

EXECUTIVE SUMMARY

This ML/TF NRA represents the first holistic national risk assessment undertaken by the Republic of Bulgaria and analyses the internal and external money laundering and terrorist financing risks that the country faces. This NRA fulfils the Republic of Bulgaria's NRA obligations as provided for in the FATF Recommendations as well as the requirements of the EU AML/CFT acquis in order to ensure national AML/CFT measures commensurate with risk.

The fight against money laundering and terrorism financing is critical to ensuring Bulgaria's security and prosperity. Bulgaria is deeply committed to preventing, detecting and prosecuting money laundering and terrorist financing activities and have put in place a robust legal and institutional framework to supervise, gather intelligence and prosecute criminals for these criminal activities. The government, however, recognises the need to further strengthen the AML/CFT framework to be coping with the changing criminal landscape. Hence, the National Risk Assessment (NRA) is a necessary step to identify and assess Bulgaria's threats and vulnerabilities to ML and TF, the main risk scenarios thereof, their likelihood and consequences for the domestic and European economy and financial system.

This NRA is the product of consultation across government, law enforcement, intelligence agencies, supervisors and the private sector. Sources used also include, public national and international reports in the relevant areas, including from Europol, the FATF, MONEYVAL and the EU supranational risk assessment of money laundering and terrorist financing. It is a valuable tool for the government, national competent authorities, the private sectors and partner countries to better understand the ML/TF risks of Bulgaria to support their own risk assessments and ongoing supervisory, detection and law enforcement activities. This NRA is also informing future actions of Bulgaria's policy makers to further strengthen the AML/CFT regime, in line with international best practices. It is expected that this NRA will assist in building a strong foundation to continuously improve the country's response to ML/TF risks while keeping Bulgaria a safe place for investment and business.

The output of this exercise also forms the basis of Bulgaria's AML/CFT Strategy for mitigation and monitoring of the ML/TF risks that the country is exposed to. These results serve as the basis to take a risk-based approach to fighting ML/TF.

The NRA was based on a comprehensive analysis of ML risks based on the following components:

- analysis of threats stemming from predicate criminality, which serves as the main source for generating criminal proceeds,
- analysis of subjects undertaking ML;
- analysis of economic sectors associated with ML;
- analysis of financial/DNFBP sectors and products abused for ML and TF;
- cross-border characteristics of ML;
- analysis of terrorism financing risks.

The findings from each of these components were cross-analysed and integrated to produce the matrix or risk-scenarios for Bulgaria attached as Appendix A to this report.

Below is a summary list of the top ML risk events (RE) identified through this assessment:

1. Laundering of funds from a range of foreign and domestic predicate offences linked to organised crime (primarily drugs, human trafficking and tax evasion) through the exploitation of the formal financial system and extensive use of cash;
2. Laundering of proceeds from corruption (including property related to embezzlement/procurement fraud with EU funds) through complex domestic and foreign-based ML layering schemes with assistance of ML professionals for subsequent integration into financial instruments abroad and commercial entities and real estate domestically;
3. Laundering of funds from tax evasion and VAT fraud using straw men, domestic and foreign legal entities for complex ML layering schemes and utilising the assistance of ML professionals;
4. Integration of significant amounts of laundered funds in the construction sector and investment in real estate in the context of a significant share of informal economy by domestic and foreign perpetrators;

5. Laundering of funds from foreign predicate offences through non-bank investment intermediaries in Bulgaria is complemented by cases of unregulated activities involving securities;
6. Laundering of illicit funds generated in the food and oil trade (tax fraud and evasion) using shell companies and informal nominees (straw men) and relying on a corrupt environment and informal economy;
7. Laundering of funds from computer and social engineering fraud perpetrated by small-to-medium organised criminal groups using Bulgarian territory for layering of the funds;
8. Possible involvement of professionals and reporting entities (facilitated by market entry and employee screening vulnerabilities) is observed as a major risk that enables organised crime to function and thus contributes to most of the aforementioned risks.

The high risk TF risk events identified through this assessment are as follows:

9. Use of MVTS and informal value transfer (hawala) to transfer funds potentially related to TF and facilitation by migrant communities aggravated by large cash-based and informal economy;
10. There is a potential risk (to a limited extent) of diverting funds allocated for NPO or religious activities in Bulgaria towards TF.

Threats

Inherent threat factors: The territory of the Republic of Bulgaria is part of an established trade and transportation corridor between the Middle East and Europe known as the 'Balkan Route'. The route is used for criminal purposes, such as the smuggling of goods and the trafficking of drugs, people, arms, and both licit and illicit goods and assets transit this route usually towards and from Central/Western Europe or North-Eastern Europe and Asia. The consequences of its geographical position mean that Bulgaria experiences a variety of predicate offences transiting its territory, the perpetrators of which abuse a number of financial and non-financial sectors. The Balkan route is also a corridor for the transportation of large volumes of cash across the borders to and from Europe, accompanied by the occasional use of hawala systems for TF purposes related to the recent migration flows.

Contextual factors: Most of the ML/TF risks described in this report are aggravated by contextual factors including the largest in EU cash-based grey economy constituting almost 30% of GDP, the identified levels of corruption and potential issues with the effectiveness of some of the competent authorities. Another contextual factor is population characteristics, with a large percentage below the poverty line. This factor makes possible the systemic use of "straw men" in ML schemes, and also serves as an inherent vulnerability factor in the TF context. A large percentage of the population migrating abroad also creates a context for the easier proliferation of transnational organised crime links with Bulgaria.

Overall, organised crime offences trafficking in human beings or narcotics, and the trade of contraband goods, such as cigarettes, alcohol, and fuel, as well as tax crimes and fraud (including computer and VAT fraud) appear to be the predominant predicate offences for ML schemes in Bulgaria. Threats emanating from corruption are also considered major even though full comprehensive information is lacking on the exact volume and scope due to the latent nature of these threats.

Stand-alone ML is considered to be conducted by "ML professionals" both within organised crime groups and those acting autonomously. The latter set up complex legal structures and operate accounts both domestically and abroad. There is a risk that selected representatives of the legal and accounting professions could be associated with this type of activity.

Subjects

Natural persons resident in Bulgaria represent the highest number of subjects involved in potential ML activity. The highest risk scenarios with use of natural persons involve the use of "straw men" (informal nominees) in ML-related schemes, which is a key *modus operandi* of organised criminal groups. And equally high risk, though lower in frequency is associated with natural persons acting as professional money launderers for criminal enterprises and PEPs. In terms of quantity the majority of natural persons in ML cases are associated with

(online) fraudulent activity usually linked to internet scams which tend to be high in volume but low in value, thus posing a medium risk. In these scenarios resident natural persons are generally used as 'straw-men' to receive/collect the proceeds generated by online fraud and other offences and transfer those abroad via large international MVTs providers. A large number of ML cases with natural persons involve tax crimes as the predicate offence (VAT fraud), with the highest risk business sectors being the food trade, followed by the trade in petrol and petroleum products (fuels) and the scrap metal trade. Natural persons are extensively involved in the smuggling of cash across the border from a variety of predicate offences.

Legal persons resident in Bulgaria represent the second highest number of subjects involved in potential ML activity, with the average volume of cases significantly higher than for natural persons. Bulgaria has a large proportion of legal persons involved in cash-based operations, with the risk of many of these entities serving as gateways for the placement of criminally acquired cash into the formal financial system. The LLC-type is particularly vulnerable to abuse, including the sole owner LLC which is the simplest formula to be used with a single "straw-man" as its owner. At the layering stage domestic LLCs tend to be used as conduits for the commingling of licit and illicit proceeds, usually through the manipulation of trade turnover volumes declared to tax authorities. Additionally, these structures enable access to the Bulgarian financial system and tend to be used as parties to fictitious loan agreements involving offshore companies or in trade-based ML schemes. Complex ML schemes often involve legal persons incorporated in Bulgaria whose ownership and management is linked to offshore companies or shell companies located in other EU MS. In this context legal persons pose a significant vulnerability to abuse by PEPs and PEP-related criminal groups for complex money laundering schemes through third countries. Last but not least companies of the LLC type that could be characterised in practice as "shelf" or "shell" companies, are offered to and misused by EU-resident persons for tax evasion/tax fraud or related ML purposes.

Non-resident natural persons: The risk events identified by Bulgarian authorities in this context tend to be predominantly associated with transnational (computer) fraud cases. These REs are rated medium due to their relatively high frequency and on-going growth in terms of likelihood, yet limited consequences so far. Enhanced recovery controls for this type of risk event will be increasingly required however due to further digitalisation of the economy and related growth of cyber fraud risks. Additional risk scenarios for non-resident natural persons relate to the investment-related residence and citizenship (IRRC) programme, as described in the paragraph below. Furthermore, non-resident natural persons are extensively engaged in the physical cross-border transportation of cash along the Balkan route, and represent both ML and TF risks.

Non-resident PEPs: A key risk scenario with regard to non-resident PEPs and non-resident natural persons is the use of associates for laundering corruption-related funds through investment in liquid assets or occasionally, participation in privatisation, as well as the investment-related residence and citizenship (IRRC) programme. The latter allows non-residents to obtain a fast-track to residency and citizenship based on investment in Bulgaria, including government bonds. The IIP carries specific risks of integration of funds of criminal origin in Bulgaria, as well as layering of funds through Bulgaria (e.g. after a 5 year period the bonds investments are paid out). At the time of drafting this NRA the Bulgarian authorities are closing the scheme, however additional risk mitigants are recommended by the NRA especially with regard to the monitoring of previous investments and related flows of funds.

Domestic PEPs: While available data is not fully conclusive there are a number of indicators that domestic PEPs represent a high risk for money laundering, which includes placement and layering of funds abroad including in offshore zones and their subsequent integration in the EU and Bulgaria through a number of schemes mentioned above. This is one of the highest risk factors identified by the NRA, given that the consequences (as recent examples in Bulgaria have shown) have the potential to lead to political and social destabilisation.

Financial/DNFBP sectors and products

Cash remains an issue of concern as it is used across sectors and businesses to perpetrate a variety of predicate offences. It also appears to be the predominant type of asset laundered. In this context the vulnerabilities represented by the formal application of some AML/CFT measures by some obliged entities and the large informal economy allow cash of illicit origin to enter the formal financial system.

Formal financial system: as the financial sector constitutes a relatively small proportion of the GDP it could be generally noted that it is predominantly used as an ML placement and layering mechanism, with most laundered funds “passing through” the Bulgarian financial system, without using it as a “final” destination to integrate laundered funds into various financial products. Hence it is notable that the predominant majority of ML risk identified in the financial system relates to various types of incoming and outgoing transfers. Nevertheless, the economic development provides incentive to further integrating the funds in the formal financial system and subsequent investment especially for funds related to domestic criminality (regardless of the place of perpetration of the predicate crime).

In the *banking sector*, domestic transfers, cross border transfers, cash withdrawals, are the banking methods most prevalent in ML cases. These avenues tend to be used by mostly resident legal persons to facilitate ML generated from tax offences (including VAT related crimes) and fraud. Non-resident legal persons generate a turnover in the banking investment intermediation sector from VAT offences and computer fraud. The key risk associated herewith is complex layering of funds by non-resident legal entities in the cross-border context, including in the sector of institutional investment and banking investment intermediation products.

In the *securities sector* non-bank investment intermediaries running on-line trade platforms pose the highest ML risks in the international context due to relatively large turnover, very broad geographic diversification and the flaws of the non face-to-face identification of the customer together with the formal application of some other AML/CFT requirements. Associated risks include ML layering scenarios from foreign predicate offences.

The *MVTS*(i.e. money remittance)¹*sector* with elements cross border transfers and cash withdrawals is both highly exposed and vulnerable to ML/TF risks. Occasional transactions, reliance on agents, global reach, cash based transactions or funded with anonymous electronic money, including electronic money benefiting from the exemption under Article 12 of Directive (EU) 2015/849, and the ineffectiveness of the cross-border monitoring within the EU hamper supervision and control.

In the *e-money sector* is considered to be exposed to ML/TF risks because of his anonymity features such as anonymous electronic money products under Directive (EU) 2015/849 and a non-nominal prepaid card under Regulation (EU) 2018/1672, as well as due to the online and non-face-to-face distribution without adequate safeguards and distribution through intermediaries that are not themselves obliged entities under Directive (EU) 2015/849.

ML/TF risks are potentially exacerbated in the cases of emerging products such as *virtual currencies*, which have yet to be comprehensively assessed by the NRA due to the current lack of regulation, anonymity and comprehensive data.

In the *insurance sector*, life insurance and volunteer pension insurance (with personal or other contributions) represent low ML risks, given that ML likelihood is considered low due to the limited volumes of these products in the market; associated consequences are not significant.

The *currency exchange sector* is the venue for ML placement risks from cash-intensive criminal markets in Bulgaria.

Among *DNFBPs* real estate represents the high risk, given the major proportion of this sector vis-à-vis the overall GDP, relative popularity of the sector among foreigners, the low-level of regulation and oversight in the ML/TF context, also further taking into account the common risk scenarios identified whereby this sector is frequently used in the ML integration stage. High-risk sectors include lawyers and accountants, from the standpoint of oversight vulnerabilities coupled with their role in complex business and estate transactions, company creation

¹ Article 4(22) of Directive (EU) 2015/2366 defines 'money remittances' as a payment service where funds are received from a payer, without any payment accounts being created in the name of the payer or the payee, for the sole purpose of transferring a corresponding amount to a payee or to another payment service provider acting on behalf of the payee, and/or where such funds are received on behalf of and made available to the payee.

and management, as well as facilitation of international transactions including with offshore territories. Dealers in precious metals and stones (DPMS), as well as casinos which demonstrate an overall trend of increased cash turnover and thus a higher risk for ML as well as TF in the case of DPMS. Post service operators are exposed the sector to some ML/TF risks due to some common features with MTVS.

Economic sectors

The NRA identified a number of economic sectors, which are normally used for ML activities at their various stages. The economic sectors most susceptible to ML activity tend to be those involved with fuels and mining, wholesale and retail trade, real estate, transport, and agriculture in the context of fraud with EU funds. Small and mid-sized companies tend to be more susceptible to ML risks as they are not as strictly monitored by oversight bodies in the same way that larger enterprises are. An illustrative example of this can be found in the real estate sector which is not subject to licensing and registration requirements and does not have an effective self-regulating mechanism. As such, it exhibits a higher degree of vulnerability as a conduit of illicit funds.

Economic sectors tend to be abused for different purposes in the ML cycle, with the trade sector primarily utilised in the TBML context for ML layering, while real estate is primarily used for ML integration.

A significant proportion of the Bulgarian economy is dependent of state and budgetary expenditures and various types of public procurement and public works, which are associated with potential for embezzlement by PEPs and potentially involved parties in the private sector. Another significant source of funding associated with various fraud are the EU funds. In this sense the public sector is potentially a major generator of criminal proceeds, which are subsequently placed and layered through a range of avenues. The construction sector receiving the largest public expenditure faces the dual threat of procurement fraud/embezzlement and ML integration schemes.

Bulgaria has several free trade zones which represent a facilitating environment to ML/TF risks due to a number of softer regulatory requirements, as well as vulnerabilities with regard to beneficial ownership transparency of subjects operating in these zones.

Terrorist financing

Terrorist financing activity appears to be relatively restricted to the use of cash, money transfer services and the occasional use of illegal/informal financial services (hawala). Some TF risks have materialised in Bulgaria with regard to the existence of limited financial and material support for foreign organisations functioning abroad and the use of hawala system as a conduit for support. The analysis of NPOs reveal certain risks currently subject to generally effective controls but an updated comprehensive analysis on the activities and vulnerabilities of NPOs is needed following the implementation of the largely redesigned NPO-related legal framework.

A total of 32 ML risk events and 11 TF risk events have been registered by the NRA. The description and rating of each risk event is carried out in the conclusions section of each respective chapter or subchapter. Certain risk events cover issues and topics interconnected by the various chapters, and are referenced throughout the NRA report in the respective sections. The integrated matrix of risk events is presented in Annex 1.