

Information note addressed to:

Financial institutions

Individual entrepreneurs and companies

Other interested parties

ANALYSIS

On Fraud Schemes through Seemingly Advantageous Business Proposals

1. Introduction

In the present world, globalization trends and unprecedented development of communication means (especially that of internet), in addition to providing a variety of new opportunities, have also given rise to significant risks, including those related to different fraud schemes through seemingly advantageous business proposals.

Such schemes are basically exercised by means of abusing unawareness or betraying confidence of people, involving them into seemingly “promising” but in reality unreasonable and, as a rule, unprofitable activities in economic terms through creating expectations about quick and large potential gains, presenting non-existent or unlikely business opportunities as real ones.

Seemingly advantageous business proposals may be made by both individuals acting as sole entrepreneurs, intermediaries or experts, as well as by legal entities most often acting as intermediary or consultancy firms incorporated in leading European or other countries (hereinafter collectively referred to as the Intermediary).

Natural persons acting in the role of the Intermediary are usually characterized by the absence of any information on them – including that of positive nature – in publicly available sources, while such sources often reveal negative information¹. In order to boost the interest towards their person, they also use to regularly mention about their personal or business ties with local and foreign famous political, social, and economic figures, refer to certain circumstances (meetings, events, acquaintances, mutual obligations) “in evidence”

¹ For example, information on being involved/ noticed in various fraud schemes in the past, criminal records, bad reputation at certain business quarters etc.

thereof, demonstratively use various articles² and have specific behavior allegedly testifying about their high social status.

Legal entities having assumed the role of the Intermediary are characterized by the lack of reliable and comprehensive information on their financial standing, scope and volume of activities, owners and managers, appropriate presence in the virtual community, which nowadays is a must for a more or less serious company, particularly availability of a properly designed and substantive website, primary domain name and respective electronic mail addresses³ etc.

2. Examples of Fraud Schemes

Below are presented examples of fraud schemes through seemingly advantageous business proposals, which have the final purpose of embezzling lawful financial funds of individuals and companies by the use of formally “legal” means.

A) Formal Due Diligence, Joint Entrepreneurial Activity

The Intermediary proposes Armenian entrepreneurs or companies to develop business projects for the attraction of large investments from abroad. In order to substantiate its proposal, the Intermediary usually submits a solid package of reference documents (most often in electronic form) containing information on its former clients (which, naturally, have been quite successful), on the wide range and geographical spread of its clientele, on various analyses concerning the economic situation and potentially profitable investments in the areas of interest, on different means and tools for securing investments; nevertheless, it never provides more or less meaningful details on the proposed activity with reference to the “customer’s trade secret” or other similar circumstances.

As a prerequisite for finding an investor, the Intermediary suggests conducting a comprehensive expert analysis⁴, for which a separate contract is concluded with the Armenian counterparty. The contract establishes the terms (deadlines, price, final outcome) for the Intermediary to conduct due diligence and, most importantly, usually contains a provision stating that by conducting due diligence the Intermediary does not assume and/or guarantee attraction of investors thereafter.

² Such as high quality special edition business cards, luxury items for personal use (expensive watches, pencils etc).

³ In contrast with, for example, e-mail addresses registered at public domains such as gmail.com, hotmail.com, yahoo.com, mail.ru etc.

⁴ The internationally used term is (formal) due diligence

Once the Armenian counterparty pays the fee for conducting due diligence, the expert(s) of the Intermediary come(s) to Armenia, take(s) certain measures – in varying degrees of meaningfulness – aimed at understanding the business of the customer, and after some time submit(s) a report. Most often, the report states that the documents provided by the customer for due diligence are deficient or non-complete, or, once the customer has provided additional documents, it turns out now that the economic performance of the company fully or partially fails to meet the criteria for attracting potential investors etc. In the end, the customer appears to have paid against something that never transforms into a real inflow of investments/ funds.

As a variety of the above-described scheme, the Intermediary may propose conducting due diligence within the framework of joint entrepreneurial activity, whereby the contribution of the Armenian counterparty would entail covering expenses for the conduction of due diligence (or, alternatively, for the start-up of joint business), while the Intermediary would participate in the joint venture by taking steps aimed at the attraction of potential investors. Pursuant to the above-articulated logic, once the Intermediary gets the “contribution” from the Armenian counterparty and takes some steps to create the appearance of joint business activities, it withdraws from further cooperation by reference to various reasons, bearing in mind that from the very beginning it had never guaranteed successful outcome of such activities.

B) Implementation of Economic Development Programs

The Intermediary contacts Armenian (public) agencies, major enterprises, social or economic structures or simply well-known individuals with good reputation among wide social groups, filing with them proposals in written form or by electronic mail, as well as communicating through the use of personal connections and acquaintances, to implement or finance economic development/ restructuring, infrastructure investment, sectorial reformation, social assistance or other large-scale programs in Armenia. At that, the proposal concerns long-term, often non-refundable programs reflecting the initiators’ exceptional humanitarian motivation, their special “warm” feelings towards Armenia and the Armenians, regional development priorities and other nice-sounding ideas.

As a precondition for launching the program or, as usually presented by the Intermediary, as an expression of the willingness of the interested Armenian counterparty to involve in the program, the Intermediary proposes that they officially invite its representatives to Armenia (or, alternatively, suggests that the Armenian counterparty signs under a predetermined text of a Memorandum of Understanding and sends it back to the

Intermediary on official letterhead form) for an on-site study of the situation and discussion of the details of program by meeting relevant bodies/ officials.

Having arrived at Armenia the Intermediary, while giving generous promises on multi-million investments in case of successful program implementation, applies different reasoning in an attempt to obtain a maximum number of written acknowledgments from public and private structures and individuals verifying that they have vested it with the function of seeking for potential sources of investments to be made in various sectors of the country. The format of such acknowledgments varies from an e-mail communication with an official on a meeting time to a power of attorney on exceptional representation rights, depending on how convincing the Intermediary is and how credulous the acknowledger turns out to be.

As the logical conclusion of the above-described scheme, the Intermediary uses the said acknowledgments as a “proof” of its credibility before third parties; that is, it abuses the factual or supposed good reputation of the acknowledger for various fraud schemes.

C) Concessional Lending Against Guarantee

The Intermediary approaches Armenian banks (or, alternatively, credit associations, investment companies) assuring that it is able to arrange attraction of long-term, low interest borrowings from major investment, venture, or trust funds and similar sources against a bank (or, alternatively, a financial, security-backed) guarantee. In order to make its proposal to look more convincing, the Intermediary provides sample contracts for guarantee issuance and loan extension⁵, recommended texts for accompanying “official” communication, schematic multi-level presentations for attraction of funds and other “reference” materials.

As a variety of the above scheme, the Intermediary may suggest that the guarantee to be issued is secured with bonds, obligations or other securities of foreign companies (often issued in paperless form, expressed in letters of advice whereby different “authorized bodies” or holders verify the availability of such securities), which, even if checked for veracity and proven not to be fake, practically have no value due to the absence of reliable information on the financial performance and factual activities of the issuer.

To dispel the doubts that the potential guarantor might have about the deal, the Intermediary may suggest a scheme whereby the guarantee is not provided from hand to

⁵ Basically in a foreign language – in English or in Russian – compiled with the use of numerous sophisticated terms and rather general/ vague definitions.

hand; instead, the guarantor simply undertakes to confirm its availability in case of inquiry (according to the Intermediary, by the potential lender), which supposedly reduces the possibility of misusing the guarantee but in fact successfully serves the purpose of the Intermediary to “prove” its credibility before third parties.

A variety of the above-described scheme is the case when the Intermediary, instead of asking for a guarantee, requests the Armenian counterparty an acknowledgment of having taken into charge certain bonds, obligations or other securities of foreign (or, alternatively, of Armenian) companies with large face value. In this case, the Armenian counterparty does not undertake any financial risk, since the said securities, although having no real value, are physically existent, and the acknowledger has taken them into charge. Nevertheless, this does not rule out significant reputation risks, since the Intermediary would eventually use the acknowledgment of the Armenian counterparty to misuse its goon name in various fraud schemes.

D) Servicing of Financial Flows

The Intermediary proposes Armenian entrepreneurs or organizations to open bank account(s) for the alleged purpose of servicing the turnover of certain funds related to certain business activities. The Armenian counterparty is offered a fee against its “services”, whereas the service itself is providing for the transfer of funds received on account(s) to the beneficiaries determined by the Intermediary. As a proof of the legal nature of the funds, the Intermediary may provide to the Armenian counterparty – and the latter to its servicing bank – various agreements on joint business activities⁶, economic development programs⁷, borrowing or lending contracts, which often have the characteristics of feint and fictitious contracts⁸.

After the account(s) are opened, the customer regularly transfers the amounts received on them to a number of foreign counterparties, while the purposes of such transfers may include, *inter alia*, reimbursement for representation, operational and other expenses. At that, the transfers as instructed by the Intermediary often are made to the accounts of third parties not indicated in relevant contracts (or, alternatively, are channeled through quick payment systems without opening an account), which the customer explains as reflecting certain peculiarities of the business.

⁶ For example, similar to those described in the scheme under subtitle A of this analysis.

⁷ For example, similar to those described in the scheme under subtitle A of this analysis

⁸ Which are described in the typology “Money Laundering by Means of Feint and Fictitious Transactions (Contracts)” approved by the Decree of the Governor of the Central Bank No 1/351A from April 18, 2012.

As a more general variant of the above scheme, the opening of the account(s) by the Armenian counterparty may be followed by large receipts and transfers within a relatively short period of time, with their only logical aim being to ensure movement of funds from point A to point B, within a framework of – in the belief of the customer – real or, quite possibly, absolutely fictitious entrepreneurial activities. At that, the customer often fails to have complete and reliable information on the origin of received funds or the real beneficiaries of transferred amounts.

3. Conclusion

In order to arrive at a conclusion on the potential existence of the schemes described above, financial institutions, as well as individuals and organizations involved in entrepreneurial activity, persons vested with decision-making powers in various areas of the country's social and economic life are urged to pay attention to the circumstances, which are essential in terms of uncovering such schemes, such as:

- Reasonability and reliability of seemingly advantageous business proposals;
- Business profile of persons making such proposals; information available on them in public and limited-access databases;
- Involvement of foreign (offshore and other high-risk) institutions/ companies in the proposed schemes.