

KROLL Investigation:

Between Expectations and Reality

Author:
Eugen Ghilețchi

Translated from Romanian by:
Tatiana Kuzminov

■ Executive Summary

In 2014, the domestic banking system was shaken by one of the biggest internal crises in our country's history. The bank fraud that resulted in the theft accounting for 12 per cent of the GDP was the consequence of flawed corporate governance in some banks, of dysfunctions and lack of coordination among state institutions, including the ones in charge of ensuring financial stability, as well as the consequence of ill-intentioned decision-makers in state institutions and banks¹. In almost 3 years after the crisis, the authorities recovered around MDL 963 million from selling the assets of the three banks, while Kroll Company, contracted to conduct an investigation and support the authorities in recovering the stolen money, detected committed crimes that together add up to around USD 600 million².

Currently, the only solution that could actually lessen the burden on citizens is to follow the missing money and to recover it to the possible extent. Taking into account the complexity of schemes used by crooks in bank frauds, the full recovery of the assets is virtually impossible in such situations. International experts believe that retrieving even 50 per cent of the lost money in such cases is an achievement³.

Given the international scale of the inquiry, an active and well-justified investigation at local level is a prerequisite for starting cross-border requests via diplomatic channels and the success of the authorities in recovering the money will depend on it. It is, thus, imperative that at least 4 actions are taken in the near future, in order to recover the lost assets to the largest extent possible and decrease the tax pressure on citizens, namely:

1. Advance the investigations that already started in the context of the bank fraud and urgently initiate new investigations regarding all final beneficiaries of the fictitious loans granted by the three banks, which can serve as grounds for cross-border requests for mutual legal assistance and the subsequent recovery of the assets.
2. Establish an independent monitoring committee on a neutral platform, consisting of representatives of regulatory authorities, criminal investigation bodies, but also experts, which would constantly inform the public on the progress achieved and developments in asset recovery.
3. Include explicitly in the law providing for the conversion of guarantee into public debt that the assets recovered as a result of the international investigation shall be used exclusively to redeem the bonds derived from state guarantees before maturity.
4. Investigate the way the money provided by NBM to the 3 banks⁴ was used and find out the role of the other involved banks.

Strengthening the collaboration and cooperation among various state entities is critical for the successful accomplishment of the recommended actions. This will also help proving the strong commitment of the authorities to reduce the tax burden carried by citizens, ensuring efficient communication for the recovery of the assets.

¹http://www.expert-grup.org/ro/biblioteca/item/download/1362_beec60db6b6ae39f664c5a00aa041b06

²<http://bnm.org.ro/content/nota-informativa-privind-progresul-inregistrat-de-investigatia-kroll>

³<http://www.economist.com/node/18836810>

⁴Derived from state guarantees No 807 of 17 November 2014 and No 101 of 1 April 2015

■ The Investigation of the Bank Fraud

The largest bank crisis the Republic of Moldova ever faced since obtaining its independence ended up with an amount equivalent to 12 per cent of GDP disappearing from the domestic banking system and the liquidation of Banca de Economii, Banca Sociala and Unibank. The bank fraud was the consequence of flawed corporate governance in some banks, of dysfunctions in state institutions, including the ones in charge of ensuring financial stability, as well as the consequence of ill-intentioned decision-makers in state institutions and banks⁵. The risk taken by the bankers representing obscure interests was well thought, since they ultimately targeted the National Bank's reserves.

According to the data published on the website of the Ministry of Finance, in almost 3 years after the crisis started, the authorities recovered around MDL 963 million from selling the assets of the three banks⁶. In this context, domestic authorities contracted Kroll, an international investigation company, to detect the financial flows and to further support the authorities in recovering the lost money. After the completion and publishing of the first Kroll Report, which had the purpose to identify suspicious transactions that happened during 2013-2014, analyze connections among transactions, as well as parties related to the banks involved in those operations, Kroll company was contracted to continue the investigation that is supposed to end up with the eventual recovery of the stolen assets.

On April 13, 2017, the National Bank of Moldova (NBM) received an interim report on the progress achieved by Kroll in the investigation of the fraud. The investigation found that embezzlements were committed in an amount of around USD 600 million. The funds detected so far have been traced to accounts in multiple jurisdictions, mainly to other Moldovan banks besides the three involved banks (USD 185 million), Cyprus (USD 63 million), China and Hong Kong (USD 61 million), and Switzerland (USD 23 million). Approximately USD 200 million has been traced to other accounts at multiple Latvian banks, subjected to further complex laundering of funds. According to the information revealed by NBM, around USD 50 million of the funds transferred to Moldova was used to purchase assets⁷.

Due to the sensitive information to be included in the final report, according to the authorities, it might be kept out of the reach of the public, at least for the duration the investigation⁸. This note aims at highlighting the main actions that should be undertaken by the authorities in order to maximize the recovery of funds, based on the analysis of another large-scale bank fraud.

■ What can we expect?

In the age of globalisation, the accessibility to off-shore areas allows creating elaborate corporate structures thus facilitating the hiding of final beneficiaries. However, also due to technological progress, there is a number of mechanisms used to follow the money once it enters the bank flow. Given that Kroll has over 40 years of experience in searching assets in extremely complicated international fraud cases, it is certainly a strength of the investigation that Kroll have been contracted by the authorities to identify the destination of the money stolen from the Moldovan banks.

⁵http://www.expert-grup.org/ro/biblioteca/item/download/1362_beec60db6b6ae39f664c5a00aa041b06

⁶<http://www.mf.gov.md/#one>

⁷<http://bnm.org.ro/content/nota-informativa-privind-progresul-inregistrat-de-investigatia-kroll>

⁸<https://www.zdg.md/stiri/stiri-politice/candu-isi-face-griji-ca-publicarea-raportului-kroll-2-sa-nu-aduca-prejudicii-statului>

Taking into account the complexity of schemes used by crooks in bank frauds, most often the full recovery of the assets is virtually impossible in such situations as the one that happened in Moldova. International experts believe, based on other cases of bank frauds and liquidations, that retrieving even 50 per cent of the lost money would be an impressive achievement⁹.

Despite the specific aspects of the Moldovan bank fraud, financial systems have been always prone to large-scale frauds. Moreover, in 2010 Afghanistan had a similar experience when one of the largest banks in the country – Kabul Bank, which handled one-third of Afghanistan's banking assets¹⁰ – went bankrupt. According to the estimates, the hole worth of USD 987 million was created as a result of fraudulent property contracts, credits offered to fake companies and massive off-book loans. This made the government take over the bank, with an infusion of funds amounting USD 825 million, from state reserves. This amount was going to be recovered through taxes during an 8-year period. Therefore, the Central Bank of Afghanistan contracted Kroll company to investigate the fraud¹¹.

Kroll investigation of Kabul Bank fraud identified over 110 rubber stamps of fake companies that were used to give an official look to documents further used to obtain loans. Last but not least, more than 90 per cent of the entire credit portfolio, which is equivalent to 5 per cent of Afghanistan's GDP, was extended to just 19 individuals, including people close to the political leaders of the country at that time, and the money ultimately got into banks from 28 countries.

In many respects, that situation strikingly resembles the bank fraud that happened in Moldova in 2014-2015. According to official information, 6 years past the Kabul Bank fraud the authorities recovered, including due to Kroll investigation, around USD 350 million – which accounts for 35 per cent of the total missing amount, while another USD 90 million consisted of forgiven interest payments.

■ Requests towards the authorities

The pressing sense of injustice felt by citizens with respect to the way the Moldovan bank crisis had been solved led to requests to abrogate the law that puts the burden of the three banks' bankruptcy on the shoulders of taxpayers¹². Some politicians, craving for a favourable rating in the polls, take advantage of this feeling and use rhetoric to abrogate the law. Despite this, the only solution that could actually lessen the pressure on citizens includes two actions:

- 1) continue the liquidation of the assets belonging to the three banks;
- 2) identify and recover the funds embezzled by the conmen.

Annulment of the law providing for the conversion of guarantee into public debt would currently lead to even bigger economic trouble. According to the NBM Law, the National Bank cannot bear losses. Consequently, if there is no coverage for the emergency credits extended to the three banks, amounting to more than MDL 13 billion, the Ministry of Finance will be obliged to issue state securities at a market rate, which is higher than the one stipulated in the respective law.

⁹<http://www.economist.com/node/18836810>

¹⁰<http://www.aljazeera.com/indepth/features/2013/02/201321618534143659.html>

¹¹<http://www.nytimes.com/2012/11/27/world/asia/kabul-bank-audit-details-extent-of-fraud.html>

¹²<http://lex.justice.md/index.php?action=view&view=doc&lang=1&id=366948>

Without providing an assessment for how the liquidation of assets has been taking place so far, it is important for it to continue in compliance with the best transparency and competition standards. According to the estimates communicated by the National Bank Governor, the maximum amount that could be obtained from selling the assets would be around MDL 1.5 billion¹³. In such circumstances, it would be obvious for the authorities to focus much more on the successful recovery of the stolen funds, which were transferred to multiple jurisdictions. This is supposed to be proven in detail by Kroll investigation¹⁴.

As the investigation advances, the successful recovery of the funds will depend directly on the capacity of prosecution bodies to press charges in the court of law. Conclusions drawn under Kroll investigation cannot replace a criminal action, but can support the gathered evidence and the drafted indictment. This is of particular importance, since, as it has already been mentioned, at least a few hundred million US dollars was transferred into jurisdictions outside Moldova. Though Kroll company has a wide range of mechanisms they can use to identify the final destinations and the actual beneficiaries of the stolen assets, given the international scale of the inquiry, an active and well-justified investigation at local level is a prerequisite for starting cross-border requests via diplomatic channels. Once such an investigation is undergoing, the competent authorities from Moldova could ask for legal assistance of another country based on a treaty like the United Nations Convention against Corruption. Among others, Article 46(3) of the Convention¹⁵, which has been ratified by the Republic of Moldova and the countries identified by Kroll in the interim reports, provides that mutual legal assistance may be afforded for purposes like investigations, seizures, freezing, but also recovery of assets. At the same time, in line with Article 46(15)(b) of the Convention, a request for mutual legal assistance shall contain the subject matter and nature of the investigation, prosecution or judicial proceeding to which the request relates

In order to diminish the burden on the taxpayers, it is important that authorities undertake a number of measures in the near future, namely:

- 1. Advance the investigations that already started in the context of the bank fraud and initiate urgently new investigations regarding all beneficiaries of the fictitious loans granted by the three banks,** which can also serve as grounds for cross-border requests for mutual legal assistance and the subsequent recovery of the assets. This also relates to the requests filed with the Interpol to declare, potentially, international searches. Though the contract with Kroll company has not been published, based on other case studies, usually the company provides all needed legal support to carry out the recovery of assets in the most appropriate way. This is also linked to the fact that in such investigations the fee is usually a percentage of the total recovered assets, which is an incentive for the investigation company to take all the needed effort.
- 2. Establish an independent monitoring committee on a neutral platform, consisting of representatives of regulatory authorities, criminal investigation bodies, but also experts.** Given the sensitive information in the second Kroll report, publishing or disclosing it before the prosecution starts could damage the investigation. At the same time, in order to ensure the

¹³<https://www.mold-street.com/?go=news&n=5344>

¹⁴On the other hand, a solution of the Government that could minimise the repercussions for citizens, increasing the trust of the society, is to define a clear mechanism that will first have recourse to non-fiscal budgetary sources to cover the created debt, such as selling the remaining assets of the 3 banks, recovering the embezzled funds, privatisation of state-owned enterprises, etc.

¹⁵https://www.unodc.org/documents/treaties/UNCAC/Publications/Convention/08-50026_E.pdf

continuity in the investigation of the bank fraud, we think it is vital to establish this committee. Given the national interest in the success of the investigation, this committee should aim at following the recovery of the assets and informing the public on the main achievements. In this way, sensitive information could be kept secret during the inquiry, while at the same time the premises would be created to put enough pressure to have the investigation successfully completed. It is relevant that Kroll company provided the NBM with a strategy for initiating legal action in multiple jurisdictions, with the view of obtaining further disclosure and recovering assets which have been misappropriated.¹⁶ The aforementioned committee could closely follow the implementation of the established asset recovery strategy.

3. **Amend urgently the Law No 235¹⁷, in order to stipulate the designation of the money recovered under the investigation**, before the cross-border asset recovery starts. This Law has rightfully provided for the subrogation of the NBM by the Ministry of Finance in relation to the claims towards the 3 banks. At the same time, it is not stipulated what is going to happen with the assets recovered as a result of the international inquiry. If at least part of the assets is recovered with the support of Kroll company, it is imperative that the money is used exclusively to redeem the bonds derived from state guarantees before maturity, thus reducing to the extent possible the tax burden put on the citizens.
4. **Investigate the way the money provided by NBM to the 3 banks¹⁸ was used and find out the role of the other involved banks.** We can notice from the transcript of the Government meeting of November 7, 2014, when it was decided to issue the first guarantee in an amount of MDL 9.5 billion, that some ministers expressed concern about possible abuse from some entities¹⁹. This concern was raised because the guarantee was provided before the banks got under special administration and there was no certainty about the confidentiality of the guarantee being approved. In these particular circumstances, the deposits of other banks placed with Banca de Economii increased from approximately MDL 300 million when the guarantee was approved up to MDL 2.3 billion at the moment when the bank was placed under supervision. When it was decided to provide the guarantee, a special commission was established with the aim to analyse the account balances of individuals and legal entities that cumulatively exceed the amount of MDL 500 thousand, in order to determine whether any affiliation existed and whether the legislation on prevention and combating of money laundering was violated²⁰. So far, no report was published regarding the results of the special commission evaluation and there are still suspicions that part of the money derived from guarantees was used to cover the deposits of some people who anticipated the events. Thus, besides continuing the Kroll investigation that follows the destination of the credits offered by the 3 banks, it is also important to investigate the way money provided by NBM was used, including the money used for redeeming the deposits of other banks placed with Banca de Economii.

¹⁶<http://bnm.org.ro/content/nota-informativa-privind-progresul-inregistrat-de-investigatia-kroll>

¹⁷Law No 235 of October 3, 2016 on the issue of state bonds in order for the Ministry of Finance to fulfil the payment obligations derived from the state guarantees

¹⁸Derived from state guarantees No 807 of 17 November 2014 and No 101 of 1 April 2015

¹⁹<http://agora.md/stiri/24962/doc--stenograma-sedintei-cand-s-a-acordat-prima-garantie-de-stat-bancilor-falimentare--ce-spune-leanca-in-sedinta-si-doi-ani-mai-tarziu>

²⁰<http://lex.justice.md/viewdoc.php?action=view&view=doc&id=358103&lang=1>

It is important to mention that there is a prerequisite that underlies each of the aforementioned recommendations and that is the strengthened collaboration and cooperation among various state entities. This will help proving the strong commitment of the authorities to reduce the tax burden carried by citizens, ensuring efficient communication for the recovery of the assets.