

Policy paper

Moldova as a case study of new money laundering patterns. Lessons to learn and implications for the EU

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Abbreviations

EU	European Union
EE	Eastern Europe
UK	United Kingdom
US	United States
FATF	Financial Action Task Force
AML/CFT	Anti-Money Laundering / Counter-Financing Terrorism
KYC	Know Your Client
OAML/CFT	Office for Anti-Money Laundering / Counter-Financing Terrorism
NBM	National Bank of Moldova
EBRD	European Bank for Reconstruction and Development
USD	United States Dollar

Executive Summary

The evolution and proliferation of new forms of terrorism, organized crime, intrusion, and information warfare is generating new patterns of money laundering to finance these types of activities. The aim is to circumvent the anti-money laundering mechanisms developed through a combined international effort. As money laundering is basically an international phenomenon, it is highly important that regulations and prevention measures be developed and implemented in all countries. This is especially relevant for the European Union (EU), where all new developments, including the 5th anti-money laundering Directive and legal frameworks for automatic exchange of information, may be undermined if neighbouring countries fail to keep up.

The EU is offering significant support to Eastern countries, especially associated countries, to align their regulatory frameworks to EU standards, in particular by supporting the implementation of anti-money laundering regulations and the development of proper prevention mechanisms. Moldova is an example of a beneficiary of both financial and technical support. One of the latest financial supports offered to Moldova is a macro-financial facility totalling 100 million EUR under the memorandum of understanding signed in November 23rd 2017. The financial facilitation is conditioned, among others, on the implementation of anti-money laundering regulations and mechanisms, responsibilities assumed by Moldova through the Association Agreement with the EU. The focus of European money laundering prevention mechanisms—and the key players targeted by international regulations in this area—are financial institutions and complementary private sector activities that can support the transfer of value, and thus are at risk of being used for money laundering as well as financing terrorism.

However, recent developments and cases in Eastern Europe show that new money laundering patterns have emerged in countries where state institutions may be key money laundering actors. The famous “Russian Laundromat” is an example of this: approximately 20 billion USD were transferred from Russia to Western countries through Moldova in a case of money laundering being enabled by state judges through court decisions. The high level of corruption and the low level of revenues in these states, especially in small East European countries, make their official institutions highly vulnerable to money laundering schemes. In spite of large media coverage of the “Russian Laundromat” case, the involvement of state institutions and the rise of new money laundering risks were not emphasized. Unfortunately, neither the Financial Action Task Force (FATF) nor EU regulations have developed recommendations to address these new patterns of money laundering. Instead, they contain only general enhanced due diligence procedures for high-risk countries. However, these enhanced due diligence procedures may not be sufficient to prevent money laundering stemming from Eastern Europe and corrupt state officials. In addition, specific measures should be implemented in those Eastern countries to ensure the effectiveness of the new AML/CFT reforms to be implemented.

The new roadmap for Eastern European countries should consider:

1. AML/CFT reforms should entail a holistic approach, rather than having a standalone objective and policy. This holistic approach should include anti-corruption measures, greater transparency and the strengthening of the institutional framework, and the independence of state institutions.
2. The development of a set of additional AML/CFT recommendations to prevent the involvement of corrupt state officials, especially judges, in the promotion, facilitation, or development of money laundering schemes.

3. Ensuring that the EU Commission more thoroughly evaluate AML/CFT reforms in Eastern European countries, in order to identify misalignments that could jeopardize the effectiveness of the newly established framework and mechanisms.

Introduction

Money laundering (the concealment and transformation of money from illegal origin in order to legally use it and enjoy it) and terrorism are global phenomena that affect all countries, undermining the rule of law and trust in state institutions. They also tend to be related to other crimes highly detrimental to societies, such as corruption, tax evasion, drug trafficking, and violence. Importantly, both money laundering and terrorism usually exploit globalization and international financial markets to achieve their goals. Therefore, responses need to also be global.

The international community has been developing international conventions (e.g. UN Conventions against corruption, organized crime and drug trafficking) and standards to fight these crimes. In the case of money laundering and terrorism, the Financial Action Task Force (FATF) has developed recommendations for anti-money laundering measures and combatting the financing of terrorism. They include provisions on transparency, the supervision of the financial sector and other related professionals (e.g. lawyers, accountants, notaries, etc.), due diligence processes, and international cooperation to prevent abuse of the financial system with the goal of facilitating the commission of crimes.

The European Union (EU) has been at the forefront of the fight against money laundering, terrorism, and tax evasion. For example, the 4th AML Directive, approved in 2015 and later amended in 2018 as a consequence of the Panama Papers and other leaks, is at the global vanguard of transparency, as it requires beneficial ownership registries for legal persons and trusts. The EU has also updated its anti-money laundering processes on customer due diligence, virtual currencies, anonymous accounts and safe deposit boxes, etc. In the field of tax evasion, the Directive on Administrative Cooperation (DAC 2) requires the automatic exchange of financial account information among all EU countries.

Given the international nature of money laundering and terrorism, the lack of effective implementation of preventive measures in foreign countries may have consequences in the national territory. An example of this has been the Russian Laundromat, where EU entities (e.g. UK legal persons) were used in a money laundering scheme that transferred money from Russia into EU banks, for example in Denmark, by means of exploiting banks and state institutions in Eastern European countries, such as Moldova and Latvia.

Both the EU AML Directive and the FATF contain provisions that address problems in high-risk third countries, for example by requiring enhanced due diligence when those countries are involved. However, these provisions have been unable to prevent the involvement of EU countries in money laundering operations that started elsewhere, as exemplified by the Russian Laundromat. In addition, the provisions aimed at high-risk third countries do not sufficiently resolve the money laundering risks in those third countries.

The EU has signed cooperation agreements to assist, both financially and technically, other countries in Europe. However, reforms in those countries have not succeeded in aligning their legal frameworks to those of the EU, not in terms of transparency or international exchange of information, nor in terms of the prevention of money laundering and terrorism. This will affect not only those countries, but also the EU, since its neighbouring countries will continue to create high risks.

New money laundering schemes, such as the Russian Laundromat, show new crime patterns involving state institutions. It is not clear if merely aligning third-country AML laws to those of the EU or even enforcing current FATF Recommendations will be enough to address these new risks that involve the abuse of state agencies (e.g. the judicial system). This paper will consider proposals that all countries (not only those with high corruption) should apply in order to prevent state institutions from being abused to facilitate money laundering.

Moldova

The Republic of Moldova, which gained its independence from the Soviet Union on 27 August 1991, is located in south-eastern Europe, bordered by Ukraine to the north and west and Romania to the south and east. It has 33.8 thousand square km and a population of approximately 3.5 million people (excluding the separatist region of Transnistria). Moldova is divided into 32 districts (rayons), three municipalities, and two autonomous regions (Gagauzia and Transnistria). The final status of Transnistria is disputed, as the central government does not control that territory where Russian troops are deployed. Moldova is a unitary parliamentary representative democratic republic. The 1994 Constitution of Moldova sets the framework for the government of the country. Corruption in the former Soviet space got even worse after the collapse of the Soviet Union. Accordingly, Moldova founded in 2002 a centre responsible for fighting corruption and economic crimes. Since then, there have been a series of reforms and regulatory improvements. However, little progress was achieved and corruption is considered one of the main causes of poverty and dissatisfaction in the country. In 2017 Moldova was ranked number 122 out of 180 countries in Transparency International's Corruption Perception Index¹ (lower position = more corruption). With Romania's accession to the European Union (EU) in January 2007, Moldova became part of the EU's Eastern border. Since then, exports to the EU have steadily grown, reaching 65% of the total exports of Moldova in 2017. On 29 November 2013, at a summit in Vilnius, Moldova initiated the process of signing an association agreement with the European Union dedicated to the European Union's 'Eastern Partnership' with ex-Soviet countries. Moldova signed the Association Agreement with the European Union in Brussels on 27 June 2014, and the deal came fully into force, following ratification by all 31 signing parties, on July 1st 2016. Moldova has also achieved a Free Visa Regime with the EU, which represents the biggest achievement of Moldovan diplomacy since its independence. Still, growth has been hampered by the 2014 Russian import ban on agriculture products from Moldova. Restrictions on migrant workers have also led to reduction of remittances from the Russian Federation. Moreover, the theft of 1 billion EUR from the banking system at the end of 2014 led to a financial crisis. As a consequence, a large reform in the banking system was launched. After the bankruptcy of three banks involved in the theft, the National Bank of Moldova put under special administration the top three largest banks in Moldova due to a lack of transparency of their major shareholders. Two of those banks have new professional investors, one of which is the European Bank for Reconstruction and Development.

The purpose of this study is to show, based on the case of Moldova, that the new money laundering patterns emerging in Eastern Europe may have global implications. Global improvements in AML/CFT recommendations may be required in order to effectively address these new patterns. The AML/CFT reform in Moldova represents a valuable case study for analysing the efficiency of the ongoing reforms in developing countries.

¹ <https://www.transparency.org/country/MDA>

Developing countries have shown increased vulnerabilities to money laundering due to high corruption and poor institutional processes and controls in state institutions. Between 2010 and 2014, Moldova was involved in the “Laundromat”, an international scheme where ill-gotten money was transferred from the Russian Federation to the US and to European countries with the help of on more than 50 court decisions in Moldova. A thorough analysis of the case was done in 2014 by Rise Moldova, a community of investigate journalists. Rise Moldova has revealed the money laundering scheme and the role judges played in it. (figure 1).

Figure 1: The Laundromat flow of money.



Source: RISE Moldova,

Authors: Iurie Sanduta, Ion Preasca (RISE Moldova), Roman Anin, (Novaya Gazeta), Mihai Munteanu, Paul Radu, Miranda Patrucic (OCCRP), Victor Ilie (RISE România), Arta Giga (Letonia), Vladimir Kostic (CINS Serbia)

<https://www.rise.md/english/the-russian-laundromat>

Payment flow of the Russian Laundromat through Moldova is shown in Annex 1

In late 2014, another scandal that significantly affected the economic situation hit Moldova: approximately 1 billion USD (or about 12% of GDP) was stolen from the banking system. Again, state institutions were involved. Following these cases, Moldova’s international partners—in particular the IMF, the World Bank, and an EU Delegation—emphasized the need to strengthen shareholder transparency, state supervision, and AML/CFT mechanisms. This goal was complemented by the requirements of the Association Agreement with the EU, which requires that the Republic of Moldova’s legal framework on AML/CFT be aligned with the EU regulatory framework, in particular with EU Directive 2015/849.

In 2016, as a consequence of the Association Agreement, Moldova’s Office for Anti-Money Laundering and Countering Financing of Terrorism (OAML/CFT) started reviewing the normative acts and the mechanisms of AML activities. In 2015, the OAML/CFT - with the support of the World Bank - initiated a country-by-country evaluation of money laundering and terrorism financing risks, as required by the FATF recommendations and

European Directive 2015/849. After extensive analyses and consultations, a report² was issued in 2017. While the report did mention the “Russian Laundromat” case, it failed to mention the involvement of state institutions or carry out an assessment of the risk of state malfeasance. No proposals were recommended to prevent these risks in the future.

On February 3rd, 2017, the OAML/CFT and the Government of the Republic of Moldova (Government) submitted for approval the draft law on preventing and combating money laundering (Draft Law on AML/CFT). The law was approved by the Moldovan parliament on December 22, 2017³. The new draft law proposed to align the national legislation to the two recently updated international standards: first, EU Directive 2015/849 on the prevention of the use of the financial system for the purposes of money laundering and terrorist financing (Directive) adopted on 20 May 2015 by the European Parliament; and second, the Financial Action Task Force (FATF) standards that were revised in 2012, containing 40 Recommendations and 9 specific recommendations (FATF Recommendations).

However, Moldova’s new law has a series of shortcomings. Given that the national risk assessment was superficial and did not identify measures to address new money laundering schemes, it was disappointing that the AML/CFT regulatory reform failed to cover the new cases presenting high risks. The main concern was a lack of any measures to address the involvement of state institutions in facilitating money laundering (especially the judicial system that was exploited in Moldova to facilitate money laundering). Similarly, there were no mechanisms included in the law that would ensure, through KYC procedures and mandatory AML checks, the prevention of money laundering during privatization processes. This may result in under-regulation and a substantial loss of efficiency and effectiveness of AML/CFT mechanisms.

Moldova has also failed to improve the transparency of its legal framework and the international exchange of information. The EU Directive requires EU countries to implement beneficial ownership registries for companies and trusts, whereby the individuals who ultimately own, control, and/or benefit from these legal vehicles have to be identified. This helps prevent criminals from hiding behind secretive entities to open bank accounts, purchase real estate, or simulate transactions that are part of money laundering or financing of terrorism. In relation to this, Moldova improved the regulation⁴ in this regard and started to implement the requirement that anyone registering a company also declare the beneficial owner. In addition, in order to tackle tax evasion, all EU countries are automatically exchanging banking information with each other and with third countries based on the EU’s Directive on Administrative Cooperation (DAC 2) and the OECD’s Common Reporting Standard, respectively. However, as of June 2018 Moldova hasn’t even committed⁵ to implement the automatic exchange of information with any other country. Not only will this prevent Moldova from fighting tax evasion where its residents hold undeclared bank accounts abroad, but this will also create risks for EU countries. Moldova established a new golden visa program in 2017⁶. EU individuals could, therefore, acquire Moldova’s citizenships in exchange for investments (without needing to move to Moldova), only to exploit these citizenship certificates. These EU individuals could abuse their Moldovan citizenship certificates to convince their banks

² <http://spsb.cna.md/ro/press-release/fost-lansat-primul-raport-na%C5%A3ional-de-evaluare-riscurilor-%C3%AEn-domeniul-sp%C4%83i%C4%83rii-banilor>

³ <http://parlament.md/ProcesulLegislativ/Proiectedeacteleislative/tabid/61/LegislativId/3592/language/ro-RO/Default.aspx>

⁴ according to the article 14 of the new law nr.308 dated 22.12.2017 regarding anti-money laundering and counter-financing terrorism: <http://lex.justice.md/md/374388/>

⁵ <https://www.oecd.org/tax/transparency/AEOI-commitments.pdf>

⁶ <https://www.occrp.org/en/daily/8319-moldova-hopes-golden-visa-program-will-bring-in-1-3-bill>; <https://citizenshipshop.com/moldova-opens-new-citizenship-by-investment-programme/>

that they are not EU individuals but residents in Moldova. If successful, these EU individuals will be able to avoid having their foreign bank accounts reported to the corresponding EU authorities⁷.

⁷ See more details on how this works here: http://taxjustice.wpengine.com/wp-content/uploads/2018/03/20180305_Citizenship-and-Residency-by-Investment-FINAL.pdf

Key issues of the anti-money laundering and prevention mechanisms

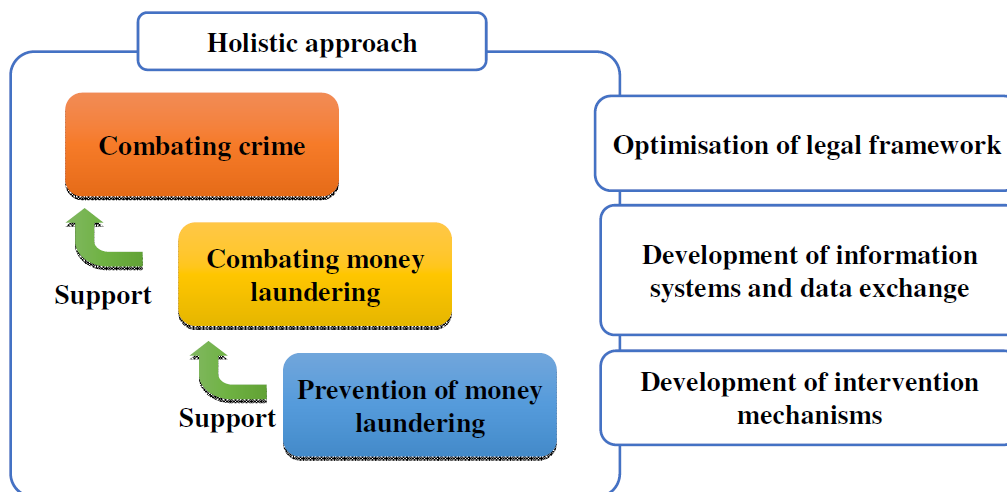
This section highlights key issues of the new AML/CFT law approved on December 22nd 2017. It also covers Moldova's mechanisms to prevent and combat money laundering, including the identification of risks as well as effective measures and the application of a rational, holistic approach to the prevention of money laundering.

One of the primary goals of modern societies and states, as established in international treaties and conventions, is to eradicate organized crime, drug trafficking, human trafficking, organ trafficking, illegal arms trafficking, and corruption. Tackling money laundering complements the fight against such crimes by helping prevent the use and enjoyment of (monetary) gains obtained from those illegal activities.

Though Moldova succeeded in approving a new AML/CFT law, several shortcomings remain. Our analysis focuses on three issues: the lack of a holistic approach, the lack of measures against corrupt state institutions, and the misalignment between the relevant EU Directive, FATF recommendations, and the newly adopted regulatory framework.

Issue no. 1: The lack of a holistic approach to crime prevention, the need for measures on crime investigation and forfeiture procedures, and the need for an institutional framework for the accountability and transparency of government agencies

Figure 2: A holistic approach to crime and terrorism eradication



Source: Developed by author

In order to tackle money laundering and predicate offenses (e.g. related crimes such as drug trafficking, tax evasion, etc.), Moldova needs holistic reform. Necessary measures include the independence of state agencies, especially those in charge of state supervision; an increase in transparency of government actions (e.g. budget

and appointment of officials), transparency for the private sector (e.g. beneficial ownership transparency), and measures to address corruption (e.g. filing and publication of asset declarations by public officials, including the source of funds used to purchase those assets). This would enable Moldova's civil society sector and journalists to hold government officials to account. In addition to increasing transparency, authorities should conduct investigations and prosecutions whenever there are suspicions of corruption or conflicts of interest, or when money laundering appears to be taking place.

However, Moldova's AML/CFT reforms focus only on the private sector, without requiring any improvement in the institutional framework. The new law requires the private sector to report suspicious transactions and imposes punitive actions in case of non-reporting. This increases compliance costs for businesses and may bring some benefits, but it doesn't ensure that governmental bodies will process and apply those reports efficiently. Moreover, in a corrupted environment, AML/CFT may often be abused to harass the business environment or specific political opponents. As consequence, Moldovan society may end up perceiving AML/CFT measures not only as merely another bureaucratic requirement with little or no effect in crime prevention, but also as an additional extortion instrument against the private sector and businesses.

Moldova's AML reform also looks disproportionate in relation to measures tackling other crimes. While the new law incorporates many new measures to prevent money laundering, there are no equal measures to prevent predicate crimes, such as trafficking of human beings and organs, drug trafficking, corruption etc. As long as the entire legal framework related to organized crime is not updated, the effects of strengthening money laundering prevention will be minimum and inefficient in comparison with the efforts made.

Recommendation no. 1: Adopt a holistic approach by addressing other relevant crimes such as corruption and organized crime.

Recommendation no. 2: Expand money laundering prevention measures to cover the reform and improvement of state institutions (e.g. more transparency and international cooperation to exchange information).

Issue no. 2: Insufficient national risk assessment of money laundering schemes and a failure to identify new patterns of money laundering schemes may result in mis-regulation and a substantial loss in the effectiveness of AML/CFT mechanisms.

According to the FATF recommendations, countries should first identify, assess, and understand the risks of money laundering and terrorist finance that they face, and then adopt appropriate measures to mitigate the risk. The risk-based approach, within the framework of the FATF requirements, is fundamental to ensure the adoption of flexible set of measures. Taking this approach is essential in order to target resources most effectively and apply preventive measures that are commensurate to the nature of risks.⁸ However, Moldova

⁸ International standards on combating money laundering and the financing of terrorism & proliferation, the FATF recommendations, February 2012, updated October 2016.

failed to undertake a thorough national risk assessment, as described below, and thus developed a new law that fails to solve all of Moldova's shortcomings.

Moldova's national risk assessment is superficial and lacks any reference to major money laundering schemes, including the Russian Laundromat⁹. The EU Directive 2015/849 and FATF recommendations strongly recommend that countries conduct a thorough AML/CFT national risk assessment exercise and compile a detailed report describing all money laundering patterns. For all types of crimes that have been recorded in the country (e.g. drug trafficking, human being trafficking, proliferation of weapons, corruption), typologies of the cash flows should be elaborated. The goal of this is to direct the AML/CFT regulatory framework to the specific risks identified. This would also minimize the impact on the business environment. However, Moldova's national risk assessment report lacks any reference to the most important money laundering schemes, including the "Russian Laundromat". For example, the judges that represented the main instrument to launder funds from Russia are not mentioned a single time in the risk assessment report. Nor are there any provisions to prevent this risk in the future. Another example is trafficking of human beings, a crime to which Moldova is significantly exposed. The report includes only a poor analysis of the trafficking of human beings, and the typology of cash flows is missing.

The involvement of corrupt state institutions (the judicial branch in the case of Moldova) in facilitating money laundering can lead to two different approaches. On the one hand, it can be seen as an issue that must be addressed by the holistic measures that Moldova should undertake in order to effectively prevent money laundering and other crimes: increasing transparency of beneficial owners of companies and trusts, ensuring supervisors' efficacy and independence, fostering anti-corruption by publishing government officials' asset declarations, etc. On the other hand, the involvement and abuse of state institutions to facilitate money laundering may require a new set of AML measures for all countries (not only those considered to present high-risk). Annex 2 analyses what these new measures could look like.

As for the private sector, the filing of suspicious transactions reports in Moldova seems excessively high when compared to other countries, suggesting a lack of quality of those reports, or a deliberate attempt to obscure actual suspicious transactions. Moldova's OAML/CFT collected and published annual statistical data on the filing of suspicious transaction reports (STRs), as well as high value¹⁰ transactions and those carried out in cash. An impressive number of suspicious transactions were reported in 2015¹¹ (662,818 of the total of 2,715,919 transactions reported). To put this in perspective, 381,882¹² suspicious transactions were reported in the United Kingdom in the course of one year. In other words, the number of STRs filed in Moldova is almost twice as many as those filed in the UK, even though Moldova's population is 18 times smaller and its GDP is 360 times smaller. This suggests that the STR provisions set by OAML/CFT in Moldova are poorly calibrated or of poor quality--or that there was a deliberate attempt to obscure actual suspicious transactions.

Thus, it is critical that OAML/CFT conduct a comprehensive risk assessment, identifying real risk areas based on the money laundering typologies detected for the crimes recorded in Moldova in order to adjust the legal framework. In this way efforts and resources could be focused on what were found to be the most important

⁹ <http://spsb.cna.md/ro/press-release/fost-lansat-primul-raport-na%C5%A3ional-de-evaluare-riscurilor-%C3%AEn-domeniul-sp%C4%83i%C4%83rii-banilor>

¹⁰ According to the AML requirements in Moldova, all transactions with a value higher than 100.000 MDL (aprox.5000 EUR) are reported to OAML/CFT

¹¹ http://spsb.cna.md/sites/default/files/documents/files/2015_Raport_RO.pdf

¹² <http://www.nationalcrimeagency.gov.uk/publications/826-suspicious-activity-reports-annual-report-2017/file>

risk areas. The collection and processing of an exaggerated volume of data, unconfirmed by a sound risk assessment, is a waste of taxpayer resources. It may also undermine the image of the anti-money laundering effort within Moldova's society.

In view of the above, OAML/CFT should perform a new national risk assessment. This should be thorough and refer to the abuse of state institutions (e.g. the judicial system). It is strongly recommended that OAML/CFT carry out this assessment with the participation of international and national experts, including from the economic and financial areas, in order to correctly and comprehensively assess all risks and to highlight the truly critical ones. We recommend that this mixed team develop measures necessary to reduce specific critical risks, and transpose these measures into the regulatory framework. The report should assess the role of state institutions, e.g. the judicial system, and propose measures to prevent their abuse with the aim of facilitating money laundering.

Once the new national risk assessment is published, Moldova should undertake consultations for new AML/CFT reforms. Following the risk assessment, the OAML/CFT should adjust the preventive legal framework to target all sectors that pose risks. There should be training and feedback for the private sector to ensure not only compliance but also the quality of the reporting of suspicious transaction reports.

Recommendation no. 3: Assess thoroughly the national risks of money laundering and adjust the legal provisions of the AML/CFT law to specifically target identified high-risk areas. Develop measures to prevent the abuse of state institutions with the aim of facilitating money laundering schemes.

Recommendation no. 4: Provide training and capacity building to the private sector, and provide feedback on the suspicious transactions that they report in order to improve the quality of the anti-money laundering framework.

Issue no. 3: Misalignment between the EU Directive and Moldova's national AML/CFT regulations may result in significant alteration of the effectiveness of AML/CFT mechanisms as well as defective policy side effects.

Moldova failed to align its "money laundering" definition with the EU Directive. Instead, it kept its old definition. This misalignment may cause the following risks. First, AML/CFT resources may be diverted to areas not regarded as money laundering according to the EU definition, resulting in less effective money laundering prevention and wasting the already-limited resources on irrelevant cases. Second, actions that do not constitute money laundering may be treated as "money laundering" by national enforcement bodies. Thus, the AML/CFT law may be used as an instrument to harass the private sector.

EU Directive, Article 1	Criminal Code of Moldova, Art. 243
<i>For the purposes of this Directive, the following conduct, when committed intentionally, shall be regarded as money laundering:</i>	(1) Money laundering committed by: a) the conversion or transfer of goods by a person who knew or should have known that such goods were

<p><i>(a) the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an activity to evade the legal consequences of that person's action;</i></p> <p><i>(b) the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property, knowing that such property is derived from criminal activity or from an act of participation in such an activity;</i></p> <p><i>(c) the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such an activity;</i></p> <p><i>(d) participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions referred to in points (a), (b) and (c). [emphasis added].</i></p>	<p><i>illegal earnings in order to conceal or to disguise the illegal origin of goods or to help any person involved in the commission of the main crime to avoid the legal consequences of these actions;</i></p> <p><i>b) the concealment or disguise of the nature, origin, location, disposal, transmission, or movement of the real property of the goods or related rights by a person who knew or should have known that such were illegal income;</i></p> <p><i>c) the purchase, possession or use of goods by a person who knew or should have known that such were illegal earnings;</i></p> <p><i>d) the participation in any association, agreement, complicity through assistance, help or advice on the commission of actions set forth in letters a)-c);</i></p> <p><i>shall be punished by a fine in the amount of 1350 to 2350 conventional units or by imprisonment for up to 5 years, in both cases with (or without) the deprivation of the right to hold certain positions or to practice certain activities for 2 to 5 years, whereas a legal entity shall be punished by a fine in the amount of 8000 to 11000 conventional units with the deprivation of the right to practice certain activities or by the liquidation of the legal entity. [emphasis added]</i></p>
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Although at first glance one may not find major differences, a more in-depth analysis reveals that these divergences in the definition significantly alter the notion of money laundering. The 'European' definition provides clearly for acts 'committed intentionally', which requires the investigation bodies to prove them. In the 'Moldovan' version, this criteria is replaced by 'should have known', and do not require the prosecutor to effectively demonstrate the existence of the intention of money laundering. While this lower threshold may broaden the prosecution of money laundering, it could also be exploited in corrupt countries with poor independence of state agencies in order to prosecute (persecute) political opponents and the private sector.

In order to avoid different interpretations or abusive practice by Moldova's law enforcement agencies, Moldova should transpose the exact definition of "money laundering" contained in the EU Directive. An analysis of six recently adopted/amended pieces of AML legislation in EU countries reveals that all of them adopted the exact wording of EU directive 2015/849 for the definition of "money laundering". Having an identical definition would allow Moldova to apply it consistently to other EU countries.

Recommendation no. 5: Moldova should adopt an identical definition of “money laundering” to that contained in the EU Directive.

Conclusions

In a globalized world with cross-border financial transactions, foreign countries' poor legal frameworks may pose risks to the national territory and local crime prevention. The international community has been developing international conventions and standards to fight against illicit financial flows such as corruption, money laundering, tax evasion, and the financing of terrorism, among others. The European Union (EU) has been at the forefront of the fight against money laundering, terrorism, and tax evasion, for example with the adoption of the 5th AML Directive and the framework for automatic exchange of information. However, the combination of weak enforcement, poor compliance, and high-risk countries may have dire consequences, affecting the effectiveness of the whole prevention framework. An example of this has been the Russian Laundromat, where EU entities (e.g. UK legal persons) were used in a money laundering scheme that transferred money from Russia into EU banks, for example in Denmark, by means of exploiting banks and state institutions in Eastern European countries, such as Moldova and Latvia.

The case of Moldova is a typical example in the region. The EU's effort to improve the AML regulations in Moldova as a consequence of the Association Agreement has proven insufficient to build an effective AML mechanism in the country. The national risk assessment was superficial and failed to consider all crimes, identify high-risk areas, or propose comprehensive measures. So it is no surprise that the AML reforms that followed lacked a holistic approach, putting too much emphasis on the private sector, and failing to propose any structural reform to fight corruption, increase transparency, and foster international cooperation.

Another highly important conclusion based on Moldova's case is that state institutions may become key players in money laundering. FATF recommendations, like many other international standards and conventions, rely on state officials being honest and compliant with the law. They require the private sector to perform due diligence and other prevention processes, whereas state institutions are merely required to supervise the private sector and cooperate with other countries. They only require enhanced due diligence in case of higher-risk third countries. However, one may ask whether state institutions should also be required to improve their legal frameworks. One approach is to require structural changes to fight corruption (e.g. increase transparency, international exchange of information and ensure the independence of state institutions). Another approach is to consider specific money laundering prevention measures also for the public sector.

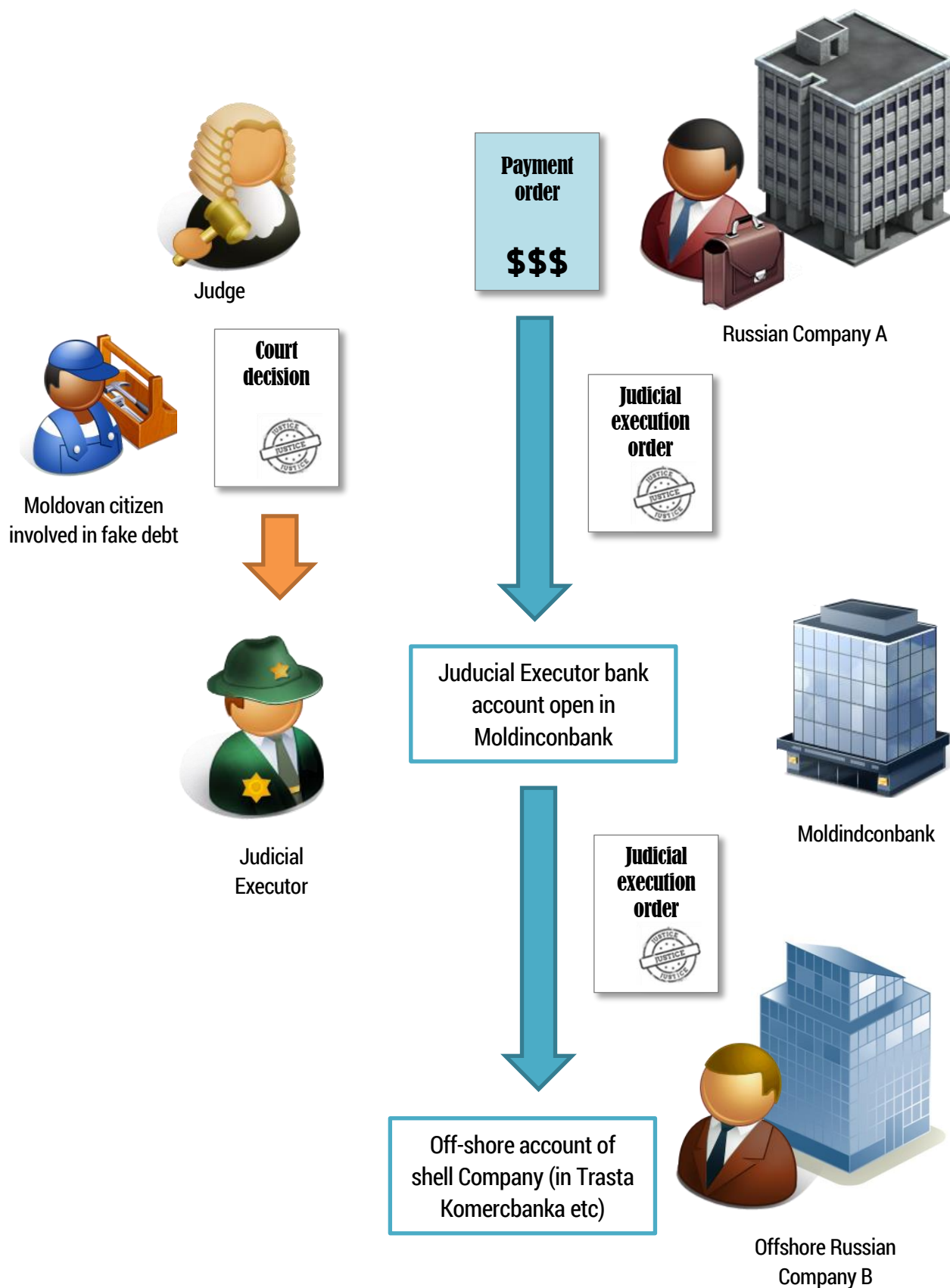
In the context of Eastern Europe, as well as other countries and regions where criminal activity is highly interlinked with state authorities (the "Russian Laundromat" case is a bright example), FATF should review and enhance its recommendations, taking into consideration that specific state institutions may play key roles in organizing money laundering schemes, especially the judicial system. For this purpose specific controls and risk evaluation mechanisms should be suggested to stop or at least diminish the effect of this phenomenon. An international team of experts should be convened to assess the new patterns of money laundering involving state institutions. This group of experts should develop tailored recommendations to build efficient regulations to prevent the development of this dangerous pattern of money laundering. Otherwise, the court system, state procurement agencies, and state privatization agencies may facilitate money laundering schemes rather than prevent them.

Failing to develop new international standards may expose the EU to money laundering risks when engaging in financial transactions with jurisdictions with poor state institutions. In such cases, confirming the legal origin of

the funds will also prove challenging. Russia represents a particular risk: it is seeking methods of financing its propaganda and informational warfare ¹³in Western countries, the EU being of a particular interest. Russia's proximity to and historical linkages with Eastern Europe make this region particularly vulnerable to money laundering schemes.

¹³ Organized Crime and Corruption Reporting Project, revealed that part of the Russian Landraumat money flowed out to a small Polish NGO that pushed Russia's agenda in the European Union and was run by Mateusz Piskorski, a Polsih pro-Kremlin part leader arrested for spying for Russia.

Payment Flow through Moldova in Russian Laundromat



New measures to prevent the abuse of the judicial system to facilitate money laundering

Frameworks to tackle illicit financial flows (e.g. FATF Recommendations, automatic exchange of banking information, etc.) usually involve actions or information obtained from the private sector, including financial institutions (e.g. banks) as well as professionals related to the financial system (e.g. lawyers, notaries, trust and corporate service providers, accountants, real estate brokers, etc., all of whom are referred to as DNFBPs by the FATF). For example, banks or lawyers may have to file suspicious transaction reports (STRs) about their clients to the Financial Intelligence Unit (FIU) if they suspect a transaction may be related to money laundering. Government authorities, such as the FIU, are the ones who receive and process information (usually considered confidential) and enforce regulations.

These legal frameworks usually subject the private sector (e.g. banks and lawyers) to supervision, audits, and or/sanctions to ensure compliance with the law. When it comes to government authorities, it is assumed that they are already in compliance with the law, so the standards and recommendations refer only to cooperation and sharing of information both at the national level (within authorities from one country) as well as internationally. Only with regard to high-risk third countries do recommendations suggest, for instance, enhanced due diligence measures.

However, the system's design was flawed from the outset, as real cases have shown: it relies on government authorities complying with the law. It relies not only on their understanding and enforcement of the law, but on something even more basic: their honesty.

Recent scandals prove that, in reality, governmental bodies do not always play along. The Panama Papers are one example of authorities not enforcing the law on lawyers and corporate service providers. The Luxleaks are an example of the authorities being part of the problem (authorities were actively engaged in illegitimate tax rulings and agreements). Now the uncovering of Moldova's Laundromat shows that judges were involved in a major money laundering scheme.

There are two approaches to this problem. One option is to consider this is a problem of corruption that cannot be solved by the prevention of money laundering, but rather requires structural changes (e.g. more transparency, independence of state agencies, etc). Another approach, which could be combined with the first one, is to propose additional measures in the framework of money laundering prevention to reduce the risks of corrupt countries (and judges). Both approaches assume that "enhanced due diligence for transactions with high-risk third countries" is not enough to prevent money laundering.

Moldova's Laundromat: exploiting two weaknesses

In order to determine that a financial transaction (e.g. transfer of money from A to B) is legitimate, an obliged entity, i.e. those subject to anti-money laundering provisions (e.g. a bank), should determine three different issues:

1. The origin of the funds (Can A prove a legal origin of the money that will be transferred to B?)
2. The nature of the transaction in relation to the business of the client (why is A giving money to B: is it a donation, a payment for a purchase? Does A usually make transfers of that much money to B or to other foreign companies? Is it related with A's business? Etc.).

3. The identity of the individuals (who are A and B, or who are the individuals ultimately controlling A and B? Are they politically exposed persons? Are they involved in terrorist activity? Do they have a profile that matches the transaction under analysis?)

In the case of Moldova's Laundromat, the criminals exploited the judicial system to "pass" point 2, the nature of the transaction in relation to their business.

While in Moldova's case it appears that the judges were actually corrupt¹⁴ and involved in the money laundering scheme, it could also be the case that judges are simply unaware that a typical commercial situation is actually part of a money laundering scheme.

Criminals may simulate a transaction (e.g. a loan that is not paid back) so that when the "fictitious" creditor sues the "fictitious" debtor, it looks like any legitimate lawsuit involving companies or individuals. In the case of Moldova's Laundromat, the lawsuits referred to a loan between two companies. They could just as easily refer to a real estate purchase, or to an employment situation (a person being fired and suing for worker's compensation). If it looks like any typical lawsuit over the transfer of funds, a judge would likely rule on the issue at hand, and not ask additional questions or try to determine if money laundering is involved.

A criminal in possession of a court ruling ordering the payment from A to B (as supporting information) is likely to have success simply going to a bank to make the transfer. For the bank employee analysing the transaction, any form court order will likely look legitimate enough (i.e. presenting a low risk of money laundering), and will certainly look much better than a request to transfer money made without presenting any supporting information.

In other words, money launderers may exploit two inherent weaknesses: first, a commercial judge's unawareness of money laundering schemes that involve certifying or endorsing a transfer of money. Second, the fact that a financial institution may in practice "relax" its suspicions if the transfer of money is based on a court sentence.

Was Moldova's Laundromat possible only because of corrupt judges?

No, Moldova's Laundromat was not the result of corrupt judges only. The whole system failed. A court order by itself (ordering the payment from A to B) may give an appearance of legitimacy. However, if several lawsuits look the same and involve paying money to the same person, then the bank should become suspicious. On top of this, when the values involved were so high (20 billion dollars!), much more suspicion should have been raised.

In addition, as explained above, the nature of the transaction is only part of the analysis: the origin of the funds and the identity of the beneficial owners (the individuals ultimately controlling the bank accounts involved) should have also been checked. This could have prevented the money laundering scheme from taking place.

Are new measures needed?

The current level of compliance with FATF anti-money laundering recommendations is far from acceptable. For example, as of July 2018¹⁵, none of the 50 jurisdictions assessed in the 4th round of mutual evaluations on anti-money laundering fully complies with Immediate Outcome 4, which assesses whether "financial institutions and

¹⁴ See for instance <https://www.occrp.org/en/laundromat/grand-theft-moldova/> and <http://www.moldova.org/en/15-judges-arrested-moldova-prosecution-office-russian-laundromat-case/>

¹⁵ <http://www.fatf-gafi.org/media/fatf/documents/4th-Round-Ratings.pdf>

DNFBPs adequately apply AML/CFT preventive measures commensurate with their risks, and report suspicious transactions.” The best case is Armenia, with an equivalent rating of “largely compliant” (called “substantial level of effectiveness”); 32 jurisdictions obtained an equivalent of “low compliant” (called “moderate level of effectiveness”) and 17 jurisdictions an equivalent of “non-compliance” (called “low level of effectiveness”).

It is certainly necessary to improve compliance with and the effective implementation of FATF recommendations. However, new measures could also be added to prevent corrupt authorities in general, and the judicial system in particular, from being used to facilitate money laundering, as in Moldova’s case.

Proposed new measures

1-For Commercial judges:

- Anti-money laundering training, so that they are aware that typical commercial transactions may be part of a money laundering scheme.
- For transactions above a certain threshold, e.g. 10.000 euro, especially when dealing with private companies (e.g. not a well-known multinational) or state-owned enterprises, require the beneficial owners of both the plaintiff and the defendant to be identified, and run a check or request that the FIU/a government agency check their background (are they politically exposed persons? Have they been involved in many similar lawsuits? Have they been investigated for money laundering before? etc.).
- Any plaintiff invoking the payment or lending of money should be required to prove it with a bank transfer. This means that, if A claims it gave 1 million euro to B, then A must show a banking record with a transfer of 1 million from an account held under its name to a bank account held by B. Merely claiming that money was lent should not suffice to prove it. Requiring all payments/loans to be done through a bank before they may be presented as evidence in court would ensure that at least one financial institution has performed a first due diligence of the person and origin of the funds. Enhanced due diligence or even a rejection of the evidence should be considered if the alleged transaction took place in countries with very low levels of transparency and of compliance with FATF recommendations.
- For transactions above a certain threshold, e.g. 100.000 euro, especially when dealing with private companies (e.g. not a well-known multinational) or state-owned enterprises, courts could be required to have an agent similar to a compliance officer who would analyse the risk of money laundering in the situation involved. Courts could be required either to file suspicious reports to the FIU or criminal judges for further investigation, or to request from them a clearance certificate indicating that the transaction looks legitimate.

2- For banks or other financial institutions receiving a request to transfer money based on a court order:

- The debtor would have to open a bank account (or use an existing bank account) to ensure that the customer due diligence has been applied (including an analysis of the beneficial owner and the origin of the funds that will be used to make the transfer).
- Court orders from foreign countries should be subject to enhanced due diligence, and banks should file a suspicious transaction report, especially if the country issuing the court order is has low levels of transparency and low compliance with FATF recommendations.

3-Public information

- Countries should publish statistics about the number of suspicious transactions reports (by type of entity that issued it) and the convictions resulting from those STRs, to measure whether they are enforcing AML regulations.
- Courts should be required to publish statistics on the duration of every case they resolve, to identify cases that are resolved much faster than the average. For example, if a typical bankruptcy case takes 3 years but one case was resolved in 2 months, it should raise suspicions, both about the judge and about the specific case (especially if such quickly-obtained court order will be used to support a transfer of money).
- Countries should establish public registries of beneficial ownership for all legal persons and trusts registered and operating in their territories.
- All public officers (including judges) and PEPs should be required to annually publish declarations of assets and those of their related persons (to identify cases of unjustified enrichment).
- Countries should implement the OECD's Common Reporting Standard for the automatic exchange of information. The loophole relating to court orders should be removed, so that any account related to a court order or an escrow account should be required to be exchanged. Additionally, information received under the CRS should also be used by FIUs and law enforcement to tackle money laundering and corruption, even if it's not related to tax evasion.