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Organized Crime, Corruption and Terrorism: It's All About the Money

Chris Kuehl
Managing Director
Armada Corporate Intelligence



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Interconnected Challenges

- Distinguishing between organized crime and terrorist groups has become harder and harder.
- Corruption almost always connected to some form of organized criminal activity.
- Motivations for criminal groups, nationalists, terrorists and others are often related and the groups feed off one another to a large degree.
- Reactions by law enforcement are much more fragmented than the organizations they are trying to control.
- The ONE thing all these groups have in common is money – they either crave it or need it to function.



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Global Organized Crime

- Underpinnings of Dramatic Expansion
 - End of Cold War
 - Expansion of globalization and trade liberalization
 - Technological advances in logistics, communication and finance
 - Expansion of global travel and immigration
 - Political disputes and divisions
- Motivations for Criminal Organizations
 - Money – illicit trade may account for over \$1 trillion
 - Power – corruption has allowed permeation of government structures
 - Politics – links between nationalists and insurgents and criminal gangs



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Characteristics of Criminal Groups

- Motivated by financial gain
- Requires and gets absolute loyalty through ethnic and family connections
- Generally thrive through the deliberate corruption of government officials
- Highly structured and hierarchical
- Very diverse in terms of activities engaged in
- Most have become mature organizations with a history and a clear niche
- Generally operate across borders with many fewer restrictions than the countries they operate in



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Most Lucrative Activities

- Drug smuggling
- Smuggling of contraband goods
- Human trafficking
- Arms trafficking
- Counterfeiting
- High tech financial crime
- Extortion
- Financial fraud
- Piracy
- IPR violations
- Sanctions busting

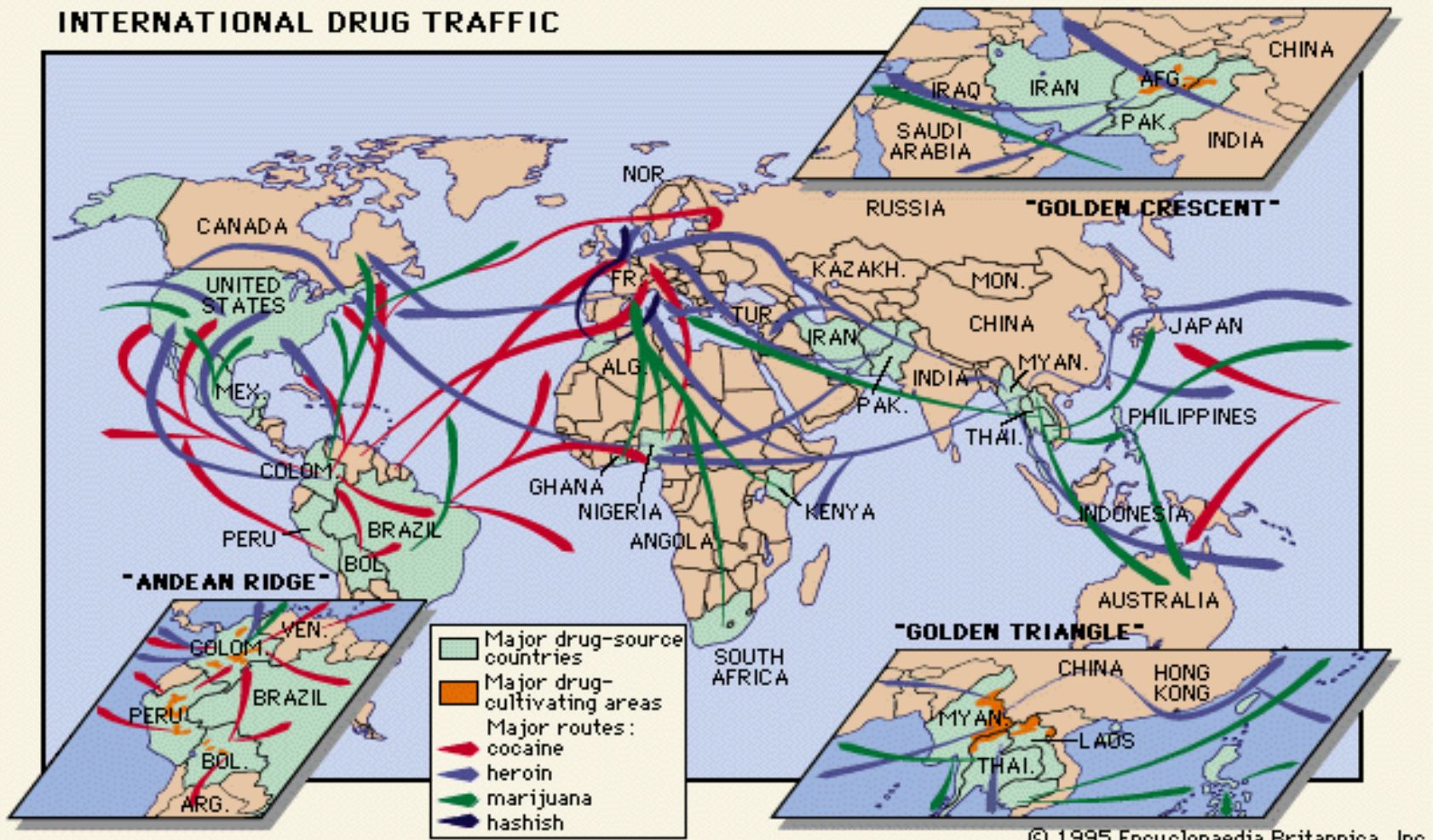


The Sandwich Mafia sends Luigi to "sleep with the fourth-graders."



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INTERNATIONAL DRUG TRAFFIC



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Financial Implications

- Estimated that over 65% of all money laundering deals involve drug trade proceeds.
- Banks have become much better at tracking money laundering linked to high risk countries and that has forced drug gangs into other techniques.
- Majority of drug operations have very well developed “front” companies – they have moved far beyond restaurants and casinos. Significant movement into transportation and logistics
- Heavy use of entertainment businesses – lots of transactions and many in cash



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Smuggling

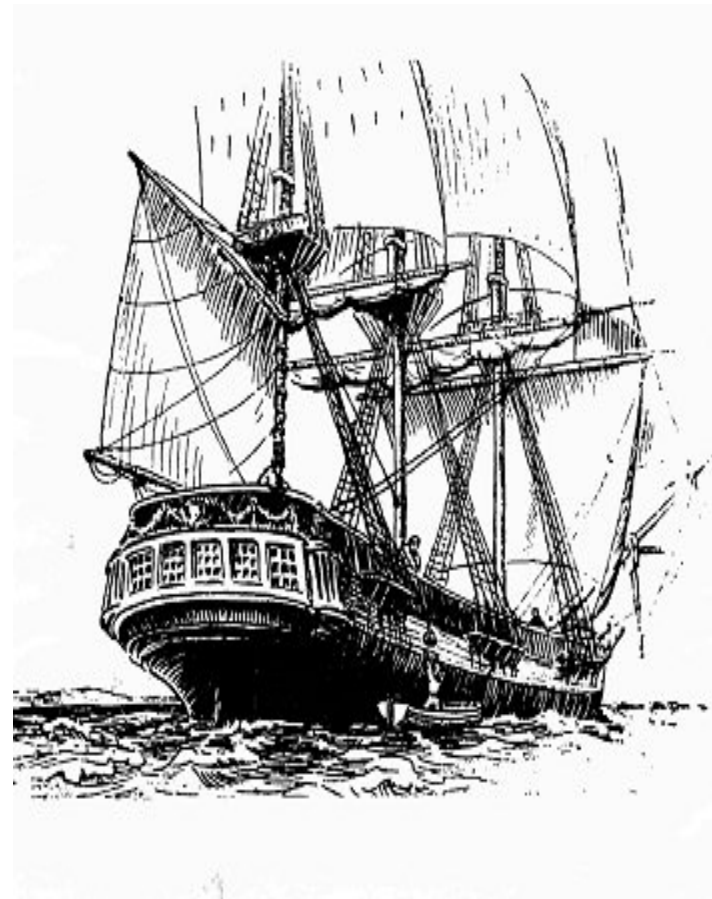
- Contraband smuggling takes place anywhere tariffs and taxes create demand for alternatives. Most common with products like tobacco, alcohol and a wide variety of heavily taxed luxury goods.
- Russia, China and parts of East Europe heavily engaged in smuggling luxury goods and cars
- Cigarette smuggling into Europe cost close to \$5 billion in 2005
- Production of counterfeit pharmaceuticals has become fastest growing illicit industry – maybe a \$15 billion to \$55 billion market



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Most Developed Operations

- Hazardous waste material into Mexico
- Luxury cars into Russia
- Protected wildlife into the US
- Cigarettes and alcohol into Europe
- Luxury goods into Latin America
- Firearms out of US to almost everywhere
- Boats and watercraft into Asia
- Art into Asia and Europe





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Financial Implications

- Legal shipments of goods used to hide illegal shipments can end up compromising the legal shippers.
- Additional costs of security and inspections are carried by the legitimate parties to a transaction.
- Collecting from an illegal operation can be more than a little difficult.
- Insurance costs mount and some types of shipments become almost impossible to finance due to the risk of pilferage.
- Countries with reputation for smuggling operations become much higher risks and more expensive to do business in



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Arms Trafficking

- Gray market dominates industry – exploiting legitimate export procedures to disguise the recipient or the supplier.
- Largest buyers are in developing world – especially in Africa, Middle East, South Asia and parts of Latin America.
- Terrorist organizations obtain much of their weaponry in this market as well as in the black market.
- Russia and East Europe remain largest source of weapons but many come from US – directly and indirectly.
- Major concerns over what has happened to some of the old nuclear arsenal from the USSR



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Counterfeiting

- Euro is now the most often counterfeited currency – replacing the dollar in 2006.
- Anything can be counterfeited – commercial checks, money orders, securities, negotiable instruments.
- Vast majority of counterfeits are passed in countries other than the one the currency is ostensibly from.
- Counterfeit money is often passed in exchange for real money in laundering process
- States with most active operations include Mexico, Russia, Iran, North Korea and Colombia.
- Best counterfeits come from governments.



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High Tech Financial Crime

- Financial losses from computer crime has grown exponentially – 85% of companies have reported hacking attempts and almost 45% have succeeded in some way.
- Estimates vary from losses of \$12 billion to \$67 billion.
- Identity theft is major problem. Almost one in five Americans have been impacted to one degree or another.
- Computer espionage is used to track money flows, identify opportune moments for exploitation and access to accounts illegally have become favorite way to money launder.
- Computer fraud has become major problem as well. Scams are now overwhelmingly via computer.



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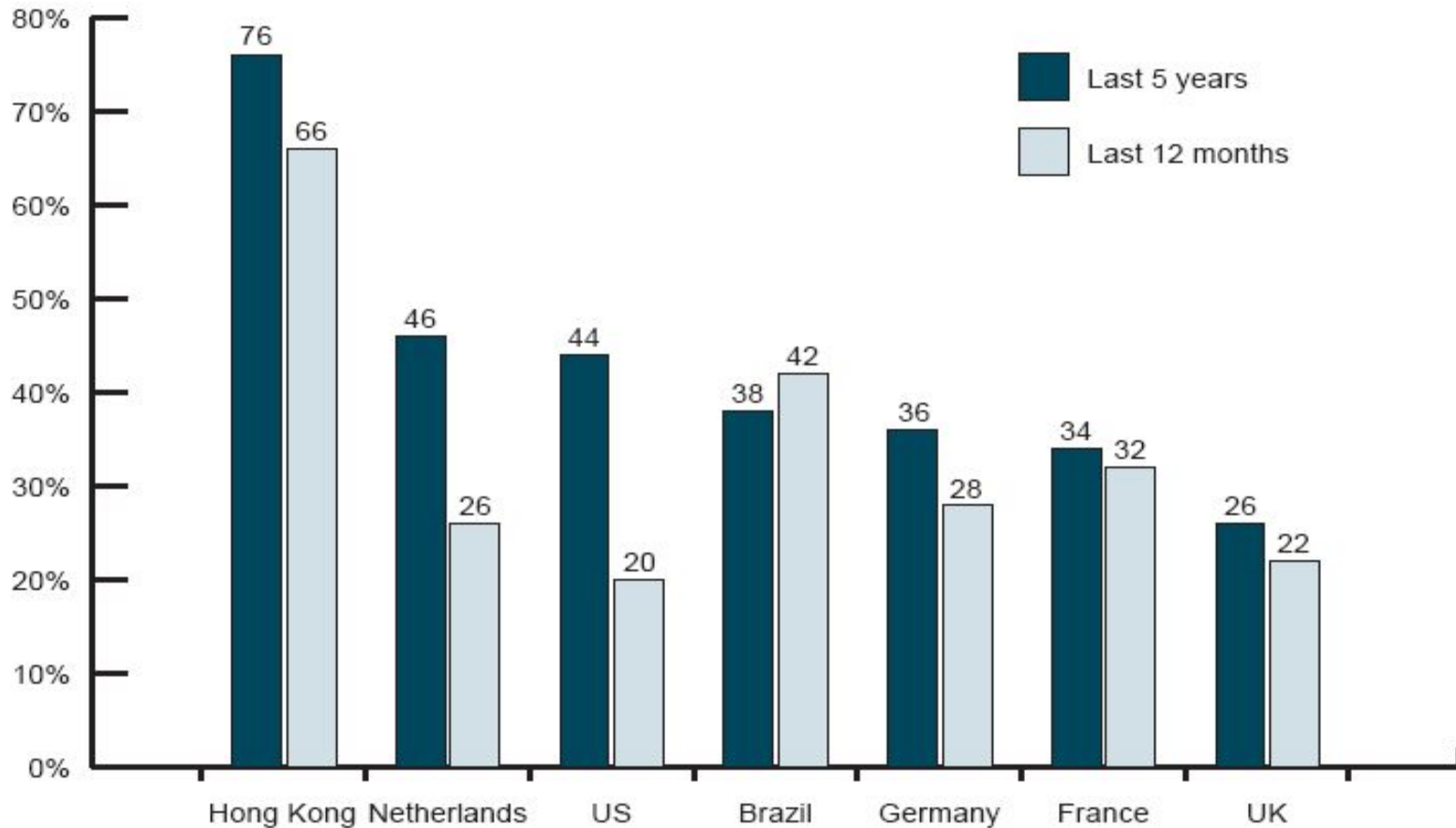
Extortion

- Least reported major financial crime. The majority of victims fear that threats will be carried out and accede to the demands
- Low level efforts are essentially protection rackets but bigger targets draw threats from insurgents and criminal gangs alike
 - Kidnapping
 - Threats of destruction
 - Threats of exposure
 - Threats of expulsion by governments
 - Forced repatriation
 - Confiscation



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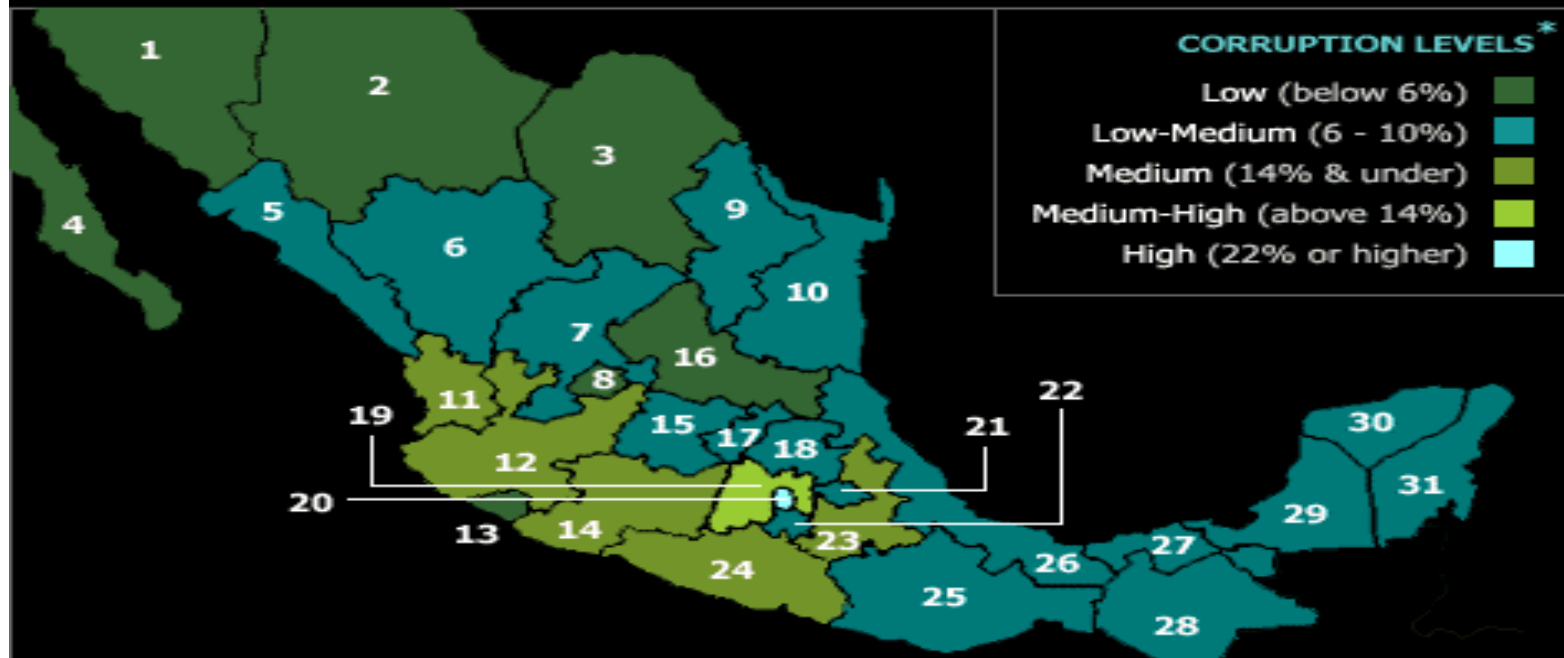
Percentage of Business Lost to Competitors Taking Bribes





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Corruption in Mexico



- | | | | | |
|--------------------|-------------------|---------------------|---------------|------------------|
| 1. Sonora | 8. Aguascalientes | 15. Guanajuato | 22. Morelos | 29. Campeche |
| 2. Chihuahua | 9. Nuevo León | 16. San Luis Potosi | 23. Puebla | 30. Yucatan |
| 3. Coahuila | 10. Tamaulipas | 17. Querétaro | 24. Guerrero | 31. Quintana Roo |
| 4. Baja California | 11. Nayarit | 18. Hidalgo | 25. Oaxaca | |
| 5. Sinaloa | 12. Jalisco | 19. Mexico | 26. Vera Cruz | |
| 6. Durango | 13. Colima | 20. Mexico City | 27. Tabasco | |
| 7. Zacatecas | 14. Michoacán | 21. Tlaxcala | 28. Chiapas | |

Source: Transparencia Mexicana

* The numbers correspond to the percentage of bribes used for the 38 public services or administrative procedures.



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Financial Fraud

- “Nigerian” scams victimize thousands of people annually – estimated loss exceeds \$500,000 million annually in US alone
- Business fraud on the rise as technology gets more efficient and criminals get better at exploiting it. May cost banks between \$3 and \$10 billion a year and other businesses may lose close to \$50 billion a year
- Major gangs in Nigeria, China, Japan and Russia. Many Yakuza gangs and triads now specialize in financial frauds
- Schemes aimed at insurance, medical organizations and governmental welfare organizations



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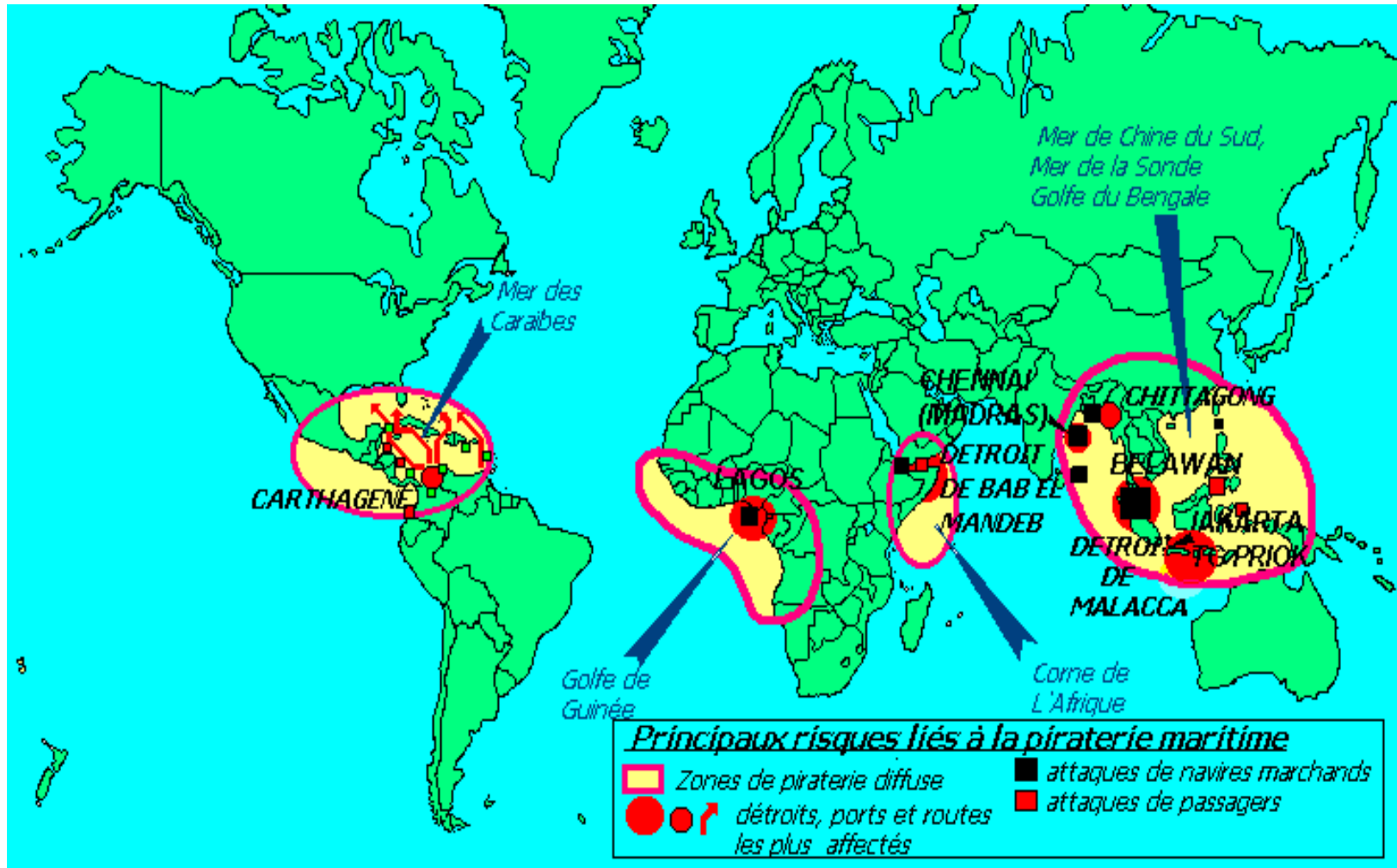


Piracy

- Direct costs of piracy reaching close to \$1 billion a year
- In 2006 there were over 600 attacks on ships in the Asian region
- Hijacking whole ships has become more common and violence has become more common
- Maritime insurance has skyrocketed and some categories of goods no longer shipped by sea



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IPR Violations

- “The good news is that over a billion people in China are using Microsoft Vista. The bad news is that they only bought one copy”.
- Entertainment and software business contributes close to 5% of national GDP for US and is at risk.
- One in every three CDs is counterfeit, stolen software costs over \$20 billion annually
- Trademark violations – sales of counterfeit products accounts for close to 10% of global sales
- Patent violations growing – especially in pharmaceuticals. WHO estimates that 11% of medicines sold are fake



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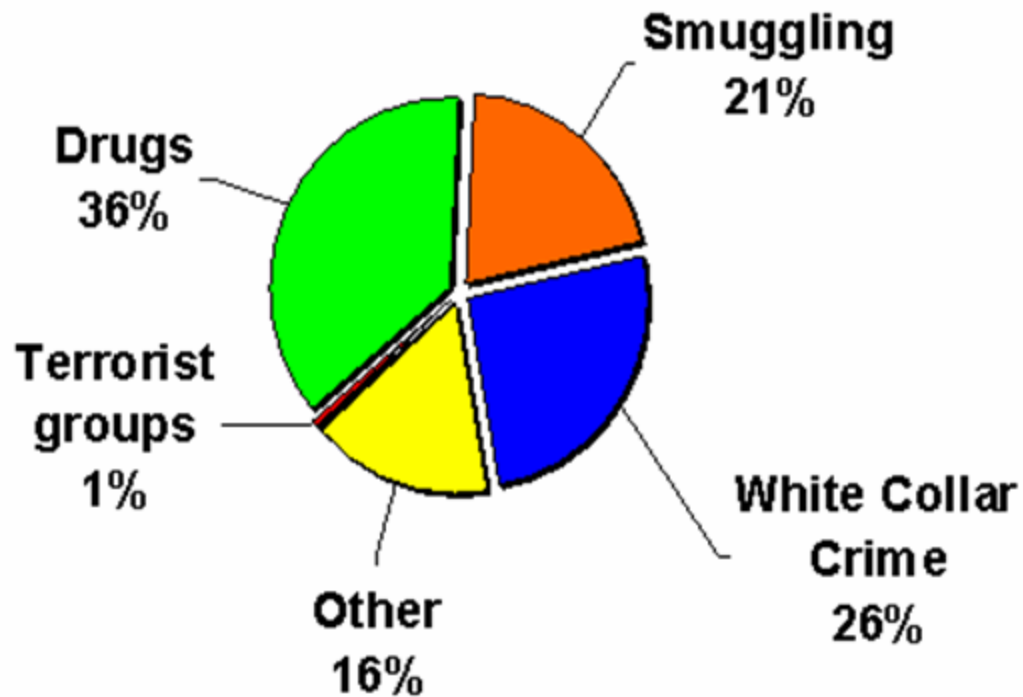
Money Laundering

- Accounts for over \$1 trillion a year, more than half is linked to the drug trade. IMF holds that money laundering at 5% of the world's GDP
- Majority of effort is through front organizations – most with heavy cash activity such as hotels, casinos and restaurants.
- More crime elements buying banks and other financial organizations.
- Offshore banking centers – Bahamas, Nauru, Lebanon are still major centers
- Massive expansion of rules and regulations that are imposed on everyone



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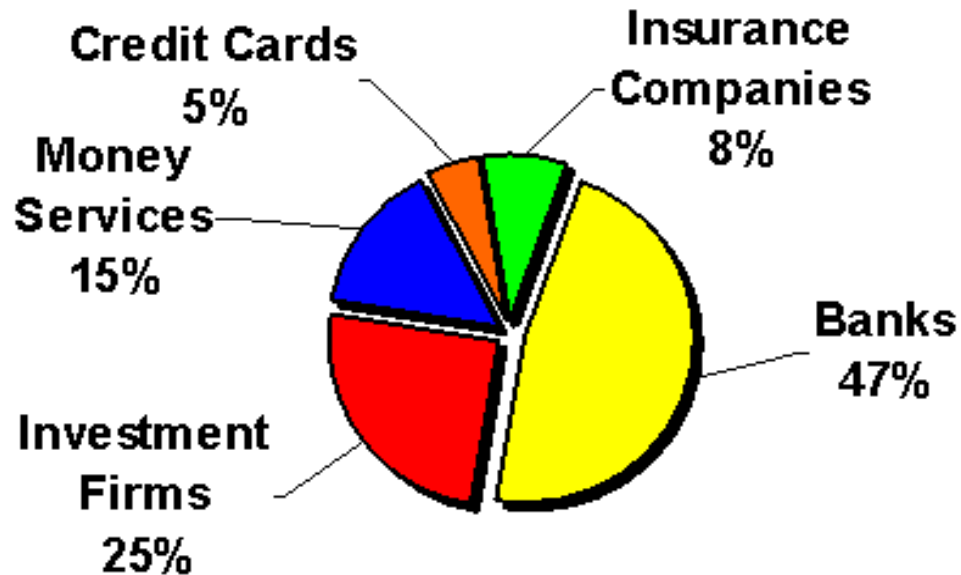
US Money Laundering Breakdown by Criminal Sector 2003





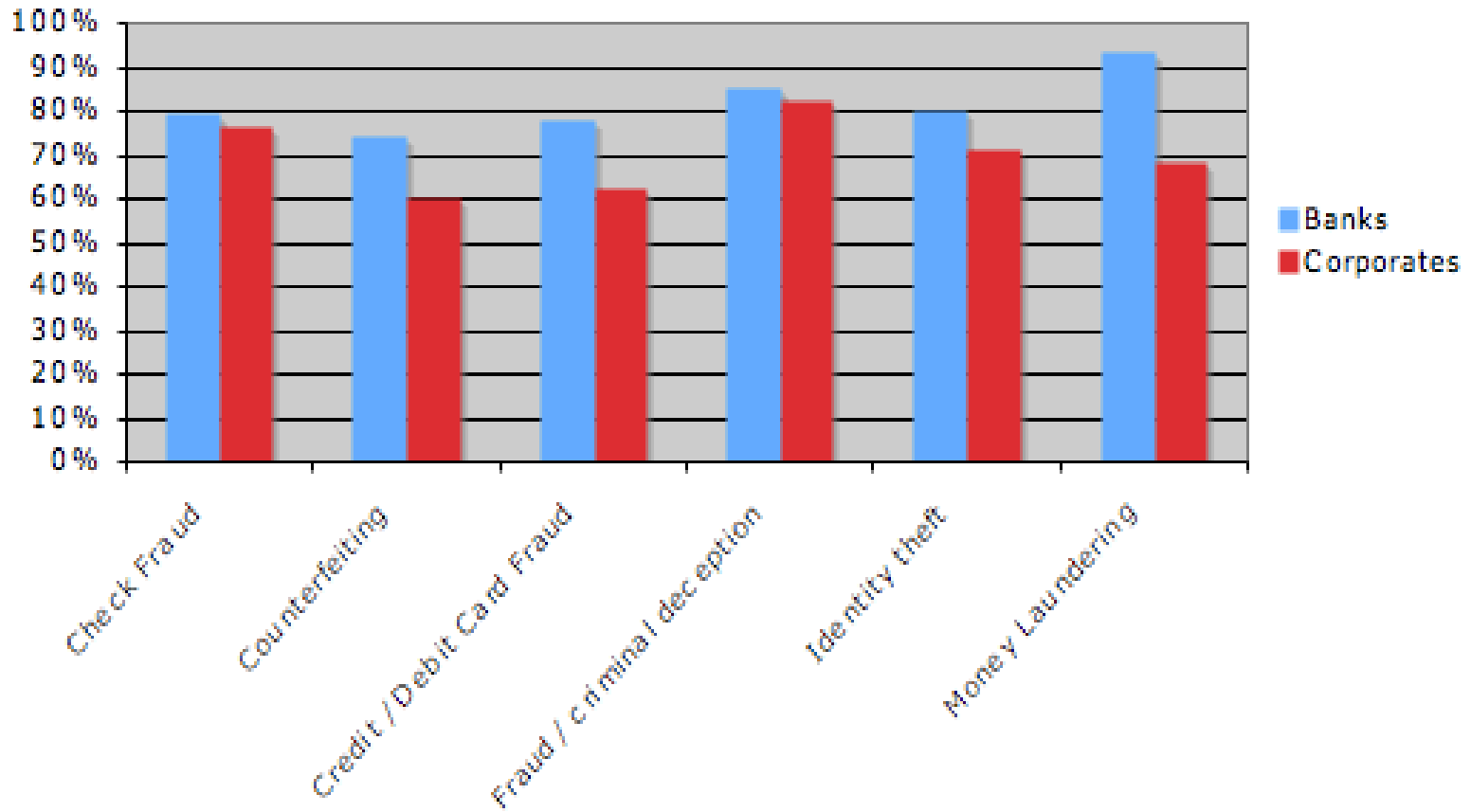
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US Money Laundering Activity by Financial Sector 2003



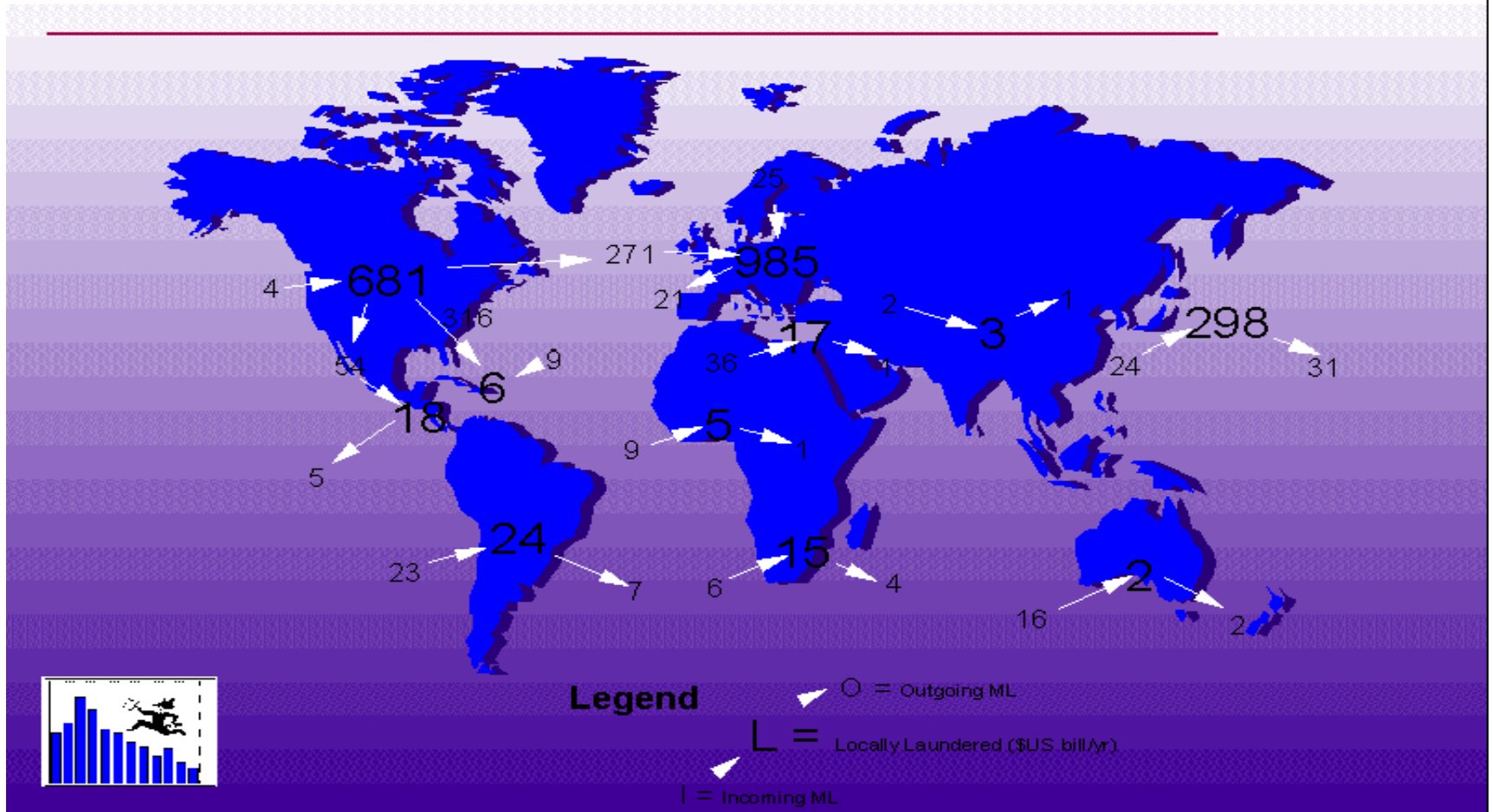


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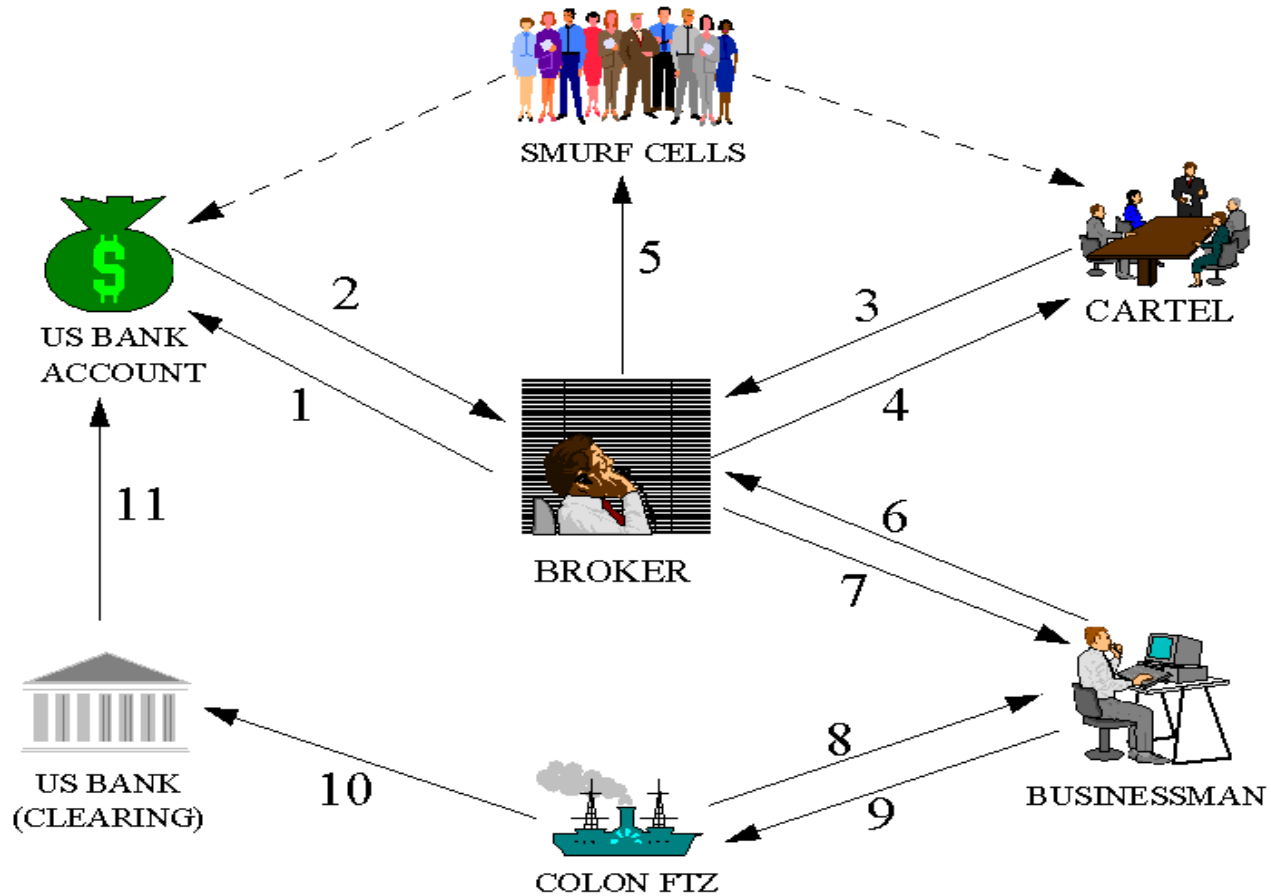


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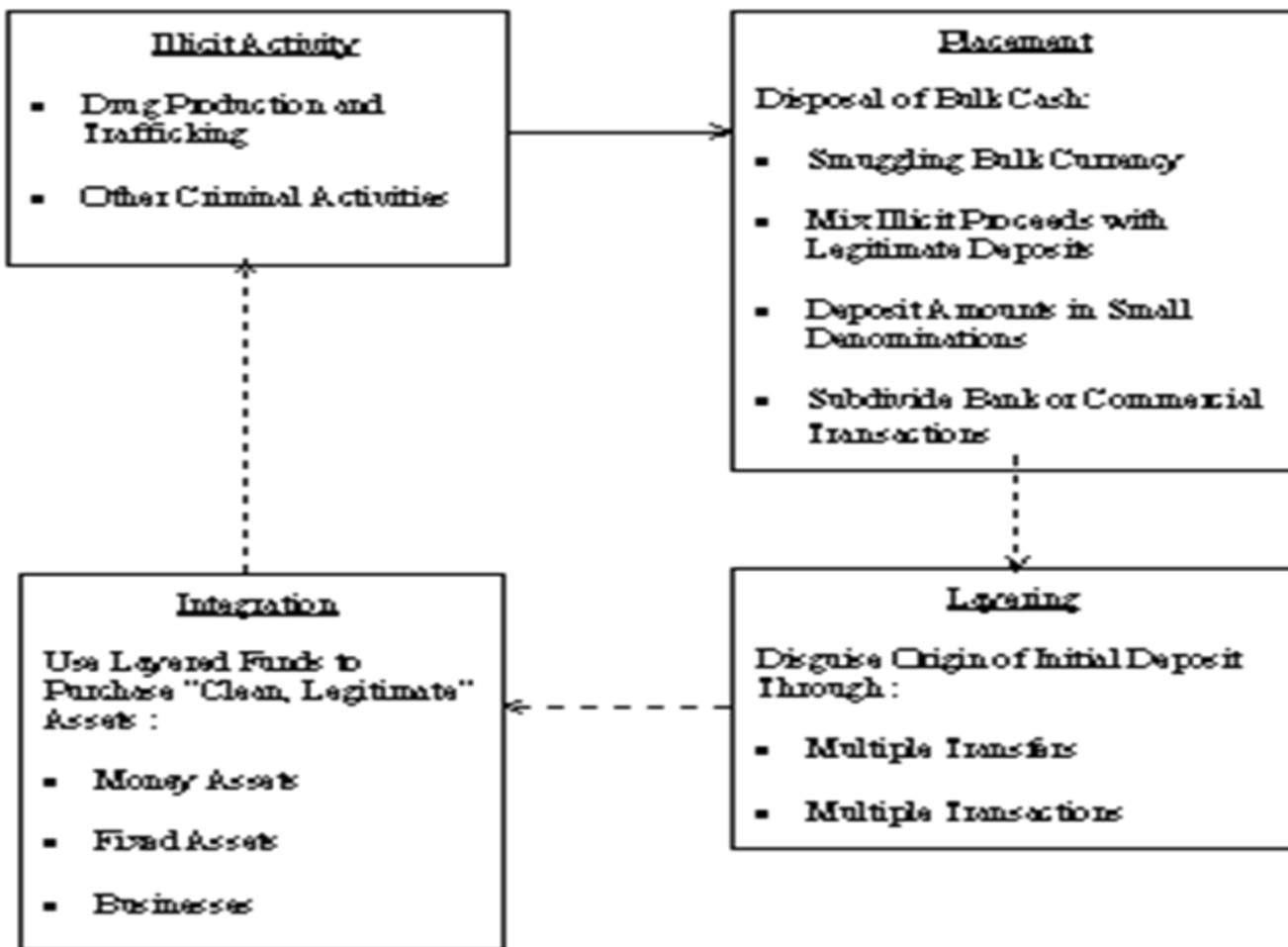
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The Laundering Process

1. Black market money brokers in Colombia direct Colombians visiting or residing in the U.S. to open personal check accounts at U.S. banks, and deposit minimal amounts.
2. Checks on these accounts are signed in blank by the customers and given to the brokers who pay them US\$200-400 for each account. The brokers keep a stock of signed checks on these "shell" U.S. accounts.
3. Colombian drug cartels sell their stockpiled cash at a parallel or "discounted" exchange rate to the Colombian money brokers in exchange for pesos which are paid in Columbia.
4. The brokers purchase the dollars at the discounted rate and the cartels lose a percentage of their profits but avoid the risks of laundering their own drug money.
5. Once the drug money is purchased, the broker directs his network *smurfs* to pick up the cash, and structure deposits into the various "shell" check accounts.
6. The broker then offers to sell checks drawn on these accounts to legitimate Colombian businessmen (who need U.S. dollars to conduct international trade) at a "parallel" exchange rate.
7. The broker fills in the dollar amount on the signed check, but leaves the name of the payee blank. The broker also stamps his symbol on the check as a means to guarantee his payment on the check in the event there are ever insufficient funds in the "shell" checking account.
8. The businessman can then fill in the payees name when he uses the signed check as a U.S. dollar instrument to purchase goods (perfume, gold, etc.) in international markets such as Free Trade Zones.
9. The businessman then ships or smuggles the goods into Colombia.
10. The Free Trade Zone distributor, who is often a knowing participant in the black market exchange process, forwards the check to his U.S. bank account or it may even clear through his local bank account.
11. Once cleared, the check account is debited, and the distributor's U.S. account is credited.



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What to Do About All This

- Government responses – increased reliance on laws and regulations, tendency has been to react to demands to “do something”.
- Private responses
 - Know who you dealing with
 - Maintain standards and monitor internal compliance
 - Create contingency plans
- Inhibitors
 - Too much to know creates vulnerabilities
 - Pressure to compete and defend market share
 - Corruption within the organization



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- Publications available to BIIA attendees
 - Strategic Global Intelligence – a daily e-mail briefing on global issues with emphasis on financial and political risk – no subscription fee
 - Armada Corporate Intelligence Program (ACIP) – a system geared to providing forecasts and assessments that form the foundation of strategy development – weekly monitor, special alerts, market assessment tools - \$2,000 annually.
 - Contact – ckuehl@strategic-briefs.com