed to provide judicial assistance. The ensuing inquiry in Switzerland mainly concerned the cantons of Geneva and Ticino. So far, it has led to a search of the premises of a large Ticino-based company, which is suspected of having paid bribes to the indicted officials in order to obtain large contracts in Russia (in particular the renovation of some of the Kremlin buildings). In this context, orders were also issued to freeze several accounts in Swiss banks. The Geneva Public Prosecutor also opened a criminal inquiry into money laundering in response to the first results of an investigation conducted by the Office of the Attorney General of Switzerland, of the letters rogatory which were issued on grounds of suspicions of corruption.

In July 1999, the Office of Attorney General of Switzerland blocked several accounts in Switzerland in response to another request for assistance from the Office of the Prosecutor-General of the Russian Federation. This request concerned various persons suspected - in Russia - of having embezzled vast amounts of public funds with the aid of companies located in Switzerland. In

this case, premises in Switzerland also were searched on the orders of the Office of the Attorney General of Switzerland, and material evidence was seized.

The cases outlined above – which are only examples – demonstrate that the Swiss law enforcement authorities are willing to co-operate actively with their Russian counterparts in the fight against organised crime and money laundering, who work courageously under very difficult conditions.

Switzerland is one of the few countries so far to have carried out investigations of such importance. Often in money laundering cases, only the second and third layer of the laundering process take place in Switzerland, whereas the predicate offence and/or the introduction of illicit funds into the banking system take place in other jurisdictions. If these jurisdictions do not co-operate the prosecution of cases in Switzerland is seriously hampered.

Switzerland appreciates the open co-operation it has enjoyed with US enforcement agencies in the exchange of intelligence and police information concerning Russian organised crime. We look forward to furthering these efforts in future cases. Such co-operative efforts are essential when combating this form of criminality.

Switzerland has established an office within the Federal Office of Police to identify and analyse organised crime originating in central and eastern European countries, and in Russia. In addition, the Swiss banking supervisory authority, the Swiss Federal Banking Commission, maintains particular contact with the US financial institution supervisory authorities concerning alleged instances of money laundering.

The Swiss Federal Banking Commission takes alleged cases of money laundering very seriously and pursues them very intensively. It also examines the banks for compliance with Switzerland's strict obligations to exercise due diligence. In this context it works closely with numerous foreign authorities.

If I try to sum up on the lessons we can draw at this stage on this subject, I would first like to recall a couple of facts and statistics: every year, Switzerland provides legal assistance in over 2000 international cases. In 1998 for instance, Switzerland and the United States have handled bilaterally more than 120 requests for Mutual Legal Assistance. In one of the more publicized cases, Swiss authorities confiscated and shared with the US Government over USD 160 million of Colombian drug money.

However, such good news should not lead us to believe that we have gained the upper hand on money laundering and organized crime. On the contrary, the very intricacy, magnitude and multifaceted nature of the international flow of illicit assets, particularly from Russian origin, calls for increasing overarching co-operation, both in the refinement of our national legal arsenals and in effective collaboration of parent agencies, regulating bodies and the financial sector itself. In implementing our duties as prosecutors, nothing less is at stake than the upholding of our democratic systems and the international rule of law.

LEGAL ANNEX

1. Swiss legislation to combat money laundering

Swiss legislation to combat the use of the financial system for money laundering has been progressively tightened over the last few years. Since the 1980s, a series of laws and regulations have been implemented in the form of penal and administrative provisions, and specific banking regulations relating to banks and non-bank financial institutions.

1.1. Penal Code: Money laundering and lack of vigilance in financial operations

In Switzerland, provisions related to money laundering were written into the Penal Code in two stages. First, money laundering and failure to exercise due diligence became criminal offences on 1 August 1990, with the coming into force of articles 305bis and 305ter. These first provisions were followed by a "second package" of amendments of the penal code which took effect in 1994.

Article 305bis penalises obstacles to the "establishment of provenance, the discovery or the confiscation of assets" proceeding from crime. The predicate offence can be any crime under the penal code (no restriction to drug related offences). Money laundering is also punishable if the underlying offence was committed outside Switzerland. Anti-money laundering legislation can also apply to transactions in all tradable assets including, foreign currency, certificated and uncertificated securities, precious stones and metals, as well as claims and objects having intrinsic economic value. Convictions may be obtained with respect not only to persons having knowledge of the criminal origin of funds, but also of those who should have presumed such criminal origin. Article 305ter of the Penal Code supplemented article 305bis by introducing a general requirement for financial intermediaries to ascertain the identity of customers through verification of "the identity of the beneficial owner with the diligence that can reasonably be expected under the circumstances" in the case of financial operations carried out in the exercise of their profession. This due diligence requirement with respect to financial transactions applies to all intermediaries who receive, manage or assist in investing funds on a professional basis, including business lawyers. A second package of amendments to the Penal Code resulted in provisions related namely to confiscation (articles 58 ff. of the Penal Code, see below) and organised crime (article 260ter of the Penal Code, see point 3).

1.2. Banking regulations

An obligation to identify the client was first imposed on the banks in 1977 by the Agreement on the Swiss banks' code of conduct with regard to the exercises of due diligence. The Agreement has been updated several times since. The current Agreement on the Banks' Obligation of due Diligence (CDB 1998) entered into force on 1 July 1998. The Swiss Federal Banking Commission considers the CDB a minimal standard to which it refers as a supervisory authority when interpreting the notion of irreproachable activity which is a condition for granting and renewing a banking licence. The core substance of the CDB consists of rules on the identification of customers and beneficial owners. Articles 2 to 5 of the CDB are principally concerned with verification of the identity of the contracting party and the identification of the beneficial owner. They inspired the formulation of corresponding articles in the Penal Code concerning lack of diligence in handling assets (article 305ter of the Swiss Penal Code, cf. above) and Recommendations 10 and 11 of the Financial Action Task Force (FATF).

In March 1998, the Swiss Federal Banking Commission (SFBC) adopted modified Guidelines concerning the prevention and combating of money laundering which came into force on 1 July 1998 (Circ. 98/1) to bring them into line with the new Money Laundering Act (see point 2.3.) The prime objectives of these Guidelines is to specify the intermediaries submitted to the surveillance of the SFBC and to extend the duties of diligence contained in the MLA of 1997. The SFBC Guidelines profile for example the kind of transactions that should prompt banks to pay special attention and perform supplementary checks: a non-exhaustive list of 30 pointers which may arouse suspicion that money laundering may be involved is provided. This list may be used to raise the awareness of bank employees, as described in FATF Recommendation 28.

1.3. Comprehensive administrative legislation: the Federal Act on the prevention of money laundering in the financial sector (Money Laundering Act, MLA) of 10 October 1997

The penal law and specific banking regulations have made a major contribution to increasing vigilance in the financial sector. They focus on the banking sector, notwithstanding the fact that the provisions of the Penal Code were designed to cover all areas of the financial sector. The Money Laundering Act was introduced to extend to all professional financial intermediaries the obligations which already apply to the banking sector, and to introduce the duty to notify the competent authorities of any suspicions they may have regarding money laundering. These two dimensions amount to the complete Incorporation of the FATF recommendations Into Swiss law.

1.3.1. Scope of the MLA

The Money Laundering Act applies to all financial intermediaries, whether already subject to federal supervision before the entering into force of the MLA or not. The category of intermediaries which are already regulated by special federal laws and subject to federal supervision includes the banks, the securities dealers, investment fund manager, and the life insurance sector (article 2, paragraph 1).

All other financial intermediaries which are not subject to any special supervision under federal law also fall under the scope of the MLA (article 2

paragraph 2). The law contains a broad definition of the financial activities considered to be particularly vulnerable to money laundering. Article 2 paragraph 3 enumerates these activities in line with the FATF Recommendations 1.

The law applies namely to payment services which are executed without the involvement of a bank. Bureaux de change and similar organisations are subject to the law, precious-metal dealers, and all asset managers which are not already authorised and supervised by the Banking Commission.

1.3.2. Obligations of due diligence

Chapter 2 of the law defines the obligations placed upon legal or natural persons - namely the obligation to check the identity of the counter party to a contract (article 3) and of financial beneficiaries (article 4), to make repeated checks on their identity (article 5), the duty to clarify specific situations (article 6), the duty to obtain documentation and to record all transactions, the obligation to declare suspicious transactions (article 8) and also organisational measures (article 9). Suspicious transactions must be reported without delay to the Money Laundering Reporting Office (MROS). Chapter 6 of the MLA stipulates the penalties for failure to comply with the obligations provided for in Articles 3 to 9.

1.3.3. Surveillance

The Swiss Federal Banking Commission (FBC) is in charge of monitoring compliance with the MLA by all intermediaries under its supervision. The same applies to the Federal Office of Private Insurance (FOP) in the framework of its supervision of insurance companies. The MLA does not limit the supervisory powers given to the SFBC on the basis of the Banking Law. An infringement of the MLA provisions can thus also lead to punitive measures in accordance with specific surveillance legislation. In addition, the supervisory authorities are required to inform the penal authorities if they are

^{1 &}quot;Persons who on a professional basis accept, keep on deposit or help invest or transfer assets belonging to third parties shall also be deemed to be financial intermediaries, particularly persons who:

a. undertake credit transactions (including consumer credit or mortgages, factoring, financing of commercial transactions or financial leasing).

b. provide services related to payments, including electronic transfers on behalf of third parties, or who issue or manage means of payment such as credit cards and travellers cheques,

c. trade, on their own account or for third parties, in bank notes or cash, money market instruments, currency, precious metals, raw materials or securities (paper or other rights) and their derivatives.

d. offer or distribute shares in funds, in the capacity of distributor of a Swiss or foreign investment fund within the meaning of the Federal Act of 18 March 1994 on investment funds, or in the capacity of representative of a foreign investment fund, if they are not subject to a supervisory authority set up by special Act,

e. undertake asset management,

f. make investments as investment adviser,

g. keep or manage securities. "

aware of violations of penal provisions contained in the specific surveillance legislation or in the Penal Code (including articles 305bis and 305ter).

The Money Laundering Act requires all financial intermediaries to be authorised. It enables authorised *Self-regulatory organisations* (SROs) to implement the measures to combat money laundering in their sector of activity. Such SROs must be authorised and are supervised by the *Money laundering control authority* which is integrated into the Federal Finance Administration. It is in addition responsible for directly monitoring compliance with the obligations laid down in chapter 2 of the MLA for legal and natural persons who are not subject to any other federal supervision.

2. Swiss efforts to combat organised crime

Organised crime is unfortunately a widespread phenomenon in contemporary society. It is both highly complex in structure and multinational in character. One of the main problems is that criminal organisations have succeeded over the years in infiltrating political, economic and financial systems and in integrating their illegal operations into legal activities. Due to these particular factors, organised crime is especially difficult to identify, define and suppress. Traditional enforcement techniques have consequently been adapted and improved with the aim of enabling Sivitzerland to fight this new form of organised crime effectively.

Swiss criminal law calls for sar Jons against all offences that come under the category of organised crime. These include money laundering, corruption, fraud, narcotics and arms trafficking, pornography, etc. It also facilitates investigations into these offences. During judicial proceedings, the judge can order the waiving of banking secrecy and obtain account information from the bank concerned. Banking secrecy is therefore not an obstacle to the pursuit and conviction of the perpetrators of organised crime.

On 1 August 1994, the Swiss parliament improved these laws by adopting a series of articles aimed at **combating organised crime** (Art 260 ter, section 1 of the Penal Code (PC): Participation in a criminal organisation declared a criminal act) and **strengthening** measures related to the confiscation of assets of illicit origin, including the reversal of the burden of proof in cases of organised crime (PC, Art. 58-60).

In 1994 also, the Central Offices for Criminal Police Matters were established within the Federal Office of Police. They are charged with conducting investigations into narcotics trafficking and counterfeiting, coordinating the inquiry procedures between Switzerland and foreign countries, and evaluating all information related to organised crime.

On the international level, Switzerland collaborates in the fight against organised crime on several fronts. It is a member of Interpol and is thus

involved in all exchanges of information between police authorities. Switzerland has ratified several international agreements, both bilateral and multilateral, through which it has committed itself to providing mutual assistance in criminal matters.

3. Swiss efforts to fight corruption

The Swiss penal code punishes both active corruption (Art. 288) and passive corruption (Art. 315) with prison sentences. Currently, active corruption is less severely punished than passive corruption. However, the relevant laws are being revised with the aim of making the penalties more severe for active corruption, as well as for the corruption of foreign officials.

On 17 December 1997, Switzerland signed the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Furthermore, Switzerland actively participated in preparing this convention, in particular, by chairing the working group charged with drafting the text of the convention. A bill containing a general revision of corruption offences and the ratification of the OECD Convention is currently being discussed in Parliament.

In addition, the Swiss Agency for Development and Cooperation supports good governance and the fight against corruption in carrying out its projects in developing countries.

4. International assistance in criminal matters offered by Switzerland

Switzerland provides extensive international co-operation in criminal matters. Requests for mutual assistance in criminal matters are becoming increasingly frequent in particular because of the growth of organised crime on an international level (narcotics and arms trafficking, corruption, trafficking in women and children). Switzerland co-operates actively with foreign judicial authorities in providing extensive judicial assistance. Switzerland receives approximately 2,500 requests from abroad for assistance each year. In the large majority of cases, assistance is granted without any difficulty. The execution of these requests often requires the sequestration of assets located on Swiss territory and of bank documents relating to the alleged offence, and their transfer to the requesting state. In this case, when all the conditions set out below for assistance are met, the Swiss authorities can lift banking secrecy.

Switzerland grants international mutual assistance in criminal matters on the basis of:

- the European Convention on Mutual Assistance in Criminal Matters of 20 April 1959.
- the European Convention on Extradition of 13 December 1959.

- The European Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime of 1 September 1993 (the United States participated in the drafting of this convention but has failed to sign it to date)
- bilateral treaties on mutual assistance in criminal matters such as those concluded on 25 May 1973 with the United States of America, on 25 November 1991 with Australia, and on 7 October 1993 with Canada.
- the Federal Act on International Mutual Assistance in Criminal Matters
 which came into force on 1 January 1983. This law permits Switzerland to
 grant judicial assistance also to states with which Switzerland has not
 concluded a bilateral agreement and which are not party to the European
 Convention.

The conditions required for judicial assistance are essentially the following:

- Double criminality: The fact which forms the basis of the request for judicial assistance must also be punishable as a criminal offence in Switzerland.
- Speciality: The foreign authorities must commit themselves to use the
 information transferred to them by Switzerland solely for the purpose for
 which it was originally given. In particular, this means that the requesting
 authority is not allowed to transfer information obtained in the course of a
 mutual assistance proceeding to an authority of a different nature.
- Proportionality: A sufficient relation must exist between the crime under investigation abroad and the requested measures in carrying out the request for assistance.
- Reciprocity: In the absence of a treaty obligation, the requesting state
 must guarantee that it will give a favourable response to a demand by
 Switzerland for judicial assistance should the case arise.

Amendments to the Act on International Mutual Assistance in Criminal Matters, which took effect on 1 February 1997, have eased the process of assistance noticeably. In particular, they have clearly shortened the procedures involved by limiting the possibilities of appeal and by reducing the number of persons permitted to resort to these means to those personally and directly affected by the mutual assistance measure. The revised Act also, under certain conditions, permits the Swiss criminal prosecution authorities to transfer information and evidence to a foreign penal authority on their own initiative. Moreover, it has enlarged the powers of the Swiss federal authorities to act directly when provisional measures must be taken, as well as in complex cases or in cases of special importance.

5. Assets of dubious origin held by foreign heads of state and politicians

The Swiss financial centre, like other financial centres, is used by foreign heads of state and government officials for investing assets. There have been individual cases in the past of assets which were found to be the proceeds

from dubious activities such as corruption or dishonest management of the state.

In most cases such investments are spread across various countries and financial centres. The problem is thus one of international order.

One specific problem arises with foreign heads of state *in office* as a result of the *immunity* they enjoy under *international* law. Immunity under international law protects heads of state - and their assets - from coercive measures, in particular those under penal law for the time they are in office.

Switzerland has a very serious interest in preventing assets of dubious origin from reaching its financial centre. However, if assets of dubious origin owned by foreign heads of state or politicians nevertheless find their way to this country, Switzerland takes measures in co-operation with the country of origin to effect the blocking and restitution of the funds in question.

Responsibility for safeguarding the integrity of the Swiss financial centre lies as far as prevention is concerned - with the financial institutions in the first place. The acceptance and management of certain funds can be in breach of the Banking Law (Art. 3 lit. c: Guarantee of irreproachable business conduct). Anti-money laundering legislation is applicable against money of criminal origin (fraud, drug trafficking, see point 2.). If such money arrives in Switzerland, the bank concerned must, on well-founded suspicion, report it to the authorities and block the funds for five days. During this period, the authorities consider whether or which further measures should be taken.

The Federal Act on International Mutual Assistance in Criminal Matters (Art. 18) authorises precautionary measures if an application for international mutual assistance is announced and the conditions for judicial assistance appear to be fulfilled (see point 5.). In addition, pursuant to Art. 102 section 8 of the Federal Constitution, according to which the government (the Federal Council) assumes responsibility for the protection of the interests of the Confederation abroad, the Federal Council can in certain cases freeze the bank accounts and assets of foreign persons.

The bank supervisory authority (Swiss Federal Banking Commission (SFBC)) has refined its guidelines to require the banks to be especially vigilant with regard to the acceptance of assets from persons with important public functions and from persons close to them. The banks are prohibited from accepting funds which they must presume stem from corruption or from the misuse of public funds (SFBC circular 1/98).

Assets are often blocked in connection with an application for judicial assistance on the initiative of a foreign authority, which must present or at least announce a request for judicial assistance. Experience has shown that the restitution of blocked assets poses difficult but not unsolvable problems, in particular over questions regarding authorised recipients. In the case of the

rormer President of the Philippines Marcos USD 550m could be returned to the Government of the Philippines.

Switzerland is one of the few countries to have taken effective measures in recent cases to block and restore to the rightful owners assets of dubious origin held on the accounts of foreign heads of state and politicians. To provide an example, one can cite the Mobuto affair, where Switzerland is the only country of the 18 contacted by the government of the Democratic Republic of Congo to have frozen all the known assets of its former head of state.



RAHARAMAHAR ПРОКУРАТУРА РОССИЯСКОЯ ФЕДЕРАЦИИ 103793 CCI1, Mockes ул. Б. Дистровка. 160

Honorable Mr. James A. Leach. Chairman of the Committee On Banking and Financial Services, U.S. House of Representatives

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Dear Mr. Leach,

I am cordially grateful for your kind invitation to take part in the hearings of the Committee headed by you on the issues of utilization of financial system of the United States by the Russian organized crime in order to launder the crime proceeds.

The theme discussed by the Committee is of especially great importance for Russia which is seeking now for ortimal economic, legal and organizational measures aimed at prevention of illegal capital flows from the country and repatriation of the illegally transferred funds. Successful results of our law enforcement in combatting this evil will mean the improvement of the life conditions for hundreds of thousands of Russian nationals.

I am deeply convinced that the forthcoming hearings will allow to develop valuable recommendations to the financial land law enforcement structures of Russia and USA in counteracting to infiltration of dirty money into our financial systems. Rich experience accumulated by the U.S. Congress in conducting similar hearings guarantees the SUCCESS.

Unfortunately, the legal status of the Prosecutor-General of the Russian Federation deprives me of the opportunity to take part in such hearings conducted by the Diet of other country. I hope that I will be able to contribute otherwise to the solution of noble tasks determined by the Committee on Banking and Financial Services and by you . personally, dear Mr. Leach.

Respectfully and sincerely,

relaysasses Prosecutor-General of the RF

Statement of Representative Judy Biggert (K-IL) Committee on Banking and Financial Services Money Laundering and Corruption in Russia September 30, 1999

Thank you Mr. Chairman.

I am pleased to participate in this morning's examination of alleged Russian corruption.

Since August, serious charges of the laundering of billions of dollars have been reported.

These reports include allegations that Russian President Boris Yelstin's own administration may have benefited from the illegal channeling of huge sums of money into foreign accounts.

These allegations are most disturbing because they begin to raise questions about what actually has been achieved in Russia.

Have these allegations of corruption threatened Russia's domestic stability? Has money laundering stunted the growth of true democracy in Russia? Has the Kremlin itself doomed any hope for a solid foundation for a market-based economy?

And what of U.S. shareholders and U.S. corporations who may have fallen victim to this corruption?

The committee also should consider if these reports raise red flags with other U.S. taxpayer-funded programs, such as loans guaranteed to Russia through the Export-Import bank.

Do we owe the American public a complete and full accounting of all Russian aid programs?

I hope all of our panelists today will shed light on these questions and many others as they provide their views on the Russian corruption problem.

I thank Mr. Leach for holding this very important discussion and look forward to hearing testimony from today's panelists.

Thank you Mr. Chairman.

STATEMENT OF REP. JOHN J. LaFALCE BEFORE THE COMMITTEE ON BANKING AND FINANCIAL SERVICES U.S. HOUSE OF REPRESENTATIVES

HEARING ON MONEY LAUNDERING, CRIME, AMD CORRUPTION IN RUSSIA

SEPTEMBER 21, 1999

Mr. Chairman, thank you for holding these important hearings.

Recent press reports have revealed major problems in the areas of money laundering, diversion of funds, and crime and corruption in Russia that have reached into the U.S. banking system. The situation has called into question the efficacy of our money laundering statutes and the monitoring capabilities of our international financial institutions.

I am very concerned with the serious allegations of crime and corruption in Russia and the alleged infiltration of the country's government institutions by organized crime. While we are not in any position to dictate how a country should run its internal affairs, we are fully entitled to an accounting of whether the funds provided by international financial institutions are being used for their intended purpose. These funds involve significant U.S. taxpayer resources and it is our duty to ensure that they are not misused.

At the same time, I believe that our national security and the stability of the world's financial system demand our continued constructive involvement with Russia. As a democracy experiencing growing pains, and still purging itself of the political and economic ghosts of its Soviet past, Russia needs our help. Isolating Russia, and isolating ourselves from Russia, is not the solution.

I see little to gain in the simplistic option some suggest of abandoning as substantial and as troubled an economy as Russia's.

I recognize there are challenges to our continued engagement, and the memorable words of Sir Winston Churchill more than a half a century ago still ring true: "I cannot forecast to you the action of Russia. It is a riddle wrapped in a mystery inside an enigma." However, as painful and frustrating as the process might be, I believe that the ultimate payoffs from our continued engagement with Russia are greater than the risks.

It is, however, time to ask some tough questions and get the answers we need to make this policy of engagement work better. We should continue to encourage economic and political reform in Russia, but we should also impose tough conditions on the assistance we give and find better mechanisms for monitoring compliance. Unless we can obtain the necessary cooperation from Russia to make that possible, our long-term involvement could be at risk.

I do believe that there is one area of our policy that deserves particular scrutiny, and hopefully will teach us some important lessons. A major part of what went wrong in Russia was the decision to embark on a program to privatize state-owned enterprises. Privatization itself can be of great benefit to a society. As I wrote in a letter to President Clinton in March, 1995, it can serve two important purposes: (1) to achieve greater equity and new opportunity in the distribution of a society's wealth and assets; and (2) to restructure key resources, such as utilities, transportation, banks and trading companies, to permit them to respond to market forces rather than government dictates.

I said then, and I re-emphasize now, that "the United States has an interest in ensuring that economic opportunities provided by privatization efforts are widely available ...in a way that allows greater access to the wealth of society...(A)n equitable approach to privatization will help ensure a more stable economy."

But there is another approach to privatization -- what I called "patron" or "nomenklatura" privatization -- and it is the road Russia took. Russian privatization has come to mean the wholesale transfer of valuable state assets to a small group of tycoons who are more interested in taking value out of the country than investing in it. This type of privatization concentrates wealth and puts an economy at risk.

Secretary Summers, I would appreciate your analysis of what went wrong and what we can learn about managing such situations in the future. And, Mr. Chairman, I would also ask that the letter I mentioned and other statements I have made on the privatization issue be inserted in the record.

Let me now turn to the specific issue of money laundering. Of the many public policy challenges facing lawmakers, the law enforcement community, and regulators today, none may represent as significant a threat to our financial system as money laundering does. The wholesale "cleansing" of illegitimate profits derived from criminal activities reaches staggering proportions – by some estimates, between \$100 and 300 billion in the U.S. alone, and nearly \$500 billion -- one-half trillion! -- worldwide. By comparison, this figure dwarfs the GDP of many small- to mid-size nations.

Press reports have now alleged that up to \$10 billion of possible illicit Russian money passed through one bank. However, the facts of this particular case are very sketchy and the criminal authorities are investigating. It would be premature for us to pass judgment on any aspect of this case without a full accounting of the facts. I look forward to the findings of the current ongoing criminal investigations.

The Banking Committee last took legislative action on the money laundering issue in 1994, when we passed the Money Laundering Suppression Act. Up until recently, the emphasis on financial institutions' compliance with cumbersome paperwork requirements worked against the effective enforcement of money laundering laws. The 1994 Act made reporting requirements under the Bank Secrecy Act more meaningful and more useful to law enforcement.

But even with these targeted changes, every so often we learn of egregious cases that our regulatory system is supposed to catch but misses altogether. And often they occur in vulnerable, emerging democracies like Mexico and Russia, places where the rule of law is still, unfortunately, not fully consolidated. When the big cases strike, we begin to wonder whether the regulatory system, our first line of defense, truly works.

I do believe, Mr. Chairman, that it would have been productive for us to examine regulatory issues in this hearing, which are ripe for revisiting. I regret that the bank regulators are not here, either today or tomorrow, to explain to us what may or may not be wrong with our current regulatory system. I hope we will hear from them in the not too distant future.

APPENDIX

STATEMENT OF REP. JOHN J. LAFALCE

COMMITTEE ON SMALL BUSINESS

HEARING ON
"THE PRIVATIZATION EXPERIENCE: STRATEGIES AND IMPLICATIONS FOR
SMALL BUSINESS DEVELOPMENT"

April 14, 1994

The Small Business Committee convenes this morning to examine the issue of privatization. It is an economic process which U.S. policy supports, but there remains substantial

confusion about what it is and how it works.

It is imperative that we achieve a better understanding of the policy implications of this important means of economic transformation. Privatization carries with it the hopes of the emerging democracies, for whom it is the primary vehicle for creating market economies under a rule of law, and facilitating economic growth and development. If accomplished successfully, privatization can legitimately be expected to increase economic efficiency and provide broad-based benefits to a country's citizens. However, if poorly implemented, privatization may only serve to channel resources to the same or different powerful elite groups. The issue this Committee meets to consider is whether privatization in practice lives up to its promise.

whether privatization in practice lives up to its promise.

The worldwide push for privatization in the past decade responds to both ideological and economic changes. Governments once committed to state ownership as a matter of ideology or to state-created enterprise as the quickest path to modernization, now see privatization and expanded private markets as the best means to increase competition, enhance efficiency, and meet urgent infrastructure and development needs. Numerous Asian and Latin American countries have made privatization a central feature of broader market-oriented reforms and democratization efforts, while reforms in Central and East European nations and the republics of the former Soviet Union are virtually synonymous with privatization.

Much of the hope surrounding privatization is based on the encouragement and support for small business that it can provide. Proponents herald privatization as a means for small-business entrepreneurs in particular to create their own economic opportunities and "grab a piece of the action," and in the process spur general development. The Enterprise Funds for Poland and Hungary were one manifestation of this approach.

Yet, however well-intentioned, the privatization process has not always resulted in equitable opportunities for citizens and businesses who wish to participate. Instead, we often see "patron" or "nomenklatura" privatization, which allows an elite with influence and power to control the outcome and rewards of privatization.

In Mexico, the Indian uprising in the southern state of

Chiapas reminds us that, however significant a country's ecc.omic reforms may appear, its success depends ultimately on significant improvements in equity. In this case, Mexico's removal of Constitutional protections against privatization of communal farmlands was one of the sparks that lit the fire of political reform nationwide. This morning we will hear more details regarding the consequences of Mexico's privatization strategies from our witnesses.

A world away from rural Chiapas, officials of the Russian Republic are also engaged in massive privatization of state-owned properties. Thousands of small businesses have been sold for cash in public auctions, and a system of private vouchers has been created to distribute ownership of medium and large-scale enterprises throughout the population. Privatization of the bulk of Russia's material wealth has set off a scramble for available assets in which corrupt, criminal and even violent methods are becoming commonplace.

In this environment, the persons who appear to have benefited most from privatization are the former elite of the Communist system, the "nomenklatura" of high-level economic managers and former party officials with access to information, political contacts and foreign currency. While even this privatization may be preferable to continued state ownership,

surely we must strive to do better.

Countries as diverse as Chile, Malaysia and Poland have put up for sale their airline systems, trading companies, banks, transportation systems, telephone services, ports and power systems. Throughout the world, privatization has raised hopes for improved efficiency, reduced bureaucracy, new foreign investment and greater prosperity.

Many of these privatizations appear successful in dispersing ownership, enhancing efficiency and increasing competition. But, as experience in Mexico and the Russian Republic suggests, other privatization efforts have failed to show that private ownership and operation are more efficient or respond better to consumers and workers.

The problem may be, not that privatization <u>per se</u> is flawed, but that we have developed little basis to measure success. Too often, issues of social equity which should be central have been ignored.

This morning we have a distinguished panel of experts on privatization who will enlighten us on the process of privatization, how it operates in various regions, and what the successes and failures have been thus far. We will hear first from Mr. James Waddell, Executive Director of the International Privatization Group at Price Waterhouse. Mr. Wadell's organization has recently developed a data base on privatization for A.I.D.

Next, Mr. Richard Barnett is Senior Fellow and a founder of the Institute for Policy Studies. Mr. Barnett is co-author of the well-known book <u>Global Reach</u> and has recently published a sequel, <u>Global Dreams</u>. Mr. Anders Aslund is Director of the

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Stockholm Institute of Soviet and East European Economics and currently is a Guest Scholar at The Brookings Institution.

Mr. Chris Whalen returns to our Committee bringing his indepth experience in Latin America and a particular focus on Mexico and Chile. Dr. Lynn Nelson is a professor of sociology at the Virginia Commonwealth University. He spent half of the past three years in Russia and recently published a study on his research there entitled <u>Property to the People</u>.

research there entitled <u>Property to the People</u>.

Finally, Mr. Daniel Singer, Of Counsel with Fried, Frank, Harris, Shriver and Jacobson, will provide the legal perspective. He is a specialist for the Central and East European Law Initiative of the American Bar Association and has traveled to Poland to lend his legal expertise to the privatization effort.

STATEMENT OF REP. JOHN J. LAFALCE

COMMITTEE ON SMALL BUSINESS

HEARING ON "PRIVATIZATION: "THE GOALS AND IMPLEMENTATION OF U.S. POLICY"

May 12, 1994

The Small Business Committee meets this morning to continue its examination of the global privatization process and its implications regarding business opportunity and economic equity in the societies involved.

On April 14, the Committee heard from witnesses representing practitioners, academics, and consultants. This morning we welcome Administration witnesses as we focus specifically on U.S. privatization policy: what our goals are and how we implement them.

Privatization is a central tenet of the economic policies of more and more countries around the globe, particularly since 1989 when Eastern Europe and the former Soviet Union began to transform their centrally-planned economies to ones that are market-oriented. However, there appears to be more concern with the number of privatizations as a measure of success--more than 8,500 in over 80 countries since 1980, according to the World Bank--than with the quality and effects of the conversions. Too much is at stake to make this merely a numbers game.

In my view, the way in which privatization takes place is at least equally as important as the fact that it occurs. Privatization can be a vehicle for either distributing the wealth of a society more equitably or for unfairly concentrating that wealth.

U.S. policy should recognize such differences, and strive for the most equitable distribution of existing and potential societal wealth as is feasible. I am concerned that U.S. policy, as currently conceived and implemented, does not do that, and may concentrate its efforts on the objective of privatization itself, with little, if any, attention to who benefits and who loses in the process. We see too much of the so-called nomenklatura or patron privatization which excludes adequate opportunity for a broader-based process that would enhance the socio-economic conditions of the greater body politic--what I would call: Empowerment Privatization.

Our policy must bring certain standards to bear, and those standards must reflect the particulars of a country's experience. Privatization comes in many forms and uses an array of methods-bids, shares, auctions, coupons, etc. Perhaps no one method is inherently preferable. Moreover, the conditions country-by-country are vastly different. As Poland's former Finance Minister Balcerowicz recently observed, how privatization functions in a country depends on variables such as micro and macro economic conditions, debt, human capital and their

interactions with political conditions. It seems reasonable, then, to have multiple criteria by which to measure success

depending on the situation of the country.

However, we must not make the mistake of using criteria that only look through the prism of economic data. At our last hearing, one witness argued that Russian privatization has been a huge success because "it has been a large transfer.. (and) there are very many owners now in Russia." In contrast, another witness pointed out that, while Russia's experience has been quantitatively impressive, the economic figures mask the less positive qualitative features of privatization. He noted that "the promise of fair property distribution among the population was not being realized, and the inadequacies of the privatization program contributed importantly to the worsening of Russia's economy and to the political conflict." This week the Financial Times reported a deep crisis in Russia as output has plunged 25 percent. According to the reported poll, a majority agreed that "privatization is legalized theft" and two-thirds of respondents believed that privatization was "undertaken for the benefit of nomenklatura and criminals."

Similarly, the New York Times reported in October 1993 that privatization in Mexico has increased competition among the handful of families bying to be Mexico's wealthiest clan. According to a quote in the report, "The booty of privatization has made multimillionaires of 13 families, while the rest of the population-some 80 million Mexicans-has been subjected to the same gradual impoverishment as though they had suffered through a war." While privatization income helped Mexico's Government service its debt, it also caused 400,000 Mexicans to lose their

jobs.

The United States and other Western governments have offered enthusiastic support for privatization efforts. But general observations of this nature must be coupled with a note of caution. Such caution is particularly important given what may be increasing skepticism about our own motives. In Russia, for instance, privatization policies have become linked in the minds of many with the United States because of U.S. officials' highly visible and public support for economic reforms. A number of Western advisors to the Russian Government, reported one hearing witness, are viewed by Russian citizens as representing U.S. and other Western business and commercial interests. In fact, in February this year, the <u>Wall Street Journal</u> reported that nearly 50 to 90 percent of the money in any given U.S. aid contract directed to assist economic transformation in Russia comes back to the United States in the form of consultants' fees. Given the perceived link between reform and Western business interests, it is plausible to expect that the United States could share the blame for economic failures and dashed expectations that would result from a privatization effort not sufficiently driven by concerns for equity.

Similarly, press reports this week announced enormous public disillusionment in Hungary with economic reform--and a resulting

nostalgia for communism that led to the former communists, now the Socialist Party, winning 33 percent of the first round in parliamentary elections. A similar resurgence of communist support has occurred in Poland and Lithuania. This is certainly nor what U.S. policy on privatization has been trying to achieve

not what U.S. policy on privatization has been trying to achieve. It is time for us to ask some probing questions about U.S. policy on privatization and how we implement it. In particular, we must assess whether we are giving adequate attention to analyzing the actual results of privatization efforts and determining who in these societies is benefiting. We must also determine who in the United States benefits from tax dollars going for privatization overseas, and whether such commercial concerns have too great an influence in the formation of our policy or nonpolicy. Our criteria for success and for failure must be made more explicit, and it is time to make any mid-course corrections in our policy efforts that are warranted.

We are pleased this morning to welcome Administration witnesses who are knowledgeable about, and intimately involved with, privatization efforts worldwide. We will begin with Dr. Carol Lancaster, Deputy Administrator for the Agency for International Development. Next is Under Secretary of the Treasury for International Affairs Lawrence H. Summers.

We also welcome two Ambassadors from the Department of

We also welcome two Ambassadors from the Department of State: Ralph R. Johnson, Coordinator for East European Assistance, and Thomas W. Simons, Jr., Coordinator of U.S. Assistance to the New Independent States. We look forward to your presentations.

September 21, 1999 House Banking Committee Russian Money Laundering Opening Statement Rep. Carolyn Maloney (D-NY)

Thank you Mr. Chairman.

Mr. Chairman, the allegations of money laundering at the Bank of New York have again brought to view the serious challenges Russia faces in becoming a stable, peaceful participant in world affairs.

While the country has shed the inefficiencies of central planning, the prevalence of corrupt elements in Russian institutions continues to restrict true market reforms from taking hold.

However, while a year ago the Russian economy resembled something of a black hole, limited signs of recovery are emerging.

The Russian Gross Domestic Product is showing signs of improving and the country is expected to have a trade surplus this year. Of course, these developments must be viewed in the proper context. They are the very small steps of a deeply troubled country.

In the long term, this progress will be lost without the development of an enforceable legal framework. In this context it is imperative that President Yeltsin and the Duma agree on a national money laundering statute. Major reforms are also needed in the nation's banking sector.

Given the example that we are reviewing today, we in the U.S. should likely review our own anti-money laundering safeguards. Where were the U.S. bank regulators as billions of dollars were laundered through the Bank of New York?

Chairman Leach, while the details of this ongoing investigation have not been fully revealed, the conduct of the Bank's regulator -- the Federal Reserve -- would appear to be a topic worthy of examination by this Committee.

I look forward to hearing Secretary Summers' views on these issues as his important work in battling the Asian financial crisis makes him a most appropriate Treasury Secretary for this hearing.

Thank you Mr. Chairman.

Opening Statement by Rep. Royce

Hearing on Russian Money Laundering and the IMF U.S. House Banking and Finance Committee Tuesday, September 21, 1999

Secretary Summers, I am glad to see you and I commend Chairman Leach for holding this timely and important hearing. What we are examining today is a very serious issue one that goes to the heart of U.S.-Russia relations. It is worth noting, however, that Russian corruption and this Administration's response to that challenge, is not a new issue.

In fact, three years ago, this committee held a hearing on organized crime in Russia and the threat to international banking systems. We heard from representatives of the Federal Reserve Board, the Financial Crimes Enforcement Network, the FBI, the Department of Justice, and recognized authorities on Russia. During that hearing, I brought up questions of extreme capital flight and accountability with respect to International Monetary Fund loans. Specifically, I raised concerns about the lack of money laundering laws in Russia and our inability to impose standards on foreign banking institutions. Further, I questioned what guarantees we had that billions of dollars in IMF and international loans to Russia reached their intended recipients and were not instead diverted outside the country by organized crime.

Two years prior to that hearing, in 1994, I said, "Our aid to Russia should be conditioned on assurances from both Russia's government and our own, that all is being done that can be done in respect to monitoring and countering the growing threat of these crime syndicates before they can choke off the infant democratic experiment in the former Soviet Union. This is about countering a real threat to the chances for a successful transition in the former Soviet Union, and it is about stopping an international crime wave before it crests on our own shores." Five years and billions of dollars later, these questions may have risen to the level of scandal.

Unfortunately, not much has been done in the last five years. IMF Managing Director Michel Camdessus recently said, "it is impossible to determine whether specific capital flows from Russia -- legal or illegal - come from a particular inflow, such as IMF loans or export earnings." Apparently, once IMF funds are released to the Central Bank, there is no way of tracking where the money, in this case maybe \$10 billion dollars, goes.

American taxpayers deserve better. However, *The New York Times* recently reported that the Clinton Administration officials learned of allegations of Russian money laundering at the Bank of New York five months earlier than they previously acknowledged. Yet, the Administration continued to rally for more aid to Russia, even though they were fully aware that these funds were not reaching their intended recipients - the Russian people. Instead of making a genuine effort on critically needed structural reforms, the emphasis was placed on touting feel-good stories about dubious success in the Russian economy. So in the end, funds flowed to a Russia where corruption ran rampant, anti-money

laundering bills were vetoed by Boris Yeltsin, and politicians did little but throw up their hands and say, "Well, this is just the nature of Russia."

What I am interested in finding out today is whether the Administration has, acquiesced to the cycle of corruption in Russia so it could claim reform in name only. Policies that turn a blind eye to real reform do irreparable damage to the process of democracy building. This does a tremendous disservice to the people of this country and to the people of Russia.

I look forward to hearing from our witnesses today.

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OPENING STATEMENT BY REPRESENTATIVE NYDIA M. VELÁZQUEZ

HEARINGS ON RUSSIAN MONEY LAUNDERING AND THE BANK OF NEW YORK HOUSE COMMITTEE ON BANKING AND FINANCIAL SERVICES

September 21, 1999

Thank you Mr. Chairman. I would like to applaud you for holding these hearings in such a timely manner. It is important that we in Congress demonstrate that we are serious about stopping money laundering through our financial institutions. In this particular case, it is important that we determine whether or not aid given to Russia was diverted to Russian organized crime figures and eventually laundered through U.S. banks.

However, I would like to focus on another problem that the Bank of New York case highlights – that of money laundering and its relationship to drug dealing. In the United States alone, estimates put the amount of drug profits moving through our financial system as high as 100 billion dollars. As most of you on this Committee know, I have been working for more than five years to improve our nation's ability to combat money laundering. Money laundering provides the fuel for drug dealers and other criminals to operate and expand their activities, which can have a devestating social and economic consequences on our communities.

Five years ago, my constituents came to me and demanded that something be done about the drugs and drug culture in their communities. That's why, in 1995, I brought together local and state law enforcement officials to discuss the effects of money laundering and drug activity on New York residents. From this Working Group came the conclusion that in order to combat drugs, we needed to stop the flow of money to and from the drug dealers.

From the insights provided by this coalition, I drafted the "Money Laundering and Financial Strategy Act," which was signed into law last year. This Act takes three important steps in combating money laundering. First, it authorizes funding to help state and local officials combat money laundering. Second, it establishes "High-Intensity Financial Crime Areas" (or "HIFCAs,") which will help concentrate the law enforcement resources in the areas where they are most needed. Finally, the Act mandates the Treasury Secretary to develop the first comprehensive national Strategy to combat money laundering.

The money laundering Strategy mandated under the Act was due in February of this year. I am pleased to announce to my colleagues today that, through the hard work of Secretary Summers, the first comprehensive anti-money laundering Strategy in our nation's history is ready to be unveiled. In fact, the Treasury Department was ready to deliver the Strategy to Congress at the end of last week, but I asked that it be postponed because Members were out of town as a result of Hurricane Floyd.

First of all, I would like to congratulate Secretary Summers for his hard work on the strategy. From the beginning, he has shown that this Strategy is a priority for his Administration, I would also like to thank Deputy Secretary Bizenstat, Undersecretary Jim Johnson, Deputy Assistant Secretary David Medina, and Chief Counsel Stoven Kroll.

I want to take this opportunity to offer my sincere appreciation to my colleagues on this Committee who supported my legislation and fought for it as if it were their own. I especially want to thank Chairman Leach, Ranking Member LaFalce, and Representatives Roukema, Bachus, and King.

I have had the chance to make a preliminary review the document, and have determined that the Strategy meets the requirements established under the Act. Although not perfect, the strategy is an important step in the right direction. And, as many of you know, the second annual Strategy is due in February of 2000, so we will have the opportunity to weigh-in with Treasury and have the Strategy improved over the next few months.

These hearings and the current investigation of several Bank of New York accounts highlight the need for a comprehensive suti-money laundering Strategy and demonstrate several important weakness in America's current anti-money laundering system.

One of the weaknesses in the current system is the lack of cooperation - both from the standpoint of local, state, and faderal law enforcement cooperation, and from the standpoint of cooperation between the financial institutions and law enforcement officials.

In this case, the Bank of New York did not file a "Suspicious Activity Report" until after the Justice Department had subpoensed account records. Had Bank of New York officials been diligent in filing the required reports, federal law enforcement officials would have had the opportunity to act more quickly.

In order for money laundering detection to work in the United States, there must be cooperation between banks and law enforcement officials. In most money laundering cases, the banks are in the best position to know if illegal activities are taking place.

The anti-money laundering strategy addresses those issues and has listed among its priorities enhancing the regulatory an cooperative efforts between financial institutions and law enforcement officials, and the strengthening of cooperative efforts between state, local and federal law enforcement officials.

Another problem with our current efforts against money laundering is the underutilization of our current resources, which often leads to duplication and inefficiency. Many times State and local law enforcement officials do not utilize the resources that are available to them through the various federal agencies. In addition, federal law enforcement agents frequently do not utilize all

of the federal resources at their disposal. In fact, a 1998 GAO report! found that 24% of the federal field agents surveyed were not even aware of the anti-money laundering products and services offered through the Financial Crimes Enforcement Network ("FinCEN").

Because the current federal anti-money laundering offices are spread out through various agencies of the federal government, state, local, and even federal law enforcement agents are unaware of how these programs should interact, and, as a result, the current potential of our nations law enforcement agencies ability to combat money laundering remains untapped.

One of the objectives of the Strategy is to define the roles of each law enforcement agency in the fight against money laundering; provide an outline as to how those agencies are to cooperate, interact, and avoid duplication; and to ensure that every agency – whether state, local or foderal – is aware of the resources provided by other agencies.

However, the most important aspect of the Strategy may simply be the development of a comprehensive national policy. For the first time, the Strategy puts in writing the goals for our fight against money laundering, and, more importantly, how the various federal agencies charged with fighting money laundering should work together to reach these goals. This will help, not only in the utilization of existing resources, but also will give the law enforcement community focus in its battle against money laundering.

The Strategy should be seen as a blue print for building a coherent and effective antimoney laundering force. Without such a plan, the coordination of the various agencies would be impossible – which is reflected in the current lack of a coherent policy. Much like trying to build a house without a blue print – it does not matter how effective your workers are if they are not all working from the same plan.

Thank you again Mr. Chairman, and I look forward to hearing from our witnesses.

^{1 &}quot;Money Laundering: FinCEN's Law Enforcement Role Is Evolving," p. 25; June 1998.

Congresswoman Maxine Waters' Statement September 21, 1999 House Banking and Financial Services Committee Bank of New York Money Laundering Hearing

I am not at all shocked that we have to convene once again to address the most serious issue of money laundering in United States financial institutions. As many of your know, I have worked very hard on the money laundering issue, particularly as it relates to drug trafficking. I was an original cosponsor of HR 4005, the "Money Laundering Deterrence Act of 1998" and had four amendments which were included in the bill.

I spoke in opposition to the Citicorp/Travelers merger due to the ongoing Department of Justice investigation into money laundering and other potential financial crimes involving Raul Salinas and Cithank. I've held press conferences and sent numerous letters to the Department of Justice, the United States President, and Members of the House Banking and Financial Services Committee. I have appeared on television shows and spoke on radio programs to discuss money laundering, drug trafficking, and their devastating impact on America's communities.

Last year, I introduced legislation to include money laundering as a priority when the Federal Reserve considers bank applications for mergers or acquisitions and I have recently introduced the "Integrity in Banking and Money Laundering Prevention Act of 1999" to help eliminate money laundering in the banking industry.

The House Banking and Financial Services Committee has not done enough to ensure that our financial institutions are free from abuse by alleged drug traffickers such as Semyon Mogilovich, one of the leading figures in the investigation of money laundering at the Bank of New York. My remarks today will focus on three problems with our current anti-money laundering laws and legislative solutions to each.

Law enforcement officials have stated that one of the biggest problems they encounter in money laundering investigations, particularly where there is an international flow of funds such as the case where money flows from Russia through offshore accounts and then into accounts in the United States, is the inability to reconstruct an audit trail for prosecution purposes. This was a major obstacle in the case of Raul Salinas and is an obstacle for law enforcement in the present money laundering scandal. I have identified two areas that should be addressed to aid law enforcement in money laundering investigations. The first is proper maintenance of concentration accounts and the second is adequate documentation of the beneficial owner of offshore accounts.

Concentration accounts are business accounts maintained by a financial institution in which funds from various sources are commingled. In July 1997, the Federal Reserve Bank of New York issued "sound practice guidelines" that highlighted concentration accounts as a weakness in money laundering controls. The Federal Reserve reported that concentration

accounts could "mask unusual transactions and flows" making it nearly impossible to establish the ownership of all funds in a single account.

During last year's money laundering hearings on HR 4005 I asked Herbert A. Biern, a witness from the Federal Reserve's Board of Governors Division of Banking Supervison, about the potential for money laundering through concentration accounts. He stated that banking organizations should make sure that they have clear records about fund transfers and if banks want to use a concentration account, also called a suspense, or omnibus account, then they should keep proper records. My legislative proposal would require that banks who use concentration accounts maintain all accounts in such a way as to ensure that the name of the account holder and the number of the account are associated with all account activity of the account holder. This requirement will aid law enforcement and help to protect banks from money laundering abuses.

Similar artention must be paid to offshore accounts. Offshore accounts are havens for money launderers and drug traffickers. In the case of Raul Salinas, a phony offshore company named Trocca was set up which allowed Salinas to hide the flow of illegal drug money. In the present case, one of the key accounts through which money is suspected of being laundered belongs to a company called Benex, which investigators believe filtered money for Semyon Mogilovich, the alleged kingpin of Russian organized crime. According to investigators, it is likely to take months before they can sift through the documents and penetrate the complex web of offshore companies and bolding companies to determine precisely where the money came from and where it went. My legislation would aid law enforcement efforts by requiring enhanced recordkeeping of the beneficial owners of such offshore accounts.

Finally, I want to address the penalties assessed against banks convicted of money laundering. During an April 15, 1999 hearing on trends in money laundering. I asked a Department of Justice witness how many United States or foreign depository institutions had lost their charter as a result of a conviction, or a civil penalty imposed for money laundering. The response I received from the U.S. Department of Justice is that "no U.S. or foreign depository institution has lost its license as a result of money laundering activities in the United States." My legislation would give courts the ability to double the sentence against persons and institutions that violate United States anti-money laundering laws with respect to foreign high-intensity money laundering areas.

If we do not have the courage to address the practices of our financial institutions the money laundering abuses will only get worse.

EMBARGOED UNTIL 10:00am EDT Text as prepared for Delivery September 21, 1999

Treasury Secretary Lawrence H. Summers Testimony before the House Banking Committee

Chairman Leach, Ranking Member LaFalce, Members of the Committee, I welcome this opportunity to discuss our financial policies towards Russia in light of recent reports and allegations regarding corruption, capital flight, and money laundering. Given the crucial law enforcement challenges these issues pose, and given our significant national security and economic interests in Russia, it is certainly timely for this Committee to hold a hearing on these matters.

Let me say at the outset, in the wake of recent allegations of money laundering through a U.S. bank, that safeguarding the integrity of the American financial system is an absolute priority for this Administration. We are committed to the full investigation of these allegations, to the prosecution of any crimes uncovered, and to strengthening our capacity to combat future abuses. We will continue to press Russia and other countries to put in place the laws and enforcement capacity to combat money laundering and other cross-border crimes.

I would like to cover four topics in my remarks this morning: first, the broad context of our economic and financial engagement with Russia; second, Russian corruption, capital flight, and international money laundering; third, our financial policy towards Russia going forward; and fourth, our policies generally to combat global corruption and money laundering.

I. Russia's Economic Transition and American Engagement

It would be difficult to overestimate the seriousness of the problems facing Russia today in the wake of the monetary and financial collapse of August 1998 – a collapse that was itself the consequence of long-standing Russian failures to finally establish and implement comprehensive

reforms against the background of a deterioration in the international economic environment. These difficulties are of grave concern to the United States and will shape the terms of our engagement with Russia in the months ahead. But even as we recognize the enormity of Russia's problems, it is important to see them in their broader context.

After the collapse of the Soviet Union in 1991, Russia faced four difficult transitions: the transition from empire to state; the transition from totalitarianism to democracy; the transition from the law of force to the force of law; and the transition from a command economy to a market economy. The American people had then, and continue to have, an enormous stake in Russia's making these transitions peacefully and successfully:

- It is a stake that derives from our national security interests, made all the more important by the large number of nuclear weapons that remain on Russian soil.
- It is a stake that derives from our interest in a strong and stable global economy and international financial system in which Russia becomes a healthy participant.
- And it is a stake that derives from our interest in protecting the integrity of our markets and
 our financial institutions from the scourge of corruption and money laundering be it in
 Russia or any other country.

The United States has pursued these critical interests bilaterally in a number of ways: through far-reaching arms control and military cooperation with Russia; through extensive formal and informal mechanisms and contacts; through bilateral aid programs; and through direct linkages between American and Russian law enforcement agencies.

Along with technical assistance, the aspect of Russia's transformation in which the Treasury Department has been, and continues to be, most heavily involved is Russia's interaction with the international financial institutions. We have supported that interaction because of our assessment of the strong U.S. interest in Russia's constructive evolution.

Conditioned financial support

From the start, the overarching economic objective of the international financial institutions in their operations in Russia has been to help Russia develop the policies and institutions of a functioning market economy as the route to stability and growth, an objective that the United States has supported as the major shareholder in these institutions. Economic instability in Russia raises important concerns for our national security, given Russia's pivotal and continuing role with respect to nuclear security, the battle against terrorism, the stability of Eurasia, and conflict resolution in global hot spots like the Balkans.

The crucial tool of the international financial institutions to support economic reform in Russia has been conditioned finance. At every step, we have been clear-headed in endeavoring to strike a careful balance:

· Between conditionality that requires what is best economically and is also politically

realistic.

- Between the desire to effect meaningful reform and the need to avoid excessive intrusion in decisions that Russia must ultimately embrace for itself.
- Between the goal of creating investor confidence in Russia and attracting foreign capital and the need to avoid moral hazard problems that would result from large amounts of unconditional finance.
- Between the goal of dismantling the apparatus of communism and the need to cushion the impacts of the process of change.

Our support for official financing for Russia has been grounded in the application of conditionality and in the recognition that we cannot want successful market reform in Russia more than Russia's government and its people do. America's interest lies in making reasonable, informed judgments on what we believe to be the right direction for Russia, and in conveying these views clearly to Russia's government and its people.

Providing assistance in a way that puts the integrity of the international financial institutions at risk serves neither American interests, nor those of Russia or the international community. It is critical that countries respect the conditions of programs reached through negotiations with the International Monetary Fund or World Bank. The IMF and World Bank must hold Russia accountable for its performance, both in implementing agreed-upon policy actions and in ensuring that multilateral financing is used for its intended purposes.

A review of the record of lending to Russia by the IMF and World Bank shows that these institutions have tailored their support to the circumstances. For example, in 1996, the IMF took the then-unprecedented step of introducing monthly monitoring of Russian policy performance in its 1996 program. In addition, the IMF withheld financing when previously agreed-upon conditions were not met.

- In 1996, monthly IMF tranches were delayed eight times, including twice before the summer elections, and two tranches were never disbursed.
- Under Russia's 1996-97 EFF program, actual disbursements were \$1.6 billion, or 28%, less than originally planned because of shortcomings in Russian policy performance.
- After the August 1998 monetary and financial collapse, the IMF ceased lending to Russia for a year until Russia began implementing a new economic program focused on restoring financial stability.

Similar failures to follow through on policy commitments have also constrained World Bank lending to Russia.

Russia's record since 1992

No one, here in the United States and certainly in Russia, can be satisfied with developments in Russia during the past decade. Growth has been stagnant, corruption has been all too prevalent, and a law-based market economy has not been established. Since August 1998, Russia has struggled, albeit with more success than most expected, to avoid the perils of hyperinflation and economic collapse. There have been some positive signs; for example, industrial production in August was 16% above its level a year ago. But the fact remains that the Russian government has failed to implement some of the most basic and critical reforms, and enormous challenges remain.

At the same time, the record also demonstrates that Russia today is in many ways a very different country than it was a decade ago:

- Russian nuclear weapons are no longer targeted at our cities; 1,500 nuclear warheads have been deactivated, and over 300 bombers, silos, and launchers have been destroyed.
- Russian military spending has dropped dramatically in real terms to about one tenth of its Soviet-era peak in 1988; Russian troops have been withdrawn from the Baltics and Eastern Europe; and Russians are working side-by-side with NATO in the Balkans.
- Russia is now more open; Russians can learn what happens in the markets and societies
 beyond their borders, have access to the ideas and products that the world has to offer, and
 have unprecedented personal freedoms, even if the capacity to exercise civil liberties is far
 from perfect.
- With 70% of the Russian economy's output now generated by the private sector, the communist system has been essentially dismantled and the state's tentacles of central control have been largely dislodged.
- Economic distortions created by energy prices that were once held far below world prices
 and the easy availability of subsidized credits have been greatly reduced.

Russia's performance reflects the policies that Russia has chosen. If not all our goals for Russia have been fulfilled, it is certainly equally true that not all the fears for Russia that were common a decade ago – or even a year ago – have materialized.

As we look at the current environment in Russia, we must be aware that Russia will shape its own destiny. What is most constructive going forward is a focus on pursuing policies toward Russia based on our national interests.

II. Corruption, Capital Flight, and International Money Laundering in Russia

Mr. Chairman, let me turn now to the separate, though often interlocking, issues of corruption, capital flight, and international money laundering, which have been critically important to our policy toward Russia for many years. Our longstanding concern about these problems has only been further underlined by the recent investigations.

Corruption

Corruption is a problem of great concern for the United States, whether in Russia or elsewhere in the world. Those who disobey Russian laws are unlikely to demonstrate any more deference to the laws of the United States or any other country. This gives us a deep interest in doing as much as we feasibly can to encourage the development of a fully functioning rule of law in Russia.

To be sure, Russia inherited profound corruption problems from the Soviet era. In the 1980s and early 1990s, for example, the Soviet system allowed the elite to profit from its access to cheap commodities and credits and to foreign markets. As Anders Aslund has pointed out, in 1990 the state-controlled price of a ton of crude oil was the same as the free-market price of a pack of Marlboros in Moscow. This distortion created opportunities for quick fortunes to be made by those able to purchase oil domestically and resell it overseas. Aslund has estimated that at least 79 percent of GDP was lost in this type of distortion in 1992. These flaws in the economic system that Russia inherited from the Soviet Union explain why a crucial piece of our efforts to combat corruption in Russia has been to push for the elimination of subsidies and price controls. An equally important concern has been Russia's failure to establish the rule of law and the inability of Russians to rely on a fair enforcement of laws and contracts. In policies toward public and private enterprises, in the collection of taxes, and in the formulation and implementation of banking regulation, there have been far too many instances of corruption in which private interests, rather than the public interest, have been protected.

A particularly problematic result of Russia's failure to establish the rule of law and a credible law enforcement system has been the growth of organized crime during the past decade. Russian organized crime has emerged as a powerful corrupting force – a force that challenges Russia's political and economic development. It has also become a global threat, one that poses a challenge to the integrity of our financial system. Clearly our efforts to combat the activities of Russian organized crime here in the United States would be bolstered by substantial progress in the establishment of the rule of law in Russia.

The first phase of Russia's privatization process was directed principally at dismantling the mechanisms of the failed centrally planned economy. Although it is reasonable to debate the specifics of that program, there is broad agreement that it accomplished its objective. Much more serious questions about a lack of transparency and competition surround a later phase of privatization, the Russian government's so-called "loans-for-shares" program. We shared those concerns. As early as April 1995, several months before the deals ultimately took place, the U.S. Executive Director at the IMF detailed our strong misgivings regarding such transactions and emphasized the need for transparency and competition in the privatization process. The international financial institutions also expressed profound concerns.

The Clinton Administration has consistently urged the Russian government to combat corruption through structural and institutional reforms and the rule of law. President Clinton made clear our concerns in strong public statements in Moscow in 1995, as well as subsequently. As the President said to Russian Prime Minister Putin in a meeting 10 days ago, corruption and money laundering "could eat the heart out of Russian society" unless the government acts aggressively

to combat these problems. That is why, for example, we have repeatedly encouraged Russia to adopt a simpler, more efficient tax code and to enforce the collection of taxes – a process that is at present woefully inadequate and subject to rampant corruption.

In addition, we have regularly supported placing specific conditions, aimed at reducing corruption and strengthening Russia's economic and legal system, on loans to Russia by international financial institutions.

These conditions have included:

- Tax systems designed to reduce bribery and tax evasion by politically well-connected energy
 companies and other large firms.
- The elimination of tax offsets for example, trading tax payments for payments for goods and services – which act as a major contributor to corruption, lack of budgetary discipline, and tax evasion.
- The creation of a Russian treasury and budgetary control system to cut expenditure leakages for corrupt purposes.
- The decontrolling of prices to eliminate corrupt, bribe-ridden distribution systems and reduce
 enormously costly insider arbitrage opportunities, in which traders buy commodities at low
 controlled prices and sell them abroad at higher market prices.
- The reduction of subsidies, which have destroyed budget discipline and created additional insider arbitrage opportunities.
- Trade liberalization to introduce more foreign competition and, thereby, reduce monopoly
 power and opportunities for corruption.
- · Reductions in government wage and pension arrears.
- Better bankruptcy laws and improved enforcement to reduce asset stripping and induce the honoring of contracts.
- The strengthening of minority shareholder rights to avert deals that benefit insiders at the
 expense of the rest.

Capital flight

If corruption is often indicative of a vote of "no confidence" in a state's capacity to establish and enforce the rule of law, capital flight is a vote of "no confidence" in a country's economic policies. Much of the enormous flight of capital out of Russia reflects Russians' lack of confidence in the ruble, in the banking system, in the economic consequences of political uncertainty, and in the capacity and willingness of the government and the parliament to work together to implement the structural reforms necessary to build a strong economy.

The most obvious manifestation of this lack of confidence is the \$35-40 billion in U.S. currency that is estimated to lie outside the financial system, largely beneath Russian mattresses. During the transition period, capital flight has drained perhaps \$15 billion a year from the Russian economy. Russia's current account surplus may reach 8 percent of GDP this year, yet foreign exchange reserves remain low, and the country has fallen behind on a substantial part of its external financial obligations. The simple explanation for this phenomenon is the withdrawal of capital from Russia.

History teaches us that the best way to stem capital flight and encourage money to return is to create a healthy business environment, one that provides the sorts of investment opportunities that will attract capital back. That is why we have pressed, and will continue to press, Russia – both through our own bilateral interactions and through the IMF and other international financial institutions – to implement policies that support competition; tax reform; improved corporate governance; greater transparency and disclosure in the private and public sectors; stronger bank supervision; and restraints on the discretion and scope of government regulation.

International money laundering

Money laundering requires neither official corruption nor capital flight. However, the three often come together where the rule of law is weak and confidence in the economy is low. Money laundering is the process of converting ill-gotten gains into "usable" funds by routing it through what appear to be legitimate transactions. Money laundering is therefore predicated on a previous crime. Money laundering through cross-border transactions can become part of capital flight.

Wherever it occurs, international money laundering poses a threat to the integrity of financial institutions both here and abroad. The current allegations involving money laundering through major American financial institutions have only reinforced our recognition that widespread corruption in another country can pose a significant danger to our interests.

In this context, a test of Russia's seriousness in its effort to combat its money laundering problems will be its ability to establish an adequate legal framework and implement effective enforcement mechanisms. To further this effort, Treasury has been assisting Russian authorities to enact and implement effective anti-money laundering programs. For instance, Treasury has actively participated in bilateral training and technical assistance programs to help Russia build its anti-corruption and anti-money laundering infrastructure. Treasury has also participated in the work of the G-8 Lyon Group of law enforcement experts, in connection with that group's project to identify and pursue Russian and Eastern European organized crime groups. A team of Russian law enforcement officials visited Washington last week and met with officials from the Justice Department, the State Department, and many parts of the Treasury Department, including the Internal Revenue Service, the Customs Service, the Financial Crimes Enforcement Network (FinCEN) and the Secret Service, as well as other government agencies, to discuss money laundering issues. The Russian officials also met with officials from the Federal Reserve to discuss banking supervision and regulation. Such dialogue represents a step in the right direction, but it must be followed up with concrete actions.

Administration officials have urged the Russian government to pass comprehensive anti-money laundering legislation. We have stated publicly that President Yeltsin should not have vetoed such legislation. In a telephone conversation earlier this month, President Clinton stressed to President Yeltsin the importance of swiftly designing and enacting a strong anti-money laundering law. President Yeltsin assured President Clinton that this was indeed his intent. In the context of ongoing IMF engagement with Russia, the United States and other major IMF shareholders will be monitoring developments in this area closely.

III. Our Financial Policy Toward Russia

Following the economic and financial collapse of August 1998, Russian economic policy and our own financial policy toward Russia moved to a very different phase. The International Monetary Fund ceased lending to Russia and did not provide any financial assistance for about a year.

Our interaction with Russia through the international financial institutions, however, is only part of our efforts to promote stability, economic progress, and Russia's integration into the global economic and political systems. Certainly it is in our interest to remain engaged with the Russian people.

The United States is continuing to help the Russian people develop democratic and legal institutions, start private businesses, and improve social services. We have supported the development of NGOs; of the 65,000 NGOs that have been created during the past decade, USAID programs have supported more than 15%. The Department of Commerce and USAID are assisting thousands of small and microbusinesses through a variety of programs, including loan programs. And through USAID-sponsored programs, we are training thousands of doctors and nurses and helping Russia improve drug therapy and care for diabetics, a disease that currently affects seven million people in Russia.

The technical assistance we provide Russia has long emphasized building the legal and regulatory infrastructure necessary for a market economy. Treasury technical assistance has focused in particular on the essential task of constructing a fair, predictable, law-based federal tax system. As part of a broad array of efforts to strengthen the rule of law, USAID has worked to promote judicial independence and ethics, providing training for close to a thousand judges and court personnel.

A new approach to financial assistance after 1998

In the difficult environment that has resulted from Russia's economic collapse in August of last year, the approach of the international financial institutions with the support of the G-7 has shifted from providing net new funds to Russia in order to promote economic reform to partially refinancing debt coming due to the IMF as part of an attempt to support economic stability in Russia. We and the international financial institutions have insisted that their support be based on adequate accounting and adequate safeguards.

The IMF program approved in July 1999 was very different from all of Russia's prior IMF

programs. The first disbursement under the new IMF program – as well as any subsequent disbursements – was predicated on the imposition of new safeguards to protect the use of that money. The funds were provided in the form of Special Drawing Rights, were paid into an account at the IMF, and can be used only to repay Russian obligations to the Fund. In addition, approval of the program required a satisfactory independent investigation of the Russian Central Bank's investment in Fimaco and of the July 1998 IMF disbursement.

Our decision to support this new program for Russia – as has been true of all of our policies toward Russia since 1993 – involved a difficult balance: between the need for engagement and the need for conditionality; and between what was economically necessary for Russia and what was politically feasible. Going forward, it will be as important as ever that we remain hardheaded and clear-eyed, and ensure that any support that is provided for Russia is used for its intended purpose and for that purpose alone.

Russia's new IMF program will be complemented by limited and measured support through financing from the World Bank and the European Bank for Reconstruction and Development for particular projects and targeted reform efforts. As in the past, any lending will depend on Russia's adherence to the conditions of these programs. Last summer, the World Bank restructured its three key structural adjustment loans to Russia to encourage greater progress toward reforms in the financial and coal sectors and in the country's pension and welfare systems. It also canceled parts of other loans amounting to \$228 million because of poor performance, largely as a result of the financial crisis. This measured approach has also informed our support for a rescheduling of Russia's bilateral Paris Club Soviet-era debt that is limited both in scope and duration.

Under the new IMF agreement, Russia is to repay about \$2 billion of its obligations to the IMF, and is refinancing the remaining \$4.5 billion coming due during the program period. This will have the consequence of reducing Russia's debt to the IMF as Russia meets its obligations. Accounting for all the operations of the international financial institutions, there will be a net financial flow from Russia to the international financial institutions as a group between July 1999 and December 2000.

Loans conditioned by adequate accounting and adequate safeguards

Our continued support for IMF or World Bank engagement with Russia is predicated on Russia's compliance with crucial conditions to ensure financial integrity and to safeguard any assistance provided in refinancing. These include:

- The completion of an investigative report on all offshore operations of the Central Bank of Russia.
- Procedures at the Central Bank of Russia (CBR) to strengthen internal controls on the
 management of reserves, exchange market intervention, and extension of credit to
 commercial banks. Each disbursement of IMF financing will be conditional on a
 determination that the CBR's reserve management since the prior disbursement has been
 appropriate.

- A regime of regular external audits of the CBR that are reviewed by the IMF. These audits should be made public.
- New procedures to strengthen safeguards on the use of the resources of the international financial institutions for budgetary support.

These conditions and considerations will govern our support of additional disbursements to Russia from the IMF and World Bank.

We have supported continued IMF engagement with Russia, based on these safeguards, not because we expected that Russia would be rapidly transformed into a market economy or that corruption would be eliminated overnight, but rather on the view that to quarantine, contain, or write off Russia as too corrupt would ill serve our national interest. Acting on that view would limit our ability to support Russian economic and financial stability; it would inhibit our ability to promote democratization; and it would raise the risk that the United States and the West would be labeled as scapegoats for Russia's failure to address its problems.

IV. Combating Global Corruption and Money Laundering

Finally, as we work to promote the adoption of sound economic reforms in Russia and in other countries around the world, fighting corruption and pursuing policies to reduce crime will be essential components of those efforts. We will pursue these measures, as we have done in the past, both through our bilateral relationships and within multinational organizations.

For example, building on the U.S.-led efforts to conclude the OECD Anti-Bribery Convention and the Vice President's Anti-Corruption conference last February, we have been pressing, and will continue to press, for the complete ratification and implementation of the OECD Convention by all signatories. In addition, the United States is working with its G-7 partners and others to coordinate anti-corruption efforts and assistance, complete a WTO agreement on transparency in government procurement, and seek ways to institutionalize international measures to identify, block and seize illicit funds gained through criminal acts.

Anti-corruption initiatives within the international financial institutions

The IMF is increasingly giving explicit consideration to addressing weak governance and corruption in all its country programs. The Fund has developed a code of fiscal transparency, which calls for governments to accurately track and disclose expenditures and thereby make them more accountable for their spending decisions. It has also consistently supported open and transparent markets, price decontrol, and trade liberalization, each of which will reduce the opportunity for bribery and corruption.

The IMF's approach to its 1997 programs with Thailand, Korea, and Indonesia included provisions aimed at reducing "crony capitalism," and other forms of corruption. For example, in the case of the Reforestation Fund in Indonesia, used by former President Suharto and his colleagues for inappropriate purposes, the IMF required that the Reforestation Fund be

accounted for as part of the national budget, and required a full audit by internationally acceptable experts that is to be published upon its completion this fall. More recently, the IMF has suspended funding to Indonesia in connection with accusations of corruption relating to Bank Bali.

The World Bank, with the strong support of the United States, is also paying increased attention to the problems of corruption in its member countries. The Bank has developed programs to combat corruption problems in individual countries, initiatives to enhance transparency and accountability in public finances, and approaches to strengthen public institutions and the rule of law with regard to investment and property. The Bank has also developed new methodologies and techniques for analysis of the nature and extent of corruption in specific countries.

Since 1996, more than two dozen countries in East Asia, Eastern Europe, Latin America, and Africa have sought the Bank's assistance in anti-corruption work. Specific country programs include: technical assistance for procurement reform in Tajikistan and Lebanon; anti-corruption seminars in Georgia, Ghana, India and Korea; Supreme Court modernization in Venezuela; and educational workshops to improve public expenditure management in Gambia.

In the IDA-12 replenishment agreement, the United States led the effort to include a strengthened linkage between new lending and borrower performance, with explicit consideration to be given to good governance and efforts to combat corruption. IDA-12 also requires the World Bank and its borrowers to undertake public expenditure reviews, procurement assessments and financial capacity assessments and to identify follow-up actions. The United States will also continue to urge the Multilateral Development Banks to give priority attention to developing uniform procurement rules and documents which can help countries combat corruption and decrease opportunities for corruption in World Bank and regional development bank projects.

Going forward, these issues will be the focus of attention and the international meetings over the next ten days. We and the G-7 will be calling for authoritative reviews by the IMF and the World Bank to identify ways to strengthen safeguards on the use of IMF and World Bank funds, especially in cases where there is heightened risk of diversion or misappropriation of funds.

National Money Laundering Strategy

This Thursday, the Treasury Department and the Justice Department will release the Administration's first National Money Laundering Strategy report. The Strategy will set forth a broad-based domestic and international program to combat money laundering, including several dozen proposed action items aimed at bolstering international cooperation in the fight against money laundering; strengthening domestic enforcement; enhancing the regulation of banks and other financial institutions; and building stronger partnerships with state and local governments.

The Strategy will contain a series of recommendations intended to combat the types of criminal activity we are discussing here today. For example, it calls for legislation to make U.S. money laundering laws applicable to a broader range of international criminals – including corrupt foreign officials. It calls for rules to extend requirements for filing suspicious activity reports

(SARs) to money service businesses, broker/dealers and casinos, as well as enhanced use and analysis of SARs by Treasury's Financial Crimes Enforcement Network and other federal law enforcement agencies. The Strategy calls for designating high-risk money laundering zone toward which to direct coordinated law enforcement efforts. And it proposes that we intensify pressure on nations that lack adequate counter-money laundering controls to adopt them.

The implementation of these recommendations will take time, but with hundreds of billions of dollars laundered each year, it is clear that we must make long-term commitments while moving forward quickly.

V. Concluding Remarks

Mr. Chairman, during the past six and a half years we have faced very difficult choices with respect to Russia even as we have sought to intensify our efforts to combat global corruption and money laundering. There are clearly no simple answers on how best to support perhaps the most complex economic transformation of our time, and the process of change in Russia is still ongoing. In many respects, the challenge has been to find the best economic policy when confronted with difficult choices. The difficulty of those choices has hardly diminished in the wake of developments that have taken place in Russia since August 1998. As I have described, since the economic and financial collapse at that time, the financial aspect of our engagement with Russia has been pursued on very different terms and with much constrained objectives. The present program, built around the very rigorous safeguards that restrict how Russia can use any financing that the IMF makes available, implies a continued reduction in Russian debt to the IMF.

It has always been clear that Russia's complex transformation from a centrally planned communist empire to a democratic market-based economy would take a great deal of time. And it has been equally clear that the United States has a great stake in the success of this process. As Russia's transformation proceeds, we will need to continually assess and adjust our strategy in light of our interests as events in Russia evolve. Discussions like the one we are having here today will be important to help guide our thinking on this crucial national issue as Russia's transition continues.

Thank you. I would now welcome the Committee's questions.

U.S. House of Representatives

Committee on Banking and Financial Services

September 21, 1999

Hearing on Russian Money Laundering

R. James Woolsey

Shea & Gardner

Mr. Chairman and Members of the Committee, it is an honor to be asked to testify today on this important subject.

I should begin by ensuring that you realize that my detailed knowledge of this particular issue is dated, limited in scope, and was highly classified at the time I was working on it several years ago because of the sources and methods we used in learning about it. My involvement arose because, during 1993, when I was Director of Central Intelligence, some very able CIA analysts came to me with an excellent briefing on some aspects of Russian organized crime.

I moved promptly to ensure that very senior officials at the Justice Department, the FBI, the National Security Council, and other relevant agencies received this briefing. In several of these cases – I remember briefings at Justice and the NSC – I personally attended in order to highlight the importance of the subject and to emphasize the excellence and the creativity of the CIA officers' work.

I then commissioned a special National Intelligence Estimate on Russian organized crime. Because of the sensitivity of the sources and methods involved, distribution of this Estimate was quite limited.

I also put this issue on the agenda of some of the Intelligence Community's most sensitive meetings on intelligence matters with some of our closest allies, and ensured that at a very senior level they were appropriately briefed as well.

I believe that through these steps the U.S. Intelligence Community and the CIA in particular performed a valuable service in putting this issue squarely before those in the U.S. Government and in allied governments who needed to know about it in order to take appropriate action.

I stated publicly during my tenure and have said frequently thereafter that this is one of the most important issues the United States faces. This is really for three reasons.

First, the organized crime and corruption problems together have the potential to destabilize the Russian state. Russia remains one of the nations that can destroy the United States within the 30-minute flight time of an ICBM. Thus political instability and unpredictability among those who command and control Russia's strategic systems are of

paramount importance to us.

Second, there is the real possibility that Russian organized crime groups may be, or become, involved with the sale of technology or materials for weapons of mass destruction or other modern military technology. Such sales could be highly profitable in the right quarters, e.g. to Iraq, or to certain terrorist groups, so this is an area where there could be a confluence of interest between Russian organized crime and bitter enemies of the United States.

Third, Russian organized crime can use its resources to corrupt institutions here in the United States. The recent case involving the Bank of New York may prove to be one such example.

I have been particularly concerned for some years, beginning during my tenure, with the interpenetration of Russian organized crime, Russian intelligence and law enforcement, and Russian business. I have often illustrated this point with the following hypothetical: If you should chance to strike up a conversation with an articulate, English-speaking Russian in, say, the restaurant of one of the luxury hotels along Lake Geneva, and he is wearing a \$3,000 suit and a pair of Gucci loafers, and he tells you that he is an executive of a Russian trading company and wants to talk to you about a joint venture, then there are four possibilities. He may be what he says he is. He may be a Russian intelligence officer working under commercial cover. He may be part of a Russian organized crime group. But the really interesting possibility is that he may be all three – and that none of those three institutions have any problem with the arrangement.

In addition to the above points, all I have said publicly, Mr. Chairman, about our work during that period is that I agreed with my successor, Mr. Deutch's public statement during his tenure that one of the groups involved with organized crime in Russia was Mr. Louchansky and his company, Nordex.

I would point out to the Committee, however, that I resigned during the second week of January, 1995. Since then, on this issue, I, like Will Rogers, only know what I read in the papers. Having brought a bit of background and some views to the subject during the now nearly five years since I resigned, however, I do have some judgments about this issue which I would offer the Committee. I want to stress, however, that at this point my testimony moves from what I know to, based on public sources, what I believe.

I have no reason to dispute the Russian government's estimate that criminal syndicates now control around 40 per cent of the Russian economy. And, as you pointed out in your piece earlier this month in the New York Times, Mr. Chairman, there are higher estimates as well. Nor does the problem seem to be declining in intensity. One of the problems pointed out to me last week by former Interior Minister Kulikov is that the Duma has passed anti-corruption legislation five times that has either been vetoed or otherwise sidetracked by President Yeltsin and his staff.

The heart of the matter seems to me to be the difficulty we have in finding an honest

institution or group of individuals with whom we can work on a long-term basis.

I might contrast the current Russian situation with that in Italy some years ago, when organized crime was an extremely serious matter there, reaching very high in the Italian government. But in Italy, by law and tradition, there was at least a critical mass of honest magistrates with the authority to investigate and prosecute – Italian "Untouchables", in other words. The FBI and other parts of the U.S. Government thus had a solid group of professional and honest partners with whom to cooperate, and although it was far from easy, substantial progress has been made against organized crime in Italy in recent years.

In Russia, although there are individuals with whom, from time to time, we can work in a frank and fully cooperative manner, there does not seem to be a critical mass akin to what was provided by the Italian magistrates: a group of Russian colleagues with whom we can work on a broad front and on a long-term basis. Perhaps the Presidential election in Russia next summer will lead to such a development within the Russian government. If not, I don't see how we will be able to make progress beyond what we can do on our own. This is important for us to do, but it will not solve the problem.

Let me conclude, Mr. Chairman, with the following point. I have been asked frequently since the story began to break a few weeks ago concerning money laundering through the Bank of New York whether during my tenure I detected any lack of willingness at the senior levels of the U.S. Government to hear information about this subject. My answer to that specific question is no, I detected no such lack of willingness as of January, 1995.

But during the last several years we have seen that to an extraordinary degree the United States has become identified with President Yeltsin and the many teams he has selected, then fired, then selected, etc. to work with him. We have also been quite generous financially, both directly and through international institutions such as the IMF. We have, through the IMF and otherwise, pushed for increased tax collections and tight budgets. Each of these approaches at one time or another may have been defensible. But if one steps back from them and looks at the overall pattern, it is easy to see how ordinary Russians, who saw us in highly idealized terms just a few years ago, have turned so sour on the United States.

In their eyes, we are the supporters of those who have stolen much of their national patrimony through a highly-corrupted privatization process and we are, at the same time, those who insist that the ordinary people of Russia bend their backs even harder. We are seen, in short, by average Russians as supporting the system and the individuals who are exploiting them. To them, America has won the cold war and then helped give them a capitalist economic system that is modeled not on Silicon Valley, but on the Chicago liquor market of the 1920's. Something is badly wrong here, but the roots of the problem do not lie solely in our knowledge about and our approach toward dealing with Russian organized crime. They are far deeper – in the fundamental approach toward Russia that has, perhaps in a fit of absent-mindedness, become American policy.

TESTIMONY OF FRITZ W. ERMARTH ON RUSSIAN ORGANIZED CRIME AND MONEY LAUNDERING BEFORE THE HOUSE COMMITTEE ON BANKING AND FINANCE

21 SEPTEMBER 1999

Mr. Chairman, I deeply appreciate the opportunity to testify before this committee on the challenge posed by Russian organized crime and its threatening practices, such as money laundering.

I would like to focus my testimony on the larger context of Russian developments that have spawned this challenge. We should have little doubt that our law enforcement agencies and our financial institutions will respond to the threat from Russian organized crime. It is both serious and novel in the forms it takes. The inquiries of this committee will surely help

But we must keep the most important issue in the forefront, as your public statements indicate that you do, Mr. Chairman.

We must consider how our country's future security and well-being will be threatened if, once again, Russia fails in the historic task of finding her way to authentic, stable democracy and a just, prosperous society with a market economy.

My bottom line is this: Russia is not lost. Russia is stuck in a swamp between the Soviet past and several alternative future possibilities, some invitingly bright, some ominously dark. The larger purpose of three hearings, in this and other committees, and of the debate now, finally, taking place in our political areas about Russia, is to understand her condition and prospects better and to inform better American policies for encouraging the brighter prospects of democracy and capitalism.

The threat from Russian organized crime springs from two fundamental and interrelated realities: first, the grave weakness of the rule of law in Russia, and second, the perversions of what we have called economic reform.

The Soviet communist system was itself a kind of structured lawlessness. To be sure, the Soviet Union had myriad laws. But they were not rules for regulating relations among the members of a self-governing society. Rather they were tools for maintaining power, to be used, abused or ignored by those who held power. They afforded ample space for official and unofficial criminality. In the later Soviet period, the manifestations of this — ranging from petty thievery, to organized crime, to enrichment of the partocracy — expanded as the structures of Soviet power decayed. The collapse of communist rule gave free rein to these phenomena in a new setting.

The new setting is something for which I have not found a good definition. It has important features of democracy and capitalism, but it is not authentic democracy and capitalism. Focusing on the economic side, I would use the term crony capitalism without much capitalism. It lacks firm properly rights and good corporate governance. It is about the distribution and especially concentration of wealth, but far less about investment and the creation of wealth. And, above all, it is about the extraction and expatriation of wealth.

This came about in large measure because of the manner in which the reformers of the post communist regime tied to create capitalism amidst the wreckage of the Soviet order. As one analyst I've read put it, they proceeded in good communist fashion to create a new capitalist class by basically appointing them. Relying largely on privileged, insider relationships, vast resources and enterprises were placed into private hands, often old communist hands, at less then fire-sale prices. Enterprises were sold off at less than cash value of annual revenues in some cases. Export and import privileges were handed out to cronies.

Thus, the process of privatization was from the outset a rip-off at the expense of the state and society. This, along with the destruction of people's savings through gratuitous inflation in the early 1990s, deeply blighted the public's view of capitalism from the outset. The reformers took a course certain to alienate society, and they deliberately ignored the task of building public understanding and support. It still might have worked out had the new owners proceeded to manage their new wealth as real capitalist entrepreneurs by investing, building, and creating. Far too often, however, they did not. Lacking confidence that their new wealth could be profitably invested in Russia or even that they could hold on to it, they all too often extracted it, stripped it, plundered it out of Russia and sent it abroad where it could be safe and productive. In this manner a country rich in natural resources and productive potential saw its state and society impoverished. The society and domestic economy reacted with various coping strategies, from barter trade to monlighting work. The state reacted with measures that went beyond very creative financing, like simply not paying its bills. Among other things, it created what appeared to be a no-lose casino in short term debt by which Russian and then foreign speculators essentially were allowed to plunder the state budget until it collapsed in August 1998.

What we've seen here is not so much organized crime as authorized crime intertwined with corrupt government and politics at all levels. And it has abetted and been abetted by organized crime with its money laundering skills and protection racketeering.

The fundamental misdemeanor of Western, including American, policy was that it bought into this phonyrony capitalism too uncritically and for too long. So did the mainstream media, and the mainstream foreign policy establishment. The protests of Russian and Western observers who knew what was going on went unheeded. One of the sad consequences was that IMF lending, while aiming to stabilize the economy and encourage investment, actually lubricated and legitimized this process of stripping and expatriation of wealth. It was more perversion than diversion of IMF money, although some of the latter probably occurred last year.

If one includes the period of the late 1980s, when much of this activity accelerated under the aegis of the KGB and the communist leadership, one might guess that from 200 to 500 billion dollars have left Russia in what is very loosely called capital flight. Some of it is derived from plain crime, like drug traffic, stolen cars and weapons. Some it is entirely legitimate except for tax evasion. I strongly believe that most of it is in the gray zone in between, that is, the product of phony-crony capitalism. Some of it gets laundered because its owners need to disguise its origins to all observers. But a lot of it just gets deposited and invested. And not much of it stays in Cyprus or other tax havens. Much of it, probably most of it, has come into the biggest, safest, most accessible, and profitable investment target in the world, the United States.

Here it undoubtedly goes in several directions. Some steys liquid for future use. Some returns to Russia for business, political, or criminal purposes. Some gets invested in portfolios, real estate, and business. And I am sure that some of it goes to political contributions of various kinds. Why can I permit yeaff this seemingly inflammatory statement? First, because of the logic of the situation; that's normal behavior for this kind of money. And I am sure it is quite bipartisan, because this kind of money doesn't care about the values, the issues, the candidates or the parties. It cares about influence. Second, because there have been some examples in the press. And, third, because knowledgeable FBI specialists in this area have said so. This is, I believe, a proper subject for the investigations of this committee.

I would assign greater weight, however, to a more general problem. Money on this scale acquires patrons, protectors, and leverage. How much leverage and with what effects on government policies? I would ask for example: Did those Americans heavily invested in the Russian GKO market, by which vast profits were extracted from the Russian budget and vast losses risked, exert influence on the US Government to encourage more IMF lending last summer? Mr. Soros and others have strongly implied so.

Mr. Chairman, let me state that the picture I have painted so far is unfair. There is real capitalism and real democracy in Russia. Thare are decent businesses, honest policemen, and clean politicians. Which returns me to my first point. Russia is stuck, not lost. If the Russians can somehow get through the current crisis of terrorism, conduct their elections, and create a somewhat stable and legitimate government, I believe there is a possibility that a window for real reforms will reopen. I hope then we shall be ready to be supportive with policies more perceptive, more honest, and more constructive than they have been in the past. At least we must avoid repetition of past errors. That I see as the most important purpose of our inquiry here. Thank you, Mr. Chairman.

Testimony Before the Committee on Banking and Financial Services, United States House of Representatives

> By Dimitri K. Simes, President, The Nixon Center, and Paul J. Saunders, Director, The Nixon Center¹

> > Tuesday, September 21, 1999

The outrage expressed by Russian officials over recent wide-ranging corruption allegations is obviously self-serving to no small extent. Nevertheless, the surprise expressed by current and former Russian officials at the Clinton Administration's "shocked, shocked" response to Russian corruption is understandable; indeed, while new cases have arisen, the administration has known the extent and magnitude of the problem for some time and has done very little.

Russian Corruption

Although corruption and organized crime had established roots in the Soviet Union and prerevolutionary Russia, they received a major boost from the collapse of the Soviet Union and Russia's early misguided efforts at reform. Facing not-so-gentle encouragement from the International Monetary Fund to liberalize its economy, Russia freed most prices from state control shortly after its independence in 1992. The resulting hyperinflation wiped out the savings of ordinary Russians well before the government was able to develop a privatization strategy. As a result, when privatization finally began, its benefits were limited to a very few.

Three key groups – so-called nomenklatura managers, commercial bankers, and organized crime lords – soon emerged as the principal beneficiaries of privatization. The managers used their administrative control over enterprises to win de facto and even de jure property rights. The bankers, who were not really bankers at all, used their initiative and government connections to win control of vast amounts of state funds, the interest from which was routinely skimmed into private accounts (as were portions of the principal, in many cases). Organized crime lords took a more direct approach, using Russia's chaos to take control of enterprises through violence, to demand "protection" payments, and to corrupt law enforcement bodies.

While the fundamental decisions that led Russia down this path were taken in Russia by President Boris Yeltsin and others, many key choices were taken under heavy pressure from the Clinton Administration and the International Monetary Fund. President Yeltsin's decision to give priority to macroeconomic policy at the expense of legislation to develop a healthy market in Russia – a move strongly encouraged by the administration – came at a particularly high cost as it discouraged investment, spurred capital flight, and facilitated widespread corruption.

In the seven years of Russian independence, corruption has penetrated virtually every sector of

¹ The views expressed in this testimony are solely those of the authors and do not represent an institutional position on the part of The Nixon Center.

society. It is not limited geographically or functionally. Corruption knows no limits within the Russian government as well; it has grown rapidly not only in the executive branch but also in Russia's legislature, where it is well known that votes are for sale.

At this very moment an effort is underway in Russia's State Duma, the lower house of parliament, to overturn President Yeltsin's veto of a recent protectionist and confiscatory insurance law. According to Russian accounts, a great deal of money has changed hands in a drive to submit a new law that would violate Moscow's existing international obligations and virtually force foreign insurers from Russia. Moreover, the companies reportedly behind the new law – such as Spasskiye Vorota and Ingosstrakh – are allegedly involved in unsavory practices including so-called "wage schemes" that evade payroll and income taxes by substituting bogus insurance payments for wages. These and other schemes deprive ordinary Russians of reliable insurance, deprive the Russian government of much-needed tax revenue, and open up the insurance industry to money-laundering rackets. One source estimates that 80% of Russia's life insurance policies are fraudulent.

American Policy

Recent revelations from the U.S. Embassy in Moscow published in *The Washington Post* and *The Wall Street Journal* demonstrate conclusively that the administration has been aware of the scale and scope of Russia's corruption problem for some time. Although there seems to have been some disagreement between the political and economic sections in the embassy in recent years, its staff produced many cables – including some signed personally by then-Ambassador Thomas Pickering – that unambiguously described the cancerous growth of official corruption and organized crime and the perversion of Russia's historic transformation. [Unfortunately, from all available accounts, this objective reporting apparently ended after Ambassador Pickering's departure from Moscow.] Central Intelligence Agency analysts brought similar information to the attention of their superiors. And, of course, scholars and journalists have published extensively on Russian corruption. Dimitri Simes, among others, has personally discussed these issues with senior officials including Deputy Secretary of State Strobe Talbott.

Thus is not a lack of information that explains the Clinton Administration's failure to act on Russian corruption but the administration's determination to ignore the problem combined with its simplistic division of Russian political leaders into "good" and "bad." Although Secretary of State Madeleine Albright insisted only last week that the administration's policy was intended to support "good people doing the right things" it seems increasingly evident that it has actually aided very imperfect people doing misguided things, at a minimum.

Some of the administration's greatest favorites in Russia have been involved in dubious activities of which the administration has been aware, and which it has ignored, for years. For example, attempting to distance itself from the Russian government's more obviously corrupt policies, the Clinton Administration is now trying to claim that it did not support the controversial "loans-for-shares" privatization program, through which leading Russian enterprises were auctioned off to well-connected banks at bargain prices. This argument is at best disingenuous taking into

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account the administration's unstinting support of Anatoly Chubais, the architect of the loansfor-shares scheme, and of Russia's privatization policies more broadly. In the words of Richard
Morningstar, then the coordinator of U.S. aid to the former Soviet Union, "If we hadn't been
there to provide funding to Chubais, could we have won the battle to carry out privatization?

Probably not. When you're talking about a few hundred million dollars, you're not going to
change the country but you can provide targeted assistance to help Chubais." Then Deputy
Secretary of the Treasury Lawrence Summers was still sufficiently enamored of Chubais and his
circle to call them "an economic dream team" in 1997. If anything, the administration's support
for Chubais grew after the true nature of the loans-for-shares privatization became apparent.

Moreover, the Clinton Administration supported Chubais, other so-called "radical reformers," and their patron President Yeltsin with much more than rhetoric and a few hundred million dollars. In fact, it pushed for a \$10.1 billion International Monetary Fund credit to Russia in early 1996 – after IMF officials criticized Russia for failing to implement reform and at a time when it was well known that substantial Russian government funds were "managed" by leading banks that were siphoning away public money. Furthermore, because the loans were given as general budget support and commingled with other Russian government monies, it is virtually impossible to determine the origin of any particular dollar or ruble in a given account – a fact that makes statements that there is "no evidence" of the misuse of IMF credits meaningless. And the IMF was no rogue elephant in its lending to Russia; senior administration officials have themselves referred to the Fund as a proxy for American policy.

It is not surprising in this climate that those Russian leaders supported by Washington, who were simultaneously making concessions to the U.S. on foreign policy matters, developed a certain sense of impunity. They may have heard the administration's half-hearted statements of concern over Russian corruption but did not take them seriously. And why should they, when as recently as May of this year National Security Advisor Sandy Berger, Treasury Secretary Robert Rubin, Secretary Albright, Mr. Summers, and Mr. Talbott received Anatoly Chubais – no longer a government official – during a visit to Washington. Enjoying such access to the administration, Chubais and others had every reason to believe that its protests were little more than a public relations measure.

The lack of seriousness behind the administration's pronouncements about Russian corruption is further demonstrated by the fact that the Clinton Administration did make clear to Moscow that there was a price to pay for disregarding American warnings in other areas. American pressure significantly influenced Russia's behavior in the Bosnia and Kosovo crises, its dealings with Iran, and many aspects of its macroeconomic policy. Corruption was never given this level of priority. As a result, even today the administration's warnings on the issue are dismissed in Russia. For example, the Russian newspaper Izvestiya – which is generally favorable in its coverage of the Yeltsin inner circle – mocked Secretary Albright's statement last week that the administration would be "outraged" if it is proven that U.S. assistance to Russia has been stolen. "That is all," the paper wrote, suggesting that an American response limited to "outrage" was not of particular concern.

Meanwhile, in Russia, there have been very few real investigations of corruption. Attempts at investigation are routinely blocked and investigators are fired, transferred, blackmailed, or themselves accused of impropriety, as has occurred in the case of former Russian Procurator General Yuri Skuratov. Since so few officials are entirely clean, counter-charges alone are often quite effective in killing inquiries. As a result, few are punished other than those out of favor or "small fish" selected to teach someone a lesson. The well connected, particularly those close to President Yeltsin, have little to fear.

All of this comes at a cost. Years of American support for the corrupt and ineffective Yeltsin regime have discredited the United States among ordinary Russians and led many to suspect that the U.S. seeks not to help but to weaken Russia. Ironically, now even the administration's "friends" in Russia are confused about American policy and are irritated by the sudden escalation of anti-corruption rhetoric from senior U.S. officials.

Corruption has seriously damaged the way the Russian people view democracy and a market-based economy, discouraged significant domestic and foreign investment, and contributed to Russia's addiction to foreign credits (which, in the view of many Russian and Western observers, do not help the country's economy but rather end up being abused or exported). Because of the high-profile involvement of the Clinton Administration and international financial institutions influenced by the U.S. in Russia's transition, these developments cannot but contribute to the growth of anti-American sentiment in Russian society. While some may argue that anti-U.S. sentiment has limited significance in a weak, fragmented Russia, it could have very serious implications for U.S. foreign policy and American interests more broadly in a recovering Russia. Moreover, just as too few analysts understood how weak the U.S.S.R. was and predicted how quickly it would collapse, today only a small minority realizes how quickly Russia could be on the road to recovery under strong leadership. If combined with a sense that the United States is a hostile power, a modest recovery, or even the perception of recovery, could drive Russia to seek arrangements with China or so-called "rogue states" such as Iraq and North Korea that would be detrimental to American interests and values around the globe.

Should the United States face a hostile, recovering Russia in the future, we may well find that the Clinton Administration's tactical gains from Russian cooperation (or, more accurately, acquiescence) in the international arena will be more than offset by the longer-term costs of failing to develop genuine partnership with Moscow. Russia still has thousands of nuclear weapons and a dangerous capability for the proliferation of sensitive technologies. And while it probably can never again be a global rival to the United States, Russia could be a major player in any of a number of potentially threatening anti-American alliances. This cannot but have a negative impact on American global leadership in the 21st century.

In its policy toward Russia, the Clinton Administration has clearly been on the wrong side of history. It has supported not democratization and economic reform but the polarization and corruption of Russian society. The administration cannot be said to have lost Russia, because Russia is not yet lost and was never ours to lose anyway. But to the extent it has had an impact on Russia's historic transition, that impact has been negative – and America's interest in a stable, democratic, and friendly Russia has suffered profoundly.

Testimony of the Center for the Study of Transnational Crime and Corruption (TraCCC)
At American University, Washington, D.C.

Money Laundering Hearing September 21, 1999

Before the Committee on Banking and Financial Services, U.S. House of Representatives

Prepared by:

Prof. Vladimir Brovkin Prof. Keith Henderson Prof. Louise Shelley

MONEY LAUNDERING/TRANSNATIONAL FINANCIAL CRIME AND CORRUPTION: A HIGH PRIORITY FOR THE 21st CENTURY

Whatever the facts and findings of the Bank of New York/Russian money laundering case, it is representative of larger, inter-related global problems: weak, non-transparent global and country banking systems, poor oversight and accountability, strong transnational criminal networks and official and corporate corruption.

As global integration, new technologies and democracy has taken root in the 1990s, international financial crimes, such as money laundering and public and private sector corruption,), should be among the highest priority issues for the new millennium. They present a new pressing threat to global economic and political stability that requires new creative solutions involving partnerships between the public and private sectors. When combined with the overall weakness of the world's financial system, as exhibited most recently in the Asian financial crisis, they have the potential to rock governments and create regional and global economic and political instability.

Just as Russian legislation was inadequate for the profound economic transition, the international financial community is poorly equipped with a legislative and enforcement framework to cope with the global economy. The Russian money in the Bank of New York case epitomizes the inadequacies of our present system. It is a wake-up call to the public and private sectors and the multi-lateral community.

An analysis of the Bank of New York's multi-billion dollar Russian money laundering scandal vividly reveals the complexity, severity and myriad public policy and private sector issues confronting the global community. This case should also be an alarming wake-up call to US and Russian policy makers, including Congress and the White House, multi-lateral institutions — such as the IMF and the World Bank, financial institutions and regulators — and the public. Scandals of this nature are not new and are not specific to Russia. However, the analysis of the money flows will help us understand the depth and breadth of Russian organized crime and corruption activities in the US and around the world.

While we do not know all of the facts, the magnitude, multiplicity and unholy marriage of players and countries in the Bank of New York case, in both the private and public sectors, is representative of a larger problem and clearly illustrates the need to address both its causes and symptoms. This global problem is estimated to be similar in size to the international narcotics trade currently estimated to be as high as \$500 billion annually. Thus, it should be treated as seriously and holistically as the war on drugs and should be seen as an important source of money for drugs and other criminal activities.

It's not just a Russian mob issue anymore. Venerable US and multi-national corporations and financial institutions, a host of countries such as the US, Switzerland, Russia and the United Kingdom, and funds from multiple criminal, corrupt, donor and legitimate sources, are all part of this complex picture whether they are directly implicated in this case. Research conducted at TraCCC on a number of Russian money laundering cases reveal the complex sources of illicit capital

and the complexity of the money laundering routes and methods.

The root causes are varied but primarily relate to the a "culture of secrecy" that exists within the cultures of the diplomatic, multi-lateral and business communities, inadequate international law enforcement cooperation and high-level public and private corruption. The failure of multinationals and international lending institutions to understand the extent and impact of organized crime and corruption have made many turn a blind eye to these phenomena. The unregulated nature of the transitional Russian economy provided more opportunities for speculation, insider trading, asset stripping and movement of assets to offshore locations.

A NEW NATIONAL SECURITY THREAT

Transnational crime and corruption of this scale and nature represents a threat to national security. They have the potential to destabilize political and economic systems — particularly in transition countries and emerging markets such as Russia, Mexico, Indonesia and Brazil. In addition, they impact disproportionately the poor and emerging middle class.

During the 1990's we began to rethink the military/national security issue within the post-Cold War global order. On the dawn of the new millennium we need to rethink the financial/national security issue within the context of the new global financial order.

THE NET RESULT: SECTORAL PERSPECTIVES/ISSUES

The net result of high level corruption, large scale money laundering and financial and economic stability is that it impacts society in general because dirty money feeds the coffers of transnational criminal networks involved in a wide range of illicit activities, including nuclear and weapons smuggling and narcotics and human trafficking. It also places at risk the security of the public's investments in pension funds and the stock market.

For the financial sector, more transparency, accountability and regulatory oversight are required. Current internal employee guidelines and training, as well as existing external regulations/laws and procedures related to international cooperation and information sharing are inadequate. Among other things, "know your customer" and "know your employee" rules should be re-evaluated and effectively but fairly enforced within a democratic context including respect for privacy rights. Maintaining the public's faith in the US and global financial system must be among the most important objectives of this united effort.

For the foreign policy sector and multi-lateral financial institutions, such as the IMF and the World Bank, new policies and procedures for dispensing and monitoring aid and loans must be developed. "Know your donee" rules, conditionality, sanctions, independent audits and civil society monitoring and oversight mechanisms should be developed and enforced. For diplomatic and political reasons, governments and multi-laterals may have to sometimes deal with corrupt public officials and representatives of the private sector. However, they should not do so with a blind eye or without accountability or regard to its full impact on the public and reforms.

For the private and professional sectors, our research shows that money laundering and high-level corruption at this scale can not be consumated without the complicity of an army of "bankers", accountants, lawyers, business and financial advisors. These and other professions and corporations should adopt the kind of practices, ethical standards and procedures that make them part of the solution -- not part of the problem. They should also be held accountable when they knowingly advance the interests of criminal networks and/or corrupt officials and help launder or hide dirty money.

For public policy makers, new laws and procedures must be developed to address a panoply of inter-related problems. Enhanced international cooperation, transparency and accountability, as we like the amended US foreign corrupt practices act, the new OECD anti-bribery treaty, the organization of American states anti-corruption treaty and other international commitments (such as those made by member countries of the financial action task force) are to have meaning and make a difference, they need to address the full range of problems and to be properly enforced. This will require more oversight and monitoring from civil society, policy makers and the law enforcement community. Of particular import is the need to step-up international efforts to regulate off-shore banking centers and shell corporations. More regulatory oversight and accountability are needed in many countries in the developing, transition and developed world. Future economic assistance to developing and transition countries should be conditioned on banking, transparency and accountability reforms.

For policy makers in transition countries and emerging markets, these kinds of transnational problems present an opportunity to focus on key institutional, political and economic reforms that will enable them to become part of and compete in the new global economic and political community. At the macro level, the majority of these countries should devote special attention to creating key institutions such as an independent media, accounting chambers (GAOs), judiciary and parliament and regulatory oversight institutions — particularly those related to the banking sector. At the micro-level, special attention should be devoted to strengthening the financial sector by adopting and enforcing international norms, laws, policies and regulatory standards that promote investment, transparency, accountability and public trust in the banking system.

For the international law enforcement and intelligence communities, more effective ways to enhance national and international coordination, to undertake joint investigations and prosecutions and to work more closely with civil society must be found. We need to help provide the resources and incentives to promote cooperation, promote reforms and build public trust and participation.

RECOMMENDATIONS

1. Rethink regulation of global financial markets

We need to rethink how we regulate financial markets in the global environment. The costs of failing to address large-scale financial crime are severe because this activity is potentially very threatening

to the US and the welfare of all citizens. The end of the Cold War has made us rethink national security in the military arena. We need to give equal attention to rethinking financial security in the international financial arena. National sovereignty of many countries may have to be diminished to facilitate international cooperation.

2. Need to be more vigilant in addressing grand corruption

We need to be much more vigilant in addressing grand corruption both in foreign leaders and in those individuals at home who facilitate corrupt activities in the global markets. The lawyers, investment firms, bankers and accountants who facilitate corruption and organized crime must be subject to greater scrutiny and to appropriate sanctions.

3. Need special inter-agency focus on non-drug related money laundering

Prevention of large scale money laundering requires greater coordination of intelligence, law enforcement work, political and financial analysis. It cannot be addressed by training programs alone but needs to be addressed in a coordinated way as we now approach drug trafficking. The bank of New York case progressed to far because we lacked an inter-disciplinary approach and adequate human resources assigned to the problem.

4. Cannot politicize issue of corruption otherwise will polarize rather than unite those addressing the problem

We need to prevent the politicization of the Russian corruption issue. By doing this, we are losing the support of those who are our natural allies on this issue. We are also undermining long term Russian-US relations that are needed to address this problem.

5. Need to address transnational financial crime and corruption in times of high profit as well as times of reduced profit such as in russia today

We need to address the financial crimes and corruption issue in times when individuals are making money as well as at such times as now after the Russian crisis in which there is less money to be made. We must change the incentive system so it is in the interests of individuals to conduct greater due diligence on their clients and to say no to questionable clients and transactions.

6. In Russia, need to encourage policies that bring money from the shadow economy without legitimizing the theft of the Russian state

Within the Russian context, reforms must be focused on developing a middle class and stake holders in a market economy and democratic society. Policy must be focused on developing a rational tax policy in cooperation with members of Russian parliament which will limit capital flight and diminish the control of organized crime. Strategies must be developed to bring back capital from the shadow economy without granting an amnesty to capital that was acquired at the costs of citizens' lives or the impoverishment of citizens.

7. Russia needs to enact legislation and adopt effective enforcement strategies

Russia needs to develop new corporate governance/ethics rules, respect for contract sanctity, effective and fair enforcement of judicial decisions, balanced regional regulation by federal and state authorities, proper income and asset disclosure, adoption and implementation of international accounting and procurement standards. New legislation needs to be adopted in the tax, criminal law, money laundering and asset forfeiture procedure arenas.

8. International banking, multinational corporations and lending institutions must enhance oversight within their institutions and in international operations

In the international banking, multinational corporate and multinational lending institutions more transparency, accountability and regulatory oversight is required. Current internal employee guidelines and training, as well as existing external regulations/laws and procedures related to international cooperation and information sharing are inadequate and must be enhanced. Among other things, "know your customer" and "know your employee" rules should be re-evaluated and effectively but fairly enforced within a democratic context

9. Greater oversight in needed in international loan policy. More attention must be paid to preventing diversion of money by corruption and organized crime.

For the foreign policy sector and multi-lateral financial institutions, such as the IMF and the World Bank, new policies and procedures for dispensing and monitoring aid and loans must be developed. "Know your donee" rules, conditionality, sanctions, independent audits and civil society monitoring and oversight mechanisms should be developed and enforced. Greater cooperation must occur with internal watchdogs such as accounting chambers. The essential role of a free press in investigating corruption must be recognized and journalists must be granted greater freedom to information and protections in case they are threatened for their reporting.

10. Greater attention must be paid to developing policies to seize and repatriate assets which promote development and public policy goals.

New and improved international policies concerning asset seizure and forfeiture laws, particularly policies related to non-drug related cases, should also be re-examined, since they provide the full for other forms of criminality, asset forfeiture policies should be developed which help foster international development and public policy goals such as clean environment and human rights.



AMERICAN UNIVERSITY

LOUISE I. SHELLEY DIRECTOR

October 12, 1999

Congressman La Falce Committee on Banking and Financial Services U.S. House of Representatives Room 2129, Rayburn House Office Building Washington, D.C. 20515

Dear Mr. La Falce:

1 have testified three times previously before Congress on the issues of Privatization and Corruption. These include:

- 1) The Threat of International Organized Crime and Global Terrorism, U.S. House of Representatives' International Relations Committee, September 27, 1997.
- 2) The Threat of Russian Organized Crime, U.S. House of Representatives' International Relations Committee, April 30, 1996.
- 3) Corruption and Crime in the Former Soviet Union, Commission on Security and Cooperation in Europe, June 10, 1994.

Two papers of mine sponsored by the National Council for Soviet and Eastern European Research addressed this issue and were circulated within the government. They are presently available at the Tumanov Library at the National Council. They were the following:

"Post-Soviet Organized Crime: Implications for the Soviet Successor States and Foreign Countries," issued on February 8, 1994. A talk on this subject followed on April 11, 1994 at the U.S. Department of State.

"Privatization and Crime: The Post-Soviet Experience," issued August 10, 1995. A talk about this paper was held at the U.S. Department of State on May 16, 1996.

I have also addressed the issue in the following forum at the Wilson Center:

"Privatization and Organized Crime", November 18, 1996.

CENTER FOR THE STUDY OF TRANSNATIONAL CRIME
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I addressed the lawyers' forum at the World Bank in a seminar on corruption in July 1998.

Sincerely,

Louise Shelley Louise Shelley Professor and Director

Testimony of Yuri Shvets

Before the

Committee on Banking and Financial Services

of the

United States House of Representatives

September 21, 1999

From 1980 to 1990 I worked with the KGB foreign intelligence service. In September of 1990, I resigned from the agency on political grounds. It was clear to me that the leadership of the KGB and the Soviet communist party were ruining the country.

Starting from 1988, the KGB intelligence service focused primarily on following domestic developments in the Soviet Union. Also, it was "preparing" for future market reforms in the country. Number one priority of any KGB officer was to work on establishing new businesses or penetrating existing businesses, including the banks. I was a senior analyst, and my responsibility included analyzing the information provided by the field officers and composing reports to the top leadership of the country.

In this report I would like to focus specifically on just one KGB business operation. I believe it will by example give the distinguished members of this committee a better understanding of how Russia has been looted. This issue is widely discussed today, but the loot in Russia started before the Soviet Union collapsed.

In September 1990, KGB active duty officer Major Chukhlantsev together with a young

free-wheeler Alexander Konanykhine established a private company named

Rosinformbank. Prior to that, 24-year-old Konanykhine had been involved in an

unremarkable construction cooperative. He did not graduate any college, was energetic

and apparently liked publicity. According to the KGB standards, he was a good candidate

for a role of a KGB front.

It should be noted that active duty KGB officers were authorized to engage in business activities under one condition only: When their activities in private business are carried out on behalf of and under directions of the KGB. In other words, Rosinformbank was a joint venture between Konanykhine and the KGB. Later, Rosinformbank gave birth to a

number of other businesses and then vanished without a trace. Even a Russian military prosecutor office was unable (or unwilling) to find a single document pertaining to the establishment of *Rosinformbank*. It is noteworthy, because from an intelligence viewpoint, it is essential that the first front organization to be established cover all traces of its successor organizations or its exposure can have a domino effect on the rest of front businesses.

In December 1990, Konanykhine and his wife established a company named Fininvestservice. In January 1991, Rosinformbank (KGB) together with Fininvestservice established a company named the All-Russia Exchange Center (AREC). In doing so, Rosinformbank provided 100 percent of the initial capitalization of AREC, but gave away 80 percent of the shares to Fininvestservice (Konanykhine.) This may not make sense from a business point of view, but it makes good sense from the KGB perspective: It made Konanykhine a front for AREC. The fact that this also turned Konanykhine into an official stockowner of AREC entitled to 80 percent of the profits did not matter. The KGB had a large arsenal of tools and methods to solve these minor technical issues much to their advantage.

The KGB Major Chukhlantsev was appointed "technical director" of AREC. He also controlled AREC's finances. Other KGB officers – Boldyrev, Chukhlantsev and Sumskoy – were appointed to the board of directors of AREC. Konanykhine officially served as the chairman of the board and unofficially – as a front for the KGB-run AREC. Later, the All-Russia Exchange Center established the All-Russia Real Estate Exchange, the Secondary Resources Exchange and finally created the All-Russia Exchange Bank (AREB). The KGB controlled all those businesses through its officers placed on key

positions. Usually, they would take the top positions, or positions of deputy boss, and always filled in positions that controlled company's finances.

The All-Russia Exchange Bank was established on 24 April 1991 by the All-Russia Exchange Center (controlled by the KGB), Investtrade (Director – KGB officer Boldyrev), Souzinformatizatsia (General Director Ryzkhov – KGB) and the All-Russia Real Estate Exchange (created under the KGB control.) All key decision-making authority for the establishment of the All-Russia Exchange Bank was the responsibility of the All-Russia Exchange Center, established and controlled by the KGB. In other words, the KGB had full control over all those businesses from the very start.

Konanykhine fronted the KGB in the All-Russia Exchange Bank as its president.

Among the Bank's employees there were about 200 KGB officers, including several Generals. Shortly after the aborted coup d'etat of August 1991, Konanykhine employed General Leonid Shebarshin, former KGB Chairman and the right-hand man of Vladimir Kryutchkov, leader of the aborted coup d'etat. Konanykhine would later claim that he hired the KGB men for protection. With respect at least to General Shebarshin this explanation is deceptive.

After the failed coup d'etat, the top leadership in the KGB turned into pariahs in Russia. Kryutchkov was thrown into jail, and his men feared for their lives. They were afraid that the events in Russia might become similar to what had happened in 1956 in Hungary, where a number of state security officers had been lynched by mobs in the streets. After the failed coup d'etat in Moscow, the mob torn down monument of the founder of the KGB and was ready to storm the KGB headquarters.

Faced with unprecedented public outrage against the KGB, most Russian government institutions, which traditionally had served as the KGB covers, declared after the aborted coup d'etat that they would close the KGB positions. The KGB top leadership was not a protection any more. They were huge liability. In that situation for a private business to employ a former KGB Chairman was next to insanity unless Konanykhine could not refuse the KGB demand. It was not General Shebarshin, who was protecting Konanykhine. It was rather Konanykhine, who was protecting the former KGB Chairman.

There are strong indications that the All-Russia Exchange Bank was a "reliable cover" for the KGB, where the front man would clearly understand that he was entirely dependent on the KGB and had to comply with all the KGB instructions irrespective of the consequences. In most cases, the front man of a reliable cover company was a KGB human asset. The KGB had a file on him with as much of compromising materials as possible. A standard material was a document signed by the front man, in which he pledges to faithfully cooperate with the KGB. Given the importance of the All-Russia Exchange Bank for the KGB, I believe the strictest standards were applied to Konanykhine.

After the aborted coup d'etat of August 1991, the KGB was ostracized and soon officially disbanded. It was reborn under the different names. The KGB men, who had penetrated businesses and banks, continued to operate there. To avoid confusion, I will keep calling them here "the KGB."

On 21 October 1991, the All-Russia Exchange Bank received a license from the Central Bank of the Russian Federation that authorized the All-Russia Exchange Bank to execute

transactions with hard currency. The license actually granted the All-Russian Exchange Bank a monopoly on banking transactions between Russian businesses and organizations and foreign institutions. Also, it authorized the Bank to buy and sell hard currency. The ruble was in a free fall. Trading it was a bonanza.

According to the Russian political tradition, the decision for granting the license could not be made without the involvement of the top government and security officials. The motives of the decision have never been made public. It's remarkable, however, that the monopoly for hard currency transactions was given to a group of people that had absolutely no experience in running a bank, not to mention working with foreign financial institutions. In normal circumstances, their chances for obtaining the license were nil. They were sure, however, they would get the license well before it was actually granted. It was not surprising – the KGB traditionally had very strong positions in the Central Bank

The All-Russia Exchange Bank did not offer or engage in or provide traditional banking services. Its main function was to serve as a pipeline in channeling large amounts of money out of Russia, and it operated in this capacity approximately from November of 1991 to May of 1992. The first corresponding account of the All-Russia Exchange Bank was opened at the Central-European International Bank, Budapest, Hungary. The Russian government and law enforcement agencies have never officially disclosed amount of money channeled by the All-Russia Exchange Bank out of Russia. However, in February 1997, the Russian interior minister Kulikov, speaking in a closed-door session of the Russian parliament, said that as a result of Konanykhine's activities as a financier \$300,000,000 had vanished from Russia. Last week, Russian acting Prosecutor General

Yuri Skuratov in personal conversation confirmed to me that his office suspects

Konanykhine of participating in a scheme, which resulted in illegally taking out of Russia at least \$300,000,000.

It should be noted that when the first democratic government of Russia chaired by Yegor Gaydar was formed, it discovered that Russian hard currency reserves were depleted. Rubles were not freely convertible, and there was an acute shortage of hard currency to import the most essential goods – food and medicine. In this situation, the government appealed to the West to provide humanitarian aid to Russia. The aid, paid by the Western taxpayers, started to flow in. At the very same time, hundreds of millions of U.S. dollars were secretly channeled from Russia to the West by the Bank run by the old KGB guard and Konanykhine.

In his resent appearance on CBS' 60 Minutes, on 19 September 1999, Konanykhine acknowledged that \$1 billion was stolen from Russia through the All-Russia Exchange Bank.

Konanykhine was not a mastermind of the crime. However, given the information available to me at this point I strongly believe that he was an accomplice, who knowingly participated in the crime.

In summer of 1992, the "pipeline" shut down – the Bank stopped channeling money out of Russia. Inexperienced founders of the Bank did not know how to operate it in normal circumstances, and it went de-facto bankrupt. Former KGB senior officials – the real masters of the Bank – withdrew. Lower-ranking KGB officers, formal officials of the Bank, started quarrel with Konanykhine over the remaining \$12 million left on the Bank's accounts.

In September of 1992, Konanykhine entered the United States. He claims he had narrowly escaped a KGB attempt to kidnap him in Budapest, Hungary. The circumstances of this story, however, show that it was a mock kidnapping, if any kidnapping at all. It looks much more as an attempt of accomplices of the theft to split the profits "nicely."

The next major financial operation was started by Konanykhine in March 1993, out of Willard hotel in Washington, D.C. At that time, Boris Yeltsin entered into a mortally threatening clash with the Russian parliament and no one could predict the outcome of this clash (it climaxed with Kremlin sending tanks to shell the parliament building in October of 1993.) Raising tension in Moscow was accompanied by massive flow of capital out of Russia.

During this critical period Konanykhine, together with his partner, Yelena Cidorchuck, approached an American consulting firm with a project: to establish a bank, which was to receive billions of U.S. dollars from Russia. He also is seeking about 125 naturalized foreign passports and diplomatic passports at any cost for very special Russian clients. His partner, Yelena Cidorchuck, made it clear to the American consulting firm they had retained that she and Konanykhine were working for the top political and social elite of Russia. They were receiving instructions from Moscow. The establishment of the bank and the purchase of naturalized foreign passports for the prominent political and social elite was a matter of urgency.

Technically, the whole operation launched by Konanykhine in Washington, D.C. has a strong resemblance to the story of Golden Ada – a Russian company established later in San Francisco, whose objective was to build Boris Yeltsin and his close associates a

financial heaven in the U.S., where they could escape in case of Yeltsin's defeat in presidential elections of 1996.

There are indications that Konanykhine and his partner were working on a similar project on the eve of a bloody clash in Moscow of October 1993. He acted in capacity of vice-president of Menatep Bank. Details of Konanykhine's operation indicate that Russian intelligence officials were involved in it, at least on the planning stage. My personal knowledge as a former intelligence officer suggests that the people who directed this operation from Moscow understood that very soon American government agencies might learn about it but turn a blind eye on it. Apparently, the Russians believed that their clout as a bastion against communism in Russia would outweigh their "small sins." Without this understanding the Russian masters would never dare to execute the operation out of American capital.

In March 1994, the Russian Military prosecutor office starts criminal proceedings against Konanykhine charging him of "gross embezzling of state property and personal property – funds through fraud." On 30 September 1994, the Russian government requested his extradition to Russia. Konanykhine was not discouraged. In December of 1994, Konanykhine made a short trip to Moscow and then went to Antigua, where he worked on the establishment of European Union Bank. The trip to Moscow shows that he did not believe he would be persecuted there and was not afraid for his life, something he claimed later while applying for political asylum.

Konanykhine was arrested by the INS and sent to jail in June of 1996. Prior to the hearing of Konanykhine case in the INS court, the Russian military prosecutor's office sent to the INS documentation, which was supposed to substantiate criminal charges against him.

Close examination of the Russian file showed it was an attempt to cover up KGB crucial role in setting and operating the *All-Russia Exchange Bank*, and also the real scope of Bank's operations. Russian military prosecutor's office, traditionally heavily influenced by the KGB, portrayed Konanykhine as the only culprit of the theft and charged him with embezzling of "just" \$8.1 million. Missing \$300,000,000, not to mention \$1 billion, was not mentioned. In was a classic KGB cover operation, when a smaller thief is exposed in order to protect the big ones.

On the first hearing at the INS court Konanykhine was denied political asylum he requested, but at second hearing political asylum was granted. In my opinion, both decisions were a mistake. The first decision was based on claims of the Russian military prosecutor taken at face value even though the INS had been notified the Russian documentation was a cover-up. The second decision totally missed the fact that although Konanykhine was not a mastermind of the theft, he was an accomplice. I believe it was made possible because the INS could not present to the court all documentation that was available to other U.S. government agencies.

As a result, decision on granting political asylum to Konanykhine opens the door to other Russian money launderer to apply for political asylum in this country or to the KGB human assets to establish themselves in the U.S. This case also shows that cooperation with the Russian law enforcement agencies on money laundering cases may be tricky. The Russian law enforcement agencies are widely corrupt and split between supporters of different Russian interest and often organized crime groups. On the other hand, given the rampant corruption and unprecedented expansion of organized crime in Russia, it is impossible not to cooperate with the Russian law enforcement institutions, and there are

honest people there, even though they do not have upper hand now. The solution may lie in following the old Russian proverb: "Trust but verify," meaning at least to scrutinize the documentation supplied by the Russian side. I believe that mistakes on Konanykhine case could have been avoided by timely and thorough analysis of all relevant information. Money laundering and organized crime in Russia have reached proportions unprecedented in human history. To a large extend it was made possible because large segment of the Russian bureaucracy reaching the top of the government has become the most dangerous part of organized crime. It is useless to appeal to Yeltsin's regime to solve the problem. The issue of what to do with the Russian kleptocracy has become an international problem.

Institutionalized crime ruins Russia. It represents a serious threat to the whole world given Russia's vast territory and huge arsenals of weapons of mass destruction and nuclear power plants. In the present situation, to continue financial assistance to Russia means to further enrich and pervert corrupt Russian elite. The house must be cleaned first, and money stolen from the Russian people should be found and returned to them. Russian and Western intelligence services, looking for a sound objective after the end of the cold war, may find a noble assignment here and fertile turf for cooperation. The most odious thieves must be identified and punished. The Russian elite must be told laud and clear that if they ruin the country, transfer money to the West and plan to get away when the country collapses, it will not work. They will have to stay in Russia harvesting results of what they sowed. This message and determination to implement it may become a major deterrent of corrupt Russian elite. Any future financial assistance to Russia should

be redirected from the Russian government to the grass-root level, where it can reach Russian people, and it should be done under strict international control.

Some analysts say that tough Western position towards the Russian government on corruption issues may have alienated Russia. I believe, it is not so. As the Russian saying goes, "Those who pay the money call the tune," and in Russia it is taken for granted. As long as the Western taxpayers pay Russian government bills, the West is entitled to state its position on corruption issue laud and clear. Otherwise, it sends the wrong signal to the Russian people that the West sides itself with the "corrupt guys in Kremlin." We should stop worrying about sensibility of corrupt Russian bureaucracy. People that loot their own country have no sensibility. They are totally dependant on the West, because this is the West where they build their safe heavens.

Today, some analysts say that at least a generation is needed to return Russia back on track. I do not think so. Russian is not lost yet. Well-designed and diligently implemented American policy on Russian money laundering and corruption issues may make a big difference for Russian people. It will be much cheaper than the present sponsoring of Russian crony capitalism. It will bring positive results faster. And it will be a contribution the Russian people will appreciate very much.

Yuri Shvets

Testimony of Anne Williamson

Before the

Committee on Banking and Financial Services

of the

United States House of Representatives

September 21, 1999

Before I begin my testimony, I just want to take a moment to thank Chairman Leach and Ranking Member LaFalce for the opportunity to share with the House Committee on Banking some of the things I have learned over eight years of watching our Russian assistance program unfold. Chairman Leach, I particularly want to commend your efforts to lead the Congress on this very timely investigation of the true nature and unhappy consequences of our Russian policies.

I should like to add just a few words about myself by way of introduction. I am the author of CONTAGION: THE BETRAYAL OF LIBERTY; RUSSIA AND THE UNITED STATES IN THE 1990s, which will be available to Committee Members and the American public in time for the nation's Thanksgiving holiday. Prior to beginning my work on the book, I covered just about all things Russian for a broad range of publications which included inter alia The Wall Street Journal, The New York Times, Mother Jones, Art and Antiques, Premiere, Film Comment and SPY Magazine. From the late 1980s until 1997, I maintained homes in both Moscow and the United States. And therefore I can say for much of the last decade I had the privilege of being a witness to a dramatic history and the pleasure and excitement of sharing with the Russian people their remarkable land, language and culture. And it is with a profound gratitude to and a deep respect for that noble, heroic and too long-suffering people that I speak to you today.

In the matter before us — the question of the many billions in capital that fled Russia to Western shores via the Bank of New York and other Western banks — we have had a window thrown open on what the financial affairs of a country without property rights, without banks, without the certainty of contract, without an accountable government or a leadership decent enough to be concerned with the national interest or its own citizens' well-being looks like. It's not a pretty picture, is it? But let there be no mistake, in Russia the West has truly been the author of its own misery. And let there be no mistake as to who the victims are, i.e. Western, principally U.S., taxpayers and Russian citizens' whose national legacy was stolen only to be squandered and/or invested in Western real estate and equities markets.

The failure to understand where Communism ended and Russia began insured that the Clinton Administration's policy towards Russia would be riddled with error and ultimately ineffective. Two mistakes are key to understanding what went wrong and why.

The first mistake was the West's perception of the elected Russian president, Boris Yeltsin; where American triumphalists saw a great democrat determined to destroy the Communist system for freedom's sake, Soviet history will record a usurper. A usurper's first task is to transform a thin layer

of the self-interested rabble into a constituency. Western assistance, IMF lending and the targeted division of national assets are what provided Boris Yeltsin the initial wherewithal to purchase his constituency of ex-Komsomol [Communist Youth League] bank chiefs, who were given the freedom and the mechanisms to plunder their own country in tandem with a resurgent and more economically competent criminal class. The new elite learned everything about the confiscation of wealth, but nothing about its creation. Worse yet, this new elite thrives in the conditions of chaos and eschews the very stability for which the United States so fervently hopes knowing full well, as they do, that stability will severely hamper their ability to obtain outrageous profits. Consequently, Yeltsin's "reform" government was and is doomed to sustain this parasitic political base composed of the banking oligarchy.

The second mistake lay in a profound misunderstanding of Russian culture and in the Harvard Institute of International Development advisers' disregard for the very basis for their own country's success; property rights. It was a very grave error. Private property is not only the most effective instrument of economic organization, it is also the organizational mechanism of an independent civil society. The protection of property, both of individuals' and that of a nation, has justified the existence of and a population's acceptance of the modern state and its public levies.

Russian property rights are tricky; property has never been distributed, but only confiscated and awarded on a cyclical basis. For the big players property exists, as it always has, <|>only</|> where there is power. For the common man, the property right hasn't advanced much beyond custom which prevents the taking of any man's shelter, clothes or tools so long as continuous usage is demonstrable. An additional, purely Slavic feature of the Russians' concept of property is the shared belief that each has a claim upon some part of the whole.

In ancient 'Rus, property existed for the individual as a claim - or an entitlement if you will - to a shared asset, a <|>votchina</|> or "estate", held by all the members of a particular clan. This understanding of property still informs the culture; though Westerners bemoan Moscow mayor Yury Lyuzhkov's retention of the system of the residential permit ("propiska") as an impediment to a flexible labor force, the policy is one of Lyuzhkov's most popular. Muscovites are well-satisfied with a mayor who polices outsiders as they believe any proprietor of such a great estate as Moscow should.

The Russians' failure to accept the Roman concept of private property has compelled them to suffer the coercive powers of the state so that at the very least a civil order, if not a civil society, might be established and sustained. The hackneyed idea that Russians have some special longing for tyranny is a pernicious myth. Rather, they share the common

human need for predictable event undergirded by civil and state institutions and their difficult history is the result of their struggle to achieve both in the absence of private property.

Since only the Tsar or the Party had property, no individual Russian could be sure of long-term usage of anything upon which to create wealth. The property right matters most of all to the poor because property is the poor man's ticket into the game of wealth creation. The rich, after all, have their money and their friends to protect their holdings, while the poor much rely upon the law alone.

In the absence of property, it was access - the opportunity to seek opportunity - and favor in which the Russians began to traffic. The connections one achieved, in turn, became the most essential tools a human being could grasp, employ and, over time, in which he might trade. Where relationships, not laws, are used to define society's boundaries, tribute must be paid. Bribery, extortion and subterfuge have been the inevitable result. What marks the Russian condition in particular is the scale of these activities, which is colossal. Russia, then, is a <|>negotiated</|> culture, the opposite of the openly competitive culture productive markets require.

Ironically, the nontransferability of the <|>votchina</|> system's entitlement was the very flaw a shareholding culture and an equities market could have addressed successfully had Lenin's revolutionary dictum of "Property to the people! Factories to the workers!" been realized. <|REF A>www.bookagency.com/oligarchy81.html>And such a program existed. It was designed by Larisa Piasheva, a free market Russian economist who was appointed by Moscow mayor Gavriil Popov to design and execute a program for the privatization of Moscow's assets. Ms. Piasheva's program was a fearless and rapid plunge into the market which would have distributed property widely into Russia's many eager hands. Further, the program – inspired as it was by the policies of Wemer Erhard and his adviser, the renowned Austrian economist Wilhem Ropke - did not rely upon Western lending but instead tailored itself to maximize direct Western investment.

When the Administration says it had no choice but to rely upon the bad actors it did select for American largesse, Congress should recall Larisa Piasheva. How different today's Russia might have been had only the Bush Administration and the many Western advisers from the IMF, the World Bank, the International Finance Corporation, the European Bank for Reconstruction and Development and the Harvard Institute of International Development then on the ground in Moscow chosen to champion Ms. Piasheva's vision of a rapid disbursement of property to the people rather than to the "golden children" of the Soviet <| >nomenklatura.</| |

Instead, after robbing the Russian people of the only capital they had participate the new market to A>www.worldnetdaily.com/bluesky_williamson/19990901 xcawi inconve.shtml>the nation's household savings - by freeing prices in what was a monopolistic economy and which delivered a 2500% inflation in 1992, America's "brave, young Russian reformers" ginned-up a development theory of "Big Capitalism" based on Karl Marx's mistaken edict that capitalism requires the "primitive accumulation of capital". Big capitalists would appear instantly, they said, and a broadly-based market economy shortly thereafter if only the pockets of pre-selected members of their own ex-Komsomol circle were properly stuffed. Those who hankered for a public reputation were to secure the government perches from which they would pass state assets to their brethren in the nascent business community, happy in the knowledge that they too would be kicked back a significant cut of the swag. The US-led West accommodated the reformers' cockeyed theory by designing a rapid and easily manipulated voucher privatization program that was really only a transfer of title and which was funded with \$325 million US taxpayers' dollars

Voucher privatization's conceits were compounded by a grievous insult; unregulated voucher investment funds, which the privatizers encouraged the uncertain Russian citizenry to patronize. Hundreds and hundreds of investment funds simply walked with their clients' vouchers, reselling them to domestic criminals, Red Directors, western investment banks and international money launderers. In other words, the lion's share of Russian money laundering occurs when capital enters the country, and what we see today in the Bank of New York scandal is, in fact, properly understood as capital flight. When the 18 month-long thieves' banquet that voucher privatization was concluded in July 1994, the program, whose very design left the controlling shareholding of any single enterprise in the hands of the state, had actually institutionalized the state as the determinant owner of all that had formerly belonged to "the people".

Co-temporaneously with voucher privatization, an early and precipitous Bush Administration initiative was coming to fruition. In early 1992, the "Bankers Forum" project was wheeled into place by a former New York Fed chief, Gerald Corrigan, who at George Bush's direction sent in a group of experts from the Fed, commercial banks and the Volunteer Corps on an off-the-books mission to teach the Russians at the Central Bank the bond game. Moscow-based Dialog Bank's Peter Derby, who explained the project's background remarked, "Basically, when Corrigan asks, I guess no one turns him down, because people reacted instantaneously. It was done by <|>private investors</|>, who were asked by <|>a person you can't say no to" (my emphases).

The improbable yields (290% on 3-month paper at one point) on the Russian market's GKO instruments were paid with US taxpayers' money via IMF loans. Guess where all investment went? By yielding those kind of non-market returns, the bond market insured that all the country's resources and all that it was capable of attracting went to the support of the state, just as Tsarism and Communism had done previously.

So lush were the bond market's rewards that dubious market participants included the Russian Central Bank itself through an off-shore firm known as Fimaco. The involvement of the Harvard Institute of International Development's [HIID] honchos in the same conflict-of-interest activities has already been admitted publicly and remains the object of a Boston grand jury's scrutiny. The Harvard Management Corporation, which invests the university's endowment, was also an avid purchaser of Russian bonds, a dubious and unsettling history since there is no legal separation of HMC and the university itself. According to the Russian Interior Ministry's Department of Organized Crime, Western employees of Russian banks, Western bankers and consultants. Russian bankers and anecdotal evidence, other likely participants include certain employees of the U.S. Treasury, of the multilateral agencies (most especially the World Bank's Moscow offices), of bilateral aid agencies, and policy and program consultants acting through accounts established in their wives' maiden names with non-U.S. reporting brokerages in Moscow. Even the Ford Foundation's Moscow office sponsored its own internal Russian bond shop for which the unthinking Russian managers once asked this reporter to drum up U.S. investors.

One particularly striking aspect of Bill Clinton's presidency is how aggressively his administration has worked to capture the political support of the financial sector, offering up heretofore unseen gobs of government favor. (A disproportionate number of firms receiving OPIC guarantees, Export-Import bank lending, and IFC and Russian Enterprise Fund participation were generous contributors to both Clinton campaign coffers and the DNC.) The basic formula was simple, it's not the rocket science Russia's Harvard advisers intimated it was: The bread and butter of all equity markets are bonds. Wall Street wanted a debt market. You build it and we'll come, they said.

The aid program delivered best it could what was in reality a flimsy contrivance, which - in turn - was really only an exotic venue through which to pass public funds to select Russians of the Clintons' and HIID's choosing and to Wall Street investment banks the Clintons hoped to entice permanently into their orbit of supporters and contributors. In short, <HREF A>www.worldnetdaily.com/bluesky exnews/1998007 xex an imperial _shtml>the Russian bond market was the Arkansas Development Finance Authority gone international.

Today the Clinton Administration's chief defense for their hand in Russia's ruin is that somebody had to keep the communists at bay. But there were no communists in Russia by late 1991, only nascent investment bankers looking to nail down a stake any which way. Communism had evaporated by late 1987, the year in which the Russian people were allowed to hold convertible foreign currencies. Overnight, the power of money displaced the power of ideology.

Though some now say the loans-for-shares privatization program marked the reformers' fall from grace, but I beg to differ. On 14 September 1991, Vladimir Shcherbakov, the last First Deputy Prime Minister of the Soviet Union, formed with two other partners, one of which was the now notious Austrian firm, Nordex GmbH, the International Foundation for Privatization and Private Investment [FPI]. FPI's charter was legitimized by Gorbachev's signature and approved by 13 heads of what were still constituent republics.

In an interview published in a 1993 issue of VIP, the vanity organ of the commercialized <I>nomenklatura.</I>, Shcherbakov reported excellent relations with the new regime of "eager young reformers" — Gaidar, Chubais et al — and their leader Boris Yeltsin. All hail-fellows-well-met. So too did FPI enjoy similarly sympathetic connections to <I>the EBRD, the IMF and the UN Industrial Development Organization.</I> Shcherbakov even boasted about FPI's "new approach to the problem of the property of the Western Army Groups in Eastern Germany that comes down to its joint exploitation by Russian and German businesses", an eyepopping admission worthy of considerable note since a year after the interview was published, <I>the</I> Russian scandal was Bonn's claim that Soviet weaponry sales to rogue regimes originating in the Western Army Group had amounted to a \$4 billion criminal take.

A former employee of FPI, speaking through clenched teeth, reported, "It's [FPI] not a well-known organization, but it's one of the most wealthy and most powerful organizations in Russia," and their work was engineering commission-paying deals for money or privilege with the Kremlin, thereby organizing a pipeline of tribute typical of corrupt regimes. "I can't say it publicly, I can't prove my position with documents, but I know they were privatizing companies, the very best companies, before we had a privatisation program."

The CIA has been determined that through Nordex, FPI seized the export earnings from Russia's natural resource companies – oil, gas, platinium, gold, diamonds – and from industrial firms exporting items such as steel and aluminum and then stashed the outrageous profits in Western bank accounts. And only now, eight years almost to the day later, do US

taxpayers learn that the "eager, young reformers" to whom their resources were sent for the purpose of building a new Russia were in league from day one with the exhausted Soviet <|>nomenklatura</|> in a scheme to loot Russia's wealth and park it in the West.

Yegor Gaidar insists to this day, John Lloyd was good enough to remind us in his recent New York Times Sunday Magazine article, that "he had no choice but to let prices rise to increase supply and to scrap trade barriers so that foreign commodities could begin to fill store shelves."

Gaidar's assertion is untenable. The Soviet Union was economically self-sufficient except for bananas, coffee and coconuts. Foreign commodities weren't required to fill Soviet shops. And even though the ruble was not convertible, that characteristic had nothing to do with the sudden shortages in late autumn 1991, which were only slightly worse than those normally encountered in the last thin years of Gorbachev's <|>perestroika</|>.

No one had stopped producing, but shops were suddenly nearly empty. Producers had begun hoarding, as had fearful consumers, but why? It wasn't that Yeltsin announced in November 1991 that the government intended to free prices, it's that he also announced <|>the exact date</|> on which prices would be freed. Predictably, producers withheld their product from market and rubbed their hands together like flies awaiting the coming feast which Yeltsin's newly announced policy guaranteed. Within a week of the ill-considered speech, Muscovites' needs were being rationed.

However, Gaidar really was under pressure, but the pressure was coming from the West to open Russia to unrestricted imports in return for multilateral lending. Gaidar soon delivered a trade policy that was 100% back-to-front, accommodating as it did the self-serving demands of both the West and Russia's nascent banking oligarchy; Russian manufacturing was to take the brunt of unrestricted foreign competition, but domestic banking was to be protected from competition! Even Russian Central Bank Chairman Viktor Gerashchenko protested, but the Russian bankers was accommodated and the IMF continued lending. So much for the "leverage" foreign policy elites claim foreign assistance programs provide the U.S.

In 1991, there was no hope whatsoever that wheezebag Soviet industries could compete with Western products. For decades, prices were set by <|>Gosplan</|> (State Ministry of Central Planning), any enterprise profits were claimed as Soviet tax revenues, all customer bases were quaranteed and therefore no enterprise had a financial incentive to compete. Without competition, there was never any need to improve quality.

How could freeing prices alone change this equation? Free prices only work to the benefit of consumers when producers compete with one another in the marketplace to satisfy customers' demands, leaving consumers postitioned to reap the most benefit at the lowest price. Clearly, an equitable and transparent privatization that would have delivered property widely to Russia's many eager hands should have preceded the freeing of prices. And during privatization, native producers should have enjoyed some protectionism at least, as did developing American industry and manufacture in the 19th century.

Competent advisers would have known Russia never did develop an effective banking sector and system of credit in a 1000 years of her history. The story of Russian banking – ancient and modern – always has the same plot, only the names and the dates change. S.Y. Borovoi's easily obtained history of 18th century banking outlines a typical episode involving a certain "Suterland, who received 2 million pounds for transfer to London, but instead lent the sums to Prince Potyomkin (800,000), Finance Minister Vyazemsky, Foreign Minister Bezborodko and even to the future emperor Pavel. The debt of these honorable people was, <|>according to the custom</|> forgiven and paid by the state."

Certainly eager Western banks should have been given admission to Russia. By working initially with more developed and well-capitalized Western banks and later by competing with them, Russian banks could have developed quickly and today be mediating capital responsibly and profitably. No good economic purpose was achieved by foisting subsidized billion dollar loans onto Russia for the purchase of Western consumer goods.

Once the crime of voucher privatization was fully realized, thereafter ensued a years-long highly-criminal and oftentimes murderous scramble for hands-on control of the enterprises. Directors stashed profits abroad, withheld employees' wages and after cash famine set in, used those wages, confiscated profits and state subsidies to "buy" the workers' shares from them. The really good stuff - oil companies, metals plants, telecoms - was distributed to essentially seven individuals, "the oligarchs", on insider auctions whose results were agreed beforehand. Once effective control was established, directors - uncertain themselves of the durability of their claim to the newly-acquired property - chose to asset strip with impunity instead of developing their new holdings.

Unsurprisingly, the entire jury-rigged effort has collapsed in flames. The bond market has gone bust, Russia is crushed by her IMF loan payments, and OPIC's nearly \$2 million in U.S. taxpayer-provided guarantees are yet to be resolved. The West's best course under whatever new government the Russian people elect is to take its own advice, stop meddling, cease all subsidies and allow what few market mechanisms that

do exist in Russia to work. The sooner the banking industry's <|>pylesos</|> ("vacuum cleaners") are allowed to fail, then the sooner the national property can return to market where more able and productive hands might yet grasp it.

Until Russians have resolved for themselves how property is to be held and secured their decision <|>de jure,</|> all the destructive economic arrangements and cultural behaviors crowding Russian history will continue. Wealth will not be created without private property; without transferable property secured legally to protect no Russian will pay taxes; without revenues no Russian government can endure without falling back upon what is every state's final reserve; coercion.

The years-long sugarcoating of what the Clinton administration's policies have wrought in Russia is just one more lie bequeathed Americans. More Western money will only work to insure the continued degradation of Russia, bequeathing her people a future that can be discerned in that most familiar object of Russian folk culture - the Matryoshka nesting doll - a perfect, visual metaphor of Russia's Brechtian universe: Each figure is captive, one inside the other, and in the end the biggest doll consumes the lot.

Turning to the question of the IMF and the World Bank generally and their specific roles in international finance, much needs to be said. When libertarians say that government produces nothing, they make a serious error. Government produces one thing in abundance - our money. US paper fiat dollars have no intrinsic value and circulate only by faith and by edict. Consequently, the dollar in a baby boomer's pocket is worth but the penny that was in his grandfather's purse less than a century ago. But granddad's penny was one hundredth of a gold-backed dollar's value, while today's dollar is the product of a government-operated pyramid scheme. Once the state slipped the "golden handcuffs" of budgetary discipline through the establishment of the Federal Reserve System, it gained the ability to create unlimited debt, thereby claiming for itself what before had been the purview of tyrants - the ability to debase the currency. It is the slow leaching of value from the US dollar, not the far lesser sums raised by direct taxation, which has enabled the political class to purchase votes for its re-election. The degradation of American society since 1971 is often remarked upon.

Any pyramid scheme remains viable only so long as its base continues to expand and it is that fact which has driven US foreign policy for much of the past century. Since politicians and investment bankers both have an interest in promoting deficits and in forcing taxpayers to redeem government debt, they were quick to come to terms on the advantages of underwriting foreign debt along with new markets and natural resources from abroad. Taxpayer-subsidized globalism then is not a new phenomenon,

but it has reached an apogee of sorts under the guiding hand of the current Clinton Administration.

Once the criminal financial flows from Russia and Asia were combined with the easy money common to presidential election cycles and began pumping into the economy in the spring of 1995, it wasn't long before asset inflation hit US corporate share valuations. Throughout 1995 and 1996, the money supply kept rising, and along with it mutual fund holders' paper wealth. Attracted by the double-digit yields found in risky, unregulated environments abroad, the banks - given the election year liquidity the Fed wished to export - lent unwisely and to excess. The moral hazard the 1995 \$40 billion bailout of Mexico unleashed (the debt was refinanced, not repaid, with additional IMF lending and proceeds from eurobond sales in 1996) led to a tripling of international capital flows. Investors took greater and greater risks in the belief that the "new paradigm" promised taxpayer-provided redemptions if necessary. The consequence of all those dollars frolicking in exotic locales is a \$141 billion bailout for Asia, more than \$20 billion for Russia in 1998 alone, and \$30 billion for Brazii in 1999.

Cures under discussion all share one quality; each has some aspect that degrades American citizens' independence and prosperity. It is one more irony of the post-cold war environment that ambitious American policymakers, who were so busy "reforming" Russia in the most appallingly cavalier and self-serving fashion, failed to honor the lesson Russia has to teach, i.e. liberty and empire do not cohabit.

The 1930s were the last era in which the international political and financial elite sought advantage through control of the global economy. What economists call "hot money" raced from one nation to the next throughout that era, leaving a trail of competitive currency devaluations in its wake. Six decades ago, as nation after nation was humbled by and strangled with the manipulations of the financial world's insiders, history saw fit to serve up Adolph Hitler.

A world war and a score of years later, the allies established the IMF as a prophylactic money bag to prevent destabilizing trade imbalances and therefore, they thought, a repetition of the preceding decade's nightmare. Yet over half a century later, the IMF, the World Bank and their similarly US-controlled spawn - the IFC, the six regional development banks and the EBRD - have become 800-pound gorillas of economic distortion and, over time, of pillage which unchecked will guarantee extensive international conflict and a broadly-based anti-Americanism.

During the Cold War, the International Monetary Fund got itself repeatedly into all sorts of financial and ethical mishaps in the West's effort to contain the Soviet empire. But the IMF's excesses were of little concern

so long as its financial firepower could be directed at whatever nation appeared on the verge of toppling into the Soviet camp.

No longer serving in an arguably wasteful manner what was nonetheless an agreed national purpose, the IMF has come to function increasingly as the personal gift of the office of the US Treasury courtesy of that office's service to the US presidency. The US-dependent IMF has been well pleased; far easier to serve a single master than answer to a committee of Congressmen such as yourselves.

The ascendancy of Treasury in foreign policy at the State Department's expense is the result of a neo-mercantilist foreign policy in which enterprise is to be subject to direction from the presidential administration it is to serve. By expanding the mandates and accelerating the use of a host of international agencies in which the US is dominant - the IMF, the World Bank, the EBRD, the regional development banks, the IFC - and combining their efforts with those of the Commerce Department, the Export-Import Bank, OPIC and USAID-financed Enterprise Funds, the Clintons succeeded in constructing an international patronage machine in which the American executive stands supreme.

Today the president's men are seeking to institutionalize the socialization of private investors' and global bankers' risks in international markets via a freshly-capitalized IMF. The price of the US's \$3.5 billion contribution to the proposed IMF bailout fund on top of another requested \$14.5 billion was said to be insignificant when weighed against the financial calamity of a worldwide recession that IMF ministrations and policing could avert. But how true is this?

Taking the IMF's behavior in Russia as a guide, the answer is that we can expect a rapid escalation of taxpayers' liabilities in the service of failed policies. After the chaos unleashed by the Fund's initial advocacy of a single ruble zone for the Commonwealth of Independent States, which handed management of the ruble to 12 central banks, the Fund's monetary sages settled down to their more usual business of lending large sums in return for secret, IMF-designed recovery programs always said to be strictly enforced. In Russia's case, only the rhetoric of strict conditions was enforced.

For example, when the IMF touted a 1996 \$10.2 billion loan on the basis of what an extraordinary job Russia had done in meeting the conditions of a 1995 \$6.7 billion loan, one crucial detail went unmentioned. The \$6.7 billion loan was extended without any conditions via the IMF's Systematic Transformation Facility, a program designed to funnel money to Russia in return for "the promise to reform". Also left unsaid was that through the magic of money's fungibility, the \$6.7 billion loan financed - almost to the kopeck - Yeltsin's bloody and disastrous assault on Chechnya.

Following the Russian Communists' success in the December 1995 parliamentary elections, the Fund proceeded into even dodgier territory with the 1996 \$10.2 billion loan, which came front-loaded with a billion dollars meant for Yeltsin's re-election. In return, tape recordings of conversations between Mr. Clinton and Mr. Yeltsin made public demonstrate that longtime Clinton supporter and campaign donor Tyson's Chicken's business of exporting chicken to Russia – a \$700 million annual business – was protected from a threatened 20% tariff increase.

Once the first tranche's payout of a billion plus dollars arrived the following May, Yeltsin pulled out all the stops; back wages for state employees and pensions were paid, and after the IMF's billion was consumed, the capricious Siberian ordered his initially mulish Central Bank to hand over a billion more. The IMF said nothing despite claiming the Fund's main achievement in the past 6 months was legislation establishing the Russian Central Bank as an independent institution. Therefore, the Fund's current denial of any knowledge of the Russian Central Bank's offshore operations through Fimaco are dubious.

But weren't Americans told that Russia's financial oligarchy paid for Yeltsin's re-election? To the contrary, Russia's bankers made serious money on Yeltsin's electoral weakness by buying government bonds at distressed prices using cheap money handed over from government deposits. The lion's share of the domestic bonds' high yields have always been paid with IMF loans. Russia's first representative to the World Bank, Leonid Grigoriev, explained, "Of course, the government was to return this money and that is why the yields on 3-month paper reached as much as 290%. The government's paying such huge, impossible rates on treasury bills, well, it's completely unbelievable. It had nothing to do with the market and therefore such yields can only be understood as a payback, just a different method."

Clearly, building an empire of finance capitalism is an expensive business. But who pays? US taxpayers and Russian workers, who paid indirectly by having their wages go unpaid and their national estate continually degraded. Secondly, the Russian people paid by being denied a means of exchange since the banking and trade sectors of the economy were quick to socialize amongst themselves what few rubles the IMF's tight money policies allowed the Russian Central Bank to print.

"The new paradigm" economy concocted by the Harvard-connected Clinton Administration appointees in the US Treasury, was designed to extend the federal government's meddling hand worldwide through its control of the multilateral and bilateral public lenders, enabling government a free ride on the back of a re-structured U.S. economy grown vigorous and

ever more innovative on account of the benefits the Reagan era's low taxation, moderate inflation, reduced regulation and expanding world trade had delivered. The overall scheme works as follows:

Sell assistance programs on an alleged "free market" and "humanitarian" basis by awarding government grants to those academics who can be relied upon to supply the intellectual camouflage politicians and journalists then repeat <|>ad nauseum</|></|> to a distracted public, move the IMF and the World Bank to target, induce target to raise taxes, fine tune target's central banking operations, encourage borrowing and debt creation through the target's government and its national banks, allowing IMF lending to pay yields if necessary; induce target to privatize national property while building a flimsy, artificial "infrastructure" for an equities market good enough to attract high risk foreign investors. Once the target nation's government flounders, step back and watch speculators assert discipline through a run on the target's currency. The subsequent devaluation delivers, in turn, a flood of cheap imports to American manufacturers and producers.

The finishing touch on the swindle is to confiscate more money from G-7 citizens (the lion's share from Americans) to pay for what is said to be an "essential" IMF bailout; thereby allowing Uncle Sam's IMF minions to entrench themselves more deeply in the target's government. Taxes are raised, the population struggles beneath indebtedness, government funding demands and the inevitable domestic inflation a devaluation delivers. Western neo-colonialists then bully the target over its rapidly compounding debt in order to extract yet more property. Once successful, the world's insiders then turn around and deliver cheap shares from privatizations and initial public offerings into the maw of US mutual funds and portfolio investors. US taxpayers get hit coming (foreign aid) and going (bailouts) and innocent foreigners' property is finagled away either from, or on account of, inattentive and corrupt leaderships. The big winners are the world's increasingly corrupt and cozy governing class, international bureaucracies and global banks.

What US policy has wrought across much of the post-cold war landscape is a moral, political and financial abomination based on fraud, theft and deceit. In Russia the results of the Clinton Administration's policies are the perpetuation of the longest depression of the 20th century in what is increasingly an unpoliced deadly weapons dump, the biggest swindle of national property since Vladimir Lenin muscled the country early in the century and the discrediting of the ideas of free markets and democracy.

But as the old saying has it, what goes around comes around. Unfortunately, all those dollars the Fed printed to get Bill Clinton re-elected in return for Alan Greenspan's third appointment as central bank chief, are

now returning to the United States in the form of manufactured goods and commodities with which U.S. producers can not compete on price.

When exchange rates fluctuate against one another as they do now, some countries will inflate more quickly than other countries. The G-7 are the only nations that try to co-ordinate their monetary policies and the effort usually ends up a failure over time. When one country inflates too quickly, the value of its currency will decline.

Some governments - especially those with an election on the horizon - actually want to devalue since national exporters, their goods now being cheaper, sell more goods. Global lenders like the IMF are also fond of devaluations because a rising national income from bargain exports leave plenty in the national kitty for principal and interest payments to them. (Global direct investors who stick to the dollar, quasi-"good guys", fear devaluations, because their profits calculated in a devalued domestic currency buy fewer dollars for repatriation.)

But when exchange rates depreciate rapidly the specter of capital flowing out of a country appears. Foreigners and residents put their savings elsewhere. The currency goes into free fall, its value plummets, more investors flee and at the end of the cycle, interest rates skyrocket. This is exactly what happened in Asia in 1997, in Russia in 1998 and in Brazil in 1999.

Yet to curse the speculators is useless; since the 1972 collapse of Bretton Woods that broke the international link between the dollar and gold, the fear of the syndrome described above is the only remaining bit of discipline in the international system. How much better, the globalists reason, if there were to be one central bank and one flat currency for everyone so that then national leaderships (and the financial oligarchies they sustain) could inflate and rob their own populations in unison.

In time, U.S. corporate profits will decline as a consequence of the IMF-induced deflation and share prices of all but premiere multinational corporations will follow suit. Alas, those Americans up to their necks in credit card debt may well be the next class of debtors to be rolled, and American farmers have been suffering for some time from the collapse of farm commodities. In time, credit will dry up, government receipts will dwindle, the national debt will skyrocket and unemployment will increase. Eventually the government will inflate its way out of its accumulated debt.

Before concluding my remarks, I would like to recall one curious and mostly unremarked detail from 1994, that sticks out in this sad story like a boy's unruly cowlick. In mid-July 1994 - at the very moment dollar-based Mexican tesobonos were being oversold to prosperous clients of Goldman Sachs and other U.S. investment banks, which, in turn, would lead to the

1995 Mexican bailout and the introduction of moral hazard into the world's financial system - Michel Camdessus told a press conference that he intended to press for the creation of a new IMF facility to give members resources with which to defend themselves against speculative attacks in financial markets.

In other words, long before bailouts of entire countries became routine Camdessus wanted a new loan program to feed the last disciplinarians in the world's financial system - currency speculators - so that national governments might become even more unaccountable to their citizens. At the time, The Economist slammed the proposal, saying it was "absurd and almost certainly unworkable," since Camdessus "bizarrely" was assuming the IMF would know more about economic fundamentals than the markets. And that assumption, The Economist noted, was the very assumption which had been the undoing of the USSR's centrally planned empire. But Camdessus' 1994 plan is the very one the Clinton Administration implemented and seeks to institutionalize.

So who wags the tail of the money dog? Michel Camdessus, a French socialist and lifetime bureaucrat, and his deputy, Stanley Fisher, who together are quite possibly the two most incompetent people on the planet? So it would appear.

It doesn't take a conspiracy theory to observe that the downward arc of citizens' liberties, independence and civic competence and of American culture generally parallels the declining value of the U.S. dollar, which has lost 99% of its value since the founding of the Fed, and 75% of that debasement has occurred since the last link with gold established by Bretton Woods collapsed. From that perspective, it's really not very surprising that at the end of the century, not quite a century after America instituted the Federal Reserve and thereby began the process that would deliver the power of creating unlimited debt to the political class, the White House is occupied by a couple who share not so much a marriage as they do a collection of felonies.

Throughout the 1990s, finance capitalism's shills have been a "new paradigm" economy so glorious one might have thought Beatrice awaited us each and every one at the very lip of Heaven itself. Their brassy tune celebrated the defeat of the business cycle by globalization, productivity gains and computer technology. Inflation was tamed, the golden homs sounded, and we were to dwell eternally in lush fields of full employment, low interest rates and a booming stock market. And, insiders winked, foreign money once mugged by speculators would have nowhere else to go but directly into Wall Street's money machine.

But what if - instead of Beatrice - what waits over our collective shoulder down Purgatory way is a repeat of the European currency instabilities of the 1930s, which culminated in the most viscious and widelyfought war in world history?

From the perspective of the many millions of her children, Mother Russia in late 1991 was like an old woman, skirts vanked above her waist. who had been abandoned flat on her back at a muddy crossroads, the object of others' scorn, greed and unseemly curiosity. It is the Russian people who kept their wits about them, helped her to her feet, dusted her off, straightened her clothing, righted her head scarf and it is they who can restore her dignity - not Boris Yeltsin, not Anatole Chubais, not Boris Berezovsky nor any of the other aspirants to power. And it is the Russian people - their abilities, efforts and dreams - which comprise the Russian economy, not those of Vladimir Potanin or Viktor Chernomyrdin or Mikhail Khodorkovsky or Vladimir Gusinsky. And that is where we should have placed our bet - on the Russian people - and our stake should have been the decency, the common sense and abilities of our own citizens realized not through multilateral lending but through the use of tax credits for direct investment in the Russian economy and the training of Russian workers on 6-month to one year stints at the US offices of American firms in conjunction with a free trade treaty.

Russia is a fabled land, home to a unique and provocative thousand year-old culture, and a country rich in the resources the world needs whose people had the courage and resilience to defeat this century's greatest war machine, Hitler's invading wehrmacht. Yet, thanks to Boris Yeltsin's thirst for power and megalomaniacal inadequacy, Russia has become the latest victim of American expediency and of a culturally hollow and economically predatory globalism. Consequently, Americans, who thought their money was helping a stricken land, have been dishonored; and the Russian people who trusted us are now in debt twice what they were in 1991 and rightly feel themselves betrayed.

The worst of it was that some pretty good ideas - private property, sound money, minimal government, the inviolability of contract and public accountability - that have delivered to the West's citizenry the most prosperity and the most liberty in world history, and might have done the same for the Russians, were twisted into perverse constructions and only then exported via a Harvard-connected cabal of Clinton administration appointees who funded - without competition - their allies at Harvard University courtesy the public purse. Joining the US-directed effort were the usual legions of overpaid IMF/World Bank advisers whose lending terror continues to encircle the globe.

But where, in a land in which today more of the people die each year than are born, lies the gain? History's yardstick will measure out the answer, and I suspect it will not suit us.

STATEMENT OF ARMAUD de BORCHGRAVE

DIRECTOR OF THE GLOBAL ORGANIZED CRIME PROJECT AT THE CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES (CSIS)

BEFORE THE HOUSE COMMITTEE ON BANKING AND FINANCIAL SERVICES

SEPTEMBER 21,1999

I am testifying today in my capacity as Director of the Global Organized Crime Project at the Center for Strategic and International Studies.

We published our first report on Russian Organized Crime and its global implications for U.S. National Security on September 29, 1997. Four days before its release, President Yeltsin told the upper house of parliament, known as the Federal Council, that "criminal elements have entered our political arena and are dictating our laws with the help of corrupt bureaucrats."

The Russian Organized Crime (ROC) Task Force is in the process of completing a companion report updating the ROC situation since the August 1998 crash. The report will be released before the end of this year.

The key findings of the 1997 report:

- Left unchecked, Russia is in danger of becoming a "criminal-syndicalist state" under the control of corrupt government bureaucrats, politicians, businessmen and criminals with which normal relations would be impossible.
- Russian Organized Crime (ROC) constitutes a direct threat to the national security interests of the United States by fostering instability in a nuclear-armed major power.
- Equally ominous is the challenge to national security and law enforcement posed by the transnational operations and alliances of ROC groups. According to the FBI, ROC groups now have relations with their criminal counterparts in 50 countries, up from 29 countries just two years ago.
 Overall, some 200 large, sophisticated ROC groups are now operating worldwide.

- ROC groups hold the uniquely dangerous opportunity to procure and traffic nuclear materials. Russia's former Minister of Defense, Igor Rodionov, has indicated that, without immediate payment of back wages, "the Defense Ministry cannot guarantee that some undesirable and uncontrollable processes will not develop in the armed forces."
- The criminal environment in Russia is often compared with the "robber baron" era of 19th century U.S. history. This is a false analogy. ROC groups stash untold billions abroad and seldom reinvest their ill-gotten gains to bolster the domestic economy through the building of modern infrastructure.
- The corruption that pervades every level of Russia's bureaucracy is the major impediment to combating OC in Russia.
- The processes of democratization and economic liberalization in Russia are being seriously undermined by ROC.
- The erosion of the government by ROC is imperiling cooperative efforts in the areas of peacekeeping, nonproliferation and economic restructuring.
- ROC has extended its tentacles throughout Russia's economy, which confers an aura of legitimacy to myriad illicit activities, including the manipulation of Russia's banking system and financial markets.
- In the absence of effective courts, a working judicial system, and consistent enforcement of established commercial and contract law, criminal elements have become de facto adjudicators. Protection rackets in effect have usurped the government's traditional legal functions and safequards.
- Efforts within Russia to combat OC by the government, the media, and others - have been weak, often sidetracked because of fear and bribery, and frequently derailed by assassinations.

The foreword to this report, co-signed by Judge William H. Webster, the former FBI Director and Director of Central Intelligence, and by me, concluded that, "If the forces of organized crime are not stymied, Russia will complete its devolution into a criminal-syndicalist state. The United States then would be faced with an agonizing reappraisal of its diplomatic and commercial relations with Russia."

What was a threat then is a reality today. Russia is a criminally-focused state from top to bottom.

The CSIS report on ROC was quickly endorsed by FBI Director Louis Freeh but dismissed by high-ranking Administration officials even though the intelligence community was well aware of the facts.

The genesis of the Global Organized Crime Project at CSIS goes back to 1994 when a wealthy friend of mine with extensive Russian contacts at the highest level received a telephone call from Moscow asking him to take care of five Russians on their way to New York. It soon became apparent that the Russian visitors wanted an introduction to a Swiss banker in Nassau in the Bahamas where my friend kept a house.

A few days later, the Swiss banker called my friend and asked whether he realized what the five Russians wanted. "I suppose they wanted to open a bank account," he answered. "Yes, but do you realize for how much?" asked the banker. My friend guessed a few million dollars. It was \$2.5 billion, which the Russians wanted, deposited in several secrecy jurisdictions in untraceable accounts. After checking with Zurich headquarters, the Swiss bank turned down the business.

Three weeks later, I was on vacation in the south of France and found myself seated at a dinner next to a Swiss banker. After recounting the anecdote, he said, "What a coincidence. I had a Russian "walk-in" two days ago who had no introduction and wanted to deposit \$400 million, also in untraceable accounts in offshore tax havens.

1994 was also the year the late Claire Sterling, a muchhonored investigative reporter, published a book titled
"Thieves World," which documented chapter and verse on the
global tentacles of ROC. Ms. Sterling had traveled the
world, including several trips to Russia, to investigate
the connections between Russian intelligence and security
agencies, organized crime syndicates, and the so-called
oligarchs who plundered Russia systematically under the
guise of privatization schemes.

There was no doubt in Ms. Sterling's mind that this lethal mix enjoyed the protection of the powers that be in the Kremlin.

I also traveled extensively on behalf of CSIS' Global Organized Crime Project without using any of Ms. Sterling's contacts. We deliberately avoided duplication. From Buenos Aires to Berlin, from London to Lugano, from Bogota to Beirut, the pattern was identical - countless billions of dollars siphoned out of Russia to be laundered before buying commercial properties or being used to pay cash for lavish private residences in Europe's capitals and in the Mediterranean's luxury resorts, as well as to purchase yachts and private planes. I discovered scores of examples of properties ranging in price from \$5 million to \$75 million paid for by Russians in cash.

Little known outside the intelligence community is the fact that the clandestine stripping of Russia's assets began as early as 1985 and 1986 when key members of the Soviet Communist Party's Central Committee (International Department) concluded that President Gorbachev's glasnost and perestroika would lead to the collapse of Communism. This is when these Central Committee members turned to the KGB for assistance in moving abroad precious metals and stones and liquid assets. The KGB was the only organization familiar with western conduits willing to handle this clandestine traffic.

When the Soviet empire began to implode in 1989, many of these Communist apparatchiks and their KGB associates became instant businessmen.

Russia's much touted instant market economics and democratic politics were little more than a sham. Prosecutor-General Yuri Skuratov ridiculed President Yeltsin's seven major crackdowns on organized crime and corruption in 1997 as a Potemkin village. "It is a charade," Mr. Skuratov said in an interview, "there is neither the will at the top nor the resources to do much about it."

Mr. Skuratov was framed in a sex scandal by the security service earlier this year and then suspended by Mr. Yeltsin for poking around the Kremlin's labyrinthine financial structure. But the Russian Parliament twice declined to endorse the suspension and Mr. Skuratov continues to speak out in interviews. He now says that \$3.9 billion of the IMF's \$4.8 billion loan last year never reached Russia but

was sold by the Russian Central Bank directly to 18 commercial banks controlled by the oligarchs.

The cult of secrecy in Russia's Byzantine politics thwarts all attempts at transparency. The rule of law is non-existent. Moscow's chief of police said publicly that 90% of his officers were on the take. Security services are part of the problem, rather than part of the solution. They run their own kryshas, or "roofs" of protection, or do so in collusion with criminal gangs. Key sectors of Russian industry are under the sway of organized crime, particularly those that earn hard currency, such as mining, petroleum, natural gas and arms manufacturing.

Former First Deputy Prime Minister and former Interior Minister Anatoly Kulikov recently told our ROC Task Force at CSIS that about half of the Russian economy is controlled by "shadow systems" that run illegal operations. Mr. Kulikov estimates the amount of capital flight since 1992 at close to \$300 billion. Some 55 offshore secrecy jurisdictions from Vanuatu in the Pacific to island nations in the Caribbean and a dozen countries from Bahrain to the Bahamas were eager to take in Russia's dirty laundry.

In 1995 and 1996, about \$1 billion a month came into Cyprus from Russia and another \$1 billion went in and out of Israel. The money laundering activities uncovered recently by the FBI at the Bank of New York (BONY) are not unusual. They have been duplicated by scores of banks the world over. Wealthy individuals have parked an estimated \$8 trillion in offshore tax shelters that guarantee secrecy. There are also approximately one million corporations anonymously chartered in these secrecy jurisdictions that sell naturalization and a new passport for \$50,000 (Dominica charges \$75,000, including a spouse and two children).

These facilities make it easy for Russia's 200 plus organized crime groups to operate in 58 countries, up from 50 two years ago, according to the FBI.

Corruption in the Russian military, where everything and anything is for sale, has worsened substantially since the August 17, 1998 financial meltdown. Apart from elite Special Forces units, it is a beggar's army. Last winter, soldiers were told to fend for themselves by scrounging for

food in the countryside. These dismal conditions in the military increase the likelihood of criminal diversion of theft of nuclear weapons and/or fissile materials, given that Russia still has some 20,000 nuclear weapons.

The failure of the Russian state is made clear in a just published book titled, "Money Unmade: Barter and the Fate of Russian Capitalism," by David M. Woodruff of MIT. If anything, Mr. Woodruff has underestimated the part that greed and corruption played in the process of national disintegration. Russians have been bitter about how what they perceive as American capitalism made them poor (40% of the population is now living below the poverty line of \$38 a month); now they are now bitter about being weak. This plays into the hands of anti-American ultra nationalists.

The totalitarian temptation has existed in Russia for the past 1,000 years. It is now rearing its ugly head again after a decade-long taste of gangster capitalism.

Last week, Secretary of State Madeleine K. Albright called on President Yeltsin to make fighting corruption a top priority. The Administration, like Inspector Renaud in the movie classic Casablanca, is shocked that there is gambling going on in the Kremlin. "The problem is real and must be taken seriously," said Mrs. Albright. The problem has been glaringly obvious since 1991 and repeated warnings that it was undermining U.S. foreign policy objectives as well as diverting U.S. financial assistance and IMF loans were repeatedly dismissed as exaggerations.

It is hardly surprising, therefore, that Russian nationalists have convinced themselves that the U.S., not content with its Cold War victory, was also bent on wrecking the Russian economy.

The Administration has invariably invoked the need to give priority to strategic arms control and economic reforms, rejecting the notion that the emergence of a criminal state was in direct contradiction with U.S. objectives.

Gen. Boris Gromov, chairman of the subcommittee on Arms Control and International Security of the Duma's Committee on International Affairs, said this week that the lamentable state of the Russian military was "a direct result of western indifference" to the way the Kremlin robbed the armed forces of the resources needed to maintain

cohesion. "Yeltsin's socalled reforms," Gen. Gromov said, "have brought nothing to the majority of the Russian population but disappointment."

Saul Bellow once said that a great deal of intelligence can be invested in ignorance when the need for illusion runs deep. The Administration's need for illusion in its Russian policies has been an evergreen commodity since the collapse of the Soviet Union. CSIS TACK FURLE KEPUKI

CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES

RUSSIAN ORGANIZED CRIME

Global Organized Crime Project

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Robert B. Wade America Online The Russian Organized Crime Task Force recommends that the following actions

Summary of Recommendations

be taken:

U	States as a national security threat.
	The development of a free market in Russia founded on the rule of law should be recognized as the only long-term policy solution for ROC and must be central to all U.S. policy decisions.
0	In order to mitigate instances of corruption within the Russian government, U.S. policies and actions should shift from support for political personalities to support for segments of the Russian government that are working to usher in the rule of law. Strengthening the rule of law will foster the emergence of a viable market economy in Russia, free from the coercion and extortion activities of ROC groups.
0	Russia must work toward the creation of a strong and impartial judiciary to implement and enforce a fair body of civil, criminal, and contract law to regain control over the adjudication role currently played by ROC groups.
0	U.S. support for reform should reinforce training and exchanges such as those currently in place, funded through the National Endowment for Democracy, the Department of Justice, and the Agency for International Development. These programs, as well as similar efforts within the private sector and the academic community, should be continued and expanded through appropriate funding by Congress.
	A similar effort should be undertaken in the private sector to support legitimate regulation of Russian industry, business, and trade. Specifically, the Russian government should be assisted in establishing uniform business operation regulations, professional standards for certain industries, and requirements for the issuance and regular renewal of business licenses and other permits.
0	Stringent requirements to ensure transparency in Russia's use of foreign aid, as well as multilateral loans and export financing, should be implemented and enforced to insulate the funds from OC and to ensure that the

☐ The United States should initiate a discussion at the level of the Summit of the Eight of an investment treaty to deny export credits to Western firms

Because ROC activity requires a response from multiple U.S. government agencies with multiple roles and missions, decisions over whether prosecution or foreign policy objectives should take precedence should be made on

Because businesspersons often become the targets of ROC activity, a greater effort should be made to provide them with relevant information. The Foreign Commercial Service of Department of Commerce in conjunction.

funds reach their intended destinations.

a case-by-case basis.

doing business with OC-controlled firms in Russia.

	State should work with other U.S. agencies and the Russian government to advise and support businesspersons, providing them especially with alternatives to paying extortion to criminal elements in Russia.
0	A shared public database on ROC, including a collation of declassified and open-source materials, also should be created to assist investors from the United States and other countries. The database could be supplemented by a classified database for use by U.S. government agencies only. Considering the transnational breadth of ROC activity, a database supporting intelligence-sharing among various groups like the P-8, Europol, and the "six nation group" addressing the transnational aspects of the ROC threat is also necessary.
0	The U.S. intelligence community must be directed to fill the immense intelligence gaps on ROC. Their elements should use well-tested operational know-how and tradecraft to recruit informants inside ROC or induce defections from the various ranks of people who can provide hard, inside knowledge of how the various ROC elements operate, do not operate, cooperate, and do not cooperate.
0	The interpenetration of Russian officialdom, businesses, and criminal organizations make it more imperative than ever that U.S. law enforcement and intelligence agencies fully cooperate and share the fruits of their respective disciplines to serve U.S. policy, security, and commercial interests more capably.
0	Close U.S. government identification with corrupt elements of Russia's political establishment risks serious popular backlash inside Russia. The United States must avoid the appearance of unqualified support for what is routinely seen as a kleptocratic establishment. Such linkage reinforces a
Ger	The "six nation group" includes the United States, Canada, the United Kingdom, many, Italy, and Russia.

growing popular perception that democratic political and market economic systems are merely code words for rapacious criminality. The United States should address this perception by increasing its public diplomacy discussion of the causes of and cures for ROC.

☐ The U.S. government must support not only senior-level reformers in the Russian government, but reformers outside government as well. The United States should not remain silent in the face of official hostility to respected human rights leaders like Sergey Kovalev of the Sakharov Foundation or fabricated charges against the environmentalist Captain Nikitin.

STATEMENT OF CACHET INTERNATIONAL, INC. ON THE INFILITRATION OF THE WESTERN FINANCIAL SYSTEM BY ELEMENTS OF RUSSIAN ORGANIZED CRIME BEFORE THE HOUSE COMMITTEE ON BANKING AND FINANCIAL SERVICES ON SEPTEMBER 21, 1999

STATEMENT BY RICHARD L. PALMER

Mr. Chairman, and other honored members of the committee, I welcome the opportunity to address this committee on a subject that presents serious threats to Western nations as well as involves the use of US taxpayers' funds to continue the looting of Russia and its former republics. I feel reasonably well qualified to speak on the subject as a result of my former government service, personal research and professional duties. I have devoted much of my time, energy, and money to Central and Eastern Europe and the former Soviet Union in the last seven years, because I believed that the collapse of the Soviet system was a historic, revolutionary event and that the outcome would shape the course of history. Unfortunately, we have thus far squandered our opportunity to help shape the outcome of this event into positive directions that benefit the majority of the people in this region rather than just a few persons at the top. We have little time left to avoid the permanent denigration of the term "democracy" in this region and the return of totalitarian regimes which may not necessarily be Communist. This would lead to instability in a region that spans 10 time zones and still remains the second ranking nuclear power.

CREDENTIALS:

I believe that I should explain my background regarding the technical topics that I am addressing today. I served five and one-half years in the US Army, including decorated service as an infantry officer in Viet Nam and then as an Army Intelligence Officer in Europe. I then served 20 years with the CIA in the Operations Directorate, of which over 18 years of this time was spent overseas, much of the time in Europe. During my CIA service, I had nine years of experience in detecting international money laundering and criminal activity. I spent 11 years as Chief of Base and Chief of Station in four different locations. I began to study Russian Organized Crime in 1989, when the Berlin Wall came down, and I focused on Russian Organized Crime and corruption in my final assignment as a Chief of Station in the Former Soviet Union (FSU) from 1992 until 1994. I then worked for three years in the FSU as a business and security consultant, as well as working as the director of training within one Russian based bank. As a result, I have experience based upon direct contact with FSU security and police services, as well as members of Russian banking, business, Organized Crime and corrupt officials. I then worked in the US as a senior analyst with an international private investigation firm, where I specialized in the investigation of financial frauds and international economic crimes. I am currently the owner of the investigative firm Cachet International, Inc., which has offices in Virginia and Washington, DC. This firm specializes in domestic and

international asset recovery, business intelligence and due diligence investigations – especially in the FSU. I organized and directed a seminar in Washington DC on "Recovering Assets In and From Russia" in October 1998. In addition to U.S. clients that include some Fortune 100 firms, I now also represent several Russian and Former Soviet Union (FSU) firms who seek to locate assets of debtor firms in the US as well as off-shore banking locations.

In addition, I am recognized in US Federal Court as an expert witness on Organized Crime, Official Corruption and the Banking System in Russia and the FSU In 1997 I wrote a monograph and an article in the journal Trends in Organized Crime on the looting of the Soviet state which is currently being developed into a book for publication in early 2000. I also has appeared on television network nescasts regarding Russian Organized Crime and the Russian business environment, and I am an advisor to two major US TV networks and several newspapers and news magazines. I have presented lectures on the background and history of Russian Organized Crime (ROC) at the University of New Jersey, Tufts University in Boston and the California Attorney General's International Conference on Russian Organized Crime. I am a consultant to several US police agencies concerning Russian Organized Crime.

I plan to provide examples of the infiltration of Russian Organized Crime into the Western banking system based upon my personal and professional research. In compliance with the laws for Private Investigators in Virginia as well as with my contractual obligations, I will not identify any of my clients.

KEY POINTS:

- Several powerful organized criminal groups exercise control over national economy.
- The corrupt government and law enforcement agencies serve as tools for Organized Crime groups; and, the Chiefs of state of those countries are unable and unwilling to fight Organized Crime and corruption.
- There is still a severe shortage of democratic institutions and mechanisms, paralysis
 of the legal system.
- The market mechanisms are suppressed by Organized Crime.
- As is illustrated by the figures shown above, most informed observers agree that the criminal Mafiya groups account for only about 10 to 15 % of the makeup of Organized Crime, with Russian officials, former officials and their "newly created entrepreneurs" accounting for the other 85 to 90 %. In other words, the criminal Mafiya groups with ostentatious cars, bodyguards and flashy attire are only the most visible portion of Russian Organized Crime (ROC) and are possibly much less dangerous than the more hidden "official" members of Organized Crime whom the West consistently attempts not to see.

OVERVIEW OF THE CURRENT PROBLEM:

In essence, most complicated financial crimes are basically very simple. (The Wall Street Journal of September 5, 1999 "A Scheme for Ducking Taxes May Be a Key In Russia Money Probe' presents an excellent, detailed look at the persons and systems involved.) For example: the background details of the current investigation regarding the alleged money laundering through the Bank of New York (BONY). Two apparent non-banking experts set up a system to simply move large amounts of money from Russia to the US and frequently on to third countries. It seems rather clear that - at a minimum - the BONY and several other Western banks skirted the legal requirements enlisting their active assistance in preventing money laundering. One crucial legal prerequisite to prove more laundering is to demonstrate that the provenance of the money being transferred or deposited was illegal. It seems that the BONY case meets this criterion and this is why:

From published accounts, it appears that Benex and similar "money transfer" firms utilized contacts (or in this case relatives) in the BONY to assist in keeping this "money transfer" operation from being "discovered". Less charitable accounts, such as of the New York Post article of August 28, 1999 "TAPE: BANK OF N.Y. BIGS KNEW OF RUSSIAN SCAM" argue that Ms. Natasha Gurfinkel Kagalovsky actually took instructions from a Vice-President of Inkombank regarding the backdating of documents to avoid attracting the attention of U.S. Treasury Agents (FinCen). If that account is proven to be true, it would indicate that even a Vice-President of Inkombank, a "priviledged" Russian bank, is so familiar with the criteria used by FinCen that he can easily "adjust" transactions so as not to alert US law enforcement to any irregularities. While no one can be certain about this accusation until it is proven in court, I would like to note that, while examining eleven cases of US and other Western firms being defrauded by Russian Organized Crime (ROC) elements, I was able to identify nine cases where US/Western executives had clearly been suborned by ROC groups to assist in looting their employers. (It is also well known that Ms. Natasha Gurfinkel Kagalovsky is the wife of Mr. Konstantin Kagalovsky, a member of the board of directors of Menatep, another "priviledged" Russian Bank, and former Russian representative to the IMF.)

Following the financial crisis in Russia in August 1998, both Inkombank and Menatep Bank were declared bankrupt and their assets were supposed to have been frozen. I represented a few of the more than two dozen Western firms that sought to trace the transfer of funds by the supposedly insolvent Inkombank and Menatep Bank to Western accounts where they could be legally attached. This is the normal part of the legal restitution of funds that Western firms lost in investments or transactions in Russia. These funds were actually easier to track outside of the US. It now appears that this is because these Russian banks were using the size, speed and efficiency of the US banking system to avoid detection. In other words, the Mafyia infiltrated Russian banks used the US banking system to prevent US and other Western businesses from obtaining legal restitution of funds lost in Russia.

The problem of obtaining legal restitution funds from Russian banks and companies has three other components:

First of all, Russia is not governed by the "rule of law" but functions under the rule of understandings. Rather, if functions under the "rule of understandings". The Russian legal system was given a major overhaul in 1964, at a time when the these Soviet government did not acknowledge that ROC existed, commercial banks and firms did not exist either, and the Communist Party had complete control of the courts, law enforcement system and all lawyers. The fact that Russian President Yeltsin recently vetoed a second attempt to pass a toothless law on money laundering shows that this is not a priority for the Russian government and that current economic interests have the final word in economic policy, despite constant assurances to the US and EU to the contrary. Therefore, the argument is normally made "the theft of these funds was not illegal in Russia." According to this, it is obvious that hardly any economic crimes – by world standards – are illegal in Russia – and those few crimes that are recognized are negotiable.

Secondly, the court system and law enforcement authorities are not independent and suffer from high levels of corruption. Until recently, some Russian newspapers published the current rates of bribes for specific acts to help subscribers avoid overpaying. Perhaps the case of several Russian officials arrested in connection with the Solntsevo Mafiya illustrate best the institutionalization of official corruption. Colonel Yevgeniy Zhigarev, a Higher Police School professor, testified that bribes from the Solntsevo crime family were distributed as follows: the prison counselor passed orders and "treasury money" to friends in law enforcement; the investigator collected information on the pertinent criminal cases, devised a plan to derail them, and by deception obtained the materials for examination and falsification. The professor found middlemen to pass bribes to investigators and judges. There was a precise fee structure: for changing the measure to secure the appearance of the accused, for dismissing the case, for lessening the sentence. Freedom was charged at \$25,000 per person.

Another case illustrates the role of the Russian courts concerning a major US fast food firm which discovered its Russian partner was a member of ROC and was defrauding the US firm. After months of litigation, the US firm obtained a \$ 1.2 million judgment by the International Arbitration Institute in Stockholm which was awarded to him in January 1997. Subsequently, the city court in St. Petersburg granted an order of enforcement to this foreign arbitration award. This was said to be the first such enforcement order issued in post-Soviet Russia. This decision by the International Arbitration Institute in Stockholm was even confirmed by the Russian Supreme Court in April 1998. However, despite of having a decision from the highest court in Russia, the US firm has not yet been able to enforce this decision and recover a dime because the Russian courts and law enforcement authorities have been thus far successful at ignoring the decision by the highest court in the country.

Thirdly, a fact that has the most detrimental effect on US businesspersons is the absence of a US-Russian Investment treaty. Despite the fact that the Gore-Chernomyrdin Commission allegedly labored for years to encourage investment by US businesses and resolve legal issues, this bilateral treaty has never been passed. While it is admittedly difficult to persuade the Russian Duma to pass any laws, it is striking that the European

Union (EU) made the passage of a EU-Russian Investment Treaty for the protection of EU investors a requirement for large scale aid or any encouragement of EU investment. As a result, EU investors can sue for damages in European Arbitration Courts and get binding orders for restitution. By contrast, US investors are left with either using the totally ineffective Russian court system or they can hope that they included a clause in their contracts that allowed them to file suit in the international Arbitration Courts, such as in Stockholm or Paris. It is no exaggeration to say that new Russian Arbitration Court in Moscow is not very effective in protecting the interest of foreigners.

Against this background, it is easy to demonstrate that tax evasion, money laundering, to name a few, are not illegal in Russia. As a result, they can not be pursued by Western law enforcement officials. Therefore, Western bankers ever chasing after fat profits, see no reason to reject this lucrative business. On the other hand, let us look at the matter of tax evasion in Russia. The primary reason for the IMF loans over the last few years has been the shortage of taxes collected by the Russian government. Thus, every year the IMF needed to provide billions of dollars to make up for uncollected taxes. The tax funds that were diverted – ended up in the hands of criminals and corrupt officials. This means that Western and US taxpayers in particular, are footing the bill for tax funds that remained unpaid by Russian businessmen and a large number of Russian state enterprises. Sadly, this cycle shows no signs of slowing. It is also quite safe to assume that these IMF loans will never be repaid.

I participated in a conference with the Russian desk officer and other Russia experts from the IMF in June of 1998, at which the IMF representative tried to vehemently convince the audience that \$ 4.8 additional millions in IMF funds would surely turn the precarious economic situation around in Russia, primarily because "the Russians were going to become far more effective in collecting taxes." The IMF key speaker and his peers conveniently ignored any warnings about the widespread top-to-bottom corruption in Russia and argued that the financial future of Russia was bright. Only two months later, the economic crisis of August 1998 saw the devaluation of the Russian ruble and the near collapse of the entire economic system. Apparently, IMF predictions do not seem to be based upon facts that are readily available to even non-Russian experts.

WHAT HAPPENED TO THE \$ 4.8 BILLION IMF TRANSFER IN JULY-AUGUST 1998?

Worse yet, there is the matter of what happened to the \$ 4.8 million in additional IMF funds that were delivered to Russian accounts on July 23, 1998. Claims that there is no evidence of the theft of these funds are grossly misleading.

First, as already mentioned, there are very few laws on the books in Russia regarding financial fraud, conflict of interest, bribery and official malfeasance. "Criminals" control the government and refuse to pass any meaningful set of criminal laws outlawing money laundering and punishing corruption.

Secondly, the Price Waterhouse audit of the Central Bank off-shore firm FIMACO, was based solely on the documents provided by the Russian Central Bank. That is the same bank that now admits that its GKO bonds (short time saving bonds) were "nothing but a pyramid scheme". It is also the same bank that originally lied about the funds passing through FIMACO.

Third, the IMF has frequently admitted that they lacked the mechanisms to monitor their funds once they have been delivered to the Russian government, respectively the Central Bank. Thus, the IMF is correct in stating that they have no evidence of stolen or misused fund, if only because the Russians did not deliver them evidence to the contrary evidence on a platter. In addition, the diversion of funds to a select few probably does not even violate the almost non-existen Russian laws governing financial fraud.

The world knows that the IMF delivered a payment of \$ 4.8 billion to the Russian Central Bank on July 23, 1998. This was part of a \$ 22.5 billion bailout package aimed at restoring confidence in the Russian. This has been a continuing IMF and US priority since the announcement of massive infusions of IMF capital just prior to Russian President Boris Yeltsin's re-election in 1996. What happened to these funds has been the subject of great debate. According to a variety of well informed sources in the US and Russia, it now appears that about \$ 471 million or slightly less than 10 per cent of these funds were actually used to support the Russian ruble. Some 90 % or \$ 4.4 billion of these \$ 4.8 billion was deposited into a Russian Central Bank account on July 23, 1998. Between July 23 and August 17, 1998 (when the Russian ruble was devalued and Russian economy collapsed), \$ 4.4 billion of these funds were sold from that account directly to Russian and foreign banks. This was extremely unusual in that it bypassed the trading session at the Moscow Interbank Currency Exchange (MICEX), which would have given all of the banks, trading houses and financial institutions an equal opportunity to purchase these funds. Only \$ 471 million, or less than 10 per cent of these funds were used to support the ruble exchange rate on the MICEX. Another \$ 100 million or less than 2 per cent went for intervention on other currency exchanges.

The bulk of the IMF money was used by eighteen large Russian and foreign banks to convert their GKO's (bonds that were used as debt instruments) into dollars just days before the Russian government defaulted on them. These bonds had yielded as much as 200 percent per annum in interest. Any educated investor would have taken this as indicator that the rate was unlikely to last over a long period of time and that only the extremely high risk of this investment tools could justify these unusually high yields. Several Western banks and investors lost amounts up to \$2 billion dollars each when the Russian government defaulted. However, the 18 banks that did receive the IMF funds and could cash in their GKO's just days in advance of the Russian government's default included the largest and most powerful banks in Russia, also known as the "privileged" group because of their supporters in high places in the Russian government. More details on the make-up and background of these banks is contained later in this written testimony.

What my sources tell me as the most striking fact about these transactions is that the Russian Central Bank account in which the \$4.8 billion in IMF funds were deposited and were distributed was their account in the Bank of New York. These funds were then allegedly distributed to correspondent accounts held by these 18 Russian and foreign banks within the Bank of New York. The Bank of New York then helped these "privileged" banks to transfer these funds out to other accounts. Only the most gullible would argue that these 18 banks did not receive special treatment and illegal advance warning of the upcoming default on the GKO's.

The fact that the Russian Central Bank allegedly left these \$ 4.8 billion in the Bank of New York over at least 25 days means that the US bank made several million dollars in . Profits, not just on transfer fees, but also on "overnight interest". These accounts have now been further verified by the written statements and documents provided by Russian prosecutor Skuratov. (NOTE: He is still officially the prosecutor although Russian government guards will not allow him to enter his office since he accused President Yeltsin and his family of corruption).

This provides the US Treasury and Justice Departments with the opportunity to prove or disprove these allegation regarding the "misuse" of these IMF funds. As these transactions took place in the Bank of New York, which is under US jurisdiction, review of these accounts would seem to provide a list of the "privileged" Russian and foreign banks. This may even include US banks which could be further investigated as to their roles in this matter. If, once again, the US government fails to investigate this matter, it will be following the policy that it has established over the last seven years and which is encouraging and facilitating the continued growth of Organized Crime, looting of the Russian state and at the cost and to the detriment of the impoverished Russian people.

THE ROOTS OF THE PROBLEM:

Corruption in Russia is as old as recorded history. It was certainly a major cause of the unpopularity of the last Czars and contributed to the eventual revolution. Even worse, corruption did not disappear with the advent of the Communist system but became even more entrenched as the Communist Party expanded the bureaucratic system throughout the country to seek total control of the people, create official jobs for Party members and increase its patronage system. While Western, capitalist systems continued their tradition of inheriting land, personal property and money from elders to their relatives, the Communist system replaced land, personal property and money with influence, connections, and opportunities for Party membership that included perquisites. With the dissolution of the Communist Party as the only legitimate political structure in 1990 these Soviet nomenklatura foresaw a threat to their previously privileged lifestyles.

To support this lifestyle, a vast underground economy of off-the-book factories, food coops, and construction companies began to flourish in the mid-1970's, in collusion with party bosses. By the late 1980's, up to 40 percent of the nation's foodstuffs passed through the black market. By the end of the Brezhnev period, the underground sector of

the economy accounted for as much as 50 percent of the personal income of Soviet workers. But the nomenklatura and black-marketeers profited the most: they lived like feudal lords in ornate hilltop sanatoriums and summer villas, shopped in special stores bulging with hard to get foreign made consumer goods, and traveled abroad – considered to be the most coveted privilege in the Soviet Union.

Organized Crime in Russia is an "oligarchy" formed by the former officials of the Soviet state and the Russian Mafiya. What makes this group unique is not only the extent of their power, influence and wealth in Russia, its republics and increasingly internationally, but also that these are two distinctly different groups, operating sometimes independently, sometimes in common. The best estimate is that the criminal Russian Mafiya only makes up 10 to 15 percent of Russian Organized Crime, while the remaining 85 to 90 percent are current or former officials of the Soviet party-state. These officials continue to manage the Russian government, its industrial complex, the new "commercial" banks, and most of the new businesses. However, they are still part of Organized Crime. The current definition at Interpol's Organized Crime unit is: "Any group having a corporate structure whose primary objective is to obtain money through illegal activities, often surviving on fear and corruption." That not only describes Russia's business, banking and industrial sector, it also describes and involves its government.

Many Russian citizens feel that their country has been stolen from them. The small group of men who have corruptly seized the assets of the state flaunt their wealth as thoughtlessly as any czar. These men are the Oligarchs. They have robbed the government of its administrative skeleton – the tax revenues to maintain state services and infrastructure. The taxes from natural resources – especially gold, minerals, diamonds, and timber – once provided 75 percent of state revenues under the Soviet system. Now these resources are controlled by the tycoons, and they use their political connections to pay no taxes, sending much of their illicit profits out of the country. More than \$300 billion has gone this way, according to Interpol and the Russian Interior Ministry.

Perhaps the best example of the close pre-1990 relationship between the various members of the oligarchy was given by retired police general Aleksandr Gurov, "He noted that at the beginning of 1970's, in Georgia, a rayon party committee secretary would summofor a conference the UVD [Internal Affairs Administration] chief, the UKGB (KGB Administration) chief, and the local crime boss, and say: How could you permit such a rise in crime? Addressing this first and foremost to the crime boss, who would immediately start 'taking steps to reduce the crime rate' in this particular rayon. And this was happening not only in Georgia." Gurov also stated that "I've estimated that 80 percent of the chiefs of small criminal groups today are former deputy directors, former administrators of factories and enterprises."

Plans for the looting of then Soviet State were first discussed in 1984 by specific sectors of the Soviet Politburo, the top officials of the Communist government. However, one

must keep in mind that this massive effort included many of the highest officials of the Soviet government, several elements of the KGB (now FSB), old and new bankers, industrialists and, of course, traditional criminals, such as the Russian Mafiya – which already had experience and significant personnel stationed throughout the West. Their primary goal was to ensure their financial and political status in the future, by taking control of the vast funds and resources of the Party and converting them into personal assets that could not be tracked or confiscated by future governments.

By late 1986, the informal planning committee had been given the services of two KGB First Chief Directorate (FCD – foreign espionage) officers who were experienced in moving funds overseas both for the Party Central Committee, but also for other operational purposes. No written records existed of their meetings or proceedings, except for one copy to the Chairman of the KGB and one copy to the Central Committee official responsible for the Administrative Organs of the Politburo: Viktor Chebrikov. The Chairman of this planning group was CC Treasurer Nikolai Kruchina. This "planning group" determined that while the local KGB residencies via the diplomatic pouch system and simply smuggling suitcases of money over borders could be used initially, this temporary system could not be used in the long term due to the frequency and amounts of the funds that would need to be transferred, as well as the need to reduce the number of knowledgeable persons to an absolute minimum. Further, the existing system utilized the Soviet bureaucracy which required too many written records. Further, it was also decided that the overt ties to the KGB and other official agencies had to be minimized.

THE STEPS IN LOOTING THE STATE:

Therefore, the following plan was carried out to gradually build the enormous support structure that would eventually be needed and then secure their wealth. (Some of these steps took place concurrently.):

- 1. Initially, smuggled "suitcases" of cash and the diplomatic pouch would be used to move limited amounts of funds to help sustain the initial firms that were to be founded and foreign accounts to be opened. In addition to cash, diamonds and gold, antiques and art objects such as icons, paintings and jewelry could also be smuggled. Some of the antiques and art objects were pilfered from Russian state museums such from the Heritage collection in St. Petersburg. However, great care had to be taken to avoid being detected by local revenue services as no plausible source for the funds could be given. (This occurred between 1986 1989.)
- 2. In the second phase, Russian organizations such as Komsomol, state enterprises and factories were used to simply transfer large amounts of funds for national reasons to their related offices and firms in the Soviet republics and, where possible, to the West. These funds were to be used to found firms and banks with no obvious ties to the CPSU, thereby preparing for the next stages of this plan. In addition, funds were to be transferred to various cooperatives founded by "friends", which would not only ensure the

financial success of these firms but also allow to provide a basis for transferring more money in the future. As a result, most of the initial "private cooperatives" in the USSR which enjoyed success, were actually funded with oligarchy funds. (This occurred between 1986-1989.)

- 3. Simultaneously, trading firms were founded to act as "intermediary" firms to sell Russian resources, such as oil, natural gas, non-ferrous metals, diamonds, chemicals and cotton. These firms received these materials at state subsidized "internal prices" and sold them at world market prices. For example, at one time, the world market prices of oil was almost ten times that of the "internal" price. Profits from these operations were deposited in tax havens such as Switzerland, Cyprus, the Caribbean, Panama, Hong Kong, Ireland and the British Channel Islands, where they would be ready to assist in forming future "non-attributable" companies as well as being available to be used as "Western investment" in Russia and the republics under the cover of being "Western Joint Ventures". It was during this period that Russian Premier Boris Putin allegedly left the KGB and became responsible for the issue of permits for the export of non-ferrous metals and other resources under the corrupt administration of former St. Petersburg Mayor Anatoliy Sobchak. (This was typical for the period between 1989-1991.)
- 4. In the fourth phase, from 1989-1992, larger firms and banks could be founded in Russia and the former republics, as well as in the West. When possible, the off-shore accounts which had been previously established were to be used to discreetly purchase controlling interests in existing banks and firms with good reputations. Wherever possible, "friends of the party", who were not overtly known to be connected to the Party, were used as the ostensible "investors". In the case of the Russian banks to be acquired under this system, they were given exclusive licenses for trading in precious metals as well as foreign currency exchange.
- 5. In the fifth stage, from 1989 –1991, "shell" corporations were founded in Western countries such as Germany and Britain, as well as Ireland and Switzerland, and the United States (especially in Delaware and California). These firms then assumed loans from off-shore banks (from funds previously raised under this program), which were used to "invest" in Russia. This system was frequently used to form "Joint Ventures" with "Western firms", that purchased key properties, factories and banks. This allowed these "investments" to be protected by the laws of the Western countries in which the "paper" firms were located, as well as by international law. Therefore, in order to provide additional protection, the "paper" firms were primarily founded in countries which provided aid and assistance to any future Russian governments; and, therefore, could not be provoked by attempts to seize these "investments". Noted below is the text of a top secret decree of August 23, 1990 under the administration of Mikhail Gorbachev that called for the creation of "an invisible economic structure" to conceal Soviet state funds

and wealth. Therefore, it is interesting to note that the Russian Central Bank formed the off-shore structure FIMACO in 1990 – allegedly to hide Russian government funds from possible attempts by Westerners to attach these funds to unnamed defaults. Although it is estimated that over \$ 50 billion passed through this one firm, no one can say where even the interest from these funds (circa \$ 5 billion at a minimum) went. The auditing firm PriceWaterhouse, the auditing firm, relied in its examination of FIMACO solely on records provided by the Russian Central Bank and not on independent research. Similar decrees were issued by the KGB and GRU in 1989 and 1990. Shortly thereafter, the current Russian Premier Boris Putin allegedly left the KGB, then working at a position that controlled permits for oil shipments out of Russia. The Russian press and some law enforcement officials note that he developed ties to ROC during that time and was investigated – unsuccessfully – for official corruption.

6. In the sixth stage, from 1994 to the present, the criminal structure became highly developed and was capable of creating new income by using its contacts in Russia and selected republics for "profitable investments", such as purchasing materials and natural resources at rock bottom discount prices (or receiving more material than was shown on the shipping documents and contracts), as well as from legitimate investments in the West. Some of these enterprises were used to make large investments in Russia and its former republics, which by then looked like "legitimate" foreign investments to outsiders. Therefore, the purchase or controlling interest of existing Western banks and firms with good reputations became an absolute priority.

There is one consistent thread throughout these steps in looting the state. The goal was to take the money outside of Russia and keep it there, safe from any threats of retrieval attempts by subsequent Russian governments. The Western banking system has provided the network with which to move these funds. From my research, less than 5 % of these funds have returned to Russia for investment. Those funds that have been reinvested, are usually masked by "paper" firms in Western countries. Many Delaware firms that are listed as US investors in Russia and the former republics are simply Russian citizens or émigrés that purchase a low cost US firm, take a mythical "loan" from a Caribbean island account which they actually own but which never comes on-shore to the US where it would be subject to scrutiny by the IRS or Treasury Department; and then becomes US investment in the FSU. The US government is then obligated to protect these investments and, of course, these "paper" firms make frequently political donations to US politicians and political parties to obtain influence. The Russians who move their money out of Russia recognize that it is an unsafe place to keep their money. They keep it in the West. They much prefer to use the money of US investors to take the risks in Russia and in some cases, to provide additional attempts at fraud.

WHERE THE KGB AND AND THE GOVERNMENT FIT IN:

In October 1990, several KGB First Directorate (Foreign Intelligence collection) workers were shifted to work in the Party Central Committee Property Directorate, so that a structure that was capable of coordinating the Party's economic activities could be established. The basis for this new group was an agreement between deputy General Secretary of the Central Committee, Vladimir Ivashko: the Central Committee Treasurer Nikolai Kruchina; KGB chairman Vladimir Kryuchkov; and, KGB deputy director Filipp Bobkov. 3 Bobkov later became the chief of Security for MOST Bank. Also in October of 1990, Bobkov sent a directive to selected overseas KGB residencies stating that they should immediately begin to submit proposals for the creation of covert KGB commercial firms and financial establishments. (This is approximately the time when Russian Prime Minister boris Putin "left" the KGB and began to play a role in helping to loot Russia.) In addition, the KGB office chiefs were to propose trusted "friends" with a clandestine relationship to the KGB who would be able to either found such enterprises on behalf of the KGB or allow KGB officers to enter their firms to oversee the management of funds or low cost raw materials that the KGB would provide. This latter list was to include even consideration of the "illegals" network. 4 KGB and Party money, more precisely oligarchy money, which made up almost 80 % of the amount invested in the new banks, stock exchanges, and businesses in 1990-1991. 5

"Staff from foreign intelligence (KGB First Chief Directorate – FCD) became the creators and developers of commercial frameworks for the illegal economics of the CPSU. Colonel L. Veselovsky, of the PGU staff, was called in November 1990 from abroad. He was a specialist in international economics and was transferred to the work on management of the Central Committee of the CPSU. Veselovsky prepared documents for the small enterprise "Galactic" and other firms, where almost one billion rubles belonging to the Party had been transferred. L. Veselovsky accounted meticulously for his activities to the leadership of the KGB. Consequently, the archives of the KGB are full of detailed accounts of the creation of commercial structures and their managers.The firing of Veselovsky two weeks before the August putsch is especially noteworthy. Veselovsky immediately left for Switzerland, where he found himself a job as consultant in four foreign firms." Prior to his departure, Veselovsky is reported to have given a briefing of his planning and organizational work to four members of the Russian Politburo – one of whom is reputed to be Yevgeny Primakov.

Yevgeny Primakov was then installed as chief of the FCD on September 30, 1991 and then made chief of the SVR the successor to the FCD, in December 1991, where he remained until January 1996. The FCD and then the SVR remained active in moving Russian funds and resources out of Russia during most of this period. Therefore, it is clear that Primakov had direct knowledge of these activities. At that time, Russia's wealth already was vanishing into a black hole. Eight metric tons of platinum, 60 metric tons of gold, hoards of diamonds and an estimated \$15 billion to \$50 billion in cash were, according to reformist lawmakers probing KGB crimes, only a small part of state property stolen under secret Communist Party Central Committee decrees and transferred to unknown hands by the KGB's espionage branch between 1989 and 1991. Primakov held the keys to their recovery. However, when the Duma Ponomarev investigative

commission repeatedly asked for information on these funds and where they had been moved, it was also Primakov who refused access to the FCD and SVR records.

When the Russian investigators focused on the son of a former Soviet premier who worked at a Luxembourg bank, as well as the son of disgraced former KGB chairman Vladimir Kryuchkov who was KGB "rezident" in Switzerland, Primakov acted quickly. He blocked the investigation and persuaded Supreme Soviet Chairman Ruslan Khasbulatov to disband the Ponomarev commission. Untainted personally by corruption, Primakov decisively sabotaged the only serious attempt to undo the massive theft that depleted Russia's treasury and strengthened its kleptocratic oligarchy. Therefore, as this information was widely known from public sources, it is noteworthy that the current US Administration took Primakov seriously during meetings of the Gore-Chemomierdin Commission or when Primakov asked for US Government assistance in looking for the funds that had been looted from Russia. In his favor, he did refuse to support Yeltsin's attempts to subvert the Russian prosecutor and was forced to resign for putting Russian's interests above Yeltsin's.

On 5 January 1991, the KGB Third Directorate ⁷ in Moscow sent Top Secret Message 174033 to military bases throughout the USSR, which was a classified directive from KGB chairman Vladimir Kryuchkov that called for the creation of private commercial firms to sell military technology overseas. In it, Kryuchkov, cited the "deteriorating domestic political situation and called for the creation of more apparently private, commercial firms. Kryuchkov stated that this program had three strategic aims: 1) the new companies were to serve as "reliable covers for (KGB) leaders and the most valuable (KGB) operatives, in case the domestic situation develops along East German lines; 2) to provide financial means for the organization of underground work if 'destructive elements' come to power; and, 3) to create conditions for the effective use of foreign and domestic agent networks during (a period of) increased political stability." The fact that this message called for the raising of funds for political opposition clearly shows that Kryuchkov was not optimistic about the chances of Gorbachev's success in maintaining the Party system and that the KGB was already taking serious steps to prepare for the future in terms of ensuring protected sources of funding.

On June 11, 1991, Gorbachev signed another secret Politburo resolution which authorized the transfer of six hundred million rubles to commercial organizations and banks established by Party bodies such as the Komsomol. The resolution directed that these funds were to be used to invest in the creation of "modern forms of economic activity, such as shareholding companies and small enterprises as well as to be made available to "reliable" foreigners willing to establish joint ventures with Party enterprises. Evidence presented in a 1992 trial concerning the banning of the Communist Party indicated that Gorbachev had signed another such Politburo resolution in 1991 directing that Party property throughout the USSR should be transferred to reliable "private" owners. ¹⁰ In the jargon of the Communist party, this normally meant that these would be members of the nomenklatura or their families.

CORRUPTION IN ROC: IT IS PUBLICLY KNOWN

As can be seen, there has long been a great deal of evidence of extreme corruption and criminal activity at the highest levels of the Russian government - the same leaders that we have unquestioningly supported and not forced to adapt meaningful reforms. To reinforce this point, let me provide one more significant illustration. On June 27, 1994, then CIA Director R. James Woolsey presented testimony before a House Committee that included a statement that detailed the size, nature and dangers presented by ROC. Woolsey noted that "Of the 2,000 banks in Russia today, a majority are controlled by Organized Crime, according to the Ministry of Internal Affairs. The Ministry says there are roughly 5,700 Organized Crime groups in Russia, with an additional 1,000 in the other former republics According to a 1994 report prepared for Boris Yeltsin by the Analytical Center for Social and Economic Policies, 75 percent of Russia's private enterprises pay 10 percent to 20 percent of what they earn to criminal organizations. 11 More recent estimates from 1996 and 1997 are 20 to 30 percent of the profits must now be paid to the Mafiya - with these costs being passed on to the consumers.....Some 40,000 state and privately run companies, including most of the country's banks, are controlled by 150 criminal syndicates. 12

Corruption among the police is rampant. Frequently, in Russia as well as former republics like Latvia, victims of car theft are referred by the police to Organized Crime groups who often will agree to return the vehicles in exchange for paying half its original purchase price. The police often offer to help the victims to contact the Mafiya. This kind of maneuver has become standard procedure, confirm other Russians. Retired Russian police general Aleksandr Gurov noted what many Russians confide in private, in that the Russian Mafiya now acts in place of several state agencies, such as the police, court systems, etc., and it is to the Mafiya that many businessmen are forced to turn to obtain payment on contracts, received paid for goods, etc. 14

FBI Director Louis Freeh stated before the US Congress that over 200 of Russia's 6,000-odd crime gangs operate with American counterparts in 17 U.S. cities in 14 states. According to intelligence reports, members of criminal groups in Russia are sent to reinforce and consolidate links between groups in Russia and the United States. Russian Organized Crime figures are also sent to this country to perform a service such as a gangland murder or extortion.

The Moscow Criminal Police reported as early as June 1991 that one third of the criminal groups in Russia were connected to the shadow" or second economy. 15

In April 1994, the Mafiya was estimated to have 55 percent of the financial capital and 80 percent of the privatization shares and vouchers in Russia. As a result, they were able to control the privatization process, arrange winning bids very much below market prices and arrange the outcome of the bidding in at least 70 percent of the privatization auctions. 6

In April 1996, a senior officer of the Federal Tax Police Service was arrested for accepting a US \$ 200,000 bribe from one single commercial company. This was one of the few such cases ever prosecuted.¹⁷

In 1996, the Russian Newspaper <u>Trud</u> reported that the number of reported murders in Russia rose from 15,500 in 1990 to 32,000 in 1995, adding that many of these murders are the result of disputes over the division of the spoils of the market economy. Related to these disputes, there were a reported 500 "contract" killings in 1995 of which 61 assailants were arrested. Although 73 percent of the reported murders in Russia are solved, only 40 percent are solved in Moscow.¹⁸

In September 1996, Komsomolskaya pravda reported that regional political leaders use Mafiya groups in inter-ethnic disputes in order to maintain their political power. The article pointed out that many small businesses were also being set up by the Mafiya and that over 300 city officials in Moscow belonged to criminal groups. In addition, the estimated Mafiya turnover in Odessa is equal to the city's official budget. 1920

In a recent television interview, the Chief of the paramilitary Russian Ministry of Interior special reaction unit stated that he believed that at least 50% of the raids that his unit makes are a result of payments (bribes) to his superiors by businessmen who want to harass their competition.

How then can any senior US official then say that they don't know or have any concerns about ROC?

Tax-evasion is another major problem, about which Russian law is very vague. The first national survey showed that in 1992, up to 40% of businesses did not pay taxes at all. By very modest estimates, and bearing in mind that all figures are approximate, this amounted to a loss of at least \$2 billion (US) in government income. This figure does not include spectacular profits made by various "entrepreneurs" from the sale of western humanitarian aid delivered to Russia during the winter of 1991-92. According to reports, up to 60% was resold at free market prices. Again, the money was laundered through the banks, loans were issued and, by conservative estimates, an estimated \$15 billion (US) was transferred abroad in 1991-92. The fact that Russian law enforcement activities are rather uneven has a variety of causes. However, it is particularly noteworthy that even some of the most effective Russian police organizations are somewhat "tainted". For example, at the meeting in which Major General Vladimir Rushaylo, former chief of the regional Organized Crime Administration (RUOP) and later deputy Chief of the Main Administration on Organized Crime of the MVD suddenly resigned in October 1996, he stated that "the resources allocated from the budget are negligible, but for several years, it (RUOP) found sponsors among commercial structures."21 (NOTE: Major General Vladimir Rushaylo returned as deputy Minister of Interior and was recently made Minister of Interior. He is frequently accused of being the official responsible for suppressing key information concerning alleged ROC kingpin Sergei Mikhailov during his trial by the Swiss authorities.) As it is commonly accepted that at least 80 % of the commercial structures pay protection to the Mafiya - at a minimum - it is interesting that commercial structures - which RUOP was supposed to control and investigate - were providing the budgetary means for this law enforcement group.

"According to the information from (Russian) law enforcement agencies, up to 70 % of the real estate put up for auction ends up in the hands of persons selected in advance... According to information received from sources in the Ministry of Internal Affairs (MVD)and in entrepreneurial circles, a gradual merging of three social groups is taking place in Russia at levels from the Rayon to the Oblast level, and they are laying their hands on various levers of power. This applies to the bureaucracy, above all, which has the experience of managerial work in the former system and which has united with the 'new people' who soared to the ruling heights in the late 1980's and early 1990's on the wave of the anti-Communist movement. It also applies to people in legal and shady business activity, who are closely linked to the third group - the criminal world.... In the opinion of the staff of the Russian MVD Department for Combating Economic Crime, a tendency has already become apparent to move away from individual, albeit very frequent, cases of bribing representatives of the power elite to that of close and regular cooperation among the apparatus elite, businessmen and criminal forces connected with them. The 33 % of all embezzled funds which was used to bribe 'State officials' in the 1980's has now increased to more than 50 %. Among those against whom proceedings have been initiated for corruption, 42.2 % are employees of ministries, State committees, and regional management organs. More than 50 % of all capital and 80 % of voting shares (in commercial enterprises) now go to criminal structures."22

ARE RUSSIAN BANKS THE ONLY THREAT?

Russian banks and firms are not the only ones that need a special level of scrutiny. Latvia, a former Russian republic, is now allegedly on the "fast track" to becoming a member of the European Union and NATO. Riga, Latvia was the scene in June 1999 of Ms. Lucy Edwards presentation on how to avoid difficulties with US money laundering laws on behalf of the Bank of New York. However, take a close look at Latvia and you will see that its banks and firms also deserve special attention.

Of interest to Russia for several centuries due to its ice free ports on the Baltic Sea, almost 48 % of Latvia's ethnic population stem from Russian ethnic origins. Lacking any natural resources, in the USSR, it was primarily a transit site with a few manufacturing industries tied to Russian raw materials. Since independence in 1991, the two main industries are acting as a "intermediate" off-shore banking center for Russia and facilitating the transit of Russian oil to the West. In June of 1997, the Russian press reported that "almost all Latvian banks are mediators in transferring Russia's money abroad" and that "a special committee, headed by PM Viktor Chernomyrdin, had been formed to stop the illegal flow of Russia's money via Latvian banks....... The average monthly turnover of such operations in one bank reaches 10-15 million dollars." Internet sites on the infamous island of Nauru now advertise Latvia as an off-shore banking center. At the same time, the United Nations report on human development listed Latvia as 93rd in the world, between Ecuador and Iran, and much lower than Estonia, Lithuania and Russia. "

In late 1996, the European Union issued a report stating that there was large scale corruption at all levels in Latvia, particularly in the Ministry of Interior for the taking of bribes. 25 The report added that "In the opinion of European Union experts, one-third of the turnover of goods and services in Latvia is controlled by criminal groups, and 50 percent of the profits obtained by criminal means goes towards bribing officials."26 The report went on that "Specific facts on the presence of corruption in the country were presented to the Latvian authorities by the European Union commission which had conducted an independent investigation. EU experts came to the unanimous conclusion that corruption exists in all branches of Latvian power. In their opinion, the transition to a free market economy in Latvia led to its criminalization. Organized criminal groups participate in every lawful and unlawful deal. In 1993, they controlled one-third of the turnover of goods and services. The commission expressed the supposition that approximately 50 percent of the profits obtained from criminal activity go towards bribing officials. An especially critical situation has been formulated in the activity of the customs service, the state income service, and Minfin [Ministry of Finance], which are influenced by government officials of all ranks who have no official powers and authority to do so. For example, the investigative agencies of the customs service do not have access to customs warehouses belonging to high-level individuals. Customs officials are bribed, and the most stubborn ones are dismissed from work. In order to get an assignment as a customs officer at a profitable border station, one must give a bribe in the amount of \$5,000. For duty-free passage of large shipments of goods across the border, one must pay no less than \$7,000. Analyzing the situation with organized crime in Latvia, the EU experts came to the conclusion that all of it is tied with Russia. But most of all, they were amazed by the fact that even businesses in which only citizens of Latvia may engage according to Latvian laws, for example pharmacology and detective activity, were associated with Russian criminals. Seemingly in confirmation of the commission's conclusions, the German journal Impulse published a rating of corruption in the countries of Eastern Europe. According to its estimates, in Latvia, for example, businessmen are forced to resort to the aid of bribes for promoting their businesses more than in the neighboring Estonia and Lithuania. Although, the journal admits, Latvia is still a far cry from Russia. There the envelopes are thicker, and there are more addressees."27

During the period of the Post-Communist oligarchy, selling low priced non-ferrous metals (among other things) to the West for high profits, Latvia became one of the major exporters of non-ferrous metals in the world - even though it has no such metal resources of its own. The deputy head of the Russian Ministry of Interior organized crime division, Boris Baturin, stated in July 1992 that "Our operative information indicates that the smuggling of raw materials (from the Baltics) is being reinforced at the highest level in Moscow. We know there is a well-organized Baltic crime syndicate run by former Parly momenklatura and former KGB and police officials, which uses its connections inside the Russian leadership to monopolize export operations". In January 1997, Latvian Prime Minister Skele resigned for a short time because the Parliament did not want to accept his proposed Minister of Finance due to concerns about corruption and conflict of interest. The proposed Minister was eventually accepted. In May 1997, Prime Minister Skele threatened to resign again if the Parliament continued to leak allegations of his involvement in the disappearance of G-24 funds, stated that "it is not acceptable that any

doubt is cast upon the premier's office". On 1997, one third of the Latvian Parliament, the majority of the Cabinet and the President of the country were found to be openly violating the new government regulations on anti-corruption passed in the Fall of 1996. When confronted on this issue, many simply refused to comply. However, when their cases were reviewed by the Prosecutor's office, most cases were found to be only "technical" violations.

According to the former Minister of Interior until 1996, Janis Adamsons, "the authorities, including the parliamentarians and the government, are so criminalized that the personality of not only a minister but even the head of government has no significance under these conditions." Adamsons lost his position after only one year, primarily due to a controversy over the Ministry's investigations concerning Latvian Prime Minister Andris Skele, on whom Adamsons' department had accumulated dozens of volumes of operative information. These files dealt with the privatization of the food processing sector, to which Skele, as the former deputy minister of agriculture, had direct relations, as well as with the expenditure of \$55 million in foreign credits which were distributed by a private firm created under that very same Ministry of Agriculture. On the eve of Skele's confirmation to the office of prime minister, Adamsons spoke out in the Parliament voicing his doubts regarding the proposed candidacy. The investigation materials of the Interior Ministry were then handed over to the State Prosecutor. Adamsons received a reply several months later, after Andris Skele had already assumed the office of prime minister, while Adamsons himself had vacated his. In a letter to the ex-minister, the State Prosecutor stated: "Considering the fact that your report was based on suppositions, the information mentioned in it is not the truth." The materials of the operative investigation were buried.32

In January 1997, Skele himself was forced to temporarily resign because of a scandal surrounding the dubious reputation of his proposed minister of finance, Vasiliy Melnik. The press attributed involvement in the trading of contraband alcohol to Melnik, as well as participation in unlawful privatization. Once again, the State Prosecutor did not find anything punishable in the businessman's actions, but the government fell nevertheless. "...on the eve of the prime minister's resignation, the country's President, Guntis Ulmanis, admitted that he surmised that corruption does exist, but that, unfortunately, he does not have any specific facts. Ten days later, after personal reproaches of Andris Skele for amorality and lack of principle, in the course of compilation of the government, the President assigned the task of formulating the new cabinet to...that very same Skele." 33

ATTEMPTS TO MINIMIZE THE RUSSIAN PROBLEM:

Most people tend to view problems in terms of their own experience and history, which often promotes false comparisons. These are two common fallacious arguments.

Image: Russia today is just like Al Capone's reign of terror in Chicago during the late 1920's and early 1930's. Fact: For the US to be like Russia is today, it would be necessary to have massive corruption by the majority of the members at Congress as well as by the Departments of Justice and Treasury, and agents of the FBI, CIA, DIA, IRS, Marshal Service, Border Patrol, state and local police officers, the Federal Reserve Bank, Supreme Court justices, U.S. District court judges, support of the varied Organized Crime families, the leadership of the Fortune 500 companies, at least half of the banks in the US, and the New York Stock Exchange. This cabal would then have to seize the gold at Fort Knox and the federal assets deposited in the entire banking system. It would have to take control of the key industries such as oil, natural gas, mining, precious and semi-precious metals, forestry, cotton, construction, insurance, and banking industries - and then claim these items to be their private property. The legal system would have to nullify most of the key provisions against corruption, conflict of interest, criminal conspiracy, money laundering, economic fraud and weaken tax evasion laws. This unholy alliance would then have to spend about 50 % of its billions in profits to bribe officials that remained in government and be the primary supporters of all of the political candidates.³⁴ Then, most of the stolen funds, excess profits and bribes would have to be sent to off-shore banks for safekeeping. Finally, while claiming that the country was literally bankrupt and needed vast infusions of foreign aid to survive, this conspiratorial group would invest billions in spreading illegal activities to developed foreign countries which provided them with foreign. In the best case of this comparison, the U.S. President would not only be aware of all of these activities but would also support them - including the involvement of his own daughters and all of his close political and financial supporters. Further, he would direct a campaign to smear and remove the Attorney General for investigating the office of the PresidentObviously, this scenario dwarfs what went on in Chicago during Prohibition. Far from assisting the mobsters, the federal government fought Al Capone, ultimately sending him to prison for income tax evasion.

Image: Conventional wisdom holds that corruption and the power of Organized Crime will diminish as capitalism and free enterprise improve economic conditions, and democratic reforms will gradually reshape the government and infrastructure of Russia, causing criminal enterprises to spontaneously "legitimize" their operations.

Fact: This view is totally misplaced. The expected improvements in the economy, infrastructure and government of Russia may well not take place for the next five to ten years and will not occur at a pace required to overcome the corruption and criminality now rampant. First, as much of the money flowing into Russia due to criminal activity and foreign aid is sent to off-shore banks for investments and to pay for the corruption of public officials in Russia and other countries as well, it is not likely to aid the Russian economy. Secondly, there is no way to reign in this oligarchy of criminals, government officials and the former cream of the Communist Party. There is no incentive to change. Most Russian businessmen claim that a deal with less than 100 % profit is not worth doing.

Organized Crime groups count on profits over 300 %. Why should they settle for less, much less allow competition? Third, if a new company is formed that shows signs of being successful, Organized Crime groups immediately vie to see who will take it over first. Finally, as bank interests rates have dropped to "only 20 %" per annum (from over 100 % in 1994), Organized Crime demands 20-30 % of a company's turnover for "protection". Bribes are almost universally required for the performance of the most mundane state administrative task, such as licenses, permits, duties, etc. The state has imposed taxes of up to 70 % on profits, and operating costs are exorbitant due to high inflation and rising costs of goods and services. Even then, the most honest businessmen are forced to have dealings with Organized Crime in order to collect business debts and enforce contracts, because the police and courts are unwilling or unable to do so. Many Russian businessmen will remind visitors that it is cheaper to pay to have your creditor killed than to repay a debt.

The general current view of the United States and other Western countries involved in supporting democracy and market reform in Russia appears to be based on the assumption that the Russian government is doing its best to simultaneously create a free market, introduce democratic reforms, conduct a fair and rapid privatization of state properties and persuasively convince a skeptical Russian public that all of this is their best interests. Within this view, the Russians are genuinely struggling to fight Organized Crime and continue to conduct a series of anti-Mafiya and anti-corruption campaigns which will lead to the eventual destruction of the mob. In actual fact, rather than protecting the masses from Organized Crime, the top party elite themselves adopted the methods of Organized Crime to insert themselves into commercial ventures. To do this, they heavily relied upon the KGB, whose predecessor the Cheka during 1920s eradicated private business, free market activity, by confiscating the citizens' private property, arresting and murdering tens of thousands of individuals for conducting any form of trade or barter. Further, the Cheka was responsible for collecting and cataloguing the spoils from these activities for the use of the Communist Party and also for tracking down exported hard currency that was in foreign banks outside Russia. Later, the KGB increasingly served the systematically corrupt Communist Party nomenklatura.35 by becoming a critical component in creating their commercial and criminal ventures.

The problems of Organized Crime and official corruption are not new in Russia. The evidence shows that the top echelon are, in fact, at the heart of the problem and actually helped create the existing dire situation. The country's corrupt bureaucracy, continued lack of adequate laws, history of disregard for the law and regulatory systems, and the close association between the, illegally enriched bureaucrats and Organized Crime groups were fertile ground for the current wave of criminal activity in Russia and around the world.

BACKGROUND ON THE RUSSIAN BANKING SYSTEM INTRODUCTION

The Russian banking system today is an adjunct to Russian Organized Crime, itself the successor to the former Soviet nomenklatura who took control of major hard currency holdings and resources of the Communist Party and the Soviet state. Thee criminal syndicates, in which the foreign intelligence service played a significant role, control the exports of raw materials and have used the profits to build business and banking conglomerates. In many cases illegal cash transfers have been laundered through two or three levels of Russian-controlled companies and banks. Now these syndicates are buying interests in Western banks and businesses.

To appreciate the process that led to the looting of the Soviet state, it is first necessary to understand the major participants, as well as how they developed a system of formal and informal interdependence. However, it is also critical to understand that there were two general criminal groups, usually working independently but occasionally joining forces. They were and continue to be sometimes competitors or even enemies, and sometimes partners of convenience. They both meet the definition of Organized Crime groups. The current definition at Interpol's Organized Crime unit is: "Any group having a corporate structure whose primary objective is to obtain money through illegal activities, often surviving on fear and corruption."

THE NOMENKLATURA

The first group, the nomenklatura, includes the former officials of the USSR (although many continue to work for the Russian government) and is made up of the apparatchiki (bureaucrats), managers, senior officials of the government, as well as the KGB and Russia's "Military Industrial Complex" (MIC). The second group is that of the Mafiya. When Russians talk of Organized Crime or criminal looting, they are frequently referring to both of these groups. While each group poses a serious danger to the state of Russia, its development, and is spreading corruption on an international level, their methodology and resources are frequently different.

The "nomenklatura" were the ruling class in the USSR. Upon the collapse of the USSR, they totaled about 1.5 million from a then total population of about 240 million. Their power came from being on a secret list of the most worthy Party members, which was prepared periodically by the Central Committee of the Communist Part of the Soviet Union (CPSU). The first name on this list was traditionally that of the General Secretary of the CPSU. The nomenklatura enjoyed a privileged life, had a monopoly on top positions in the state structures, such as ministers, deputy ministers, CPSU Party leadership positions at the regional and republic level, all senior government positions millitary officers as well as key industrialists and managers, particularly in the Military Industrial Complex (MIC). Similar to the aristocrats in England, France and Russia in past times, the nomenklatura, as a rule, did not mix with outsiders or marry outsiders. They lived in special compounds, had special holiday retreats, and their children attended special schools. In addition, they had special privileges in the form of subsidized stores, state transportation at their disposal and reserved places for their children at the university.

They also formed the top echelons of the so-called "apparat" (bureaucracy) and were the top "apparatchiki" (bureaucrats). They enjoyed almost a total monopoly on power and information. In short, they had the most to lose with the fall of Communism.

CONCEALMENT OF STATE-PARTY ASSETS

The first formal planning sessions by an elite group of the Soviet Politburo and senior members of the nomenklatura to place the funds, properties and resources of the Communist Party of the Soviet Union (CPSU) beyond the reach of any subsequent "democratic" regimes began in 1984, the year of Yuri Andropov's death and the beginning of Konstantine Chemenko's thirteen-month reign. Within two years, the elite economic planners had requisitioned the services of specialists in the First Chief Directorate from the (KGB). They were experienced in moving money abroad for the CPSU's International Department and for KGB operations. The movement of money abroad was a closely held secret. Only a handful of officials were informed on a need-toknow basis, among them the CPSU Politburo's administrative chief Viktor Chebrikov and Central Committee treasurer Nikolai Kruchina. The financial planners group determined that the local KGB residencies overseas would not be able to be the principal movers of hard currency abroad over a protracted period. The volume of money involved was simply too large for the diplomatic pouch and such crude techniques as lugging suitcases stuffed with cash, gold, raw and cut diamonds, jewelry or art across the border. However, KGB channels and techniques did account for a portion of the initial movement of funds that helped establish the first of these covertly held commercial endeavors.

As the 1980s drew to a close, it became clear that General Secretary Mikhail Gorbachev was rapidly losing control of his attempts to make incremental adjustments to the government and economy while retaining the preeminent position of the Communist Party. At this point, the elite economic group began to put into effect contingency plans to move assets to safety abroad. Soviet state enterprises transferred assets to subsidiary enterprises newly established in foreign countries from Cyprus to the Caribbean. Subsidiary enterprises included export-import offices, banks and trading companies established to market Soviet products. Some had no obvious ties to the Soviet government, but were instead formed by individuals who had obtained 'loans' from the associated banks. The result was that most of the ostensibly private cooperatives formed in the Soviet Union in the late 1980s and hailed as success stories of "perestroika" (restructuring) were formed with state funds and were fronts or covers for state interests.

Trading companies established to market an assortment of state resources took on a larger role. These firms obtained products from petroleum to cotton and diamonds at the state subsidized price and sold them abroad at market prices for hard currency. The profits were enormous and were not sent back to Moscow, but were placed in all the world's tax havens such as from Switzerland to Hong Kong and from Cyprus to the Cayman Islands. There, the profits could be "laundered" by being put to use in forming a new generation of companies in which the Soviet Party and state origins were even harder to discern. Some of the money did come back to the USSR, sometimes in joint ventures with Soviet entities, but was represented as Western direct investment. This practice gained

momentum in the period from 1989 through the dissolution of the Soviet Union in December 1991.

In June of 1990, the first of many private banks were established with Party funds. (Some quasi-independent banks had been established using State funds in 1988, as part of early experiments to see how effective these banks would be in removing funds from the USSR.) Some thirty-one million rubles (about \$1.2 million at commercial 1990 rates) were placed as start-up capital for an operation envisioned as leading to large-scale credit and investment transfers in Russia and abroad. Officials reported that they planned to transfer an additional five hundred million rubles (about \$20 million) from the Party's reserves to the account by that autumn because of what was seen as the deterioration of the economic and political situation in the country.

A Politburo resolution entitled "On Emergency Measures to Organize Commercial and Foreign Economic Activity of the Party," dated August 23, 1990, directed the creation of several new "commercial organizations." These were to include a consulting firm of provide foreign brokerage services and a bank for administering the Party's hard-currency holdings, as well as its investment in international firms controlled by Communist parties abroad. The resolution also directed that structures created under this directive were to have minimal visible ties to the Communist Party. "Anonymous organizations [will] mask direct links to the Party when launching commercial and foreign economic Party activity." These structures were to be called "Friends of the Party" or "Companies of Friends." (INCLUDE TEXT????)

Taking advantage of the nominal requirements of less than \$20,000 to found banks, members of the Russian Mafiya groups also began to form new banks.

Organized Crime in Russia is an "oligarchy" formed by the former officials of the Soviet state and the Russian Mafiya. What makes this group unique is not only the extent of their power, influence and wealth in Russia, its republics and increasingly internationally, but also that these are two distinctly different groups, sometimes operating independently, sometimes in common. The best estimate is that the Russian Mafiya only makes up 10 to 15 percent of Russian Organized Crime hard core members, while the remaining 85 to 90 percent are current or former officials of the Soviet party-state.

The party-state nominees (individuals not publicly known to be allied with the Communist Party) used funds from the sale of raw materials held in accounts in foreign banking havens to buy the new Russian banks. Some were given extraordinarily profitable monopolies and quasi-monopolies, such as the right to exchange foreign money or to trade in commodities. This growing commercial and banking network was used to set up another level of firms in Western countries, especially the United States, England and Germany, countries whose governments were committed to providing aid to the "reform" government of the Soviet Union and later the Yeltsin government. These new firms then obtained loans from the banks for still more "joint ventures" to purchase important factories, banks and properties.

As a result of these banks and a variety of other structures used to illegally and covertly transfer assets, funds and undervalued assets totaling between \$300 and \$500 billion were moved outside of Russia and the former republics into the West. To date, less one half a percent, or about \$2.5 billion, has been moved back into Russia as investments. Thus, the primary goal has been to invest Western funds in save and stable Western economies, while maintaining their stolen funds in offshore tax havens.

For the past several years, Russian enterprises, formed with the assets of the party-state and controlled by the organized criminal groups that participated in the looting of state assets, have been buying controlling interests in banks and commercial entities in the West.

In 1994, then-Director of Central Intelligence James Woolsey stated that "of the 2,000 banks in Russia today, a majority are controlled by Organized Crime, according to the Ministry of Internal Affairs." In August 1995, the Ministry of Internal Affairs (MVD) All-Russia Scientific Research Institute estimated that criminal groups controlled more than 400 banks and 47 currency exchanges. An even more pessimistic assessment was given by Professor Lydia Krasfavina, head of the Institute for Banking and Financial Managers, who estimated that 70 to 80 percent of private banks in Russia are controlled by Organized Crime. Illicit banking practices are widespread.

According to a 1997 report by the Washington-based Center for Strategic and International Studies (CSIS) that drew heavily on FBI data, 71 percent of Russian banks violated Russian Federation banking legislation in 1995. The report also claims that one half of Russia's 256 largest banks have ties to Russian Organized Crime because they present lucrative targets for extortion and money laundering. Those figures are actually severely understated. There are literally no Russian banks without ties to Organized Crime; otherwise they would never have accumulated the necessary funds and would not continue to exist. Incredibly enough, most definitions of Russian Organized Crime fail to include the overwhelming number of current and former Russian officials involved and focus strictly on the Russian Mafiya.

The "instantly privatized" banking industry initially had over 800 banks and then grew to over 2,500 by 1995. That number has been steadily declining. By 1995, there were banks in Russia that were paying interest rates of 1,000 to 1,500 percent per annum. However, by the spring of 1995, some banks, the MMKB, began to collapse; and the overall number of banks began to dwindle. In the aftermath of the1995 banking crisis, liquidity in the Russian banking sector grew tight. There was a general flight to quality among both borrowers and depositors, exacerbating liquidity problems for many second-tier institutions. Liquidity difficulties at larger banks often were triggered by asset quality problems (like Autovozbank and Credobank) or over extension of the balance sheet (like in the case of Unikombank). Yet in the case of larger banks, the Central Bank illustrated its willingness and ability to intervene, lending support to important banks such as to Tveruniversalbank.

By early 1996, Russian banking had rapidly decreased in numbers to about 2,132 banks which were active domestically. About half of Russia's banks were financially distressed

and were not expected to be able to meet more stringent reserve and regulatory requirements introduced by the Central Bank. By late 1997, some 1,700 banks continued to struggle for existence. A small, influential group of about fifty banks, several of which got their start with state or Communist Party funds during the Soviet period, have made large profits in recent years due to their connections to political and economic big-wigs. These banks became part of what are known as Financial-Industrial Groups (FIGs), in other words holding companies with large industrial enterprises. 1996 was a watershed for Russian banks. This was the year that FIGs exponentially increased their strength and discovered their ability to "guide" the political structures via direct and indirect campaign funding. Powerful banks play key roles in all the major groups of FIGs, including even that of former Russian National Security Council leader Boris Berezovsky's LogoVAZ group. With the exception of Inkombank, these institutions bankrolled President Boris Yeltsin's 1996 reelection campaign. Since that time, its moguls have fallen out with one another. Power struggles continue as these groups strive to increase their control over key sections such as energy and minerals, to name a few.

Bank leaders have held key posts in the government and played a major role in reflecting Boris Yeltsin in 1996. The government sometimes depends on large banks to make up budget shortfalls through the purchase of short-term securities and (sometimes) paying taxes. The government has "authorized" more than 50 banks to handle state funds. The city of Moscow, for example, has spread the funds from city agencies around several financial institutions. Some banks are authorized institutions for a wide variety of national, regional and city governments, as well as jurisdictions in the former Soviet republics. "Authorized banks" and their managers have often generated huge profits by delaying budget transfers in order to invest in the high-yield government securities market. (Firms usually must transfer customs payments in advance of actual delivery of goods, which leaves the money sit in the accounts for several weeks.)

Obtaining status as a favored, authorized bank is highly dependent on the political connections of the individual bank's management and is most likely fostered corruption. In 1996, for example, the watchdog State Control Chamber found that \$4.4 billion in state funds intended - though never legally budgeted - for restoration in Chechnya and funneled through favored commercial banks wound up in the pockets of government officials. In order to eliminate these problems Yeltsin has called on the Central Bank to set criteria for the selection of authorized banks for federal money to ensure that, with few exceptions such as the Defense Ministry, they are selected through open competition.

However, these banks - who "found" millions of dollars of resources and turned dozens of members of the former Party nomenklatura into instant millionaires, used their new wealth and old connections to acquire more holdings in large industrial enterprises - the FIGs.

In the fall of 1996, Berezovsky bragged that he and six fellow tycoons, who also are FIG leaders and sometimes are called the "Big Seven," controlled half of Russia's economy.

Some FIGs were created from above by the fusion of several large industrial enterprises. A second group of FIGs was created at the initiative of industrial giants such as Gazprom,

LUKoil and VAZ to service their own financial needs. The third group comprised those FIGs that grew from the large banks that were the direct descendants of the previous state banks.

THE LEADING FIGS (BEFORE THE FINANCIAL CRASH OF AUGUST 1998)

- Promstroibank (Industrial Construction Bank), owned by about 20 juridical persons corporate entities and individuals. Represents state interests.
- Vneshtorgbank (Foreign Trade Bank). Represents state interests.
- Menatep Empire, owned by about 60 juridical persons. A semi-private, highly privileged financial group.
- ONEXIMBank-MFK (United Export-Import Bank/ Financial Corporation): owned by about 30 juridical persons. A semi-private privileged financial group).
- Rossiisky Kredit ([Russian Credit) empire: owned by about 30 juridical person. A semi-private, privileged financial group.
- Inkombank (Bank of Foreign Commerce) empire: owned by about 30 juridical persons. A semi-private, privileged financial group.
- The MOST banking empire: owned by about 42 juridical persons. A semi-private, privileged financial group.
- Yuksi empire: In January of 1996, Mikhail Khodorkovsky, a high-profile banker who headed the AO Yukos oil company, and Boris Berczovsky, the dollar-billionaire believed to control the Sibnest oil company, announced the merger of their oil companies. The new company, AO Yuksi, is the world's largest public company by proven reserves [16.1 billion barrels] and the third biggest company by oil production, behind only Royal/Dutch Shell and Exxon. On the weekend of March 21-22. Yuksi announced a five-year contract with the U.S.-based Schlumberger Ltd., an oil service provider, to manage certain of Yuksi's vast yet antiquated oil fields. A day later, Yuksi's Khodorkovsky announced the sale, for more than half a billion dollars, of a five-percent stake in Yukos to France's Elf Aquitaine. Facilitated by Goldman, Sachs & Co and Salomon Inc., the deal with the French company would have provided the money and the Americans the technology and know-how for secondary and even tertiary extraction of crude petroleum from Yuksi's wells. Elf and Yuksi were considering a joint bid for the largest remaining oil-producing Russian state concern, NK Rosneft, a 75 percent stake in which is being offered for \$1.2 billion. Finally, at the last moment, this merger did not take place.
- SBS-Agro [formerly Stolichny] with Aleksandr Smolensky, president; chairman of the board of directors, Agroprombank.

• Alfa Group: Not to be confused with the SPETZNAZ commandos who killed the president of Afghanistan and seized Kabul's airport in December 1969, the Alfa Group grew out of Courier, a trading company founded in 1987 by graduates of the Moscow Steel and Alloys Institute. It later thrived on foreign trade activities and connections to the Ministry of Foreign Economic Relations as well as the former KGB. Alfa Group is owned by Mikhail Fridman and Pyetr Aven, who was a minister in Gaydar's government. In 1995, Alfa Group appointed as its chairman, L. Vid, who formerly was deputy head of Gosplan, and chaired Premier Chernomyrdin's Russia Is Our Home party. Its current political patrons include Anatoly Chubais and Yegor Gaydar.

The elite banks and their FIGs are also the key financial players in the constantly shifting, informal networks of alliances -- sometimes called clans -- that dominate Russian politics. In addition to authorized banks and their industrial groups, these networks include political leaders, media holdings and armed security forces. These clans are in constant struggle with one another for political and economic advantage. Some banks, however, spread their political and financial support among several major leaders.

As a result, Russia has developed an economy distinguished by the following features:

- First, it is based upon large FIGs, with financial capital prevailing over industrial capital;
- Second, it has at its foundation the class of "authorized" or major property owners, to
 which the State has entrusted the development of the market; and
- Third, in the absence of equal opportunity, it functions as a money maker for a thin strata of chosen entities and people.

The elite or "authorized" banks and their FIGs are also the key financial players in the constantly shifting, informal networks of alliances sometimes called clans, that dominate Russian politics. In addition to authorized banks and their industrial groups, these networks include political leaders, media holdings and armed security forces. These clans are in constant struggle with one another for political and economic advantage. Further, the large scale efforts of the FIGs to acquire major media outlets have given the "Big Seven" control of the majority of the newspapers and radio and TV stations in Russia. Thus, they can exert direct influence not only on the political structures but also upon the entire population. Most banks, however, spread their political and financial support among several major leaders.

For example over the years, Berezovsky has been close to political backers of a remarkably wide variety of political stripes, including Alfa Group's Pyotr Aven, Yegor Gaydar, General Aleksandr Korzhakov and Oleg Soskovets. He drifted toward Viktor Chernomyrdin in the months before his dismissal in November 1997. There is evidence

that Berezovsky also provides financial support to Sergey Kurgiriyan's anti- Semitic, ultra-nationalist Experimental Creative Center, a Moscow-based think-tank with ties to the anti-Yeltsin opposition. Now Berezovsky is also very close to Tatyana Dyachenko, Yeltsin's daughter and his de facto campaign manager.

KEY POINTS

In the lower ranks, many banks were and will continue to be absorbed into larger institutions, while others may face mergers. With so many players in the market, no bank is likely to play a dominant role, though foreign transactions are concentrated among a few, for Russian standards, relatively sophisticated institutions. Moscow-based banks dominate more than 70 percent of the market. Possibly the top fifty local banks will maintain significant international profiles over the longer term as the World Bank and EBRD Financial Institutions Development Project works at creating "international standard banks." Foreign banks have yet to set up business in Russia and challenge the hegemony of Russian banks. However, this is not likely to happen soon.

The Central Bank's power to set interest rates and establish reserve requirements can make life quite difficult for a major bank, but on many issues the individual banks get what they want by relying on personal connections to the establishment. The Association of Russian Banks, the sector-wide banking organization, lobbies the government on narrow, professional questions. However, their ability to finance and publicize political candidates will continue to obviate the need for the leading major banks to respond to serious regulatory initiatives from the government. In fact, several prominent personalities in these FIGs - among them former Premier Viktor Chernomyrdin, former First Deputy Premier Boris Nemtsov and Moscow Mayor Yury Luzhkov - currently are jockeying for high political office that includes possibly replacing Yeltsin in the year 2001 or even sooner.

The argument that some of the larger banks no longer engage in criminal activity is false. They have simply evolved into a higher, more sophisticated level of criminal activity that includes wholesale corruption of public officials and influence peddling. Russia's banker criminals now control the government.

The major Russian banks need to remain deeply involved in politics and corruption in order to retain their "authorized bank" status, which is necessary to survive and remain competitive. Since the Banks cannot risk the loss of this special status, they have become even more directly involved in politics. That also means that any attempts to reform the banking system and inject Western banking controls will be futile. Attempts to reform the legal and law-enforcement sectors will be unlikely to overcome such strong resistance.

Russian Organized Crime has supplanted the state. It offers basic services such as security, debt collection and even its own "court system" for handling civil law claims. Organized Crime controls the vast majority of the Russian banks; and in turn, the Russian banks largely control the Russian government and legal system. The Russian banking system has and will remain integrally intertwined with the Russian government until one

or the other falls. Corporate, criminal and political Russia have developed into one single entity.

BANKING INSTABILITY

Two points best illustrate the fragility of the banking system and the economy in Russia.

During the final two days of the 1996 election campaign, when Yelstin's victory was uncertain, there were 32 corporate jets standing by at airports in the Moscow area and every seat on Western airlines departing Moscow and St. Petersburg were booked "as a precaution." Should there ever be a dramatic political change in Russia, the ensuing panic may make it come to resemble Tehran in 1979.

Less than \$2.5 billion of the \$300 to \$500 billion Dollar siphoned out of Russia from 1991 to 1997 has returned to be invested in Russia. Rather, the emphasis has been on attracting foreign investment – which, against all odds, still continues at a fairly significant rate. If investments in Russia were indeed secure, why would the Russians continue to insist on the influx of foreign investment funds?

Some economists have argued that the situation in Russia will soon "normalize" and the political and economic elites who comprise about 85 percent of Organized Crime in Russia will allow the development of a free market economy, political and economic reforms, an independent and effective judicial system and law enforcement structures. Leaving aside the fact that the Russians have no traditions to draw on as a guide for structures or models, this begs the fact that the political and economic structures now in power can not allow these changes lest they want to lose their power. Any democratic changes in the current system of oligarchy would jeopardize their new-found power and wealth.

CONCLUSION

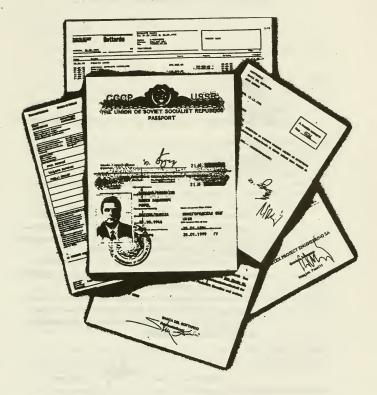
Even the most honest businessmen are forced to have contact with Organized Crime in order to collect business debts and enforce contracts. The Russian criminal justice system is by any democratic international standards utterly inadequate. The police and courts are not only unable but frequently unwilling to enforce contracts and collect debts. Many Russian businessmen continue to remind visitors that it is cheaper to pay to have your creditor killed than to repay a debt.

- end -

Three Appendices are attached.

APPENDIX A

COPIES OF PERSONAL DOCUMENTS AND SWISS BANK ACCOUNT INFORMATION FOR PAVEL BORODIN, OF CHIEF OF RUSSIAN PRESIDENT YELTSIN'S PROPERTY MANAGEMENT OFFICE



APPENDIX B

COPY OF DIRECTIVE BY PAVEL BORODIN, OF CHIEF OF RUSSIAN PRESIDENT YELTSIN'S PROPERTY MANAGEMENT PROVIDING APARTMENT WORTH \$ 500,000 TO NEW FEDERAL PROSECUTOR REPLACING SKURATOV



УПРАВЛЕНИЕ ДЕЛАМИ ПРЕЗИДЕНТА ЭССИЙСКОЙ ФЕДЕРАЦИИ

Генарыльному дирактору АОЭТ "МОСЯРОМСТРОВ"

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APPENDIX A

TRANSLATION OF 1990 DECREE BY COMMUNIST PARTY CENTRAL COMMITTEE UNDER GORBACHEV THAT WAS ISSUED AT THE TIME THAT THE RUSSIAN CENTRAL BANK FOUNDED FIMACO

"The General Division of the Central Committee of the CPSU August 23, 1990

Re: Urgent measures on the organization of commercial and foreign economic activities of the party (memo)

... A special place in the CPSU's new circumstances is taken up by the question of establishing a connection between its enterprises, its economic organizations, and its finances to foreign economic activity. This is vital not only for the development of an autonomous channel for the obtaining of currency into the party's cash box, but also for the financing of interparty connections.

For this purpose there must be a strict observance of discreet confidentiality and the use of anonymous facades to disguise the direct issue of money to the CPSU. The final objective is to build a structure of "invisible" party economics that will be on a par with the "commercialization" of party economics; a very narrow circle of people have been allowed access to this structure. This was determined by the General Secretary of the Central Committee of the CPSU or by his deputy. All this is confirmed by the experiences of many parties, working for decades within a framework of multiparty cooperation and market economics.

It is considered that the following measures should be undertaken in an urgent manner in order to guarantee the conditions for the development of commercial and foreign economic activity of the party along with its central organs:

- . . . --To analyze in depth its real legal basis--the laws of the USSR and its republics--in order to determine the optimal legal grounds for a transition toward a commercial and foreign economic activity by the Party. In addition, to actively establish links (through deputy communists) to prepare new legislative rulings in the Supreme Soviet of the USSR and of certain republics with the aim of safeguarding the protection of the Party's economic interests;
- --To prepare a program on the formation of new "transitional" economic structures (foundations, associations, etc.) which will act as formation centers of the "invisible" party economics.
- --To immediately start preparing motions to use anonymous forms to disguise the yields for the CPSU in the process of developing the commercial and foreign

economic activity of the Party. To analyze, specifically, the question of the possibilities of annexing international consortiums through presently existent and functioning relevant enterprises through a consolidation of capital, etc.

-- To consider the questions regarding forming a bank controlled by the Central Committee of the CPSU possessing rights to conduct currency operations; and of the participation of the Party through its currency resources in the capital of those firms operating on an international level which would, in their turn, be controlled by the economic organization of friends. To insure foreign economic activity, it is also advisable to urgently begin a new savings account in the CPSU that would come from party dues from foreign institutions.

--To carry out consultations with the Gossnab (State National Bank) of the USSR on the question of using national property for the foreign economic work of the Party; the property left after the Soviet armies left Czechoslovakia, Hungary and the German Democratic Republic.

Comrade V. A. Ivashko"

¹ Moscovskiy Komsomolets, "Interview with Police Major General (Ret.) Aleksandr Gurov by Mark Deych; place and date not given: "Aleksandr Gurov: 'Mafia Money Should Work for the State", 10 November 96 p 2, in Russian, translated by FBIS in Daily Report FBIS-SOV-96-237-S.

² Stephen Handelman, "Comrade Criminal: Russia's New Mafiya", by, (New Haven: New Haven Press, 1995), p. 57, in a conversation with Handelman.

³ Personal conversations in 1995-1996 with "Ivan", a former Russian KGB officer who participated in this program.

Personal conversations in 1995-1996 with "Ivan", a former Russian KGB officer who participated in this program.

Personal conversations in 1995-1996 with "Ivan", a former Russian KGB officer who participated in this program. The CC agreement was confirmed independently by "Igor", the former member of the CPSU CC Administrative Department who participated in this program during conversations in 1995 and 1996.

⁶ Kpemlevskij Zagovor: Versija Sledstvija (The Kremlin Conspiracy: An Account of the Investigation), ("Ogonjok": OGIZ: Moscow, 1992), edited by Ya. Kikitina, Appendix 2, "Funds for the Phantom of Communism", pp. 280-301. KGB First Main Directorate Colonel Leonid Veselovsky, had gained experience in working with KGB owned and operated foreign front companies in the 1970's and 1980's which would later provide him with the expertise that the Central Committee needed in 1991 to help conceal its assets in joint ventures. Following his work with the CC International Department as a participant in the hurried attempts to conceal its assets in joint ventures; he then became a consultant to the international Swiss-based firm Seabeco AG (controlled by Soviet émigré Boris Birstein). He then gained international prominence in 1993 a former KGB officer who first surfaced prominently in international for his business dealings business dealings in 1993 when he was named by the Russian Procuracy as a target of investigations into vanished Communist Party funds and into the nature of his subsequent, highly profitable financial dealings - particularly with the firm Seabeco..

The Third Main Directorate was responsible for military counter-intelligence, primarily in monitoring the activities of the Russian military.

Mark Devch, Literaturnaya Gazeta, June 25, 1992.

⁹ This resolution was found in the Central Archives of the Communist party in Moscow and published in the magazine Ogonyok, November 12, 1991.

Reported in "What the Papers Say", July 7, 1992.

[&]quot;The High Price of Freeing Markets," The Economist, February 19, 1994, p. 57.

¹² Sunday Times London, April 10, 1994. Also See "The Russian Mafia" (Washington D.C.: U.S. Department of Energy, Office of Intelligence and National Security, Office of Threat Assessment, 1993); Stephen Handelman, "The Russian 'Mafiya'," Foreign Affairs 73 (March/April 1994), p. 83; Claire Sterling, Thieves' World, The Threat of the New Global Network of Organized Crime (New York; Simon & Schuster, 1994), pp. 34, 90; Mark Elliott, "Economic Crime and the Necessity of Morality," a chapter in William Clark, ed., Economic Crime and Market Reform in the Former Soviet States (Boulder, Col.: Westview Press, forthcoming).

¹³ Personal conversations in 1995-1996 with victims of car theft in Latvia and Russia as well as several

Latvian police officials.

4 "Russian MVD Fights Shadow Economy and Organized Crime", as heard on Radio Rossii on 13 June 1991 in an interview with Chief of the Detective Division of the Mocow Criminal Police, translated in RFE Weekly News on 18 June 1991 by Victor Yassman

^{15.} National Drug Intelligence Center, October 1993, cited in the report "Russian Organized Crime', from the Office of the Attorney General of the State of California, Daniel E. Lungren, (State of California: California, 1996), March 1996, page 5.

^{16 &}quot;Mafia Accumulating Property", translated from Russian language broadcast of radio station "Ekho Moskvy" on 22 April 1994, in RFE Weekly News on 26 April 1994. Quoted researchers from the Russian Academy of Sciences.

[&]quot;Tax Police Colonel in Corruption Scandal", translated from Russian language broadcast of NTV on 9 April 1996, in RFE Weekly News on 26 April 1994

18 Trud, 18 May 1996, as reported in RFE Weekly News, "Murder Wave", 22 May 1996, by Peter Rutland.

¹⁹ Komsomolskaya pravda, 24 September 1996, in RFE Weekly News of 25 September 1996 by Victor Yassmann.

²¹ Kommersant Daily, October 22, 1996, "Vladimir Rushaylo Took the Floor" by Dimitry Pavlov, Maksim Varyyvdin and Mikhail Mikhaylin.

²² Moscow "Izvestiya", Russian language, July 20, 1994, "Who Wields Power in Russia?".

²³ Baltic News Service, 1 July 1997, quoting the Latvian newspaper "Diena", on a report from "Expert" magazine in Russia.

²⁴ Baltic News Service, 12 June 1997, "Baltics Lagging in Human Development, U.N. Report Indicates".

²⁵ Baltic News Service, "Latvia Concerned About EU Report on Corruption", 3 January 1997, in English, quoting Latvian Minister of Interior Dainis Turlais who complained that the report gave no details and that other countries had corruption as well.

Moscow Literaturnaya Gazeta in Russian, "RUSSIA, LATVIA: Organized Crime in Latvia Tied to Russia: International Mafia: The Baltic Corridor", 5 Mar 97, No 9, p 13 by Tatyana Fast in an interview of former Latvian Minister of Interior Janis Adamsons.

Moscow Literaturnaya Gazeta in Russian, "RUSSIA, LATVIA: Organized Crime in Latvia Tied to Russia: International Mafia: The Baltic Corridor", 5 Mar 97, No 9, p 13 by Tatyana Fast in an interview of former Latvian Minister of Interior Janis Adamsons.

²⁸ Komsomolskaysa pravda, "Baltic Smuggling Has Ties to Kremlin", in Russian, 4 July 1992, p. 2.

²⁹ Baltic News Service, "Premier Sends Letter to President Explaining Resignation", of 20 January 1997, cited in FBIS-SOV-97-014 of 20 January 1991.

³⁰ Baltic News Service (BNS), "Latvian PM May Consider Resignation", Daily Report, 21 May 1997. Born 1958, Skele graduated from Latvian Agricultural Academy as mechanical engineer in 1981. By 1991, he was also the deputy director for production of the scientific production company STARS. In 1990, he was appointed first deputy Minister of Agriculture and from May until September 1993, he was also the acting Minister of Agriculture. While in this position, he also founded a series of companies which now control the majority of food processing factories in the country and is also involved in alcoholic beverages and cigarettes, farm property, and food markets. Further, a company formed with contacts to the Ministry of Agriculture went bankrupt with losses of US \$ 10,000,000 of G-24 funds and bank accounts in Luxembourg for the government officials. He also acted as the Director of the Latvian Privatization Agency, Chairman of the state Unibank and chairman of the Latvian Shipping Company. These positions followed his work on these firms at the Privatization Agency. He is now a shareholder in these banks and has arranged EBRD funding for these banks as well. He is now one of the wealthiest men in the country.

³¹ BNS, 16 May 1997, "President Discusses Corruption Charges".

³² Moscow Literaturnaya Gazeta in Russian, "RUSSIA, LATVIA: Organized Crime in Latvia Tied to Russia: International Mafia: The Baltic Corridor", 5 Mar 97, No 9, p 13 by Tatyana Fast in an interview of former Latvian Minister of Interior Janis Adamsons.

³³ Moscow Literaturnaya Gazeta in Russian, "RUSSIA, LATVIA: Organized Crime in Latvia Tied to Russia: International Mafia: The Baltic Corridor", 5 Mar 97, No 9, p 13 by Tatyana Fast in an interview of former Latvian Minister of Interior Janis Adamsons.

Gertz, Bill, "The Washington Times", "Most of Russian's Biggest Banks Linked to Mob: CIA Report Says Illegal Activities Spread to District", 5 December 1994, p. A1. Look for article by sheriff

³⁵ Simis, Konstantin, "The Corrupt Society" (New York: Simon and Schuster, 1982), pp. 83-86.

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MEASURES TAKEN BY THE REPUBLIC OF CYPRUS TO COMBAT AND PREVENT MONEY LAUNDERING

In view of the fact that Cyprus was mentioned during the recent hearings of the House Banking & Financial Services Committee on money laundering in Russia, I thought that the Committee might be interested in knowing about the measures taken by the Government of the Republic of Cyprus to prevent and combat money laundering.

I would like to clarify, at the outset, that Cyprus has been faced with a unique problem caused by the continuing occupation of 37% of its territory by Turkey and the use of that area for criminal activity. Although most of the reports regarding money laundering refer to activities in the Turkish occupied part of Cyprus, they, regrettably, often fail to distinguish between the Government-controlled area and the occupied part of the island. Cyprus, therefore, has been doubly victimized, since the country's reputation has suffered through the association of its name with the illegitimate activities taking place in the occupied part of the island, over which it is prevented from exercising control by the Turkish occupation forces.

Consequently, a solution to Cyprus' political problem, would contribute to the elimination of any such activities, since it would then be possible to implement throughout the territory of Cyprus the strict controls and regulations which the Government of Cyprus is applying in the Government-controlled areas of the Republic.

The Republic of Cyprus has signed and ratified all international Conventions aiming to combat money laundering and in 1996 it enacted the 'Prevention and Suppression of Money Laundering Activities Law' which was adopted in line with the requirements of the Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime of the Council of Europe, as well as the relevant 1991 Council Directive of the European Union.

The new Law includes far-reaching provisions as it defines and criminalizes laundering of proceeds from serious criminal offences, it provides for the confiscation of proceeds from serving crime, it empowers courts to issue freezing and restraint orders in respect of such proceeds, it empowers the courts to order the disclosure and production of information held by any natural or legal person related to money laundering investigations, it requires customer

identification and record keeping procedures, internal control systems and staff training and it enables the registration and enforcement of foreign orders for the freezing and confiscation of proceeds.

The new Law criminalizes money laundering not only connected with drug dealing offences but with such serious crimes as arms trafficking, kidnapping and extortion.

Furthermore, the Law requires that even the mere suspicion of money laundering should also be reported to the Police or the Unit for Combating Money Laundering and it imposes a statutory duty on every person to report any such suspicious activities.

Banks are required also to adhere to the prescribed procedures of this Law for customer identification, record keeping and internal reporting as well as to ensure adequate training of their employees concerning the provisions of the Law. They are also required to appoint properly qualified persons as compliance officers.

The 1996 Law provides for the establishment of a Unit for Combating Money Laundering (UCML) which is mandated to gather, classify and evaluate information relevant to money laundering offences, conduct investigations whenever there are reasonable grounds to believe that a laundering offence has been committed and to issue directives for the more effective exercise of its functions and the cooperation with its counterpart foreign units.

Moreover, the Law provides for the establishment of an Advisory Authority Against Money Laundering, whose main task is to inform the Council of Ministers of any measures taken, as well as of the general policy against money laundering and to advise on any necessary additional measures.

The 1996 Law designates the Central Bank of Cyprus as one of the bodies having supervisory authority for all persons licensed to carry out banking business, including offshore Banking. Other such bodies are the Office of the Attorney General and the Department of Customs.

In addition to the 1996 Law, the Central Bank of Cyprus has taken its own measures to combat and prevent money laundering by setting strict guidelines for all banking operations. These guidelines are based on the provisions or recommendations of relevant international bodies such as the Basle Committee on Banking Supervision, the European Union and the Financial Action Task Force of the OECD.

Accordingly, all banks in Cyprus have been directed by the Central Bank to implement customer identification and record keeping, to exercise due diligence, to cooperate with the Police and the UCML, to establish adequate internal control procedures and to arrange in-house training on the prevention and combating of money laundering, as well as the identification of all electronic transaction dealings.

The Central Bank of Cyprus has for many years operated a strict regulatory framework aimed at eliminating the misuse of the offshore sector by criminal elements. Thus, offshore companies are required to divulge the names of their beneficial owners, submit good bank references, prepare and submit annual accounts to the Central Bank and file annual returns to the Central Bank.

Other measures to combat and prevent money laundering include the setting up of a Special Drug Law Enforcement Unit that is also empowered to investigate cases of money laundering. The Special Drug Unit of the Customs Department is also empowered to investigate money laundering cases, in close cooperation with the UCML and the Police Drug Law Enforcement Unit.

Cypriot authorities have extended full cooperation to all international bodies and organizations with a view to contributing to the mutual effort of combating money laundering.

With this in mind, Cyprus has concluded a number of bilateral agreements with a number of countries on judicial/legal cooperation. Cyprus also cooperates closely with:

- i) The Community of Drug Liaison Officers: Drug Liaison officers from 12 countries are stationed in Cyprus and cooperate closely with the Cypriot authorities in combating money laundering.
- ii) Interpol: The Cyprus Police Force has developed close cooperation with Interpol for combating all forms of criminal activities.
- iii) The World Customs Organization: Cyprus is a member of the WCO. The Customs Department has established a Special Intelligence Unit that cooperates closely with the WCO for the prevention and combating of money laundering.
- iv) Financial Action Task Force (FATF) of the OECD: FATF is the only international body dealing exclusively with money laundering. Cyprus cooperates very closely with this body in order to strengthen the effort against money laundering.

It should be stressed in this regard that, following an assessment of the prevailing situation in Cyprus as regards the legal framework and the enforcement mechanisms against money laundering, the FATF decided in 1998 to declassify Cyprus as a priority country in the external relations program of its Task Force.

v) Council of Europe: Cyprus is a member of the Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures of the Council of Europe (PC-R-EU) which is mandated to evaluate the measures against money laundering taken by the member-States of the Council which are not FATF members.

Cyprus itself proposed to the PC-R-EU to be included in the first group of countries to be evaluated. An evaluation mission took place in April 1998 which concluded in its Report (June '98) that ".... Cyprus is to be congratulated on the very comprehensive legal framework that has been put to place. It compares favorably with others in place in larger countries that are members of the FATF. Moreover, as has already been indicated, its impressive legal structure, based on existing international anti-money laundering standards is significantly in advance of any other country in its geographic sub-region".

vi) Cooperation with Financial Intelligence Units (FIUS): The Cypriot authorities work very closely with their counterparts in other countries, including the US, for the exchange of information and the investigation of crimes, including money laundering.

A number of delegations from third countries have visited Cyprus in order to be briefed on the efforts of Cyprus to combat money laundering, including a team of experts from the US (Money Laundering Assessment Team) which visited Cyprus in April 1997, and a team of experts from the FATF which visited Cyprus in September 1997. Both teams expressed their satisfaction for the work being done in Cyprus against money laundering and the cooperation offered by Cyprus at the international level.

The work done by the Cypriot authorities and their continuing efforts in this field have also been recognized by the US authorities in the current International Narcotics Strategy Report, as well as by the Select Committee on the Evaluation of Anti-Money Laundering Measures of the Council of Europe mentioned earlier, which found that "there is an important discrepancy between reality and the rumors, absolutely in the Cypriot Government's favor".

In view of the above it is evident that Cyprus has adopted all necessary legislative measures to keep laundered funds out of its structures and to contribute to the international efforts for the suppression of this crime.

Although Cyprus may be vulnerable to money laundering, this vulnerability is not unique to Cyprus alone. Realizing the dangers it faces, the Cypriot authorities are developing full cooperation with foreign countries and international organizations in fighting this phenomenon. The goal is common and its

accomplishments demand mutual effort. International cooperation is, therefore, essential.

The Government of the Republic of Cyprus emphasizes in the most emphatic way that it is ready to discuss and adopt any additional legislative and regulatory measures, in force in other countries, which have contributed effectively to the elimination of money laundering.

It is also ready to cooperate with the US and any other Government and body with a view to ensuring that our world is rid of such criminal activities. For this purpose, it stands ready to investigate any specific queries, allegations, suspicions or complaints concerning money laundering practices on the island and to work closely with all the relevant international bodies towards this end, because it fully realizes that in a country of Cyprus' size, with 37% of its territory under military occupation, there is no margin for allowing criminal activity of any kind to infiltrate the island's financial and social fabric.

October 1999

APPENDIX

July 22, 1999



CURRENCY

Committee on Banking and Financial Services

James A. Leach, Chairman

For Immediate Release: Wednesday, September 22, 1999 Contact: David Runkel or Andrew Parmentier (202) 226-0471

Opening Statement Of Rep. James A. Leach Chairman, House Banking and Financial Services Committee Hearing on Russian Money Laundering

Today we begin another of our hearings on money laundering and corruption in Russia.

For much of this century there has been a philosophic contest between communism and capitalism, which clearly has been won by capitalism. Now we have a contest between capitalism under the rule of jaw and capitalism without jaw.

Among the weaknesses of communism was the theory of economic determinism, which implicitly denied individual accountability, and the precept of class struggle which Karl Marx defined as extending from feudal to capitalist times.

The irrony is that in the wake of the cratering of communism there are un-Marxist elements of class concern in today's Russia. If one believes, as I do, that no society can be sustained if a few have all the assets and the many are robbed not only of public funds but individual opportunity, public accountability in today's Russia requires that the people hold kleptocrats to account for social theft.

In this regard, we in the West have an obligation to cease standing up and identifying with the current government and unite instead in concern for the Russian people. As I suggested yesterday, our aid should be micro-ized and decentralized.

Macro-economic polices utilizing the International Monetary Fund that provide aid to a central bank which then disburses funds to private banks which, in turn, divert dollars, marks and pounds to the West instead of providing for investment in business activities in Russla to create jobs for the Russian people are indefensible.

But, it would be folly to isolate or walk away from Russia. The stakes are too high, for them and us.

In this unprecedented circumstance, I believe America should de-emphasize reliance on IMF lending to Russia and lead instead in seeking greater utilization of the other principal international financial institution - the World Bank - in assisting the Russian transition to democracy and free market

Priority should be given to establishing people-centered community banks and credit unions and expanding branches of Western institutions willing to commit to extending credit to legitimate Russian entrepreneurs or outside investors who bring jobs and technology to Russia.

Opening Statement: Spencer Bachus Russian Money Laundering

We in Congress have an obligation to make sure that U.S. taxpayer money is not wasted. These hearings are designed to help answer some of the many questions that are being asked about Russian money laundering at American banks, about possible misuse of IMF funds, and about wide-spread corruption in Russian businesses and government.

It is imperative that we find the right answers to these problems, because it is in our vital national interest that Russia not fall off the map of legitimate sovereign partners in the global community. The heritage of hundreds of years under corrupt regimes under the Russian Tsars and nearly a hundred years under Communist hegemony have left an enduring mark.

These regimes created an environment that is tolerant and protective of corruption, an all pervasive type of corruption that affects the smallest purchase of a car or appliance, or the most sophisticated million dollar business transaction. Corruption this widespread is only possible when tolerated or protected by the highest levels of enforcement and government officials.

So we should not turn a blind eye to the corruption that is evident in this fledgling democracy. Nor should we give up and leave Russia to drift back into totalitarianism. What we should do is evaluate their mistakes, and ours, to redesign our strategic goals and our methods to reach these goals.

Russia represents a challenge to the belief that democracy and free markets are best suited to serve the needs and uphold the dignity of the human person and society. Though we in America only share a small part of the responsibility, we must do whatever we can to encourage the development of the rule of law, of respect for private property rights, and truly competitive and open markets.

Pon Paul

Opening Statement of Rep. Ron Paul , Hearings on Russian Money Laundering House Committee on Banking and Financial Services September 22, 1999

Chairman Leach, ranking member LaFalce, thank you for holding a hearing so quickly in response to the reports of scandal regarding the Bank of New York and allegations of laundering of International Monetary Fund payments to Russia.

An examination of the objective facts illustrates clearly that our current approach regarding money laundering has failed. It also questions the wisdom of more unfunded government reporting requirements—and attacks on consumer privacy such as the Know Your Customer proposal (still required under the Federal Reserve's compliance manual of the Bank Secrecy Act despite overwhelming public opposition).

Overwhelmed with millions of bank forms required to detect money laundering, U.S. law enforcement officials did not act for months on British leads (initiated by a kidnapping charge) of money laundering at the Bank of New York. The bank did not file any Suspicious Activity Reports on the questionable accounts until after they were notified that the accounts were under law enforcement investigation.

Given that the IMF claims not to know what happened to the money and admits that the Russian central bank lied to them, we should not allow the IMF to hide behind the shallow defense that there is no evidence of wrongdoing. When using taxpayer funds, we must demand a higher standard: IMF, World Bank and U.S. Treasury officials should provide evidence that no public funds were siphoned off and that no officials profited from the conversion of the high-yield Russian GKO bonds into dollars just days before the default or from other public funds.

When Allan Meltzer, head of the congressional commission on the IMF, asked recently whether the use of IMF funds could be traced, Joint Economic Committee staffer Chris Frenze replied that someone "would have to be rather an incompetent criminal to conduct their affairs in such a way that it could be traced." We cannot justify taxpayer money going to an organization with such a lack of accountability.

In the (Russian) St. Petersburg Times ("Skuratov Says IMF Billions Sold on the Sly," September 17, 1999), Russian Prosecutor General Yury Skuratov charged in an interview that the IMF money funded profitable insider trading. He quoted from a memo President Yelstin refused to accept, "An analysis of the Central Bank's use of the account where the IMF stabilization loan was deposited showed that \$4.4 billion was sold from that account between July 23, 1998 and August 17, 1998. Of that money, \$3.9 billion was sold directly to Russian and foreign banks, bypassing the trading session at the Moscow Interbank Currency Exchange." He claimed only \$571 million went to support the ruble.

I am concerned that Treasury Secretary Larry Summers cites Anders Åslund, senior associate at the Carnegie Endowment for International Peace, given his controversial views on the benefits of encouraging bribery! He clearly states in his article "Russia's. Collapse" in the current issue of Foreign Affairs, "As Andrei Shleifer of Harvard and Robert W. Vishny of the University of Chicago have observed, the best way of fighting corruption is encouraging competition in bribery [emphasis added]. August's financial crisis was a logical outcome of the oligarchs' war, as they tried to maintain their high and dubious incomes by any means. In the end, the Russian state could no longer deliver enough cash to satisfy their ravenous appetites. The crash radically reduced the amount of money that could be made on the state--and thus the power of the corrupt businessmen."

George Washington University professor Janine Wedel has warned about the appearance of corruption surrounding Andrei Shleifer heading the Harvard Institute for International Development ("The Harvard Boys Do Russia," the Nation, June 1, 1998) and the effects of collusion in her book Collusion and Collusion: The Strange Case of Western Aid to Eastern Europe 1989-1998. It seems the best course for avoiding any perception problems would be more transparency of the activities of U.S. officials.

Our IMF/Treasury policies are not only a waste of taxpayer dollars, they are often counterproductive. "German officials both in and out of office are infuriated by the manner in which the U.S. Treasury rewrites history to paper over its own colossal blunders mainly to service financial interests on Wall Street," writes Klaus C. Engelen, "American Arrogance" in the current issue of The International Economy. He quotes Jürgen Stark, deputy to the Bundesbank president, as confronting IMF Managing Director Michel Camdessus, "I do not concur with the argument that exceptionally high IMF financing is justified in financial crisis situations with systemic or contagion risks...Starting with the Mexican crisis in 1994/95, [IMF financing policy] might have contributed to moral hazard and encouraged reckless financial behavior, both by the private sector and by governments."

Economists Kurt Schuler and George A. Selgin ("Replacing Potemkin Capitalism: Russia's Need for a Free-Market Financial System, Cato Institute Policy Analysis No. 348, June 7, 1999) point out, "Approaches that do not eliminate Russia's socialist monetary institutions are unlikely to put the monetary system on a sound basis for the long term" and explain that the Russian central bank, one of the world's oldest, directs credit to particular favored firms though the banking system and that past loans to the government served as a drug helping to maintain an unhealthy system. We need to stop funding socialist institutions impeding economic growth and not "encourage competition in bribery."

I agree with the Investor's Business Daily editorial on September 1, 1999, "Get Rid Of The IMF," when they said, "The only way to stop [the IMF] from sucking up scarce resources to waste on favored nations is to end it. Some in Washington advocate reforming the IMF. But it's useless to reform an outfit with such a poor record. Abolish it now." Passage of HR 1147, the Bretton Woods Sunset act is important and urgently needed as the best way to prevent more corruption.

EDITORIALS

Get Rid Of The IMF

ord that cash from the International Monetary Fund's bailout might be part of the Russian money-laundering scheme has put fund officials on the defensive. They should be. The IMF has long outlived its usefulness and should be abolished.

It's hard to defend the IMF's record. It has wrecked economies. It's propped up thugs who get their hands on its loan. It spotices have toppled governments. All in the name of sound currency and fiscal policies.

We're now learning the IMF's economic analyses are anything but sound. In fact, it seems the IMF cooks the numbers when it wants to make loass.

A new report from the Heritage Foundation shows that the IMF has overestimated growth in developing nations for the last 27 straight years. Is the fund being optimistic because it presumes its interventions will help the economies in those countries?

The Heritage report concludes that it is. It notes that the size of the errors grows as the degree of IMF aid increases. For every additional \$1 billion in aid to a Western Hemisphere recipient, its forecast error increased by 0.17 percentage point.

Errors were similar in African and Asian forecasts.

Why would the IMF do that? Well, its forecasts have a large impact on its funding. As long as fund officials can cowince lawmakers in its member nations that its ballouts will work, it can rake in the cash — \$18 billion last year from the U.S., the largest contributor. Indeed, why would any country fund a program that would have little to ao beneficial effect?

And then what would those highly paid international bureaucrats do when their raison of etre ceases to exist? Yes, the IMF has a strong incentive to make promising forecasts. For a real-time example, look at Russia. Just last Sunday the IMF said Russia's economy "is better than expected." The pronouncement came a month ahead of the next \$640 million payment of a \$4.5 billion IMF bailout of the Russian economy, is the IMF embellishing for the sake of the next payment?

Surely, it is. The Russian economy has been repeatedly bailed out. The IMF alone has doled out \$20 billion to Russia over the last seven years.

Yet the economy has retreated every year of the last 10, except 1997, when it grew by 0.4%.

It doesn't look like it's going to getter. Ar much as \$10 billion illegally leaves the country every year. Though it has outwardly cast off communism. Russia hasn't made the transition to a market economy. It's crippled mobaters, corrupt bureauerasts and an inept industrial sector still controlled by central planners.

Rep. Jim Leach, R-Iowa, chairman of the House Banking and Financial Services Committee, says Russia "appears to be an anarchist kleptocracy" that has "no hope of economic progress unless the social plundering is halted."

Russia isn't the only country charged with misappropriating IMF cash. Critics have long said large portions of the fund's bailouts are never used as intended. Instead, the aid ends up in the hands of criminals and the politically connected (in many countries, these two are synonomous).

So it's not surprising that the \$10

billion Russian laundering scandal that surfaced two weeks ago is said to include IMF bailout money.

Fund officials have — predictably — denied it. But their record chewhere is abysmal, lan Vasquez at the Cato Institute says dozens of countries have been receiving IMF aid for decades. Their economies never improve as they subsist year to year on one fund loan after another.

Loan addicts, Vasquez calls them.

The IMF was established in 1944 to possible the international fixed exchange rate system. That collapsed in 1971 and was replaced with a floating-rate method. For nearly 25 years the IMF provided advice to its member countries and made relatively small loans to economically troubled countries.

By 1995, though, it had completed its transition to an international Santa Claus, its toy sack bulging with bailouts.

Clearly, the IMF has outlived its usefulness. It has little accountability. It deals in secret. Its bailouts tell cowboy investors that there's no risk involved in bad decisions. And its view of proper fiscal policies sends economies further on the path to ruin.

If the IMF were a private lender, it would have failed by now. The only way to stop it from sucking up scarce resources to waste on favored nations it to end it. Some in Washington advocate reforming the IMF. But it's useless to reform an outfit with such a poor record. Abolish it now.

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News from Russia in English —

BUSINESS

Skuratov Says IMF Billions Sold on the Sly

By Natalya Shulyakovskaya STAFF WRITER Photo by Igor Tabakov

MOSCOW - Almost \$4 billion of last year's IMF bailout went straight back out of Russia and into the now famous Bank of New York as the Central Bank sold dollars to banks eager to flee the doomed treasury bill market, Russia's suspended prosecutor general told The St. Petersburg Times.

And that money was sold directly to those banks, bypassing the currency markets, Prosecutor General Yury Skuratov said in an interview Monday.



Last July, the International Monetary Fund put together a \$22.6 billion bailout package aimed at restoring confidence in the Russian economy.

Skuratov's revelations make it clearer than ever that most of that money instead went to bail out a handful of well-connected banks as they fled Russia's ill-fated market for ruble-denominated short-term treasury bills, known as GKOs.

In a memo that Skuratov prepared for President Boris Yeltsin but was never able to submit to him, he detailed where much of the IMF's \$4.8 billion first installment - sent to Russia on July 23, 1998 - went during the hectic 25 days that were left before Moscow's financial armageddon.

"An analysis of the Central Bank's use of the account where the IMF stabilization loan was deposited showed that \$4.4 billion was sold from that account between July 23, 1998 and Aug. 17, 1998. Of that money, \$3.9 billion was sold directly to Russian and foreign banks, bypassing the trading session at the Moscow Interbank Currency Exchange. And only \$471 million went to support the ruble exchange rate on MICEX. Another \$100 million went for intervention on other (currency) exchanges."

That \$3.9 billion was used by 18 large banks to convert their GKOs into dollars just days before Russia defaulted on the short term bonds - which had been paying yields as high as 200 percent, he said.

The banks bought the dollars from the Central Bank with rubles they received from the sale of their GKOs.

And it seems it was shipped out of Russia with the help of the Bank of New York.

"These operations between the correspondent accounts of the Central Bank and these banks were done with the involvement of the Bank of New York," Skuratov said.

The bailout cash in fact never even made it to Russia, Skuratov said.

The money went from the IMF to the Central Bank's U.S. account and then to Russian

banks' Bank of New York accounts, with the Russian banks paying for the dollars by depositing rubles with the Central Bank in Moscow.

The money was sold through special arrangements that the Central Bank had already struck with major banks operating on the Russian market, under which they could purchase hard currency directly from the Central Bank.

"We got an explanation that the deal was justified because it was lifting the pressure from the ruble by satisfying the banks' dollar needs even before they turned to the exchange," Skuratov said.

However, he criticized the Central Bank for selling the IMF bailout cash through those deals.

"I cannot understand why only \$471 million went to support the ruble, and the rest - without even landing in Russia - was sold to commercial banks."

Skuratov was unable to say at what rate the dollars had been sold. However, the PricewaterhouseCoopers report into the Central Bank's use of the July bailout shoes that banks were able to buy dollars from the Central Bank at an average rate of 6.33 during July and August 1998, while the average MICEX rate for the same period was 6.97.

"There was a list of 18 banks, nearly 20. All of our major banks were on that list, SBS-Agro was listed as was Uneximbank," Skuratov said. He said he could not reveal the entire list.

The Bank of New York is now the subject of a probe into whether or not some \$4.2 billion to \$10 billion that moved through its accounts between October 1998 and May 1999 included ill-gotten gains being "washed clean" by Russian mobsters.

Investigators' suspicions regarding money coming from Russia were reportedly fueled by a surge in capital flight from that country to the United States in the wake of last year's crash, according to a report by The New York Times last month.

The Bank of New York has denied any impropriety regarding its business dealings with Russia. The bank, one of America's oldest and largest, had built a dominant position in servicing Russian customers wanting to do business in or through the United States.

Skuratov opened an investigation last September into the Central Bank's role in the August financial crash. That investigation was one of several that have ground to a halt since the Krem lin succeeded in effectively pushing the Prosecutor General out of office earlier this year.

He first submitted his resignation Feb. 1, after a meeting with then-head of the presidential administration Nikolai Bordyuzha, Skuratov said.

Bordyuzha pressured him at that meeting to stop his investigations into Swiss-based contractor Mabetex, he added.

Mabetex has since become the center of a wave of allegations that top Kremlin figures - including Yeltsin, his two daughters, and the head of the presidential administration, Pavel Borodin - accepted bribes from the firm in return for lucrative contracts to help renovate the Kremlin palaces.

When he first began investigating Mabetex, Skuratov kept the probe secret. Only he and one other investigator at the Prosecutor General's Office knew about the probe. He declined to identify that investigator.

The first person that he informed outside of his own office was Yevgeny Primakov. Skuratov went to Primakov soon after he was appointed prime minister last fall. Soon after he was confirmed by the State Duma, Primakov had declared a tough stand on corruption.

Regarding the investigation into the IMF money, one major question left unanswered was whether or not the flood of cash be had traced as far as New York had been the result of insider trading on GKOs, Skuratov said.

"Some of those individuals who got rid of their GKOs right before the August financial crisis turned their GKOs into hard currency and funneled it to the Bank of New York," he said.

Earlier this month, Skuratov said that former First Deputy Prime Minister Anatoly Chubais was among 780 former and current officials under investigation on suspicion of insider trading in GKOs.

Chubais has denied ever using inside knowledge to trade GKOs. Furthermore, he has said that he only ever traded in the debt instruments when he was a private citizen and that he in fact lost money on his GKO holdings.

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Congresswoman Marge Roukema

Fifth District — New Jersey

2469 Rayburn House Office Building Washington, D.C. 20515

(202) 225-4465 September 22, 1999

Roukema Statement on Russian Money Laundering

Following is the opening statement of House Financial Institutions Committee Chairwoman Marge Roukema, R-N.J.-5th, as prepared for delivery at today's Banking Committee hearing on Russian money laundering.

First of all, I want to apologize for missing most of the first day of these very important hearings on money laundering. I was only able to hear the third panel yesterday, due to my late arrival from New Jersey.

As many of you know, Hurricane Floyd caused significant flooding damage in northern New Jersey. I, along with Governor Whitman, met with the administrator of FEMA on Tuesday morning to survey the flood damage in my congressional district. Unfortunately the damage which has been suffered in Bergen and Sussex Counties is quite extensive.

Money laundering is a serious problem which demands our attention. I held two days of hearings on money laundering in April. Based on those hearings — as well as recent prese reports — I am convinced our money laundering laws need to be tightened up. I have proposed H.R. 240 — the Bulk Cash Smuggling Act of 1999, which would criminalize the large and growing problem of billions of dollars being smuggled into and out of the United States every year. In addition, I am proud to have cosponsored the Foreign Money Laundering Deterrence and Anticorruption Act, which Mr. Leach dropped in yesterday. That bill will address serious problems: increasing the foreign crimes which are covered by our money laundering laws, prohibiting certain types of offshore banks from operating in the U.S. and requiring disclosure of the identity of foreign account holders. These are important reforms I support strongly.

I will be listening carefully today to our witnesses to determine whether there are other items — such as including securities fraud and tax fraud in the list of foreign crimes covered by our money laundering laws — which should be added to money laundering legislation. In addition, I believe we need to look at making sure that law enforcement has sufficient resources — money, manpower and equipment — to do the job we expect. Adequate funding for the Customs Service and law enforcement agencies to fight money laundering should be examined and in that context we should look at whether the Treasury and Justice Asset Forfeiture Trust Funds should be used.

Mr. Chairman, I am looking forward to hearing from our witnesses. I congratulate you for holding these very important hearings and look forward to helping you and others move money-laundering legislation through the Congress this year. Congresswoman Maxine Waters Statement September 22, 1999 House Banking and Financial Services Committee Bank of New York

Money laundering has become an indispensable element of drug trafficking and other criminal activities as organized crime has expanded its economic influence both domestically and internationally. According to the United Nation's 1999 Human Development Report, the world's organized criminals have a greater economic output than all but three of the world's national economies. The increase in drug profits is due largely to the ability of drug traffickers to launder large sums of money between continents through our financial institutions.

Money laundering provides drug traffickers with the ability to "cleanse" monetary proceeds obtained through illegal activities into funds with a seemingly legal source. It is the means through which criminals are able to disguise assets and use them without detection of the illegal activity that produced them.

According to a 1998 report by the Financial Crimes Enforcement Network, drug profits have injected an estimated \$100 billion into the financial systems of the United States. Additionally, money laundering is a way for drug dealers to manipulate the financial systems of the global market in an effort to help continue their illicit activities. My concern today is with the reporting regulations required by current anti-money laundering laws and why these laws did not prevent the monumental money laundering that took place at the Bank of New York.

Several laws currently exist to address the problems of money laundering. The Bank Secrecy Act of 1970 "imposes recordkeeping and reporting requirements on financial institutions in order to supply law enforcement with evidence of financial transactions."

The Money Laundering Control Act of 1986 strengthens the Bank Secrecy Act requirements by creating criminal liability for individuals who conduct monetary transactions knowing, or with reason to know, that the proceeds involved were obtained from unlawful activity.

The Money Laundering Suppression Act of 1994, which amended the Bank Secrecy Act, mandates a liberalization of the "rules for exemption of transactions from the currency transaction reporting requirement, in an effort to reduce the number of Currency Transaction Report (CTR) forms filed by at least 30%. Additionally, The Money Laundering Suppression Act allows the Department of Treasury to determine which agency will be the sole entity to receive reports of suspicious transactions from financial institutions. These laws have not been able to address the evolving and complex problems that money laundering and drug trafficking present.

A recent article in the <u>Wall Street Journal</u> titled "Prosecution Faces Hurdles in Bank Case" highlights the need for stronger anti-money laundering laws. The story details the events in the Bank of New York money laundering case but it also points to the case of Raul Salinas and Citibank.

The story states that, "an investigation into Citigroup Inc's Citibank unit's handling of accounts by...Raul Salinas has languished for nearly four years. Citibank, which helped Mr. Salinas move tens of millions of dollars out of Mexico, hasn't been charged with any crime and has denied wrongdoing."

Raul Salinas, a convicted criminal, used a United States financial institution to launder huge drug profits and both he and the financial institution have escaped prosecution in the United States. The same can be said for Semyon Mogilovich, a reported drug trafficker and money launderer whose illegal profits flowed into the United States, and the Bank of New York.



Department of Justice

STATEMENT

OF

JAMES K. ROBINSON
ASSISTANT ATTORNEY GENERAL

CRIMINAL DIVISION

BEFORE THE

COMMITTEE ON BANKING AND FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

THE NATURE AND THREAT OF RUSSIAN ORGANIZED CRIME

PRESENTED ON

SEPTEMBER 22, 1999

GO 7

Testimony of James Robinson

September 22, 1999

Chairman Leach, Ranking Member LaFalce, members of the Committee, thank you for the opportunity to discuss the nature and scope of the threat posed by Russian organized crime groups and the steps that the Department of Justice is taking to combat that threat. This morning I intend to give a brief overview of the problem of organized crime in the United States emanating from the former Soviet Union and some of the measures on which we in law enforcement have been working to combat international organized crime in general and Russian organized crime in particular. In this context I will discuss, albeit necessarily briefly, some of the allegations that have appeared in the media regarding possible money laundering at the Bank of New York.

Finally, I will close with some suggestions for legislative action which would help us in our continuing efforts to respond to international crime, especially money laundering.

As stated in the Chairman's letter inviting us here today, I know that you are all interested in the recent allegations that have appeared in the press involving possible Russian money laundering at the Bank of New York. However, as the Chairman recognized and agreed with us prior to today's testimony, it would potentially prejudice the criminal investigation to discuss the details of that investigation. While I will try to give you some idea of the structure of that investigation, I will not be able to disclose the details of the investigation or what it has uncovered so far.

Background - Scope of the Problem

The roots of organized crime in Russia reach back to the days of the Soviet Union and even back to Imperial Russia. Among the criminals incarcerated in the vast Soviet prison system,

certain hardened criminals who won the respect and obedience of their fellow inmates were termed "thieves in law." The "thieves in law" formed a loose organization across the criminal element in Russian cities, bound together more by mutual respect than by any rigid organizational structure.

Since the fall of the Soviet Union, Russian criminal groups have become more open and more organized. We have identified several dozen fairly well-organized crime groups operating in Russia and other countries of the former Soviet Union. For convenience I will refer collectively to these groups as "Russian organized crime" although in fact they originate and often operate simultaneously in many countries of the former Soviet bloc. Their activities run the gamut of traditional organized crime activities, from protection rackets to prostitution to white collar fraud to extortion to murder for hire. These groups have a much more hierarchical structure than the thieves in law, with ordinary members assigned to "brigades" whose leaders in turn answer to the bosses of the organization. Some of these groups have hundreds of members.

Russian organized crime groups have seized upon the opportunities offered by Russia's brand of "Wild West" capitalism, and they have in some cases forged close ties with corrupt Russian businessmen. In addition, organized crime groups in Russia have been implicated in the corruption of current and former Russian government officials, a problem that is certainly not unique to Russia but that appears to be a serious problem there. Russian organized crime groups provide corrupt businessmen and government officials with protection, muscle, assassination teams and lines of communication to other groups of criminals, government officials and businessmen. The president's International Crime Control Strategy of May of last year recognized that:

Increasingly powerful organized crime groups in Russia, the other Newly Independent States of the former Soviet Union (NIS), and Central and Eastern Europe have infiltrated many key industries. These syndicates have demonstrated a willingness to use violence, corruption and other illicit tactics to maintain and expand their criminal empires.

I think it is fair to say that organized crime groups in Russia play a direct or indirect role in much of the criminal activity that unfortunately pervades almost all aspects of Russian life and society today.

Russian organized crime is beginning to make itself felt abroad as well. At the present time much of the so-called "Russian" organized crime in the U.S. is being disrupted through our proactive investigations and prosecutions, or is at best organized only at the local level.

However, we are beginning to see evidence that the larger Russian organized crime groups in the former Soviet Union are deliberately extending the scope of their illegal activities to other countries including the United States, as well as to Europe and a variety of offshore money centers.

Of particular interest to today's discussion is the fact that Russian organized crime groups may be playing a role in the massive outflow of capital from the former Soviet Union. Allow me to explain. We know that, since the collapse of the Soviet Union, billions of dollars have flowed out of Russia every year to foreign bank accounts. These outflows resist comprehensive analysis. Some of the activity may result from Russian individuals and businesses sending their legitimate assets abroad for safe keeping, or from their conducting business with western companies and paying for western goods. Neither of these activities are per se illegal under U.S. law. However, this activity could violate Russian currency, tax, or other laws.

Russian organized crime groups play two important roles in this capital flight out of

Russia. First, Russian organized crime groups use western financial institutions to launder the proceeds of their own illegal activities in Russia. Second, we believe that Russian organized crime groups may assist Russian businesses and individuals to move their own assets out of Russia in a manner that evades the scrutiny of Russian law enforcement and tax officials. Both of these forms of activity are extremely dangerous in that they enhance the power of Russian organized crime and weaken the authority of and respect for the law in Russia. Furthermore, the flow into the U.S. and other countries of large amounts of Russian money connected with illegal activities threatens to undermine and/or corrupt financial institutions and markets in these countries. We do not want to become the world's repository of foreign criminal proceeds.

Before I detail our strategy against Russian money laundering and Russian organized crime generally, I would like to make a point about the difficulties that we face in prosecuting Russian organized crime money laundering cases of this sort in the U.S. In order to prove a charge of money laundering under federal law, one of the elements we must allege and prove beyond a reasonable doubt is that at least one of the Specified Unlawful Activities (SUAs) listed in the money laundering statutes, Title 18, United States Code, Sections 1956 and 1957, gave rise to the illegal proceeds. The money laundering statute lists dozens of federal crimes which can serve as the predicate SUA, and we have found the money laundering laws to be powerful tools for attacking organized crime activity occurring within the U.S.

However, only a very limited number of <u>foreign</u> offenses, namely: trafficking in narcotics, murder, kidnaping, robbery, extortion, destruction of property by means of explosives, and fraud against a foreign bank, qualify as SUA's under the money laundering statute. Unless we can prove that the funds in question resulted from one of these very limited list of overseas illegal

activities, we cannot bring U.S. money laundering charges against the people who moved the money into the U.S. So, for example, under current law, we would be precluded from bringing money laundering charges in a situation where a corrupt foreign government official embezzled foreign government funds and laundered them through a U.S. bank. In such situations, of course, we also consider the possibility of bringing other federal charges which may apply to the activity, such as the interstate transportation of stolen property.

As a practical matter, our prosecutions of possible Russian money laundering have also been hampered by the considerable difficulty in obtaining evidence from Russia and other countries that would show these funds to have been generated by the particular offenses specified in the money laundering statutes. This is a continuing problem where we are constantly trying to improve our cooperation with other countries. Despite these difficulties, we continue to investigate vigorously signs of suspicious financial activity in our banks emanating from former Soviet bloc countries.

Strategy

Our strategy in attacking Russian organized crime is embedded in the president's comprehensive International Crime Control Strategy issued in May of 1998. That strategy, in turn, derives from Presidential Decision Directive 42, which designated international organized crime as a threat to national security, and in which the president ordered U.S. law enforcement, diplomatic and intelligence agencies to intensify their international organized crime-fighting efforts. The International Crime Control Strategy sets out eight broad goals, such as countering international financial crime and responding to emerging threats such as high-tech and computer-related crime, and proposes various steps to achieve them, including possible new legislative

provisions.

In the area of international organized crime the Department has worked to consult and coordinate more closely with other agencies, including the Departments of State and Treasury and the intelligence community, to assess the threat posed by particular organized crime groups and develop long-term strategies to combat those groups. One aspect of this cooperation is the writing of the classified comprehensive threat assessment called for in the International Crime Control Strategy, which is the joint product of the intelligence and law enforcement agencies. In general, the Department of Justice has recognized that other organs of the executive branch have extensive experience and a wealth of information on overseas crime and law enforcement issues, and we are moving to take full advantage of this resource.

In addition, the Department and other law enforcement agencies are aggressively expanding our own presence in other countries and building new relationships with foreign governments. U.S. law enforcement officials posted overseas work closely with foreign counterparts to investigate crimes against Americans and American businesses committed overseas. The FBI has 35 overseas offices and is considering establishing several new offices.

To complement the increasing number of U.S. law enforcement personnel overseas, the Department of Justice also is seeking to augment its cadre of overseas attorneys. Their role includes facilitating requests for mutual legal assistance and extradition, providing substantive legal guidance on international law enforcement and treaty matters, and increasing cooperation between U.S. and foreign prosecutors. Currently, the Department has attorneys in Brussels, Paris, Rome, Mexico City, Geneva and London. In addition, the Department has stationed Resident Legal Advisors, who provide training and technical assistance to foreign prosecutors.

judges and police in a number of other countries, including Russia, Ukraine, Latvia and Georgia.

These measures complement an aggressive policy of investigating and prosecuting Russian organized crime activity in the United States. As of December 1998, the FBI alone had approximately 260 pending investigations targeting Russian and Eastern European criminal enterprises. The cases resulting from these investigations are prosecuted by highly experienced prosecutors in the twenty-four Organized Crime Strike Forces attached to U.S. Attorneys Offices around the nation. The Organized Crime and Racketeering Section in the Criminal Division in Washington coordinates both our investigative and prosecution efforts.

Our work in this area has already scored some notable successes, as in the conviction in 1996 on extortion charges in Brooklyn of Vyacheslav Kirillovich Ivankov, at that time the most powerful Russian organized crime leader in the United States. Currently, Organized Crime Strike Forces in every major city from New York and Philadelphia to San Francisco and Los Angeles are engaged in significant Russian organized crime investigations and prosecutions, including the ongoing Bank of New York inquiry. The Ivankov and other recent cases are described in more detail in exhibit A attached to my testimony.

In the past few years we have seen with increasing frequency suspicious financial transactions emanating from the countries of the former Soviet Union, which naturally raise the question of money laundering. The Bank Secrecy Act and the money laundering provisions of the Criminal Code are our major weapons in the war against the laundering of proceeds of organized crime. The three most frequently used statutes are sections 1956 and 1957 of Title 18, and the anti-structuring provision found in § 5324 of Title 31. This latter statute is used to prosecute persons who structure or "smurf" currency into financial institutions in a manner designed to

avoid the filing of a Currency Transaction Report. The numbers of defendants charged under these statutes for the past three years are as follows:

Year	18 USC 1956	18 USC 1957	31 USC 5324
FY1996	1627	341	170
FY1997	1692	344	155
FY1998	1768	321	180

As you can see, over the past three years, the Department of Justice has charged and prosecuted more than 2,000 defendants each year for violations of these money laundering statutes.

Approximately 50 percent of these cases involved the proceeds of drug trafficking. The remainder involve the proceeds of white collar crimes such as health care fraud and telemarketing fraud, as well as the proceeds of organized crime activity such as prostitution, gambling, extortion and interstate transportation of stolen property.

While the Department uses the money laundering statutes to prosecute the movements of illegal proceeds, when we have probable cause we also use our forfeiture statutes to forfeit the proceeds of criminal activity and the property used to facilitate criminal activity. Indeed, because the money launderer is often a fugitive, or a person whose identity remains unknown, an effective way to enforce the money laundering laws is often to confiscate the money.

Before I address the question of additional assistance and legislative proposals that we offer for your consideration as important aids in the fight against Russian organized crime, let me briefly address the ongoing inquiry into possible money laundering transactions at the Bank of New York. In most cases, as you know, the Department faces a number of severe legal restrictions which prevent us from commenting publicly on pending criminal investigations. In

addition, we are sensitive to a number of significant policy considerations which make us extremely reluctant to make any public comment on a case even where we arguably have the legal authority to do so. Among these are the need to protect the identity and safety of witnesses and prevent the subjects of the inquiry from learning the progress of the investigation against them. Premature disclosure of the investigation can cause subjects of the investigation to destroy, alter and manufacture evidence and deter potential witnesses from coming forward. Also present is the need to prevent the unfair damage to reputations that would result if we were to prematurely accuse persons of crimes.

In addition, especially in complex, fast-moving matters, there is the very real danger that any comment that I might make about the investigation on Day 1 may be disproved or significantly altered by new evidence on Day 2. To make matters worse, the new evidence disproving my earlier comment might be obtained through the grand jury or other channels which legally restrict any disclosure of the new information. Under such circumstances, I would be forced to stand idly by while my earlier comment, now proven incorrect by subsequently obtained evidence, continued to contribute to and maintain a false impression in the minds of policymakers and the American public.

With these restrictions in mind, I can tell you that the inquiry into the suspicious transactions at the Bank of New York is being conducted by agents from the FBI's New York office and prosecutors from the U.S. Attorney's Office for the Southern District of New York. Analysts from the Federal Reserve Bank of New York and the Internal Revenue Service are working with the investigative team and are bound by the same nondisclosure rules that bind the prosecutors and FBI agents. This has been and will continue to be a complex and painstaking

investigation. Significant investigative resources have been and will continue to be expended in an effort to ensure that we uncover the full story behind those transactions and bring any merited criminal charges.

Last week, as part of the inquiry, I, other prosecutors and agents, and representatives of the State and Treasury Departments met with a team of Russian law enforcement officials in Washington. We discussed ways to cooperate with each other consistent with applicable law and our respective law enforcement policies and practices, and we agreed on improved procedures for requesting assistance as necessary. As I am sure you realize, given the fact that much of activity giving rise to these transactions occurred in Russia, we have no choice but to request extensive cooperation from the Russians if we are to discover the true facts of this matter. A brief description of the means by which we seek to obtain legal assistance from other countries is attached as exhibit B to my remarks.

Finally, while the inquiry is still in progress, we will be unable to make any definitive statements concerning the facts of the case.

Measures

While we are making great progress in dealing with on Russian organized crime, the laws which we use to wage this effort, particularly in the area of money laundering, are not keeping up with developments in the techniques of international crimes being used by the criminals. With the addition of some new legislative provisions, our efforts in this fight would be much enhanced.

Most of these legislative provisions are contained in a bill that will shortly be submitted to Congress as the Money Laundering Act of 1999. These provisions, among other things, would add additional foreign crimes such as fraud to the list of permissible SUAs for U.S. money

laundering charges, make it easier for federal prosecutors to gain access to foreign business records, and enhance our ability to prosecute money transmitters who knowingly accept criminal proceeds. In this regard, I understand that you, Mr. Chairman, are preparing legislative to achieve many of these objectives. We welcome the tenor of your legislation, as we understand it, and we look forward to working with you on these issues. A more detailed description of the provisions of the Money Laundering Act of 1999 is attached as exhibit C to my testimony.

In addition, last year, the Administration sent to Congress the International Crime Control

Act of 1998, a package of more than 50 new legislative measures to help us fight international

crime and to implement the objectives of the International Crime Control Strategy. The package
included measures that would provide new authority to investigate and punish acts of violence
committed against U.S. nationals abroad; to strengthen our air, land, and sea border security; to
deny safe haven to international criminals; to seize and forfeit the assets of international criminals;
to respond to emerging international crime problems such as international computer crimes; and
to promote global cooperation.

A number of the provisions in the International Crime Control Act were passed by the Senate last year. We plan to resubmit them to Congress again this year as part of the Administration's crime bill, and I would urge the Members here to pass these important and _ much-needed provisions that will give law enforcement the tools we need to fight international crime.

As I have noted, we also are seeking to expand the FBI's Legal Attache program and the stationing overseas of additional Department of Justice attorneys. In many key countries, such as Russia, FBI Legats are stretched very thin and the Justice Department has no operational presence

at all. We feel strongly that additional FBI Legats and Justice Department attorneys would greatly enhance our effective cooperation with those countries. While many U.S. governmental bodies contribute to U.S. law enforcement cooperation with other countries, at the messy day-to-day, operational level, where actual cases are made, there is simply no substitute for "cop to cop" and "prosecutor to prosecutor" links between affected nations. We therefore would ask for your support of these crucial programs.

Mr. Chairman, for many years now the Department has been engaged in the struggle against Russian organized crime, both at home and abroad. We are still in a steep learning curve, and clearly much remains to be done. However I am confident that, with your help, we will strike heavy blows against the power of Russian organized crime wherever it is found and succeed in driving its influence from our shores.

Thank you, I would now welcome the Committee's questions.

Exhibit A

Recent Prosecutions of Russian Organized Crime

- 1. <u>United States v. Vyacheslav Kirillovich Ivankov</u>, prosecuted in the United States District Court for the Eastern District of New York, involved a prosecution of a high ranking organized crime figure who emigrated from Russia to the United States in late 1989. Ivankov was convicted of violating the <u>Hobbs Act</u> in relation to his exploitation of his fearful reputation as an organized crime figure to attempt to extort money from other immigrants from Russia. The facts of the case presented at trial showed that a banker who had taken money from the now defunct Charra bank in Russia for investment in the United States employed Ivankov and his organization to collect more than two million dollars from these immigrants after they had invested the money in losing ventures. Ivankov was sentenced to serve approximately 10 years in prison as a result of his conviction.
- 2. United States v. Alex Mishulovich, et al., being prosecuted in the Northern District of Illinois, involves an allegation that the defendants obtained fraudulent visas to import Latvian women to work as prostitutes in Chicago area strip tease clubs. The defendants are charged with conspiracy, peonage and visa fraud. Two defendants have entered guilty pleas to charges of visa fraud, one defendant is a fugitive and the other two defendants are currently scheduled for trial on November 29, 1999.
- 3. <u>United States v. Oleg Kirillov. et al.</u>, prosecuted in the Southern District of Florida, involved interstate transportation of stolen money and drug trafficking from South America through the United States to Eastern Europe by a Russian organized crime group from Nizhny-Novgorod, Russia. This group, led by Kirillov, had relationships with the Solntsevskaya and other major Russian organized crime groups, as well as Colombian drug gangs. The defendants were convicted of all charges in April 1999 and are awaiting sentencing.
- 4. <u>United States v. Alexander Lushtak</u>, being prosecuted in the Northern District of California, alleges a multi-million dollar investment fraud scheme and the subsequent laundering of nearly two million dollars of the proceeds of that scheme by depositing moneys involved in the fraud in an account at the Bank of New York. The indictment in the case was returned on September 1, 1999. A trial date has not yet been set.
- 5. Operation Gas Gangsters was an investigative project in which a series of ten indictments were returned in the Central District of California resulting in more than 40 convictions of various persons associated with Armenian ethnic organized crime enterprises. The defendants in these various cases participated in a scheme involving evasion of diesel fuel excise taxes. This scheme was first uncovered in prosecutions involving the Colombo LCN family in the 1980's.
 - 6. United States v. Dimitri Gufield, et al., a prosecution being conducted in the Eastern

District of New York, is a RICO case in which kidnaping, prostitution, medicaid fraud, extortion, arson, by members of an organization known as "the Gufield/Kutsenko brigade," is alleged. All of the defendants entered guilty pleas. The leader of the brigade, Dimitri Gufield pled guilty to arson, conspiracy to extort and the use of violence in aid of racketeering. Sentencing has not yet been set, but preliminary sentencing guidelines calculations indicate lengthy prison sentences ranging up to twenty years in prison.

- 7. <u>United States v. Dominick Dionisio. et al.</u>, is a case being prosecuted in the Eastern District of New York, in which two persons alleged to be associated with the Colombo family of La Cosa Nostra and an alleged member of the "Bor" Russian organized crime group are alleged to have operated a multi-million dollar investment fraud and to have laundered the proceeds of the scheme. The indictment was returned in June 1999, but no trial date has yet been set.
- 8. <u>United States v. Alexander Spitchenko, et al.</u>, is an ongoing prosecution in the Southern District of New York of members of a Russian organized crime brigade involved in extortion, murder, money laundering, and drug trafficking and controlled by the highest levels of Russian organized crime.

Exhibit B

Obtaining International Mutual Legal Assistance

As in any major investigation with international aspects, it will be essential to obtain swift, effective international cooperation from foreign governments. Right now, there are several legal mechanisms through which the United States may seek mutual legal assistance in criminal matters from a foreign country. Three such legal tools that are frequently utilized are (1) mutual legal assistance treaties (MLATs), (2) executive agreements, and (3) formal requests pursuant to letters rogatory. In addition, of course, law enforcement agencies can obtain international cooperation through their attaches posted at the various U.S. Embassies overseas, through foreign nations' liaison officer posted to foreign Embassies in Washington, or via INTERPOL.

Mutual Legal Assistance Treaties

Some of the most effective and efficient international cooperation is achieved under a mutual legal assistance treaty (MLAT). Over the past twenty years, the MLAT channel has proven very useful in transnational financial investigations, such as the BCCI investigation, the investigation of Banco Nationale de Lavoro (BNL), and the money laundering aspects of the "Pizza Connection" heroin trafficking case.

The United States currently has MLATs in force with 26 countries, including several foreign countries that may have evidence relevant to Russian money laundering and Russian organized crime. These include Switzerland, Antigua, and the United Kingdom. (A complete list of the 26 MLAT countries is attached hereto). There is no MLAT in force between the U.S. and Russia yet, but an MLAT with Russia was signed on June 17, 1999, and it should be submitted to the Senate for advice and consent soon.

Under the MLATs, each party is obliged to assist the other in the investigation, prosecution, and other proceedings related to criminal matters. Assistance may include taking testimony or statements, obtaining documents or items, serving documents, transferring persons in custody, conducting searches and seizures, assistance in forfeiture proceedings (and in the repatriation of all or part of confiscated assets, in accordance with the laws of the Party having custody over them), and any other assistance not prohibited by the Requested State's laws. MLATs usually provide for assistance without regard to whether the matter under investigation would be a crime in both countries, and are especially helpful in assuring that the evidence produced is in a form that is admissible at trial in the Requesting State.

Typical provisions found in MLATs include: (1) a designation of a "Central Authority" or implementing official, in each State, permitting direct communication between law enforcement communities for purposes of the MLAT; (2) a limited number of agreed bases for denying assistance (e.g., a request related to a political or military offense or a request that would

prejudice the sovereignty, security or similar essential interests of the Requested State), and (3) a description of the form and contents of a request, the manner in which requests shall be executed, and the costs that each side will assume in connection with MLAT matters. The MLATs usually specify clearly upon request, the Requesting State may use or reveal the evidence produced pursuant to MLAT requests only for the purpose for which it was requested.

MLATs have proven to be an especially useful mechanism for processing a large number of requests for law enforcement assistance in complex financial investigations.

Executive Agreements on Mutual Assistance

Another means by which the United States may obtain international legal assistance is via a bilateral executive agreement. As I indicated, there is no MLAT in force with Russia, but there is an Agreement Between the Government of the United States of America and the Government of the Russian Federation on Cooperation in Criminal Law Matters, signed June 30, 1995, which entered into force in February, 1996. This U.S.-Russia Agreement is an interim arrangement that is intended to serve as a legal vehicle for mutual legal assistance until such time as the bilateral MLAT, signed on June 17, 1999, enters into force.

The Agreement somewhat resembles an MLAT, in that it provides for assistance in obtaining evidence in a form admissible at trial. However, the Agreement is much narrower in scope than an MLAT, as the Agreement only applies to nine categories of crime listed in an Annex attached to the Agreement. Russian and U.S. authorities have exchanged diplomatic notes that expand the list of covered offenses to include tax and customs offenses. Once the MLAT enters into force and replaces the Agreement, the offenses for which assistance may be sought will greatly expand to include any offense that is an offense in both the United States and in Russia.

Article 1 of the executive agreement provides that the Central Authority for the United States is the Attorney General and the Central Authority for Russia is the Office of the Procurator General. While the article provides further that the Central Authorities may communicate directly for purposes of the executive agreement, as a practical matter, the Russian authorities have failed to designate and consistently maintain a single point-of-contact with whom U.S. authorities can cooperate. U.S. authorities have brought this to the attention of high-level Russian authorities, who have acknowledged this as a problem and stated that the Procurator General's Office has been considering establishing an office, similar to our Office of International Affairs in the Criminal Division, in order to alleviate this problem and enhance the level of our cooperation.

Currently, there are numerous requests for assistance pending from Russia to the United States, and from the United States to Russia. The majority of the executive agreement requests currently pending involve various fraud offenses and seek such assistance as requests for bank records, company documents, and interviews of witnesses.

Letters rogatory

In the absence of a bilateral treaty or agreement, the United States may seek assistance from a foreign country through submission of a letter rogatory. A letter rogatory essentially is a formal request for legal assistance from a judicial authority in one country to a judicial authority in another country. Typically, letters rogatory are transmitted via the diplomatic channel, which can be a slow and time-consuming process. The Requested State has no obligation to provide assistance, but, as a matter of comity, generally does so if possible under its domestic laws. The letters rogatory process enables us to seek evidence from virtually any country in the world for use in an investigation, trial or proceeding in the U.S.

UNITED STATES MUTUAL LEGAL ASSISTANCE TREATIES (MLATs) - September 17, 1999

MLAT with:	Signed:	Entered into Force: Citation	
			(if any):
Switzerland	May 25, 1973	Jan. 23, 1977	27 UST 2019
Turkey	June 7, 1979	Jan. 1, 1981	32 UST 3111
Netherlands	June 12, 1981	Sept. 15, 1983	TIAS 10734
Italy	Nov. 9, 1982	Nov. 13, 1985	
Canada	March 18, 198		1, 1990
Cayman Islands	July 3, 1986	March 19, 199	0
Bahamas	Aug. 18, 1987	July 18, 1990	
Mexico	Dec. 9, 1987	May 3, 1990	
Argentina	Dec. 4, 1990	Feb. 9, 1994	
Thailand	March 19, 1986	June 10, 1993	
Morocco	Oct. 17, 1983	June 23, 1993	
Spain	Nov. 20, 1990	June 30, 1993	
Uruguay	May 6, 1991	April 15, 1994	
Jamaica	July 7, 1989	July 25, 1995	
Panama	April 11, 1991	Sept. 6, 1995	
Philippines	Nov. 13, 1994	Nov. 22, 1996	
United Kingdom	Jan. 6, 1994	Dec. 2, 1996	
Hungary	Dec. 1, 1994	March 18, 1997	
South Korea	Nov. 23, 1993	May 23, 1997	
Austria	Feb. 23, 1995	August 1, 1998	3
Israel	Jan. 26, 1998	March 25, 1999	
Antigua-Barbuda	Oct. 31, 1996	July 1, 1999	
Lithuania	Jan. 16, 1998	August 25, 1999	
St. Vincent	Jan. 8, 1998	Sept. 8, 1999	
Grenada	May 31, 1996	Sept. 14, 1999	
Poland	July 10, 1996	Sept. 17, 1999	
	•		

The U.S.-Cayman Island MLAT was extended to Anguilla, the British Virgin Islands, and the Turks and Caicos Islands on Nov. 9, 1990, and to Montserrat on April 26, 1991.

Several additional MLATs have been signed but are not yet in force, with:

South Africa	Sept. 16, 1999
Russia	June 17, 1999
Romania	May 26, 1999
Greece	May 26, 1999
France	Dec. 10, 1998
Ukraine	July 22, 1998
Egypt	May 3, 1998
Estonia	April 2, 1998
Czech Republic	Feb. 4, 1998
Brazil	Oct. 14, 1997
Venezuela	Oct. 12, 1997

Sept. 18, 1997 St. Kitts-Nevis Latvia June 13, 1997 April 30, 1997 Australia Hong Kong April 16, 1997 March 13, 1997 Luxembourg Oct. 10, 1996 Dominica St. Lucia April 18, 1996 Trinidad-Tobago March 6, 1996 Barbados Feb. 28, 1996 Org. of American States Jan. 10, 1995

 Org.
 of American States
 Jan. 10, 1995

 Nigeria
 Sept. 9, 1989

 Belgium
 Jan. 28, 1988

 Colombia
 August 20, 1980

BOLDFACE indicates a new treaty approved by the U.S. Senate on October 21, 1998.

Exhibit C

Description of Selected Provisions of The Money Laundering Act of 1999

Stopping the flow of cash drug proceeds out of the United States

- Expand the Bank Secrecy Act to make bulk cash smuggling of amounts exceeding \$10,000 a crime, and provide for confiscation of the smuggled currency as part of the penalty. We believe this is an enormously important provision to the law enforcement community, and will do all possible to work with this Committee to enact this provision.
- Make it an offense for a currency courier, who knows that the money is unlawfully derived, to transport more than \$10,000 in currency in interstate commerce.
- Enhance our ability to prosecute money transmitters who knowingly accept criminal proceeds.
- Enact penalties for violating "geographic targeting orders" that require the filing, in specified geographic areas, of reports by money transmitters and vendors of money orders when cash transactions exceed a threshold amount.

Holding foreign banks and other entities liable

Enact a long-arm statute allowing federal courts to exercise jurisdiction over foreign banks
and other entities that violate the federal money laundering laws by conducting
transactions in the United States so that they may be subject to civil penalties.

Thwarting "black market" transactions

- Require persons who purchase drug dollars on the black market to prove when they
 challenge our attempts to confiscate the money that they were bona fide purchasers for
 value with no reason to know that the dollars were derived from unlawful activity.
- Give federal prosecutors greater access to foreign business records that may be used to trace the money sold in specified circumstances by providing sanctions for those who hide behind the bank secrecy laws of other countries.
- 8. Close a loophole in the federal money laundering statute, 18 U.S.C. § 1956, by making it clear that it applies to both parts of a parallel transaction when one part involves criminal proceeds. For example, if a person sends drug money from account A to account B, and then replenishes account A with the same amount of money from account C, the latter transaction would constitute a money laundering offense.

Confiscating the assets of criminal defendants

- Bar fugitives from contesting confiscation orders unless they surrender on criminal charges.
- Authorize federal courts to order the repatriation of criminal proceeds from abroad, and authorize pre-trial restraint of all property subject to criminal forfeiture.
- Bar incarcerated prisoners from waiting until the statute of limitations has run to file
 challenges to confiscation orders. Prisoners should have to file their challenges within two
 years after the orders are final.

Encouraging cooperation with foreign governments

- 12. Provide for freezing of U.S. assets of defendants who have been arrested in a foreign country, and for the confiscation of the proceeds of specified foreign crimes under federal law.
- 13. Create a procedure for enforcing foreign confiscation orders against the property of foreign criminals when the property is found in the United States.
- 14. Make it a crime to launder the proceeds of additional specified foreign crimes in the United States.
- Authorize the sharing of confiscated property with co-operating foreign governments in cases where that authority does not currently exist.

Testimony of

Thomas A. Renyi
Chairman of the Board and Chief Executive Officer
The Bank of New York Company, Inc.

before the House Committee on Banking and Financial Services

September 22, 1999

Mr. Chairman, Congressman La Falce, members of the Committee: My name is Tom Renyi. I am Chairman of the Board and Chief Executive Officer of The Bank of New York Company.

I appreciate the opportunity to testify before the House Banking Committee on behalf of The Bank of New York. We are the nation's oldest bank, founded in 1784 by the same man who established and first headed the United States Treasury, Alexander Hamilton. Our business today focuses on providing services to the global financial services sector. We are one of the leading correspondent banks for commercial banks around the world. We provide corporate and retail services in our home market, as well as a variety of other trust and investment services. The Bank of New York has consistently produced earnings that rank among the best in our industry, while maintaining a culture and reputation of prudence and responsibility over our 215 year history.

You can therefore imagine how dismayed I have been by the suggestions in the press that The Bank of New York has been involved in, or been used as a vehicle for, money laundering or other illicit activities. Let me set the record straight at the outset. No charges have been filed against The Bank of New York. No relevant authorities have asserted that The Bank of New York has engaged in money laundering or violated any other law. Neither the Bank nor any of its customers have lost any money as a result of the activities in question. We have cooperated fully with the ongoing investigations being conducted by numerous US and foreign law

enforcement agencies and bank regulatory authorities. We have provided these authorities with tens of thousands of documents and millions of electronic bits of information. We continue to cooperate with these investigations, which are not yet complete and remain highly confidential. Our commitment is to continue to participate fully in these investigations until they are completed. But, as you can understand, there are limits to what we can disclose prior to the completion of the investigation.

In my testimony, I would like to address three broad questions relating to our inquiry into possible misuse of the international funds transfer system: First, what were the events that actually took place, and how did they take place? Second, what have we done as a result of these events and the subsequent inquiry? And third, what else might be done, by entities or groups with a scope and mandate broader than our own? In the course of this discussion, Mr. Chairman, I will address in some detail the six specific topics relating to procedures, actions and relationships of The Bank of New York that you raised in your letter inviting me to appear before you today.

What took place and how?

Press accounts have tended to ignore The Bank of New York's cooperation with investigating agencies here and abroad. Although, Mr. Chairman, there are limits to what I can say about these investigations because of their ongoing nature, let me try to describe what I can. The Bank learned of these investigations a year ago, in September 1998. When we requested the U.S. Attorney's permission to close the accounts they were monitoring, we were asked to keep the accounts open; to advise no one, other than our bank regulators, about the investigations; and to take no action that would compromise the confidentiality of the investigations. We did all these things. It was our commitment then, and remains our commitment now, to cooperate fully with all law enforcement efforts.

Issue (4) in your letter of invitation deals with the opening of these accounts. As I said before, the Bank's internal investigation is still in its early stages, so I am not in a position to make final or definitive statements about every aspect of these accounts. What we have learned about these accounts is this: When opened, the accounts were quite normal. The principal

accounts were opened at a New York City branch of the Bank by Peter Berlin, a New Jersey resident who became a US citizen in 1996, and who represented himself as operating small businesses in the New York City metropolitan area. The accounts were referred by an officer of the Bank, Lucy Edwards, Mr. Berlin's wife. The initial history of the accounts was unremarkable, and account activity was consistent with a modest business.

However, the volume of funds moving through these accounts increased to levels well beyond what would have been expected for businesses of this kind. When Bank employees noticed the increased volume, questions were asked within the Bank about Mr. Berlin and his companies. But the questions were not pursued with sufficient vigor or follow-through, and the questioners relied too heavily on the fact that Mr. Berlin was married to a well-regarded Bank officer, Lucy Edwards, who had referred the accounts.

Allowing these accounts to remain open and active without sufficient questioning was a lapse on the part of the Bank. I have taken personal responsibility for implementing remedial actions. I will describe these later in my testimony.

From a broader perspective, the questions of how these accounts operated extend to our business presence in Russia and to the nature of the global funds transfer system. The Bank of New York has done business in Russia since 1922, when Irving Trust, which we later acquired, opened an account for Vnesheconomobank, the Bank for Foreign Economic Affairs of the USSR. With the collapse of the Soviet Union in 1991, a new banking system began to emerge in Russia. Responding to public and private initiatives and encouragement to "bring Russia west," we – and many of our nation's other leading commercial and investment banks – were asked to aid the development of this system, in our case focusing on the development of the infrastructure for the Russian capital markets, where our expertise in funds transfer and American Depositary Receipts was pertinent. We committed Bank personnel and resources to planning committees, training sessions, technological discussions and the like with Russian banking executives and personnel.

The business role we chose for ourselves in Russia was similar to what we do in many other countries: Correspondent banking and securities processing activities, bank-to-bank business, that generates stable, predictable fees with relatively low risk and capital exposure. These businesses include funds transfer, cash-collateralized confirmations of letters of credit, handling of collections, acceptance of deposits and the extension of limited credit to the Russian banking system out of the New York office.

We have no branches or bank subsidiaries in Russia, just one office that employs five people who perform administrative functions. We take no deposits in Russia. We extend no credit in Russia. Here in the US, we are a leading depositary for American Depositary Receipts for Russian companies, as we are for many countries around the world. This is a record-keeping and processing function. The Bank of New York does not underwrite, invest in, or sell Russian securities.

Issue (2) in your letter of invitation deals with our practices and procedures when establishing correspondent bank relationships. The Bank of New York employs the following procedure for opening correspondent relationships with foreign banks. All new relationships must be sponsored by a Bank of New York relationship manager who works in the department that is responsible for the correspondent bank's home country. Before an account is opened, the relationship manager must have a written request from the prospective correspondent bank, develop a list of other correspondent bank references around the world, and meet with the bank on its premises. The prospective correspondent must submit financial statements and other regulatory filings. The relationship manager must secure a reference from two existing Bank of New York correspondent banks.

A related issue, issue (5) in your letter of invitation, addresses The Bank of New York's relationship to the American Depositary Receipts of Inkombank and Bank Menatep. As you may be aware, The Bank of New York is the world's leading ADR bank, and our services for these two banks were basically the same as our services for approximately 1300 other companies around the world. As previously stated, The Bank of New York did not underwrite, invest in, sell or assist any other entity in selling shares or ADRs for these Russian companies. The Bank

acts as the Depositary bank, fulfilling administrative functions dealing with the legal transfer and registry of ownership of these securities.

The ADRs sponsored by Inkombank and Bank Menatep were issued against shares already trading in their home market. Although our role was limited to an administrative function and therefore did not involve underwriter's due diligence, we met with the banks' principal executives and their U.S. counsel. Both banks sought and obtained regulatory approval to offer ADRs in the U.S. from Russia's Central Bank. As required by U.S. law, registration statements relating to the ADRs were filed by both banks with the U.S. Securities and Exchange Commission and were declared effective by the Commission. And both banks were required to and provided information to Russia's Central Bank and to the SEC under Rule 12g3-2(b), including Annual Reports and Financial Statements audited under international accounting principles by Big Six accounting firms.

A final business-relationship issue is issue (6) in your letter of invitation, the Bank's relationship with Bruce Rappaport and Inter-Maritime Bank. Mr. Rappaport is a shareholder of The Bank of New York Company, Inc., which is the parent of The Bank of New York.

According to filings with the Securities and Exchange Commission, the last time he owned more than 5% of our stock was 11 years ago in 1988. We believe that he currently owns substantially less than 5%.

The Bank and Mr. Rappaport are co-owners of Bank of New York – Inter-Maritime Bank (BNY-IMB) — a Geneva-based, Swiss bank. The Bank of New York owns 27.9% of this entity. BNY-IMB focuses on private banking and investment management. It is a small institution, with a total staff of 90 people and total assets of CHF 266 million. The Bank has a traditional correspondent banking relationship with BNY-IMB, which includes credit, cash management, custody and clearing services. The Bank of New York has no other commercial relationship with Mr. Rappaport.

Again, our principal business in Russia is in correspondent banking. Satisfying ourselves as to the credit-worthiness and business-worthiness of any correspondent bank, however, does not give us any knowledge as to the identity or activities of their customers. Our correspondent banking businesses involve dollar clearing or the transfer of US dollars through the global payments system. The essential characteristics of this system are its size, its speed and its lack of transparency. I want to focus on these key features of that system, because they help to explain how funds moved into and out of the Berlin accounts, and because they are the source of considerable frustration to anyone who seeks explicit information about the use of these, or any other, accounts.

First, the US dollar payments system is huge – close to a million transactions, with a total value of four trillion dollars, flow between the US dollar accounts of world banks every single day. Some \$1.4 trillion of that daily volume moves through the Federal Reserve System.

Another \$1.4 trillion moves through the Clearing House International Payments System (CHIPS). And \$1.2 trillion moves through "book transfer," often using the Society for Worldwide Interbank Financial Telecommunications (SWIFT), a cooperative system with 6500 members in 178 countries. The system is automated, so that transfers are virtually instantaneous and virtually flawless in their efficient execution. These massive amounts tend to obscure the complexity of individual international transactions. A seemingly routine transaction, a company in New Delhi paying \$5 million for auto parts made by a company in Detroit, can involve as many as five or six banks in several different countries, using a variety of payment systems.

Because of the extraordinary dollar value of the average transaction (approximately \$4 million), errors are costly. To provide the necessary level of efficiency and accuracy, the system is designed to provide the highest possible level of straight-through or automatic processing.

Manual intervention is minimized. This offers greater security at certain levels, because people can be compromised more easily than machines.

However, this system is also opaque, even to the practiced eye. The funds transfers here involve not physical cash or checks, but computer-driven electronic messages. The messages consist of little more than sums, accounts numbers and bank identifiers in digital form and are not intended to and only rarely would provide any reliable indication of the originator or ultimate beneficiary or the intended use of the payment. This is the form that assures the smoothest

functioning of the payment system, because it minimizes errors of misinterpretation of data and instructions.

We and other banks realize the danger that funds transferred through the international payment system could have been illegally obtained or are being illegally diverted. That is why there are safeguards designed to limit access to the system to legitimate financial institutions. These safeguards include membership criteria for such organizations as CHIPS and SWIFT, and the review that should take place before we, or any bank, grants another bank correspondent status and access to the global payment system. Additionally, there are features which we all use to identify transactions that have been blocked by Executive Order. Scanning systems are used to stop and review transactions containing such pre-set identifiers as Cuba and Havana, Baghdad and Iraq. But these scanning systems only work when we have a suspect and some indication of his access to the global system to guide us.

To sum up, the global payments system is excellent at tracking funds flows within its internal electronic pathways; but the system is not very good at all at identifying who controls the origination or destination accounts, how they came by the money, or what they plan to do with it.

So we share the frustration of the authorities in these ongoing investigations. In the five weeks that we have been conducting our own investigation, we have examined vast amounts of data – but it is simply not possible for this data to identify the source or legality of any individual transfer of funds. Once a bank grants a customer access to its payments system and, by extension, the US dollar payment system, it is extremely difficult to track the flow of funds or to stop a transaction before it happens.

What have we done about the events and their causes?

Issue (1) cited in your letter of September 2 is The Bank of New York's internal procedures for identifying and reporting suspicious account activity. The Bank has reviewed and revised its program that identifies and reports suspicious funds transfer and money movement transactions. These elements are brought together by the new Anti-Money Laundering

Committee, which reviews unusual customer activity, documents its investigations and recommends appropriate action for the reviewed accounts directly to the Chief Executive Officer of the Bank and to the Board of Directors. These actions include closing of accounts and filing Suspicious Activity Reports. One important aspect of the committee's mission is to address the possibility of an individual within the bank deflecting future questions about unusual account activity.

The Anti-Money Laundering Committee relies upon six automated review systems to analyze accounts for unusual activity, such as excess balance growth, excess fund transfers, transfers to high-risk countries and activity inconsistent with the original stated purpose of the account. The Committee also oversees the Bank's Anti-Money Laundering Training Program, which has provided awareness training for literally thousands of employees who deal with customers or who process customer transactions.

At the foundation of the Bank's program are detailed Anti-Money Laundering Policies and Procedures, including comprehensive Know Your Customer procedures for individual banking units. This entire program has been independently reviewed by a Big Five accounting firm, who found it satisfactory. The firm has made recommendations for further improvement, which the Bank is implementing.

The Bank has in place a state-of-the-art computer-based system (the Atchley System) for monitoring the flow of funds transferred through the Bank. We have been working with outside consultants to take funds transfer monitoring to a higher level – one that examines behavioral patterns to detect abnormal activity. This approach is similar to the behavior-based systems that are used by many credit card issuers to monitor card activity. We have identified such a system, which we are testing for approval and final implementation.

Addressing issue (3) cited in your letter, the improved anti-money laundering program described above is a major element of the Bank's response to the recent allegations. In addition, the Bank has commenced a comprehensive internal investigation into the Berlin-related accounts with the assistance of outside counsel and forensic accountants. Because that investigation is

still in its early stages, it would not be fair or appropriate to report on the findings to date. I will say this, however: our review is a searching one, conducted with fairness to all Bank employees, and I have instructed those conducting the investigation to "let the chips fall where they may." All employees are required to cooperate in the investigation. In two instances where employees refused to meet with our investigators they were promptly terminated. Our investigation determined that the two employees of the Bank, including Ms. Edwards, had also violated our Code of Conduct. The Code of Conduct, which every officer must review and sign annually, is the ethical centerpiece of our Bank's performance. Violations of the Code have never been, nor will they be, tolerated. If other violations or weaknesses are identified in the course of this investigation, or by the investigations being conducted by the authorities, appropriate action will be taken.

What can be done at the public policy level?

My testimony today deals mostly with the actions of a very few individuals and one bank. But the investigations involve many other institutions around the world, and the question of possible misuse of the international funds transfer system is a truly global question. If we are to improve our global system, we must do so through international cooperation. Heightened domestic surveillance in any one country may simply drive would-be wrongdoers to less stringent points of entry into the system.

To do so unilaterally would have the impact of moving trade flows into non-US dollardenominated currencies and their respective payment systems. Thus, any policy action that would reduce the importance and attractiveness of the US dollar as the currency of choice for international trade – and as a reserve currency – would place the United States at a distinct competitive disadvantage in the world economy.

Another policy issue is what the role of US banks should be in establishing correspondent relationships in Russia and other emerging countries where there are concerns about corruption. In this case, if western banks redline Russian banks, the emergence of a modern capitalist economy in Russia will probably be impossible.

We should, as well, determine if and how US foreign policy should address illicit business activity that uses the US dollar payments system. Today, an agency of the US Treasury, the Office of Foreign Assets Control, provides enforcement against economically embargoed countries, including Cuba, Libya and Iraq. OFAC instructions prevent funds transfers through our banks to these nations. Should that approach be applied to money laundering? Should that approach be applied more broadly to include flight capital? Could it be done selectively, without restricting legitimate trade flows?

This leads us to the final policy issue, that of privacy. If we choose to step up surveillance activities, can we do so with appropriate respect for our fellow citizens' right to privacy? We have seen considerable public debate just this year to new Know Your Customer regulations proposed by federal bank regulatory agencies, and also to bank practices that shared customer records with marketing companies. We will need to keep in mind the need for a careful balance between transparency of financial transactions and the right to personal financial privacy.

I believe these are legitimate and important issues that touch on the central themes of these hearings. Yet the broader considerations should not obscure the essential responsibility that we and all the participants in the global payments system have in ensuring its appropriate use. When any financial institution provides access to the system or facilitates its use, it must do everything it can to prevent illicit activity from taking place as a result. And if illicit activity does take place, it must detect it and bring it promptly to the attention of appropriate authorities.

This is our responsibility. On behalf of The Bank of New York, I reaffirm it today.

101 BARCLAY STREET, NEW YORK, N.Y. 10286

JOSEPH M. VELLI SENIOR EXECUTIVE VICE PRESIDENT

November 3, 1999

U.S. House of Representatives Committee on Banking and Financial Services 2129 Rayburn House Office Building Washington, D.C. 20515-6050

Attention: Janice Zanardi

Dear Madam:

After Thomas Renyi's testimony before the House Banking and Financial Services Committee on September 22, 1999, Anthony F. Cole, the Committee's Staff Director, requested that The Bank of New York ("BNY") respond in writing to questions submitted by Congressman Edward Royce. Mr. Cole's letter, which we received on October 14, 1999, posed the following questions:

"In 1996, the Bank of New York assisted a Russian bank called Inkombank in obtaining regulatory approval to sell its shares in the U.S. as American Depositary Receipts (ADRs). At the time, Inkombank was under intense scrutiny for multiple violations of Russian banking rules, and Russian banking regulators had recommended that the bank's operations be curtailed. Inkombank was subsequently declared insolvent. Given Inkombank's well-established pattern of regulatory and legal infractions at the time it sought your assistance, why did the Bank of New York sponsor Inkombank's sale of ADRs on the U.S. exchange? What due diligence did the Bank of New York perform prior to rendering this service to Inkombank?"

Mr. Cole asked that we direct our response to you.

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There are several mistaken assumptions in these questions, which appear to be based on a misunderstanding of the legal framework and process for establishing an ADR facility and BNY's function as an ADR depositary bank. I will address these points first, and then explain the nature and extent of BNY's dealings with Inkombank.

BNY's Role as a Depositary Bank

1. Congressman Royce's questions seem to assume that BNY sold or underwrote in the United States Inkombank's shares, or ADRs representing shares, and was required by U.S. securities laws to conduct underwriters' due diligence in connection with establishing Inkombank's ADR facility. That reflects a misunderstanding of ADRs and the role of a depositary bank issuing ADRs. In its role as a depositary bank, BNY did not act as an underwriter of Inkombank's securities or ADRs and, under U.S. securities laws, had no obligation or practical reason to conduct underwriters' due diligence in connection with establishing Inkombank's ADR facility.

American depositary receipts (or "ADRs") are essentially receipts issued by a depositary, usually a bank, representing the right to receive the securities of non-U.S. companies "deposited" with the depositary bank's custodian in the company's home country. Upon deposit, the depositary bank issues ADRs representing the right to receive the number of securities deposited.

ADRs are simply an alternative way of holding the underlying foreign securities. The advantage of holding ADRs instead of holding the foreign shares directly is that the ADRs are transferable on the books of the U.S. depositary bank, thereby avoiding the substantial mechanical problems and risks of transferring securities on foreign registries. No U.S. investor in Russian ADRs issued by BNY has lost money from any of these risks. While ADRs minimize settlement and custody risks, investors continue to bear the investment risks of the foreign issuer and country.

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The regulatory treatment of ADRs recognizes that U.S. investors can (and do) hold securities of foreign issuers directly in a global custody account or indirectly in ADR form -- a decision based upon such factors as the cost, convenience, and services provided by the U.S. securities market and depositary bank versus those provided by the foreign securities markets and global custodian. ADRs are generally more attractive to U.S. investors because the depositary undertakes (i) to convert dividends paid in foreign currency into U.S. dollars, (ii) to distribute to ADR holders annual reports and other notices from the foreign issuer, and (iii) to exercise voting rights, if any, in accordance with instructions received from ADR holders.

BNY served as the depositary bank that administered Inkombank's ADR program. This was a ministerial, not an underwriting, function, and one in which BNY's role was that of a securities processor. As a depositary for ADRs, BNY plays four administrative roles:

One, as the depositary bank, BNY issues ADRs in the U.S. to or to the order of a depositor delivering shares of a foreign company to a custodian bank located in the company's home country.

<u>Two</u>, upon cancellation of the ADRs, BNY delivers the foreign shares to the depositor or, upon the order of the person canceling the ADRs, releases the shares into the foreign market.

Three, as a transfer agent and registrar, BNY processes ADR transfers and keeps records of the registered ADR holders.

And <u>four</u>, as an administrator, BNY assists foreign companies in establishing and administering ADR programs.

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These functions are essentially the same as the registration and transfer functions BNY performs in its securities processing business, so our ADR systems and procedures are similar to those we employ in our stock transfer agency department for U.S. companies.

We have been conducting our ADR business this way for nearly 80 years, and have issued ADRs representing the securities of more than 1,300 non-U.S. companies in more than 70 countries. Other depositaries conduct their ADR business the same way.

Congressman Royce's questions also appear to assume that (i)
 Inkombank sold its shares in the U.S. in the form of ADRs and (ii) that Inkombank's
 ADRs were traded on a "U.S. exchange." Neither assumption is correct.

Inkombank's ADR program was a so-called "Level I" facility. As a Level I ADR facility, the ADRs were traded in the United States in the "over-the-counter" market. Neither the ADRs nor the underlying Inkombank shares were listed on a U.S. securities exchange or quoted on NASDAQ, and Inkombank was not required to be, and was not, a reporting company under the Securities Exchange Act of 1934 (the "1934 Act"). Because there was never a registered public offering in the U.S. of Inkombank's shares, no due diligence was required under the Securities Act of 1933 (the "1933 Act").

Under the regulatory scheme established by Congress and overseen by the Securities and Exchange Commission (the "SEC"), as well as practices in the ADR market, it was never contemplated or expected that a depositary bank would conduct due diligence in connection with any type of ADR program. And there is no reason it should. Except when an ADR is issued in connection with a public offering, the issuance of an ADR has none of the characteristics of a primary offering of securities and is just a mechanism for secondary trading in foreign securities. An investor's decision to make a secondary market investment in foreign securities relates to the underlying security, not to the ADR. The ADR is merely a receipt entitling the holder to receive the underlying security, like a receipt for baggage or a coat.

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In contrast to Inkombank's Level I ADR facility, an ADR program established in connection with a U.S. public offering by a foreign issuer (i.g., a capital raising transaction) which requires a full 1933 Act registration statement and results in the ADRs trading on a U.S. securities exchange is called a Level III ADR facility. Foreign issuers making an offering of securities in the U.S. capital markets will use U.S. investment bankers, be represented by U.S. counsel and have their financial statements audited by independent public accountants. When an underwriter represents a foreign issuer in a registered Level III ADR offering, the underwriter will be responsible for conducting due diligence within the meaning of U.S. securities laws, and the broker-dealer who solicits U.S. investors to purchase securities in the offering will have to make sure that the security is a suitable investment for its customers. As a depositary bank, BNY serves neither of those roles.

3. Although BNY, in its role as a depositary bank, was not required to conduct underwriters' due diligence on Inkombank, BNY did satisfy itself as to Inkombank's financial standing and that Inkombank was among Russia's leading commercial banks. This point is explained in greater detail below. As part of this process, BNY met with Inkombank's principal executives and its United States counsel. Inkombank sought and obtained regulatory approval from The Central Bank of the Russian Federation (the "Central Bank") to establish an ADR facility in the United States. And, as required by U.S. law, a statement (Form F-6) registering only the ADRs under the 1933 Act was filed with the SEC and declared effective by the SEC. (The short-form F-6 provides no investment information, but merely summarizes the depositary contract information.) To establish its Level I ADR facility Inkombank was not required to file a registration statement (on Form F-1) with respect to its deposited shares underlying the ADRs. Inkombank was required to provide and provided information to Russia's Central Bank and, under 1934 Act Rule 12g3-2(b), to the SEC, including Annual Reports and Financial Statements. Inkombank's financial statements,

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although not required to be, were audited in accordance with international principles, rather than Russian standards. Inkombank was required to provide to the SEC the information required by Rule 12g3-2(b) continuously during the life of its ADR program.

BNY Had Been Closely Following Inkombank's Progress for Years

Before BNY began working on Inkombank's ADR program, BNY employees had satisfied themselves over a period of years as to Inkombank's financial strength and that Inkombank was among Russia's leading commercial banks. BNY had been calling on Inkombank for several years before Inkombank opened a U.S. dollar account in March 1992. And, from time to time, BNY employees called on Inkombank's senior executives in Moscow and Inkombank's executives frequently visited BNY's offices in New York.

Inkombank appointed BNY as depositary for its Level I ADR facility in January 1995. Apart from former state banks, Inkombank was reported to be Russia's largest private bank with 200,000 individual customers, 40,000 corporate customers and 6,000 employees in 50 offices across Russia's 30 regions. And Inkombank's record is replete with a long string of firsts for Russian banks. Inkombank was the first (or one of the first) Russian banks:

- to join the SWIFT payment system permitting it to electronically process international transactions for its clients;
- through which the World Bank granted investment credits to smalland medium-sized businesses as part of the World Bank's structural transformation program in Russia and Eastern Europe;
- to establish a line of credit with the European Bank for Reconstruction and Development ("EBRD");
- to produce audited financial statements prepared in accordance with international accounting standards;

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- authorized by the Central Bank of Russia to establish an ADR facility representing 3% of its share capital;
- to become a principal member of VISA International and Europay International and to launch its own VISA and MasterCards;
- to raise \$20 million in Russia's first unsecured syndicated loan from Western banks.

BNY was not alone in its appraisal of Inkombank. Scores of financial institutions and governments extended credit to Inkombank. The number of governmental agency programs in which Inkombank was involved is one concrete measure of the recognition it had earned among Western institutions:

- United States Department of Agriculture
- U.S. Export-Import Bank
- World Bank
- European Bank for Reconstruction and Development
- Hermes (Germany)
- Eximbank (Hungary)

- Oesterreichische Kontrollbank (importexport bank) (Austria)
- Office Nationale du Ducroire (Belgium)
- Garanti-Instituttet for Eksportkreditt (Norway)

BNY also knew that Inkombank had scores of correspondent banking relationships, including accounts at Bankers Trust, Bank America, Chase Manhattan, and Republic National Bank, and was starting to open representative offices in the principal financial centers around the world. In March 1995, The American Banker reported that Inkombank was finalizing applications for a license it planned to submit to the Federal Reserve Board and New York State Banking Department to open a representative office in New York. (The American Banker, March 31, 1995). And, in September 1995, Inkombank received permission from the Bank of England to open a representative office in the United Kingdom.

Apart from our own dealings with the bank, we were aware that Inkombank had hired a U.S. management consultant firm, McKinsey & Co., to undertake

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a strategic and operational review of the bank and to assist it in developing a corporate strategy. Based on McKinsey's advice, Inkombank began heavily to invest in "state of the art systems and controls" and to reorganize its operations. These were regarded as "significant improvements" and were reflected in banking analysts' assessment of Inkombank's continued strengths. (BankWatch, August 14, 1996).

We were also aware that Inkombank had hired Westdeutsche LandesBank Girozentrale, a German bank, to implement control and integration systems and KPMG, a highly regarded international accounting firm, to audit its books for fiscal years 1993, 1994 and 1995. KPMG's audits for fiscal years 1994 and 1995 were prepared using international auditing standards. For both years, KPMG gave Inkombank qualified opinions because the bank was not yet reporting subsidiaries and affiliates on a consolidated basis and because of deficiencies in the level of its loan loss reserves. Inkombank was also working with Merrill Lynch on longer-term plans to raise capital in the international capital markets.

According to the audited financial statements, Inkombank's net profit more than doubled in 1994, when growth was generally flat for the Russian banking industry. Throughout 1995, Inkombank's fortunes continued to climb. Analysts who followed Russian banks were reporting that during 1995, when 30% of Russia's commercial banks posted losses, Inkombank's financial performance improved. (Capital Market Report, August 1, 1996). In November 1995, the BBC reported that for the first nine months of the year Inkombank reportedly continued to post better-than-average profits, making it the second most profitable bank in Russia. (British Broadcasting Corporation, November 30, 1995; Moscow News, November 24, 1995). By the end of 1995, Inkombank was ranked as one of the world's largest 1,000 banks, with \$2 billion in assets. For 1996, while its profitability was lower, Inkombank still reportedly generated higher earnings than any major bank in Russia.

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BNY's Reaction to Questions Raised by Russian Bank Regulators

During the first half of 1996, the Moscow regional department of Russia's Central Bank conducted a routine examination of Inkombank. According to contemporaneous press accounts, a draft of the preliminary report raised questions about mistakes in "the conduct of [Inkombank's] operations and accounting." (PR Newswire, July 12, 1996). In a statement attributed to the Central Bank's Chairman, these "preliminary conclusions were 'leaked out' before" the Central Bank could consider Inkombank's response. This was followed by rumors that Inkombank was experiencing liquidity problems.

Following the leaks and rumors, the Central Bank issued numerous public statements of confidence in Inkombank. On July 10, 1996, the Central Bank's First Deputy Chairman, Alexandr Khandruev, publicly denounced the liquidity rumors as "false," announced an internal investigation into the source of the leaks, and assured the market that Inkombank was continuing to "fulfill its obligations [to its] clients" and maintained "a solid viability margin." (PR Newswire, July 12, 1996). Central Bank Chairman Sergey Dubinin later publicly stated "that Inkombank's position today is sufficiently stable."

On July 12, 1996, the PR Newswire reported that:

"The final version of the inspection report of the Central Bank presented to Inkombank on July 9, 1996, reads: 'Information presented herewith warrants a conclusion that the Bank is actively controlling liquidity and profitability, ensures high stability of operations and is capable of performing in full its obligations before its depositors and creditors.'

At the same time, the final document contains a number of criticisms related to bookkeeping in Inkombank arising from the differences between Russian and international accounting standards and from contradictions within Russian legislation and

U.S. House of Representatives

regulations. These bookkeeping errors, however, do not affect the Bank's performance."

The report went on to observe that the Main Administration of the Central Bank and Inkombank point out that "since the beginning of 1996, the accounting policy of the Bank has demonstrated improvement and the majority of pre-existing bookkeeping deficiencies have been eliminated." (Id.).

Throughout July 1996, BNY was closely following developments at Inkombank. Employees in our Eastern European Division ("EED") were the principal bank employees directly and continuously in discussions with Inkombank's management about its response to concerns raised in the Central Bank's audit and the press. The BNY employees working on Inkombank's ADR program were kept apprised of these developments and were satisfied with the close monitoring of Inkombank's progress.

The EED employees were provided with copies of the unfolding press coverage of its audit, the Central Bank's statements expressing continued confidence in Inkombank, and Inkombank management's detailed responses to the Central Bank examiners' questions about its operations and accounting practices. This information showed, among other things, that Inkombank's responses to the Central Bank's audit had been reviewed and summarized by KPMG, Inkombank's external auditors.

Inkombank provided BNY with current information about its financial condition, updated through the first half of 1996. Inkombank also provided BNY with a copy of KPMG's letter commenting on management's opinion "that the observations and recommendations set out in the letter of July 15, 1996 to [Inkombank] from the Moscow Main Territorial Department (the "MMTD") of the Central Bank of Russia do not have any effect on the accounts of the Bank as of 31st December 1995 and for the year then ended prepared in accordance with International Accounting Standards" (the "IAS")

U.S. House of Representatives

(emphasis added). Based on its review of the Central Bank's examination report, KPMG concluded that "nothing came to our attention which would have caused us to revise as at 24th March 1996 our audit opinion in the IAS accounts for the year to 31st December 1995."

The Central Bank confirmed that Inkombank's liquidity never fell below statutory minimums, but, rather, had been improving since October 1995. Other independent research analysts reached the same conclusion. Standard & Poor's, the credit rating agency, observed that "[t]he bank survived and has flourished." (S&P, December 1997). BankWatch, which is also an independent credit rating service, also concluded that Inkombank's "liquidity [was] adequate and strengthening though it remains vulnerable. . . ." (BankWatch, August 14, 1996).

BNY's Ongoing Scrutiny of Inkombank's Financial Condition

In 1996, Inkombank had unsecured lines of credit with BNY and a substantial correspondent banking relationship that included funds transfer, trade services, foreign exchange and investment management. Given our exposure to Inkombank, BNY continued to follow developments affecting Inkombank's financial condition. After the events of July 1996, BNY's International Credit Committee was frequently called upon to assess Inkombank's creditworthiness, which included both a risk profile and credit analysis of Inkombank. Based on our continued review of its financial strengths, BNY extended credit to Inkombank time and time again:

- In November 1996, BNY's Credit Committee considered and approved a \$10.6 million commercial line of credit for Inkombank, which was guaranteed by U.S. Eximbank.
- In March 1997, the Credit Committee considered and approved BNY's \$1 million participation in a \$25 million syndicated term loan to Inkombank, which was arranged by Bank Austria and in

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which other Western banks participated. The loan syndication turned out to be oversubscribed, and closed at \$27 million. Inkombank repaid the loan according to its terms at maturity in March 1998.

- In June 1997, the Credit Committee considered and approved

 (i) increasing Inkombank's short-term trade finance facility from
 \$10 to \$15 million; (ii) increasing its foreign exchange limits from
 \$20 to \$30 million; and (iii) extending Inkombank a \$5 million currency deposit line.
- In August 1997, the Credit Committee considered and approved increasing Inkombank's foreign exchange facilities from \$30 to \$50 million.

In our appraisal of Inkombank, BNY also looked to and relied upon the assessment of independent credit rating services, which continued to look upon Inkombank favorably. Some rating agencies covering Russian banks continued to assign favorable credit ratings to Inkombank:*

IBCA Standard & Poor's	BB/B B+

Indeed, Standard & Poor's maintained a B+/Stable credit rating for Inkombank until May 1998, when it put seven Russian banks (including Inkombank) on CreditWatch. In its December 1997 rating analysis, S&P concluded that Inkombank's "risk profile compare[d] favorably with that of its peers" because Inkombank had less related-party exposure; had a superior banking infrastructure; had less equity risk than major rated banks and was more transparent; was less political than its peers; and was the most important retail presence in Russia, after state-owned Sberbank.

At the end of 1996, the Russian Federation was assigned sovereign foreign currency credit ratings of Ba2/Ba3 by Moody's Investor Service.

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Inkombank Was a Victim of Russia's Economic Turmoil.

In establishing its ADR Program, Inkombank was represented by reputable U.S. counsel, Powell, Goldstein, Frazer & Murphy, who had the primary responsibility for satisfying the necessary legal preconditions under the U.S. securities laws for Inkombank's exemption from Exchange Act reporting, provided under Rule 12g3-2(b), by furnishing to the SEC, among other things, copies of Inkombank's Annual Report and Financial Statements. When the SEC was satisfied that Inkombank's information was complete, it notified Inkombank that its 12g3-2(b) exemption was "perfected" and that its Level I ADR could be established. Once the preconditions were satisfied, BNY and Inkombank negotiated the terms of a deposit agreement, the document governing the rights of Inkombank, BNY and the ADR holders, which was submitted to the SEC as part of Inkombank's Form F-6 filing. In the final deposit agreement, BNY and its counsel reflected the SEC staff's comments.

Inkombank was also required to obtain approval from the Central Bank of Russia to establish its Level I ADR program. The Central Bank required that Inkombank provide it with, among other things, proof of the SEC's action. The SEC declared Inkombank's ADR registration statement effective in May 1996, and the Central Bank gave its approval in November 1996 -- well after the Central Bank's audit in July 1996.

In May 1998, when Standard & Poor's put Inkombank and six other
Russian banks on CreditWatch, it forecast that "[a] precipitous drop in the rouble would
spell disaster for the banking system as a whole." In July 1998, S&P lowered its rating
for Inkombank (and for five other Russian banks) from "B+" to "B" because the
economic weakness, which began in October 1997, had intensified. In S&P's words, this
created "risks of a systemic crisis." In August 1998, S&P lowered Inkombank's rating to
"CCC" to "reflect the precipitous deterioration of market conditions in Russia, owing to a
severe confidence crisis, and the drying up of liquidity sources of the Russian banks..."

U.S. House of Representatives

By September 1998, the threat of imminent defaults, from what S&P termed a "profound crisis" in the Russian banking sector due to the "sharp depreciation in the rouble," forced S&P to further lower Inkombank's rating.

Inkombank was bankrupted by the sharp collapse of the Russian rouble that ensued after the currency was devalued in August 1998 and the government defaulted on short-term treasury bills. Inkombank's ultimate demise had nothing to do with events in mid-1996, which were more than two years before the Russian rouble crisis took its toll on Inkombank.

Sincerely yours,

Congressman Edward Royce

cc:

WRITTEN STATEMENT OF REPUBLIC NATIONAL BANK OF NEW YORK

Ву

ANNE T. VITALE Managing Director and Deputy General Counsel

Before

THE COMMITTEE ON BANKING AND FINANCIAL SERVICES

Of

THE U.S. HOUSE OF REPRESENTATIVES

September 22, 1999

Mr. Chairman and Members of the Committee:

On behalf of Republic National Bank of New York, I would like to thank you for inviting me to appear at today's hearing. I am a Managing Director and Deputy General Counsel of Republic, where I have been employed for nine years. As part of my duties at Republic, I am responsible for the development Republic's global anti-money laundering policy. Prior to joining Republic, I served as an Assistant United States Attorney for the Southern District of New York where I prosecuted money laundering, narcotics and organized crime cases.

Republic supports the efforts you have made in discussing how financial institutions can protect themselves from attempts to launder money through the use of the international wire transfer payment system.

Republic is committed to making every effort to ensure that its banks around the world are not being used for illegitimate purposes. I am here to share with you the policies and procedures that Republic has developed in order to achieve that goal with respect to international wire transfer activity.

As a preliminary matter, all international dollar wire transfers, no matter where they originate, must pass through a bank account in the United States. For the most part, such wire transfers pass through the accounts of foreign banks. These foreign banks maintain bank accounts in their own names at banks in the United States. Bank accounts in the name of one financial institution, which are opened at another financial institution, are one aspect of what is commonly referred to as Correspondent Banking.

Correspondent Banking also includes trading activities, credit relationships and other bank to bank activities.

Before a correspondent account is opened at Republic, Republic obtains information about the foreign bank, which is detailed in a seven-page questionnaire, a copy of which I have attached to this statement. The information that Republic obtains includes the names of the owners and managers of the bank; its asset size; the identity of the bank's regulatory supervisor; and a description of the procedures the foreign bank employs to know their customers.

The total volume of U.S. dollar wire transfers processed each day is staggering in terms of both the number of transfers and the dollar amounts. For example, on any given day over 600,000 transfers amounting to over two trillion dollars are processed through U.S. banks each day. Because of such a high volume of activity, it is indeed difficult, if not impossible to review a large proportion of these transfers. The challenge is to develop profiles of suspicious activity and design systems to capture data that falls within the defined parameters.

Republic's system filters out certain transfers and captures patterns of transactions, which meet or exceed selected thresholds. We then apply the combined judgment of the members of our Know Your Customer Committee to determine whether certain activity may be suspicious. Republic is proud of its initiative in developing its wire transfer monitoring system for correspondent banking. We believe that it is unmatched in the industry. As stated in a letter that Republic's Chairman received from the FBI, Republic's Wire Transfer Monitoring System was found to be "highly effective in

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detecting wire transfer patterns indicating possible illegal activity." The FBI letter is attached as an exhibit to this statement.

There are basically two types of wire transfers through correspondent accounts. The first type is a bank to bank transfer in which a foreign bank is making or receiving a payment for its own account, for example to settle a foreign exchange contract with its correspondent bank. There are approximately 92,000 bank to bank wire transfers totaling \$306 billion in an average month at Republic. Republic's examination of bank to bank transfers has not resulted in uncovering any significant pattern of activity that was suggestive of suspicious activity. For this reason, Republic excludes bank to bank transfers from its monitoring program.

The second and more critical type of wire transfer is a third-party transaction in which the foreign bank is making or receiving a payment for the benefit of one of its customers. There are approximately 58,000 third-party customer wire transfers totaling \$65 billion in an average month at Republic. Republic has focused on these third-party wire transfers in its monitoring program.

Commonly, the role of the bank in the United States is an intermediary one. A customer of a foreign bank, ABC Company, has an account at XYZ Foreign Bank. XYZ Foreign Bank has an account at Republic. ABC Company wants to send a wire transfer in the amount of \$1,000,000 to DEF Company, which has an account at USA Bank. USA Bank also has an account at Republic. In this scenario, you have five entities in the flow of funds:

Originator: ABC Company

Originator's Bank: XYZ Foreign Bank

Intermediary Bank: Republic

Beneficiary's Bank: USA Bank

Beneficiary: DEF Company

In this example, Republic does not have the account of either the Originator or the Beneficiary, but rather serves as an intermediary bank. Nonetheless, when the flow of funds between ABC Company and DEF Company is significant in terms of number of transfers and dollar amounts, Republic seeks to capture the data.

In order to produce a report that was manageable size and quantity of information,

Republic set thresholds for the type of activity that is to be captured. After trying various approaches, Republic designed the system to capture the following data:

- Same Originator to Same Beneficiary 3 times a month with Dollar amount greater than or equal to \$500,000
- Same Originator to Different Beneficiaries 10 times a month with Dollar amount greater than or equal to \$500,000
- Different Originators to Same Beneficiary 10 times a month with Dollar amount greater than or equal to \$500,000

It should be noted that there is nothing magical about the number of occurrences or the dollar threshold, which Republic has selected. Indeed, Republic varies these numbers as it continues to monitor its accounts. (See attached exhibit, which more fully describes Republic's wire transfer-monitoring system.)

Once a pattern is identified, Republic checks databases to see if there is public information available about the Originator or Beneficiary that would support the legitimacy of the amounts and pattern of the wire transfers. For example, if Republic

discovered information that established that an Originator was a publicly traded company having business activities consistent with the amounts and geography of the transfer, Republic would document this information and take no further action.

If, however, Republic has not been able to discover anything about the Originator or Beneficiary that would seem to justify the activity and volume, Republic would contact the Originator's or Beneficiary's bank and inquire about the purpose of the transfer. Additionally Republic would inquire about the business in which the parties to the transfer are engaged. If the correspondent bank provides the information, the Know Your Customer Committee would evaluate the explanation and determine whether it sufficed.

In August 1998, the programming generated a monthly report for the wire transfer activity through correspondent banks in July. This report identified the accounts of Republic's correspondent banks, which had patterns of activity that met the thresholds that I have previously described.

In August 1998, as a result of its wire transfer monitoring, Republic discovered that substantial amounts of funds were being transferred from one particular Originator to four Beneficiaries. From the information supplied in the wire transfer message, it appeared that the Originator was a corporation, which had an account at a Russian Bank. The Russian Bank had an account at Republic and the four Beneficiaries had accounts at three other U.S. banks located in New York City. One of the four beneficiaries was Benex, which had an account at Bank of New York. In one month, the total amount of the wire transfers from the common Originator to the four Beneficiaries was approximately \$22 million.

Republic was unable to determine any particulars about the one Originator and four Beneficiaries other than that information on the wire transfers indicated that one beneficiary, Benex, was located at 118-21 Queens Blvd. Forest Hills, New York. After sending an investigator to this address, Republic was unable to confirm that Benex was in fact located there. Republic informed the FBI and other authorities about the wire activity that I have described in August 1998.

Since August 1998, Republic has continued to monitor for patterns of significant activity that may be suspicious. It has reviewed the patterns that are identified by its systems and documents its determinations resulting from its reviews. If Republic is able to obtain information that seems to justify the wire transfer activity, it takes no action. If Republic is not able to obtain such information, it reports the transactions to the appropriate authorities. In some instances, Republic will cease processing transactions that appear suspicious by informing its correspondent bank that it will no longer process such transactions. At other times, Republic has ceased processing transactions with certain offshore havens. In yet other instances, Republic has terminated its relationship with specific correspondent banks.

The decisions that the Know Your Customer Committee makes are by no means infallible. They are based on judgment calls, which I believe are supported by independent factors. They are the result of the Committees best efforts to detect, report and prevent proceeds from suspicious activities from passing through our banks.

In addition to the procedures in effect in the correspondent banking department,

Republic has policies and procedures in place in each of its business areas. Republic has
had a written global corporate Know Your Customer Policy since 1992, which provides

the framework for its anti-money laundering efforts. I have included a copy of that Policy as an exhibit.

I hope that I have conveyed to you the importance that Republic places on its antimoney laundering efforts. In the course of my nine years at Republic, Senior

Management has been committed to prevent the use of its banks as a vehicle to launder the proceeds of illegal activity. The Chairman, Mr. Schlein, and his predecessor, Mr.

Weiner, have been staunch supporters of implementing the Know Your Customer Policy in all departments in all locations. Indeed, their commitment reflects the views of Republic's principal shareholder and founder, Mr. Edmond Safra, who has repeatedly encouraged our efforts and stressed the need for ongoing training in this area. Two years ago, at his initiative, Republic convened a two-day Anti-Money Laundering seminar for 170 of our Senior Private Banking Officers from all Republic locations. Annually we hold training classes for our officers and support personnel. Adherence to Know Your Customer Policy is tested in our audits.

Finally, Republic has a policy of cooperating fully with our regulators, law enforcement, and as you can judge by my presence here, with Congress. I am happy to answer any questions that you have.

ATTACHMENTS TO THE WRITTEN STATEMENT OF REPUBLIC NATIONAL BANK OF NEW YORK

By

ANNE T. VITALE
Managing Director and Deputy General Counsel

Before

THE COMMITTEE ON BANKING AND FINANCIAL SERVICES

Of

THE U.S. HOUSE OF REPRESENTATIVES

September 22, 1999



U.S. Department of Justice

Federal Bureau of Investigation

In Reply, Please Refer e

26 Federal Plaza New York, New York 10278 August 5, 1999

Mr. Dov Schlein Chairman of the Board Republic National Bank 452 Fifth Avenue New York, NY 10018

Dear Mr. Schlein:

I wish to express my sincere appreciation to Anna Vitale, Managing Director and Deputy General Counsel, and Anna Liddy, First Vice President, for their assistance to the New York Office of the Federal Bureau of Investigation in an ongoing major money laundering investigation. This investigation was initiated primarily as a result of Suspicious Activity Reports (SARS) filed by Republic National Bank.

During the course of this investigation, we have found Republic's Wire Transfer Monitoring System (WIMS), which was developed by Ms. Vitale and Ms. Liddy, to be highly effective in detecting wire transfer patterns indicating possible illegal activity. This system can generate reports in various formats tailored to the needs of the investigator, which makes it an effective tool for SAR follow-up investigations.

In summary, the assistance provided by Republic National Bank is much appreciated and we look forward to its cooperation in the future.

Sincerely yours,

> RAYMOND C. KERR, JR. Supervisory Special Agent

Legal Investigative Department Wire Transfer Review Guidelines for International Correspondent Banking

- Generate the Monthly High Profile Pattern Summary report. This report shows correspondent banking accounts having wire transactions meeting any of the following monitoring criteria:
- Originator and Beneficiary patterns with > = 3 transactions and Total Amount > = \$500,000;
- Originator and Beneficiary patterns with only one transaction and Total Amount > = \$500,000;
- Originator or Beneficiary patterns with > = 10 transactions and Total Amount > = \$500,000.

Note: All wire monitoring reports capture only customer (ie: 3rd party) wire transfers. Bank to bank wire transfers are not captured in the reports.

Generate and review the Monthly High Profile Pattern Detail reports for correspondent accounts appearing on the Monthly High Profile Pattern Summary report. These reports include details of the wire transfer patterns, such as transaction date, amount in / amount out, originator, beneficiary, originator's bank, sending bank, intermediary bank, and beneficiary of shark.

<u>Note:</u> Detail pattern reports are reviewed for all correspondent accounts within Russia. NIS Countries, the Baluc States, Asia Pacific, Middle East, and Latin America. Detail pattern reports for correspondent accounts within FATF countries, with the exception of Greece and Turkey, are not reviewed.

- 3. From information provided on the Monthly High Profile Pattern Detail reports determine which party (originator or beneficiary) is a customer of our correspondent bank. Run this party name through Lexis-Nexis and the Internet. If information is obtained, review in conjunction with wire activity patterns to determine if activity makes sense. If no information is obtained, or a determination cannot be made, forward the detail pattern report to the appropriate account officer.
- 4. Account officer will contact our correspondent bank and ask the following questions:
- What is the type of business of the company or source of wealth of an individual?
- Where is the company or individual located?
- · What is the reason for the transfer?

Particular attention is paid to (i) the path of the wire transfer, (ii) transfers involving red flag countries or sensitive locations in the U.S., (iii) transfers involving trading companies, investment companies, and nominee companies, (iv) misspellings of originator and or beneficiary names.

- 5. Explanations for the wire activity patterns are presented weekly at the International Correspondent Banking Know Your Customer Committee meeting. Explanations are either accepted, rejected, or pended. If an explanation is rejected the account may be closed, wire activity involving that particular parry may be suspended, and/or a Suspicious Activity Report filed. An explanation may also be pended by the committee for various reasons, including uncertainty as to nature of business of, for example, an export import company. In these instances the account officer must obtain more specific information from our correspondent bank. If sufficient information is not obtained, the committee may decide to take action as noted above.
 - 6. Originator and Beneficiary patterns with only one transaction and Total Amount >= \$500,000 are not presented to the International Correspondent Banking Know Your Customer Committee unless red flags are apparent, such as (i) a circuitous path. (ii) occurring within a red flag country, or (iii) an unusually large dollar amount. Rather, the originator or beneficiary is placed on an "On Wasch" status. If the originator or beneficiary appears on the Monthly High Profile Pattern Summary report three times within a six month period, the name and associated patterns are given to the account officer to obtain explanation from the correspondent bank. Results are then presented to the International Correspondent Banking Know Your Customer Committees for review.

Originally issued: October 22, 1992 Revised: March, 1998

KNOW YOUR CUSTOMER POLICY STATEMENT

INTRODUCTION

epublic New York Corporation (Republic) has built a solid reputation as a safe and strong banking institution, following conservative banking principles and a fundamental goal of protecting depositors' funds. However, there can be no safety of funds without the safety of the institution itself. In charting Republic's course into the twenty-first century, the board of directors and senior management are dedicated to maintaining Republic's reputation as a premier international banking organization. To this end, we are as concerned about compliance with laws and regulations as we are about profits.

Report Suspicious Activity In today's world, there is an increasing international dimension of organized criminal activity, which threatens financial institutions. Fraudulent schemes, theft, counterfeiting and most particularly, drug dealing and money laundering, weaken the reputation and standing of a financial institution. All efforts must be made to detect and thwart suspicious activity at the earliest stages. Suspicious activity, when discovered, must be reported to senior management, legal counsel, and compliance for appropriate action.

Commitment to Compliance

Republic is strongly committed to preventing the use of its worldwide operations for criminal purposes and to cooperating with appropriate authorities in efforts to stop any person from misusing the banking system. The best way to fulfill this commitment and ensure the safety of the institution is to know our customers, monitor transactions and train all personnel.

Republic has established a strong compliance program that has been approved by the board of directors. This program is to be implemented at all levels and subject to periodic reviews. The board of directors and senior management will be kept abreast of compliance efforts through regular reports by the audit, compliance and legal departments.

Compliance Duties of Each Employee Compliance expectations are to be included in the job descriptions and performance standards of tellers, branch managers, platform employees, lending, account and marketing officers, traders, representative office employees, consultants, operations personnel and management.

This manual is designed to formalize the Know Your Customer policy and procedures for preventing the use of our banks as vehicles for money laundering and for the other illegal activities listed above. Compliance with these corporate policies and procedures is a condition of employment. These practices are mandatory.

Failure to adhere to these principles may result in disciplinary action, diminished compensation or termination of employment.

INTERNATIONAL EFFORTS TO COMBAT MONEY LAUNDERING

The issue of how to prevent individuals from laundering the proceeds of illegal activities through the financial system has attracted substantial attention from legislative authorities, law enforcement agencies, banking regulators and the press in a number of countries.

Throughout the world, nations have enacted laws and regulations which criminalize the laundering of money derived from drug trafficking and other illegal activities. In some countries, legislation has been enacted whereby governments may seize and forfeit assets and property which represent the proceeds of these activities. Numerous regulatory and enforcement measures, as well as reporting requirements, have been implemented or proposed in an effort to limit money laundering. Moreover, the international press has publicized the fact that vast amounts of money emanating from drug trafficking has infiltrated the banking system and has criticized financial institutions for their failure to detect and prevent criminal activity.

Stages of Laundering In response to the focus of the international community, money launderers have become more and more sophisticated in their techniques. Consequently, it is critical for us to understand changing regulatory requirements and sophisticated money laundering schemes as well as to implement effective procedures to know our customers and monitor their transactions. Basically, the money laundering process involves three stages:

- Placement—the physical disposal of cash proceeds derived from illegal activity
- Layering—separating illicit proceeds from their source by creating complex layers of financial transactions designed to hamper the audit trail, disguise the origin of such funds and provide anonymity to their owners
- Integration—placing the laundered proceeds back into the economy in such a way that they re-enter the financial system appearing to be legitimate business funds.

Having identified these stages of the money laundering process, law enforcement agencies and bank regulators require financial institutions to adopt procedures to guard against and, in some countries, report suspicious transactions that occur at each stage.

Liability of Employees Employees and the bank itself are subject to criminal and civil penalties, which include imprisonment, fines, forfeiture of assets, and the revocation of the bank's charter if the bank fails to develop and adhere to policies to know its customers and avoid doing business with individuals involved in illegal activities.

Every employee must be mindful that such criminal liability may be imposed on the individual and the bank if either is willfully blind to suspicious activity or should have known that activity was suspicious. These standards are very strict and may result in both the employee and the bank being fined and/or prosecuted.

This manual contains Republic's policy and procedures, which when followed, will enable us to be duly diligent in preventing the use of our institution for criminal purposes.

OBJECTIVES OF THE KNOW YOUR CUSTOMER POLICY

Identification Procedures The Know Your Customer policy increases the likelihood that the bank is in compliance with established laws and regulations and decreases the likelihood that the bank will become a victim of fraud or illegal activities. Moreover, this policy protects the good name of the bank without interfering with good customer relationships.

First. comprehensive procedures for opening accounts, establishing loan and other business relationships, and conducting transactions with non-account holders must be developed and implemented in each Republic location. Inherent in the procedures is the principle that Republic know the true identity of all customers. including beneficial owners, requesting any of the bank's services. Identification must be verified to prevent establishment of accounts for fictitious beneficiaries.

In addition to knowing the identity of the customer, it is of paramount importance to know the customer's business or professional activities, sources of the customer's income, wealth or assets, and the particular source of the funds which are the subject of transactions at the bank. An additional objective is to enable the financial institution to predict with relative certainty the types of transactions normally expected to be engaged in by a customer.

Second, internal systems must be in place for monitoring transactions which are inconsistent with each customer's transaction profile.

Third, educational programs should be held annually and on an ongoing basis to review the practices of Republic, the laws of the location, and the transactions of customers that may warrant investigation.

Monitoring Procedures

Training Procedures

CUSTOMER

Please note that

banks are the only

customers approved

banknote customer

must have the approval of head office

Approval of head

the division head.

son of the executive

Know Your Customer committee in New

chairman of the board, and chairper-

office management is

defined as the unanimous consent to a

written submission by

management.

for banknote transactions. Any non-bank

The following customers will not be accepted:

- Customers whose character, integrity, or honesty are questionable.
 - Customers whose activities make it impossible to verify the legitimacy of the activities or the funds.
 - Customers who refuse to provide required information or documentation.
 - Customers who are casinos, gambling or wagering entities.
 - Cambios, check cashiers, money changers and money transmitters.
 - Accounts managed by law firms, accountants or brokerage houses for which the identity of the true beneficial owner is not known.
 - Customers who are government officials, who open accounts in jurisdictions outside their home country.

The following customers will only be accepted with the authorization of head office management:

- Customers who deal in production or distribution of arms and other military products.
- Customers who are principals of cambios, check cashing services, and money transmitter services.
- Existing customers who become government officials.

Any exception to this policy must have the explicit approval of head office management.

OTHER CUSTOMER CATEGORIES

York.

Transactions engaged in. by. or for the benefit of countries sanctioned by the U.S. and their Specially Designated Nationals. as well as Specially Designated Narcotics Traffickers as defined by the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) are prohibited.

Revised March, 1998

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PART I -ACCOUNT OPENING REQUIREMENTS

The account opening process is a critical stage of the Know Your Customer policy. No account should be opened without obtaining proper identification information, an understanding of the source of the customer's income, wealth, and legitimacy of his/her business activity, as well as a description of the initial deposit and the expected account activity. All identification information must be verified. Verification is the responsibility of the customer contact officer, representative officer or consultant. All applications must be signed by the officer opening the account and reviewed by the operations department.

No exceptions to account opening procedures will be permitted unless fully documented and approved by the location's senior manager. For locations having various departments, the division, department, or group head must approve any exception. For domestic retail banking, the branch manager must approve any exception. Documentation of the exceptions must be maintained at each location and will be subject to periodic review by audit, compliance and legal departments.

The following Know Your Customer profile information is required for each individual on all accounts (including retail CDs) and for each individual on whose behalf the account is opened.

A). Identification:

- 1. Name and signature
- a) Numbered or designated name accounts will only be accepted in those locations where senior management has approved the practice and head office has concurred.
- b) The identity of the account holder and all identification requirements must be obtained. If the account holder is opening the account on behalf of another individual, the identity of the beneficial owner of the funds must be obtained.
- 2. Date of birth
- 3. Place of birth (if available)

4. - Permanent residence and mailing address of account holder and beneficial owner, if different.

(Post office boxes and third party addresses are unacceptable as

(Post office boxes and third party addresses are unacceptable as a permanent residence except in those jurisdictions where post office boxes are the only address possible.)

5. —Home telephone number and if available fax and telex numbers

Personal Accounts

Any exception to the identification requirements that apply to beneficial owners must be approved by the senior manager of the location and have the unanimous consent to a written submission by the chairman of the board and the chairperson of the executive Know Your Customer committee.

B) Verification of identity, nationality, and residence:

Wairers:

Citizens or residents of the United States establishing accounts at Republic locations outside the United States must sign a form consenting to the waiver of applicable bank secrecy laws.

Tax Matters:

Forms required for tax purposes must be filed according to the laws of the United States and local statutes.

- At least one of the following identification documents must be reviewed for authenticity and expiration and, except for personal retail lanking relationships, a copy must be retained in the file:
- -valid passport (check current status of visa when appropriate)
- -valid official identification card with photograph
- -valid driver's license with photograph
- Verification of passport or official identification card with photograph is mandatory for all non-residents of the country in which the booking unit is located.
- 3. A Republic officer or representative must certify on the copy of the document that he/she has seen the original. This is especially critical when the booking unit has not seen the customer or the document but relies on the representative office or affiliate to send a copy to the booking unit.
- 4. For domestic retail banking relationships, the Republic officer must certify on the signature card that he/she has seen the original.
- Verification of beneficial owners identification is required for accounts in the name of personal holding companies.
- C) Customer's Business and Transaction Activity:
- Nature of customer's business: give name and address of place of business (where applicable), customer's position or rank, office address and telephone number.
- 2. Source of income or wealth if not listed above
- 3. Source and description of account opening funds should be indicated when known. When the account opening deposit is a eash transaction, the source of the funds must be indicated.
- 4. Description of expected account activity (except for personal retail banking relationships)

D) References:

Republic requires references for all new accounts before the account is opened.

For private banking customers, the referring party should be an existing customer, an officer of the booking unit, an affiliate unit. a representative office, or well respected third party, cleared by local senior management.

Form of Account:

- · Form of account must be clearly indicated.
- No omnibus account may be maintained with sub-accounts for the benefit of a third party unless the beneficial owner of the sub-account is listed with the booking unit.
- Trust accounts must comply with the laws of the local jurisdiction and Republic's procedures and be reviewed by the legal or relevant trust department.
- · Powers of Attorney must be executed in compliance with the local jurisdiction and Republic employees must adhere to Republic's standards of conduct and procedures.

The booking unit must

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obtain additional refer-

The information must be reduced to writing by the account officer and include the following information:

- 1. Name of referring party
- 2. Description of the prospective customer's relationship to the referring party
- 3. Statement of how long the referring party has known the customer
- 4. The referring party's description of the customer's occupation or business
- 5. Description of the source of wealth, character, honesty and integrity of the account holder and beneficial owner

If an officer of the booking unit, affiliate, branch, subsidiary, or representative office is the referring party, it must provide a written referral which includes:

- 1. -The above information
- 2. Sufficient information for the booking unit to complete a customer profile and monitor account activity. This should include providing copies of know your customer profiles and other supporting documentation.
- 3. Certification that identification has been seen and copied. A copy of the identification should be provided.
- 4. A description of the customer's current relationship with the affiliate or representative offices
- 5. The purpose of the new account
- 6. A statement of recommendation
- 7. The signature of an authorized individual

party does not know the prospective customer well or the referring party is not well-known to Repub-

For domestic retail banking customers, a bank reference or reference as described above is required. An exception to obtaining a reference letter is made for customers who only have CDs aggregating less than \$100,000. For retail customers wishing to establish CDs over \$100,000, prior approval of the branch manager is required. Subsequently, bank references should be obtained.

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Business Accounts

Principals of businesses should provide evidence of legal status (e.g. sole proprietorship, partnership, incorporation or association) when opening a business account.

For personal holding companies, the names and addresses of beneficial owners and information about the source of the beneficial owners' wealth must be obtained. Identification documents of all beneficial owners of personal holding companies must be verified. Any exception to this requirement must be approved by the senior manager of the location and have the unanimous consent to a written submission by the chairman of the board and the chairperson of the executive know-yourcustomer committee.

In the case of partnerships, the information required for business accounts is required for the partnership, and information required for personal accounts is required for the managing partner(s) and general partners having at least a 20-percent interest.

A) Identification:

For corporate prospects which are not publicly traded, the following information is required:

- 1. Name and address of main office and relevant location(s)
- 2. Telephone number
- 3. Fax and telex numbers where applicable
- 4. Names and titles of officers
- 5. Names of beneficial owners
- 6. Certified articles of incorporation and by-laws (including all amendments). Certification must be by an appropriate government authority.
- 7. Corporate resolution (Republic's form with corporate seal where applicable), partnership agreement or limited liability banking agreement.
- 8. Certificate of good standing (where applicable) of recent vintage from jurisdiction of incorporation and where principal office(s) located
- 9. Extract from commercial registry of recent vintage (where applicable)
- 10. Annual report and/or financial statement (where available)

For corporate prospects which are publicly traded, the following information is required:

- 1. Name and address of main office and relevant location(s)
- 2 Telephone number
- 3. Fax and telex numbers where applicable
- 4. Corporate resolution (Republic's form with corporate seal where applicable)
- 5. Annual financial statement
- B) Customer's Business Activity:
- 1. Description of customer's business activity. For example, information on business type, date started, size of husiness, products sold or services provided and type of customers
- 2. Current banking relationships/customer contact personnel at other banks if available
- 3. Description of expected account activity. If the customer expects

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to have a transaction account having significant cash or wire transfer activity, additional information must be obtained: for example, more detailed information on annual sales and revenues, information on major suppliers or customers to or from whom wire transfers or letters of credit are to be transacted and information on foreign jurisdictions with whom customer expects to transact business.

C) References:

or private banking corporate customers, the referring party should be an existing customer. an officer of the booking unit. an affiliate unit, a representative office. or well respected third party. cleared by local senior management.

The information must be reduced to writing by the account officer and include the following information:

The booking unit must obtain additional references if the referring party does not know the prospect well or the referring party is not well-known to Republic.

- 1. Name of referring party
- 2. Description of the prospective customer's relationship to the referring party
- 3. Statement of how long the referring party has known the customer
- 4. The referring party's description of the customer's occupation or business.
- Description of the source of wealth, character, honesty and integrity of the account holder and beneficial owner.

If an officer of the booking unit, affiliate, branch subsidiary, or representative office is the referring party, it must provide a written referral which includes:

- 1. The above information
- Sufficient information for the booking unit to complete a customer profile and monitor account activity. This should include providing copies of know your customer profiles and other supporting documentation.
- Certification that identification has been seen and copied. A copy of the identification should be provided.
- 4. A description of the customer's current relationship with the affiliate or representative offices
- 5. The purpose of the new account
- 6. A statement of recommendation
- 7. The signature of an authorized individual

For domestic retail banking customers, a bank reference or reference as described above is required. An exception to obtaining a reference letter is made for customers who only have CDs aggregating less than \$100,000. For retail customers wishing to establish CDs over \$100,000, prior approval of the branch manager is required. Subsequently, bank references should be obtained.

FOREIGN CORRESPONDENT BANKS Identification/ Ownership

Activity in correspondent bank accounts has been the focus of congressional and law enforcement inquiry and investigation. Therefore, the following information should be obtained and documented in the EPIC system when establishing and updating accounts for banks which are not regulated by the U.S. or where the primary regulator is not the U.S.

- Name. address, telephone and fax numbers, telex address, SWIFT address, etc.
- If the bank or its parent is listed on a major stock exchange.
 list the name of the corporation and the exchange.
- If the bank is owned by a federal or state government, list the country and the government entity through which the bank is owned.
- If the bank is located in a country that is a member of the Financial Action Task Force, list the country.
- · Information regarding bank charter and bank regulator.
- Names of principals/large shareholders with a 10% or more ownership interest.
- · Names and titles of corporate officers.

References

Business Activity

Documentation

The following information should be documented:

- Name of referring party and relationship with Republic.
 - · Other correspondent banking references and accounts.

Description of current and expected transaction activity.

For banks which are not traded on an exchange:

- List of authorized signatures and/or corporate resolution.
- . Articles of incorporation and by-laws and/or banking license.
- Current annual report and/or current financial statement which is no more than two years old.
- For Russia and NIS countries, a copy of the banking license is required.

For banks which are traded on an exchange:

- Current annual report and/or current financial statement which is no more than two years old.
- · List of authorized signatures and/or corporate resolution.
- For Russia and NIS countries, a copy of the banking license is required.

Visitation

An initial visit should be conducted within six months of establishing a new banknote, funds transfer or check clearing relationship. The initial visit should be accelerated if there is a significant increase in client activity or adverse information is received. For banknote clients, subsequent visits should he conducted on an annual hasis. For funds transfer or check clearing clients, subsequent visits should be conducted on a bi-annual basis. Subsequent visits should be accelerated when the nature or size of the relationship and/or activity has changed. Any exception to this requirement must be approved by the senior manager of the location and have the unanimous consent to a written submission by the chairman of the board and the chairperson of the executive know your customer committee.

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Management Assessment/KYC Description

Payable Through Account

DOMESTIC BANKS

Identification/ Ownership

Business Activity

INVESTMENT ADVISORS AND FUNDS

Each customer profile should contain an assessment of the ownership and management and a description of the Know Your Customer practices, policies and procedures of the bank.

Use of a foreign correspondent bank's account by its customers will not be permitted without the approval of head office management. This type of arrangement is commonly referred to as a "payable through account." Approval of head office management is defined as the unanimous consent to a written submission by the division head, chairman of the board and chairperson of the executive Know Your Customer committee in New York.

The following procedures should be implemented when establishing and updating accounts for banks and the primary regulator is the U.S.

- · Name, address, telephone and fax numbers.
- If the bank or its parent is listed on a major stock exchange, list the name of the corporation and the exchange.
- Date of incorporation, bank's rank in the country and primary regulator.
- Names of principals/large shareholders with a 5% or more ownership interest.
- · Names and titles of corporate officers.
- Description of current and expected transaction activity.
- Financial information including current annual report or current annual financial statements.

The following procedures should be implemented when conducting transactions with or on behalf of investment advisors (whether acting on behalf of an individual, group or a fund) and/or funds (including mutual funds, hedge funds, pension funds and the like):

- Prepare Know Your Customer profile for the investment advisor. (KYC profile information for business accounts must be prepared. See pp. 12-13). This should include a description of the KYC procedures employed by the advisor or fund.
- Prepare Know Your Customer profile for any investor having a 20% or greater interest. (KYC profile information for individual or business accounts should be prepared. See pp. 9-13). Any exception to this requirement must be approved by the senior manager of the location and have the unanimous consent to a written submission by the chairman of the board and the chairperson of the executive Know Your Customer committee.
- If a fund is involved, indicate whether the fund is regulated by a government authority. If so, indicate which country or authority regulates the fund.
- · If a fund is involved, indicate the size of the fund.
- A description of the purpose of each account and the expected transaction activity should be obtained. The activity should be reviewed periodically.

CUSTOMER VISITATION POLICY

Introduction to Two Officers

Standards

Reports of Visits

Customer visitation is an essential element of the "Know Your Customer" process. Visits provide the best opportunity to verify and update on an ongoing basis the information provided at the time the account was opened. It is especially important to visit customers at their places of business in order to substantiate the type and volume of business activity and income.

It is also essential that certain customers be introduced to and known by at least two officers of Republic. This is especially important when a referring office or representative introduces an account to a booking unit. Customers have a relationship with Republic, not with an individual officer or representative.

Each location must establish standards as to which accounts must be visited or known to at least two officers. For domestic retail branches, standards will be formulated by branch administration. Frequency of visits should be related to the nature of the account. Whenever there is a significant change in the customer's activity, the account must be referred to and reviewed by the appropriate Know Your Customer committee.

The officer(s) who has visited the customer must write, sign and file a report of the visit. This report should be detailed and constructed to enable an independent third party to determine the quality of the officer's diligence. In addition to including information about the client's portfolio performance and satisfaction with services, the report should include discussions with the customer about KYC related factors (e.g., reasons for increase in account volume, change in ownership, change in pattern of transactions, new business ventures, etc.).

DOCUMENTATION COMPLETION

count is opened on a permanent basis.

officer and the department head. Each booking unit must have a document control unit which will be responsible for ensuring that all documentation is properly completed and executed before an account is opened on a permanent basis.

Responsibility for obtaining documentation lies with the account

Summary Reports

The control unit will prepare monthly summary reports of missing documentation by account officer and circulate such reports to the appropriate account officer(s) and department head(s) and the location's Know Your Customer Committee. All funds will be frozen and no credit or trading facilities will be granted pending completion of documentation except as authorized by the location's senior manager. In jurisdictions where it is not possible to freeze funds, the account should not be opened without complete documentation.

Documentation Exceptions If a documentation exception involving another Republic unit is outstanding for 90 days, the item should no longer be a matter between account officers. The document control unit for the booking location must provide written notification to the document control unit and/or the senior manager of the referring office. The document control unit or the senior of the referring office will be responsible for expediting the follow-up process.

Review of Existing Accounts For existing accounts, the document control unit will conduct a review to determine that proper documentation is in the file. Such a review will begin with the larger corporate transaction accounts and continue through the remaining portfolio. The document control unit will prepare periodic management reports on findings and initiate follow-up efforts to obtain missing documentation.

For domestic retail branches, document control lies with branch management and will be subject to review by Branch Administration as well as periodic audits.

No exceptions will be permitted unless fully documented and approved at the time.

Revised July, 1996

PART II -INTERNAL MONITORING

Know Your Customer Committee Account officers are responsible for reviewing and monitoring their accounts on an ongoing basis. Supervisors are responsible for developing and implementing criteria to ensure that accounts are being properly monitored.

Additionally, each Republic booking location will establish a Know Your Customer Committee. At a minimum, this committee will be comprised of the senior manager, the senior operations officer, the senior compliance officer, and counsel of the location plus department group heads where applicable. In larger units, it may be necessary to have a senior management policy committee as well as other operating committees that actually review accounts. Branch Administration will establish the Know Your Customer Committee for domestic retail branches.

Each office must designate an individual or individuals with adequate time and authority, who will be responsible for ensuring that proper documentation and know your customer profile information is obtained and maintained. This individual or individuals should also be a member of the Know Your Customer Committee.

The committee will meet at least once a month and more frequently as required. Minutes must be maintained and presented to the location's senior manager and available for review on site by internal audit and head office compliance personnel. Minutes must be distributed to all committee members and signed by the chairperson.

The committee will be responsible for coordinating the development and implementation of local procedures and training to ensure adherence with corporate-wide Know Your Customer requirements and respective local laws. In addition, the committee will be responsible for monitoring the location's compliance with these procedures and reviewing significant or unusual customer activity.

Monitoring Accounts

The committee must review the customer database and determine what situations require additional study. For example, the committee should examine:

- prospective new customers making an initial deposit over a threshold amount or requesting transactional activity over a threshold amount.
- accounts with more than "x" number of wire transfers per month or wire transfer activity over a threshold amount,
- accounts with more than "x" number of check transactions per month or check activity over a threshold amount,
- accounts with frequent cash transactions or cash transactions over a threshold amount,
- · accounts reflecting a significant increase in activity,
- accounts in which numerous travellers checks, third party checks, money orders, bank checks, cashier checks or internal transfers have been observed,

- · accounts of non-bank financial institutions.
- accounts where activity may not be commensurate with the nature of the business,
- accounts against which a subpoena or other legal process has been served.

Once an account has been identified for review, the committee must determine whether the account will be:

- · approved for continuation,
- · closed, or
- subject to additional monitoring.

Any decision to close an account for suspicious activity must be reviewed by the location's compiliance officer and counsel in order to determine whether reporting to any regulatory or enforcement agency is warranted.

SUSPICIOUS TRANSACTIONS EXAMPLES

Use of Cash Transactions

Listed below are detailed examples of customer activities which may be suspicious. When any employee becomes aware that a transaction from the list below has occurred and raises suspicion, the employee should report the suspicious or unusual activity to the compliance officer and counsel. Thereafter, the account and related relationships should be reviewed by the Know Your Customer Committee.

- Unusually large cash deposit(s) made by an individual or company whose business activities would normally involve checks and other instruments.
- Substantial increases in cash deposits of any individual or business without apparent cause, especially if such deposits are quickly transferred out of the account to a destination not normally associated with the customer.
- Customers who deposit cash by means of numerous deposit slips so that the total of each deposit is unremarkable, but the total of all such deposits is significant.
- Company accounts whose transactions, both deposits and withdrawals, are denominated by eash rather than the forms of debit and credit normally associated with commercial operations (e.g. checks, Letters of Credit, Bills of Exchange, etc.).
- Customers who constantly deposit cash to cover requests for bankers drafts, money transfers or other negotiable and readily marketable money instruments.
- Customers who seek to exchange large quantities of low denomination currency for those of higher denomination.
- · Frequent exchange of cash into other currencies.
- · Bank branches that have unusually frequent cash transactions.
- · Cash deposits which contain counterfeit notes.
- Customers transferring large sums of money to or from overseas locations with instructions for payment in cash.
- Use of night deposit facilities to make large cash transactions to avoid direct contact with bank staff.
- Cash withdrawals that are inconsistent with legitimate business activity and are designed to break the audit trail.
- · Cash businesses that do not deposit cash.
- Transactions that are consistently below any threshold limit required by law, regulation or Republic policy.

Use of Bank Accounts

- Multiple small deposits into different accounts which are subsequently consolidated into one account.
- Customers who have numerous accounts which involve utteraccount transfers for no apparent husiness reason or which are used to divide large amounts of cash among each of them.
- Any individual or company whose account shows virtually no normal personal banking or business related activities, but is used to receive or disburse large sums which have no obvious purpose or relationship to the account holder and/or his business (e.g. a substantial increase in turnover on an account).
- Reluctance to provide normal information when opening an account or when asked for information about account activity, providing minimal or fictitions information or, when applying to open an account, providing information that is difficult or expensive for the financial institution to verify.
- Customers who appear to have accounts with several institutions in a nearby area and who consolidate those funds before requesting their transfer.
- Depositing large third party checks endorsed in favor of the customer.
- Large cash transactions in a previously dormant/inactive account, or from an account which has just received an unexpected large credit from abroad.
- Customers who together, and simultaneously, use separate tellers to conduct large cash transactions or foreign exchange transactions.
- An increased use of safe deposit facilities and the deposit and withdrawal of sealed packets.
- · Customers avoiding contact with the branch.
- Substantial increases in deposits of cash or negotiable instruments by a professional firm or company using customer accounts or trust accounts, as well as transfers between customer, company and trust accounts.
- Customers who decline to provide information that in normal circumstances would make the customer eligible for credit or for other banking services that would be regarded as valuable.
- An imprudent use of banking facilities, such as maintaining large balances in accounts which pay lower interest rates.
- Large number of unrelated parties making deposits into the same account without an adequate explanation.
- Customers who put husiness receipts directly into or make business dishursements from non-business accounts.

- Accounts that appear to be clearing accounts, having high volume, high velocity, and low, constant, or overdrawn balances.
- Accounts that appear to be part of circle transactions in which funds originate from and are disbursed to the same person or controlled group.
- Customers whose transactions appear to break or confuse the audit trails normally maintained by legitimate businesses.
 - Accounts whose checks appear to have been signed in blank, with the payee, date and amount entered in a different handwriting, ink or type.
 - Purchases of securities to be held by the financial institution in safe custody, which appear inappropriate given the customer's known business or standing.
 - Back-to-back deposit/loan transactions with branches, subsidiaries of, or affiliates of, financial institutions in known drug trafficking areas.
 - Requests by customers for investment management services (either foreign currency or securities) where the source of the funds is unclear or not consistent with the customer's known business or standing.
- · Large or unusual settlements of securities in bearer form.
- Buying and selling of a security with no discernible purpose or in circumstances which appear unusual.
- Customer introduced by a branch, affiliate or other bank based in countries where production or transshipment of drugs or drug trafficking may be prevalent.
- Use of Letters of Credit and other methods of trade finance to move money between countries where such trade is not consistent with the customer's usual business.
- Customers who make regular and large payments. including wire transactions, that cannot be clearly identified as bona fide transactions to. or receive regular and large payments from. countries which are commonly associated with the production. processing or marketing of drugs; proscribed terrorist organizations; or the laundering of money.
- Building up of large balances, not consistent with the known turnover of the customer's business, and subsequent transfer to account(s) held in another country.
- Unexplained electronic fund transfers by customers on an in and out basis or without passing through an account.
- Frequent requests for travelers checks, foreign currency drafts or other negotiable instruments to be issued.

Use of Investment Related Transactions

International Activity

- Frequent deposits of travelers checks, money orders, officer bank checks, third party checks or foreign currency drafts, particularly if originating from another country.
- Customers who request wires to be sent bank to bank, without
 designating the originator or ultimate recipient or who receive a
 significant number of wires which do not show the originator or
 by order of party.
- Incoming wire transfers under instructions to the bank to pay upon proper identification (PUPID).
- Changes in employee characteristics, e.g. lavish life styles or avoiding taking holidays.
- Changes in the performance of employees or agents e.g. the salesman selling products for cash has remarkable or unexpected increase in performance.
- Any dealing with an agent where the identity of the ultimate beneficiary or counterparty is undisclosed.
- Any employee who manages a significant number of accounts in which suspicious transactions occur.
- · Changes in employee's banking activity.
- · Customers who repay problem loans unexpectedly.
- Request to borrow against assets, where the origin of the assets is not known or the assets are inconsistent with the customer's standing.
- Request by a customer for a financial institution to provide or arrange financing where the source of the customer's financial contribution to the deal is unclear, particularly where property is involved.
- Loan proceeds that are disbursed in a manner or to a party that is inconsistent with the stated purpose of the loan.
- · Loans with vague, unclear, or no stated purpose.
- Permanent financing loans with short life spans or short balloon payments.
- Loans that are paid from unknown sources or sources inconsistent with what is known about the loan customer.
- Requests for loans to offshore companies or loans secured by obligations of offshore banks.
- Loan proceeds channeled offshore.
- Loans, whether secured or unsecured, where the customer has no visible means of repayment.
- Loans against property where the proceeds are to be disbursed in another jurisdiction.

Use of Financial Institution Employees and Agents

Secured and Unsecured Lending

Legal Process Served on Accounts

- Cash collateralized loans.
- Loans secured by third parties who have no apparent relationship to the borrower.
- Any account that is the subject of a subpoena, summons, seizure order, or other legal document production request from a government agency.
- Any account which is the subject or a referral to government authorities.
- Any account that is the source or recipient of a significant amount
 of funds relating to an account that is subject of legal process
 from a government agency.
- Any account that is controlled by a signatory on an account that is the subject of legal process from a government agency.

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CASH Since the p

Since the placement of cash is a primary goal of money laundering, cash transactions must be carefully scrutinized.

The most basic problem to the money launderer is to convert large amounts of eash received from unlawful activity into more manageable monetary instruments or other assets, which conceal its illicit origins. Criminal organizations need to convert the cash itself into a more easily transferable and manageable form. In order to complete the money laundering scheme of conrealing the true source and ownership of the proceeds, the illicit proceeds must be laundered without leaving a recognizable audit trail.

Recognizing that large volumes of cash may draw immediate attention to their illegal source, criminals often physically remove the bulk cash from the location of its acquisition and structure transactions into smaller amounts.

Approval of Cash Transactions

TRANSACTIONS

Each Republic location must establish levels of authority for approving cash transactions. Where appropriate, cash receipts may be authorized, but only up to pre-established approval limits.

Approved cash transactions must be consistent with the nature of the customer's relationship with the bank, and must be fully documented so that any future investigation may be accomplished in detail.

The threshold amounts of cash that will be approved may vary from location to location. In no event, however, may cash over the equivalent of U.S.850,000 per customer per transaction be accepted or withdrawn without the approval of the senior manager of the location. The only exception to this rule relates to banknote transactions with approved banking counterparties in those locations at which banknote trading is an approved activity.

Large cash transactions other than deposits and withdrawals should not be allowed. Customers who want to negotiate or purchase non-deposit account transactions, such as loan payments, wire transfers,

CDs, securities, letters of credit must be required to have the transaction occur through an audit-trail account. A cash deposit must be made to an account before a customer may purchase an instrument, make a loan payment, or obtain a letter of credit.

Customer contact personnel may not accept cash from, or deliver cash to, anyone. A customer must deposit cash with, or withdraw cash from, a teller in person.

Any exception to the cash deposit or with-drawal procedure must be approved by the senior manager of the location and have the unanimous consent to a written submission by the chairman of the board and the chairperson of the executive Know Your Customer committee.

Monthly Reports

Each location will forward a monthly cash report to the compliance department in New York. This report will include a listing of all cash transactions over \$55,000. along with a short summary of the reason(s) for the transaction(s). In those jurisdictions that are unable to provide names of clients. a mutually agreeable coded system will be set up so that New York can monitor activity.

If the deposit or withdrawal of \$50,000 or more is made by a customer of another Republic unit, the senior manager will hase approval of the transaction on the documented approval of the senior manager of the customer's local Republic unit.

Cash transactions for non-account holders are permitted only as set forth by procedures developed in each location.

Systems

Systems must be developed in each location to generate reports that capture large cash transactions as well as attempts to structure cash activity to avoid any internal restrictions or to avoid any government reporting requirements.

Revised August, 1995

CHECK

Monitoring Negotieble Instruments Check transactions, while generally less subject to the extreme scrutiny required for cash transactions, must be subjected to some of the same criteria. It is important to distinguish between normal activity and activity which indicates a suspicious transaction. The volume of check activity must be gauged so that it is consistent with the nature of the customer's relationship with the bank, the nature of the customer's husiness, and the bank's guidelines regarding the undesirability of transactional accounts.

Moreover, certain check transactions are inherently suspicious. Third party checks, quantities of cashier checks, travellers checks, money orders, and in some locations, checks which do not indicate the identity of the account holder constitute suspicious transactions.

Transactions involving these types of negotiable instruments must be identified, examined and approved by account officers accepting the transaction. Any suspicious transaction should be immediately reported to the compliance officer.

Customers, especially retail institutions and correspondent financial institutions who accept these checks and clear them through Republic, must be contacted and advised of the dangers inherent in these transactions and their obligation to know their customers. Such accounts should be reviewed to make certain that the businesses do not function as cambios or check cashing services.

Each location must establish a threshold amount of check activity for each department in terms of number of transactions and total currency amount, or combination thereof, that will be reviewed by the Know Your Customer committee.

WIRE

Wire transfers are probably the most important layering method available to money launderers. Wire transfers offer criminals many advantages as they seek to cover their trail. Speed. distance. minimal audit trail. and increased anonymity amid the enormous daily volume of fund transfers are all major benefits.

Monitoring Wire Transfers As with check transactions, the volume of wire activity must be gauged so that it is consistent with the nature of the customer's relationship with the bank and the nature of the customer's business.

If a customer conducts or intends to conduct wire transactions on a regular basis, he or she must be advised that regulations have been enacted in the United States that require U.S. banks to provide specific information on the originator of a wire as well as the ultimate beneficiary of that wire.

Each location or business unit, in conjunction with its Know Your Customer committee, should determine the wire transfer activity over a certain amount and frequency which will be subject to ongoing monitoring by the account officer and Know Your Customer Committee.

COLLATERALIZED

Collateralized loans wherein the collateral is held in one jurisdiction and the loan is made from another serve a legitimate business function and make certain transactions, which may be unacceptable due to credit risk, bankable. However, such loans, when conducted in certain ways have become the preference of money launderees.

Customer contact personnel may not advise customers with regard to advantageous tax structuring or tax avoidance. If a customer has a tax question, he or she must be asked to refer the question to a qualified tax attorney or accountant.

Collateralized loans raise different legal issues depending on the jurisdiction of the loan. Foremost among these issues is propriety and implications of silent guarantees. Unless a jurisdiction specifically permits loans with silent guarantees. Republic will uot grant such loans. In other words, all parties guaranteeing the loan must be officially noted on the books of the unit granting the credit facility.

In those jurisdictions that permit the practice of silent guarantees. a letter opinion from outside counsel to this effect must be sent to head office and kept on file.

In all cases, the Republic location that has the asset guaranteeing the loan must make sure that the Know Your Customer profile is completed in a satisfactory manner and updated annually. Before issuing the guarantee, senior management or a department head of the location having the asset guaranteeing the loan must review the Know Your Customer profile, determine if the request for the loan is consistent with the nature of the customer's business, and tell the location issuing the loan that the Know Your Customer profile has been satisfactorily completed.

The location that is issuing the loan must know the purpose of the loan and must complete a Know Your Customer profile for the borrower. If the loan proceeds are going to another country, the location granting the loan must obtain the reason for such transaction. Additionally, it must review how payments for the loan are made and know the reason for and source of substantial unanticipated reductions.

Some key questions include the following:

- · How long has the deposit been on account?
- · What is the purpose of the loan?
- · Where loan proceeds are destined?
- · When and how loan is to be repaid?
- Are interest rates tied?
- Is interest, in addition to the principal, securing the loan? (In some jurisdictions, this may raise tax problems.)

REPRESENTATIVE OFFICES

Activities of the Republic representative offices are limited by U.S. government regulation. They are allowed to solicit business on behalf of the parent bank or act as an administrative liaison between the parent bank and the customer. However, representative offices are not authorized to accept deposits, pay checks, lend money or conduct any cash transactions.

FLASH ALERTS

All Republic units must report any information relating to improper activities, whether or not they involve customers or suspect individuals or entities, to the compliance department in New York for circulation to all other units. The compliance department can be reached by telefax number (212) 525-509 or the following telephone numbers (212) 525-6704, 6692, 8327, 3629 or 8850.

Reporting units must provide the compliance department with as much information as possible concerning the identity of the individual or entity (such as, birth date, address or tax identification number) and the reason for concern or suspicion. The compliance department will immediately seek the approval of head office counsel and thereafter notify all Republic units.

Each location must immediately determine whether the subject of the flash alert is known to the unit and forward a response to the compliance department indicating that it acknowledges receipt of the alert.

Where feasible, a master listing of all names reported on the flash alert system should be provided to operational staff in account opening or document control functions. At the time of opening a new account, such staff should document that the account name is not listed on the flash alert master report. In locations where this procedure is not feasible, quarterly searches of customer records should be conducted to determine if a new relationship exists with any of the flash alert names. Any new information regarding a flash alert name should be forwarded immediately to the compliance department in New York.

COMPLIANCE WITH LOCAL REGULATIONS/ AUTHORITIES

All Republic locations must comply with any official subpoenas and search or seizure warrants after verifying their accuracy and genuineness.

The legal department in New York must be notified immediately when a government subpoena is served. Domestic retail branches must contact the control department upon receipt of any serving. Representative offices must notify head office of all legal servings.

Each location must designate a limited number of individuals who are authorized to contact and respond to local authorities.

Disclosure of the existence of a legal serving should not be made without direction from the control, compliance or legal departments.

Revised March, 1998

MAINTENANCE OF RECORDS

Account records, including the account opening forms signed by the client, documents identifying the customer and, if different, the beneficial owner of the account and records of account transactions, must be retained for at least five years after the relationship with the customer has ended. Records must be held for longer periods of time if required by local laws or if circumstances so dictate.

NON-DISCLOSURE

Employees shall not disclose to the client or to third parties that any criminal investigation is being carried out or that information has been provided to authorities unless authorities so allow.

INTERNAL

Each location must define a program of work to be followed by internal auditors to verify implementation of the Know Your Customer program.

PART III -TRAINING

Each Republic location must provide Know Your Customer training to all customer contact employees, traders, operations personnel and management at least annually. More frequent training is required whenever there are changes to local laws and regulations or Republic practices.

It is of critical importance that all training be documented. Following each training effort, the location must prepare a file memorandum indicating the date training was offered, who attended and the format of the training session. A copy of the memorandum must be forwarded to the Compliance Department in New York.

It is essential to know our employees as well as, if not better than, we know our customers. All new employees, consultants and representatives must be trained in Republic policy and procedures before undertaking their respective responsibilities.

PART IV EXCEPTIONS

Unless explicitly stated otherwise, exceptions to this policy must have the written approval of senior management of the location and head office management. Approval of head office management is defined as the unanimous consent to a written submission by the division head, chairman of the board and the chairperson of the executive Know Your Customer committee in New York.

Revised July, 1996

I. General Inform	nation		Status:		
			Activity Status:		
Type of Client:	○ Benk	○ Non-Benk	○ Branch	0.04.11	O
	O 341.m	Name of Parent:	O branch	O Subsidiary	O N/A
Address:		realise of Parent,			
Country:					
Telephone:			Fax:		
			Telex:		
Swift Code:					
New Client or Existing Client:	○ New	○ Existing	Date Accoun	t Activated:	
Primary Account N	umber:				
Other Accounts:					
is the Cilent or its Parent Name of	traded on an Exchange:	Exchange or State	owned Yes	○ No	
is the Client's Shareholde	era' Equity 25	Million USD or me	ore ? 🔘 Yes	○ No	
Hae the client been under 10 years ?	r the same ow	mership for the la	O Yes	O No (NA (new bank)
is the client owned by a s the "Current Members of List" Which Financial Action	the Financial	Action Task Force	on O Yes	○ No	
Specify entity/agency/ which the client is own	government o	ffice through			
General comments:					

II. Ownership/Management

1. Name of Principals (lame shareholders - 10% or more)

% of ownership

2. Name of Corporate Officers

Tipe

- 3. Total Number of Employees:
- 4. Where is the Client incorporated:

Your Established:

- 5. What is the Client's Rank in country (asset based
- 6. How many branches does the citent have:

Where ?

- 7. List license type and year of issuance:
- 8. Indicate reporting agency(les) / supervisory body(les) in the country(les) of operation:
- 9. Please list principal affiliated relationships if any:

lien		

III. Referral Information

How was the client introduced to Republic ?

By whom:

If yes, by whom:

Indicate Banking References and Relationships (List 3):

Reference documentation for Russia and

NIS in Credit File ? O Yes

Credit File ? NA (all other countries)

IV. Visitation

Was the client visited ?

○ Yes ○ No

If Yes,

Date last visited: By whom ?

Call report in Credit File ?

O Yes O No

If No.

Why Not?

When is the visit expected:

V. Transaction Activity

The Know Your Customer (KYC) Policy requires a listing of the client's business activity with Republic. Please list:

Transactions

Clearing (Funds Transfer)

Check collection (Cash Letters)

Guarantees (CD offset, Deposits)

Asset Management

Checks Printed

Current Account

Managed Account

LCs / BAs

Time Deposits

Trading - Banknotes

Trading - Precious Metals

Trading - Options

Trading - FX

Trading - EMT

Trading - Bonds

Money Market

Derivatives

Trading - Securities

FRA (Forward Rate Agreement)

Swaps

Commercial Line

Loans

Commitments

Factoring

Frequency

Activity Status:

VI. Banknotes Activity	For RNB Office:
Monthly average of sales by RNB: (for new clients, enter anticipated monthly volume manually)	Autometic Manual
Monthly average of purchases by RNB: (for new clients, enter anticipated	Automatic Manual
monthly volume menually)	For BN figures refer to paren
 Are there seasonal varietions in volume of activity? If so, explain: 	
4. Credit limit per transaction	
5. Currencies traded:	Meinly Non USD
 Please describe the reason for dealing in banknotes transactions including with whom this offert is dealing - retail, wholesels, domestic, cross border etc.; Where will Banknotes be shipped to: 	
8. Where will Banknotes be shipped from:	
9. Method of settlement:	
Wire transfers from:	
Wire transfers to: Debit/Credit RNB account #:	
10. Credit line requested (including secured):	○ Yes ○ No
Credit approvel received:	○ Yes ○ No Dets Approved:
Banknotes Signature Section	Status:
I have reviewed the information listed above and criteria. I recommend this bank for Banknotes but	the "Know Your Customer" and "due diligence" siness.
Name of the Trader/Banknotes officer authorized to sign: Electronically signed by:	
Name of Unit Manager authorized to sign:	
Electronically signed by:	
Legal department authorized to sign: (if required by KYC policy)	
Electronically signed by:	

. Financial Summary (Tob	e completed only on initial KYC)
Financial Statement Date: Currency: Exchange Rate: Note: All amounts are in	Automatic (from BankStr Manual
Assets:	
Loens:	
Deposits:	
Shareholders Equity:	
Net income:	

VIII. Documentation Checklist

For counterparties that are not pladed on all excita-	100		
List of Authorized Signatories and/or Corporate Resolution If no, explain:	○ Yes	○ No	○ N/A
Articles of Incorporation and/or Copy of Banking License	○ Yes	○ No	O N/A
If no, was it waived?	○ Yes	○ No	O NA
Current Annual Report or Current Financial Statement	O Yes	○ No	O N/A
Date of Statement:			
For counterparties that are traded on an Exchange	or State o	wned	
List of Authorized Signatories and/or Corporate Resolution If no, explain:		○ No	○ N/A
Current Annual Report or Current Financial Statement	○ Yes	○ No	○ N/A
Date of Statement			
For Russia and N.I.S. and other countries as design	ated		O
Copy of Banking License	O Yes	○ No	○ N/A

Signature Section

We have reviewed the information provided above in the context of Republic New York Corporation's L J
"Know Your Customer" policy and "due diligence" requirements and oriteria. Based on the following
summary of reasons, we feel comfortable recommending this bank for banking business.

Briefly describe ollent's own KYC policy, procedures and practices.

Summary of reasons:

Name of Global Rulationship Manager authorized to sign: Electronizatily signed by: Name of Unit Manager authorized to sign: Electronizatily signed by: Executive Dept. authorized to sign: (if required by KYC Policy)

Legal Dept. suthorized to sign: (if required by KYC Policy) Electronically signed by:

Electronically signed by:

Statement of Karon von Gerhke-Thompson, Vice President

First Columbia Company, Inc.
Established in the District of Columbia in 1954
Consultants Representing the Defense Industry Sector in International
Marketing, Strategic Alliance Formation and Government Affairs

Prepared for Hearing Before the

COMMITTEE ON BANKING AND FINANCIAL SERVICES

UNITED STATES CONGRESS

One Hundred Sixth Congress

September 22, 1999

Thank you, Mr. Chairman and members of the committee, for extending an invitation to me to appear before this distinguished committee. Please permit me to express my gratitude. This is a unique, first time, experience for me. I have never had the privilege of appearing before a committee of the United States Congress so I thank you, Mr. Chairman and your distinguished colleagues, for this opportunity.

The importance of this hearing— an inquiry into allegations of Russian money laundering operations that may have tainted U. S. banking and international financial institutions—cannot be underscored.

From April of 1993 through September 1993, I served as an unpaid volunteer intelligence asset on a CIA operation to penetrate what the CIA, FBI, and DOJ knew was a KGB money laundering operation that had tentacles that reached into the Kremlin to President Boris Yeltsin. The target of the CIA operation was Alexandre Konanykhine, a Russian national whose first visit to the U. S. was as a member of Boris Yeltsin's first official visit with President George W. Bush in June of 1992. He alleged that he was a Kremlin "insider," a new reformer who had contributed \$10million (50% of the financing) in support of Yeltsin's presidential campaign. When he returned to the U. S. in September of 1992—two months after his first visit—he represented himself to be a stockowner and the U. S. vice president of Menatep Bank, a bank owned by Mikhail Khodorkovsky who is Russia's seventh largest oligarch.

L. Carter Comick, Eugene Propper and Jonathan Ginsberg of the Washington, D. C. law firm of Ginsberg, Feldman and Bress, brought Konanykhine to my attention. Comick is a retired deputy director of the FBI's Intelligence and Counterterrorism and Eugene Propper is a former prosecutor with the Criminal Division of the DOJ. Jonathan Ginsberg is an attorney and the son of one of the founders of Ginsberg, Feldman and Bress. a law firm that Propper joined after leaving the DOJ. I worked with Cornick and Propper on a classified law enforcement operation. They also teamed with me in representing Raytheon Corporation and Boeing Aerospace on marketing their defense products in Brunei.

Jonathan Ginsberg's father had long established business relationships with senior government officials in the former U. S. S. R. dating back to World War II. High-level Russia government officials with whom his father had long established ties referred Konanykhine to Jonathan Ginsberg. Cornick, Propper and Ginsberg represented to me that Konanykhine's bono fides were impeccable; that he was one of Russia's youngest, most brilliant, financial tycoons.

Konanykhine alleged that Menatep Bank controlled \$1.7billion in assets and investment portfolios of Russia's most prominent political and social elite; that one hundred of his clients had individual assets and investment portfolios in excess of \$100million (U.S.). Because of the uncertainty of the political and economic stability in Russia at the time, Konanykhine alleged that Menatep Bank wanted to establish an offshore bank to protect the assets of its clients with an initial capitalization of \$1billion and to purchase one hundred "naturalized" passports for preferred clients of Menatep, twenty five passports for employees of Menatep and fifteen diplomatic passports at any cost for very, very, special clients of Menatep.

He wanted to establish the bank and obtain the naturalized passports from a Latin American or Caribbean country that offered unrestricted repatriation of capital and stringent bank secrecy laws. He also wanted to obtain naturalized passports from a Latin American or Caribbean country with unrestricted or limited visa requirements that would enable Menatep's clients to travel freely into Eastern and Western European countries to manage their assets and business investments. Cornick, Ginsberg, and Propper wanted my help in gaining access to officials who could facilitate a favorable negotiating climate for the establishment of the bank and who could expedite the procurement of the passports.

Russia was in the early phase of its transition from a command economy to a free market economy. We had a pending appropriation bill before the Senate to provide Russia with \$4billion in foreign aid to assist them in their transition to a free market economy. The \$1.7billion Konanykhine wanted to move out of Russia and the \$100rds of millions of dollars of assets held by individuals raised a "red flag with me. No pun intended!

I telephoned a senior official with the CIA who had served as the director of the Soviet Eastern Division. Mr. Z of the CIA's National Intelligence Service returned my telephone call to him. Without identifying Konanykhine or Khodorkovsky by name, Mr. Z informed me that the CIA was extremely interested in obtaining intelligence on their activities. He advised me that I would be contacted by Mr. V. On the same day, I received a telephone call from Mr. V. He informed me the CIA believed they were engaged in an elaborate money-laundering scheme to launder billions of dollars stolen by members of the KGB and high-level government officials. Neither Mr. Z nor Mr. V identified Konanykhine or Khodorkovsky by name. It was not until after I learned Konanykhine and Khodorkovsky's identity through Propper that Mr. V confirmed the CIA and FBI had been monitoring their operations long before Konanykhine's arrival in the U. S.

It was evident Konanykhine was dissatisfied with the rather high fee structure proposed by Cornick, Propper and Ginsberg. He did not show up for three scheduled appointments. Mr. V proposed, and I agreed, that I would offer to represent them rather than lose the opportunity to penetrate the KGB money laundering operation. I volunteered my services and the use of my company, First Columbia Company, Inc., to collaborate with the CIA on what I was told was among the Agency's highest ranking operations. It was clearly understood that I was not in the passport procurement business, much less establishing offshore banks, and would have under no circumstances enter into a relationship with Konanykhine if it had not been for the implications to our national security interest that were conveyed to me by Mr. Z and Mr. V. According to Mr. V, Konanykhine was a member of the KGB who was moving money hundreds of millions of dollars out of Russia into Eastern and Western European banks—a war chest controlled by corrupt government officials and members of the KGB.

Mr. V, and his superiors, believed the intelligence that could be obtained through Konanykhine and his money laundering operation was vital to our national security interest. The CIA interest was in obtaining the names of the individuals, the names of the banking institutions they were operating through and the names and types of businesses in which they held

investments. The Agency was aware that billions of dollars was being laundered through offshore banks by the KGB and corrupt government officials with ties to Russian organized crime families. They believed corruption was so all-pervasive in Russia that it was posing a serious threat to genuine economic reforms and the transition to a free market. As early as July 1993, the CIA believed that financial aid from the U. S. and international lending institutions to support Russia's transition was being laundered through front firms into offshore banks. A substantial amount of the laundered money was believed to be in safe havens in offshore banks or was used to establish offshore businesses and joint venture partnerships with Western firms. According to Mr. V, Konanykhine and Khodorkovsky were key players to unraveling the ties between the KGB, senior government officials and Russian organized crime families.

I elicited the help of my business partner, Charles A. Ragan, a founding member and president of First Columbia Company, Inc. ("FCC"), who was based in Chevy Chase, Maryland. Ragan is a fifty-year veteran of strategic international marketing with a remarkably distinguished career. I was residing at my parent summer home in the Adirondacks at the time. Ragan was here in D. C. and available to attend the meetings with Konanykhine Elena Cidorchuk-Heinz-Volevok his associate, "Cidorchuk"). Konanykhine was traveling extensively to Russia, Switzerland, Germany, Austria, Greece and Turkey. Mr. V informed me that the CIA and FBI were tracking his every move; that he was moving massive amounts of money out of Russia into Eastern and Western European countries. During his frequent absences from the U. S., Cidorchuk made decisions and authorized initiatives on behalf of Konanykhine. Mr. V confirmed my suspicion that she was calling the shots; that she was his boss and not vice versa. He told me that her orders were coming direct from a senior KGB official in Moscow; that she was relaying instructions to Konanykhine. He believed, as I believed, that she was his boss.

In late July, early August, obtaining the passports became a matter of urgency. Konanykhine and Cidorchuk put enormous pressure on us to begin the passport procurement process. I traveled to Washington for to formalize FCC's agreement with Konanykhine and to meet with officials with the

Embassy of Uruguay, the country that exceeded all other Latin American countries with respect bank secrecy laws and passport requirements. With Mr. V, I wrote a formal proposal which was presented to Konanykhine by Ragan on September 7, 1993. Everything was a go. I traveled to Washington for the formal signing of the contract but the meeting was cancelled. Chidorchuk said Konanykhine was in Moscow on business.

On September 21, 1993, I telephoned Chidorchuk to inquire about the status of contract they had solicited from us. For inexplicable reasons, she informed me that they had no intention of executing the agreement with us and requested that I not telephone their office again. Ragan telephoned her the following day, requesting to speak with Konanykhine. Cidorchuk informed him Konanykhine was in Turkey; that he had telephoned her from Turkey to instruct her to terminate any further communication with us. The reason she cited Konanykhine based his decision on was that I was a phony. She instructed Ragan not to attempt to contact them again.

In April of 1994, I was summoned to an urgent meeting by a CIA intelligence officer with the CIA's National Recruit/Washington office. He informed me that Mr. V had submitted a report that stated I had been compromised by Aldrich Ames on the operation. I arranged to meet with him the following day. Again he informed me that I had been compromised by Ames on the operation; that my name was on a computer as a CIA spy; that I would be killed or arrested if I ever traveled to Russia or any other communist country; and, that unless I wanted my photograph on the front page of the New York Times or Washington Post as a spy, he would not recommend that I travel to Russia. I telephoned Mr. V at his home who corroborated that he had, in fact, submitted a report for inclusion of the CIA's damage assessment on Ames espionage activities. He informed that the traffic on the operation had been routed to Ames and that I had been compromised by him.

In July 1996, following Konanykhine's arrest by the INS for allegedly filing a fraudulent visa, I learned from Tom Battaglia, then staff director of the Senate Select Committee on Intelligence ("SSCI"), that an FBI report

submitted to the SSCI confirmed that Konanykhine and Ames were in Turkey at the same time and same location. He pointed out, however, that no one saw them together. It is more than a coincidence that Ames and Konanykhine were in Turkey together at the same time and same location at the same time that Konanykhine allegedly issued the directive to Cidorchuk to cancel the contract with FCC on the basis that I was a phony. An SSCI report, entitled An Assessment of the Aldrich H. Ames Espionage Case and Its Implications for U. S. Intelligence: A Report of the U. S. Senate Select Committee on Intelligence, November 1, 1994 (Pages 56-57.63-63) stated that Ames downloaded onto his laptop computer the S. E. Division's classified operations and cables which he brought to Turkey in September of 1993 to his KGB handlers. It defies reason that he would leave the classified cables on the KGB money laundering operation that were routed to him by Mr. V on his desk at the CNC but bring the entire S. E. Division's classified cable with him. Mr. V was outraged. The operation was a coordinated interagency operation with the full participation of the CIA and FBI. From reports Mr. V received by his FBI counterpart, the FBI had also corroborated the Ames compromise. He was certain that the FBI report would "be clean" and would prove beyond a doubt that I had been compromised by Ames on the KGB money laundering operation.

The operation was not reported to appropriate congressional oversight committees as a significant failed intelligence operation as mandated under the National Security Act of 1947, As Amended. The failure to report the operation as mandated under the National Security Act of 1947, As Amended concerned me greatly. From reports I received from CIA intelligence officers, the operation was ranked among one of the CIA's highest priorities. According to Jeffrey H. Smith, former general counsel of the CIA's Office of the General Counsel, of all of the operations involving U. S. intelligence assets who were compromised by Ames, of which I was told there were many, my compromise was the only one that was not reported.

It singled to me that it was a "policy" verses "intelligence" failure. Konanykhine's money laundering trail led directly to Boris Yeltsin. It was a politically unpalatable situation for the Clinton administration, the Yeltsin administration and the CIA who left Aldrich Ames in the catbird seat at the Counternarcotics Center monitoring Russia money laundering operations that was under the control of two of his former KGB handlers who also had direct ties to Konanykhine—Viktor Cherkashin who was responsible for recruitment and vetting of KGB assets and Leonid Sherbarshin, former chairman of the KGB who Konanykhine hired to work for him at the All Russian Exchange Bank—a bank established and controlled by the KGB.

Konanykhine is on the top of Russia's most wanted return list. He is INS' highest profile case and the FBI's biggest quid pro quo with the Russian Military Procuratura. Konanykhine was a KGB asset conducting a KGB money laundering operation out of the Willard Hotel in downtown Washington, D. C. The money was being laundered through Menatep Bank that is alleged to be KGB owned and controlled, as is its wholly owned subsidiary Yukos Oil. Khodorkovsky of Menatep Bank is the subject of the investigation into the Bank of New York's involvement in facilitating the laundering of an estimated \$10billion. Some of the \$10billion is believed to be money loaned to Russia by the I. M. F. Khodorkovsky and Konanykhine were also the subject of an investigation by the Federal Reserve Bank, Board Governors, for their involvement in the establishment of the European Bank in Antigua, one of eight Russian banks in Antigua alleged to have been established for money laundering purposes.

Here is a man who conducted not one but two money laundering operations out of the Willard Hotel directly across the street from the Executive Office of the President of the United States—the KGB money laundering operation and the European Union Bank both of which were undertaken by Konanykhine on behalf of Khodorkovsky of Menatep Bank. The CIA, FBI, and DOJ were knowledgeable of the KGB operation and the FRB was knowledgeable of the European Union Bank. Surely all were knowledge able of Khodorkovsky's involvement in the money laundering through the Bank of New York.

Here is a man who first came to the U. S. as a member of Yeltsin's first official meeting with President Bush—a man who alleges he financed 50% of Yeltsin's presidential campaign, who Yeltsin then rewarded with a dacha previously owned by Mikhail Gorbachev, and who Yeltsin allegedly authorized his then chief of security, General Korzackov, to assign a Kremlin security detail for his personal safety and protection. Here is a man who was conducting a KGB money laundering operation with tentacles that reached to Yeltsin that was penetrated in 1993 by the CIA—the President's foreign intelligence operational arm—that was compromised by Aldrich Ames and no one told the Administration and no one reported it to appropriate congressional oversight committees.

I have only two heroes in my life. Foremost is my father who taught me respect, compassion and sensitivity for the human condition. My other hero is E. C. Harwood, founder and director emeritus of the American Institute for Economic Research of the Behavioral Research Council. He was my mentor, I his protégé. Following his death in 1992, a commemorative silver coin was minted in his honor. The inscription reads: "For Integrity There Is No Substitute." Integrity was the embodiment of his life and his greatest gift to me. They are acquired virtues. They cannot be found in Darwinian theories of survival of the fittest and they certainly cannot be found in a how to survive the politics of Washington, D. C. Like the Constitution and The Bill of Rights they transcend ideology and political partisanship.

They are what my objective is all about—integrity, respect, compassion, sensitivity for the human condition—all embodied in the Constitution and the Bill of Rights. It is not "We, The President in collusion with the Office of the Directorate of Operations, hold these truths..." It is "We, The People, holds these truths to be self evident." The Agency claims it is protecting the information in the interest of national security. That does not exempt them from reporting the operation as a significant failed intelligence operation to appropriate congressional oversight committees as mandated. Their authority to invoke national security authority over the release of information granted to the them under the president's constitutional authority is in conflict with my constitutional right to due process. My constitutional rights were violated to protect a hidden foreign policy agenda that at the end of the day aided and abetted corrupt Russian officials.





