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A Case of Insufficient Safeguards or State-Enabled Money Laundering? 'Golden Passport' and 'Golden Visa' Investment Schemes in Europe

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Purpose – To critically examine recent developments and proposals for the regulation and supervision of 'golden passport' and 'golden visa' investment schemes in Europe. We argue that FATF standards constitute an appropriate response to money-laundering risks associated with such investment schemes, but the EU needs to introduce further common rules, safeguards and control mechanisms in the aftermath of the recent scandal in Cyprus.

Design/methodology/approach – This paper draws on reports, legislation, legal scholarship and other open-source data to examine golden passport and golden visa investment schemes in the EU.

Findings – The EU has to forge a common approach to mitigate money-laundering risks associated with golden passport and golden visa investment schemes, taking into consideration the FATF standards.

Originality/value – This is the first study examining golden passport and golden visa investment schemes in the EU in the aftermath of the Cypriot scandal and proposing the overhaul of the EU legal framework in this regard.

Keywords – Golden Passport, Golden Visa, Investment, Money laundering, European Union, Financial Action Task Force

Paper type – Research paper

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1. Introduction

The idea of granting citizenship and residence permits to individuals who invest in the economy of the host country dates back to the 1980s. The pioneer of such citizenship-by-investment (CBI) and residency-by-investment (RBI) schemes has been Saint Kitts and Nevis [1], and its example was followed by other countries, including the United States (US), which introduced its EB-5 visa in 1990 [2]. In addition, several jurisdictions have experimented with special migration-related and investment-related schemes to attract skilled migrants or innovative entrepreneurs. This is the case with ‘start-up’ visa programs (Patuzzi, 2019) such as the one in Denmark, which benefits people with entrepreneurial potential and facilitates the setting up of innovative and technology-intensive businesses. It is also the case with ‘talent passport’ programs, such as the one in France (Tech Visa), which benefits researchers and qualified employees (de Lange, 2018). Similar entrepreneurial schemes put emphasis on human capital, contrary to passive investment programs, in which the applicant simply writes a check and ‘parks money in the country’ by investing in such things as real estate, bank deposits, and government bonds, with no other obligations attached to the investor (Surak, 2020).

‘Golden passport’ and ‘golden visa’ investment schemes fall into the latter category, passive investment programs, and they shift focus away from talent and skills, as well as from cultural characteristics, family ties, or other long-standing ties to the country that have been the key criteria for citizenship or residency in the past (Cerna, 2014). Proponents of CBI/RBI programs point out the promising economic advantages, in particular the increase in capital inflow, private sector investment and fiscal revenues for the host country. They also argue that the entrepreneurial state has to put emphasis on financial competitiveness (Parker, 2017), which is enhanced by robust foreign investment. Nevertheless, the key criterion of eligibility in CBI/RBI schemes is a pre-defined financial contribution that takes place once with no requirement of a substantial or long-term nexus between the investor and the host country. In that respect, golden passport and golden visa schemes constitute a controversial form of commodification of public law (Grell-Brisk, 2018; Shachar, 2017; Dzankic, 2018), and they have been criticized, among other reasons, for being a product of neoliberalism and undue pressure from the markets to the state (Mavelli, 2018; Boatca, 2015). For their part, legal scholars, especially in the field of migration law, have raised the questions of justice, fairness, and transparency in the design and implementation of these programs (Mau et al., 2015).

At the EU level, there has been a proliferation of CBI/RBI schemes (section 2). Tempted by the prospect of fast economic gains, policy makers have not always taken into appropriate consideration the economic and compliance risks associated with this development model. Firstly, if poorly designed and implemented, CBI/RBI schemes may fuel unsustainable development and market bubbles, in particular in the real estate sector, while sponsoring over-dependency of the economy on volatile investment inflows, particularly in non-diversified economies (Xu et al., 2015). Secondly, it has been established that golden passport and golden visa schemes give rise to serious compliance issues and risks of money laundering, corruption and tax evasion (section 3), which need to be addressed by the introduction of controls and safeguards.

Recently, several serious scandals, such as the one in Cyprus (section 4), have called into question the effectiveness of existing due diligence safeguards, as well as compliance and supervision mechanisms. The European Parliament has even urged Member States ‘to phase out all existing citizenship by investment (CBI) or residency by investment (RBI) schemes as soon as possible,

especially when there is insufficient verification and lack of transparency, in order to minimize the often-linked threat of money laundering, the undermining of mutual trust and the integrity of the Schengen area, in addition to other political, economic and security risks to the EU and its Member States' (European Parliament, 2020). We argue that perpetuating the existing inefficient framework and disregarding the recent scandals and the manifest risks of money laundering could amount to wilful blindness and even state-enabled money laundering. For this reason, the development of EU common rules on CBI/RBI schemes is necessary to address gaps, disparities and carelessness in anti-money laundering (AML) compliance and control mechanisms at the national level (section 5).

2. Golden Passport and Golden Visa Investment Schemes in the EU

Golden passport and golden visa investment schemes have bloomed worldwide and in the European Union (EU) in the last 20 years, and they remain popular, evolving in form, size and eligibility criteria. Several EU Member States have been competing to attract high net-worth individuals and their families, especially in the aftermath of the 2008 global financial crisis, which has increased the appeal of such schemes for countries that faced budgetary problems. As a result, there is currently a wide range of options for wealthy third-country nationals and their families who want to live in the EU, with residency costing as little as €250,000, as in the cases of Latvia and Greece.

Granting a permanent residence permit allows successful applicants not only to reside in their new homeland but also to travel to other EU countries, but granting citizenship to a foreign national allows him/her to enjoy additional rights and privileges, in particular political rights and the right to obtain a national passport. Unlike residency, citizenship has no time limitations, is valid for life, and is inheritable; it is revoked only in rare and exceptional cases, and it is maintained even if the investment made in the context of the CBI scheme is sold after a certain period (usually five years). Most importantly, in the case of EU Member States, successful applicants to CBI schemes enjoy the extensive rights and privileges of EU citizenship, including the free movement of persons in the EU under Article 3(2) of the Treaty on European Union (TEU), Article 12, Titles IV and V of the Treaty on the Functioning of the European Union (TFEU) and Article 45 of the Charter of Fundamental Rights of the European Union.

As a 2018 study by Transparency International has illustrated, 6,000 new citizens and close to 100,000 new residents have benefited from similar schemes to enter the EU in the period 2008–2018 (Transparency International, 2018). Cyprus and Malta currently face a storm of criticism over their golden passport and golden visa investment schemes; however, other EU Member States, such as Spain, Hungary, Latvia, and Portugal, which are not currently under the spotlight, have each approved more than 10,000 golden visas in the same period, according to the TI study. The exact size of this phenomenon is difficult to assess, as opacity reigns in this market segment worldwide. In the EU, no detailed statistics or lists of the beneficiaries are published by Member States other than Austria and Malta. There is a similar lack of transparency with regard to the total volume of investment raised in these schemes, with the aforementioned TI study attempting a rough estimate and putting the number at around €25 billion in a decade for all EU Member States. These estimates and sporadic reports in the press allow us to assume that these programs have brought substantial profits to host states and thus have become quite popular.

3. Building on Crumbling Foundations: Compliance Issues and Risks of Money Laundering and Other Criminal Activities

As investment in real estate becomes globalized and deterritorialized, a new 'transnational class of super-rich homebuyers' emerges and challenges the functioning of the local housing market (Pow, 2017) as well as the efficiency of the AML legal framework and rules on investment compliance. For this emerging class of investors, 'the primary value of citizenship lies in the mobility rights attached to passports' (Shachar, 2014). The potential return on investment is another factor that investors consider, although the inflow of investments may cause an asset bubble and misleading expectations. From an AML compliance perspective, third-country nationals do not always have legitimate reasons for choosing to apply to RBI/CBI government schemes. There have been instances of applicants who were facing criminal proceedings in their home country or were trying to launder illicit proceeds and shield them against freezing and confiscation measures. In this regard, risks of the following emerge:

(i) Risk of money laundering: The competition between jurisdictions that offer RBI/CBI schemes may degenerate into a 'race to the bottom' as far as AML safeguards are concerned. In several jurisdictions, including the US with its EB-5 program, there have been troubling instances of the misuse of golden passport and golden visa schemes involving money laundering and the use of fake documents and applications by individuals having ties to foreign intelligence services (Nixon, 2016). Insufficient due diligence, lack of transparency, inefficient control mechanisms and, in some cases, the wilful blindness or complicity of the system's gatekeepers have afflicted golden passport and golden visa investment schemes. The root of the problem is the lack of a comprehensive assessment of money-laundering risks, which hinders their proper mitigation (Council of Europe/MONEYVAL, 2019).

(ii) Risk of corruption and conflicts of interest: Investment migration must not be based on corrupt practices by public authorities empowered to grant golden passports and golden visas. With regard to the design of RBI/CBI government schemes, officials implicated in the norm-building process have 'effectively demonstrated their preference for quick gains over longer-term impacts' (Transparency International, 2018). There has also been criticism of private interests that mobilize legislators and coach them in the design of the programs (Dzankic, 2012; Carrera, 2014). The profit-driven private sector has often lobbied in favour of politicians and parties that support the programs, putting political pressure on them and financial support behind them. With regard to the screening process in RBI/CBI schemes, the key problem has been the use of wide discretionary powers by the national authorities that review applications. Conflicts of interest, actual or perceived, have also risen, as politicians, their associates, and/or their family members have had business transactions and interests with applicants for golden passport and golden visa programs.

(iii) Risk of tax evasion: CBI/RBI government schemes have the potential to undermine the efficiency of the automatic exchange of information between tax authorities, which has been a promising trend in the fight against cross-border tax evasion (Ahrens and Bothner, 2020). Wealthy individuals acquire the citizenship of a foreign jurisdiction that is not the centre of their vital interests and thus circumvent requirements to report their financial information to the tax authorities of the nation of their original citizenship. This form of regulatory arbitrage constitutes a trend that seems to be increasing over time, though it is not yet widespread in the field of tax planning (Ahrens et al., 2020; OECD, 2018; Menkhoff and Miethe, 2019).

(iv) Risk of investor fraud: The issue of investor protection also has to be addressed, as applicants for the golden passport and golden visa programs may fall victim to investment fraud. Hastiness in investment decisions attracts fraudsters, who have often targeted applicants for RBI/CBI schemes (Sheng, 2016). In the US, there have been several FBI criminal investigations (Wamsley, 2017), and the Securities and Exchange Commission has brought numerous enforcement actions, including several high-profile cases, against individuals or companies for misuse of EB-5 projects and misappropriation of investors' funds (Securities and Exchange Commission, 2018).

4. Case Study: The Rise and Fall of the Cypriot Investment Program

The rise and fall of the Cypriot Investment Program (CIP) illustrate the risks and shortcomings of RBI/CBI government schemes. Under this program, foreign nationals could pay €2 million into real estate and infrastructure projects to receive Cypriot citizenship and a passport. The program has had huge success, and it is estimated that it has attracted more than €6bn in real estate development, by far the most common type of investment, or on average €900 million on an annual basis. This amount constitutes a considerable part of the country's nominal GDP of €24–25 billion per year.

In 2019, the government reinforced the safeguards of the program, in particular AML mechanisms, as a response to academic, political and media criticism, but this reform was too little too late. Under the Cypriot scheme, registered service providers, either natural or legal persons, submitted applications to the Cypriot Ministry of Interior on behalf of the applicants [3]. Applications had to include a self-declaration by the applicant and the service provider, as well as a report of the findings of the due diligence review for each applicant, under the Code of Conduct that was adopted in May 2019. At that time, the Cypriot government established a Committee of Supervision and Control with the participation of representatives from the Ministry of Finance, the Ministry of Interior and Invest Cyprus to enhance the program's AML safeguards.

Nevertheless, in the summer of 2020, a journalistic investigation brought to light confidential government documents and revealed that several foreign politically exposed persons (PEPs) and their families had been granted citizenship with little consideration to due diligence. An independent committee was set up to examine the application files and identify cases where the criteria and the procedures had not been respected. At that time, the Cypriot legislation on citizenship [4] did not provide for a process for revoking citizenship granted under the CIP, which was another of the CIP's flaws. The final blow to the CIP came in late 2020, before the independent committee had completed its investigation. Undercover reporters from a major international news network contacted politicians in Cyprus, as well as lawyers and real estate agents, and asked them to facilitate the application of a fictitious character with a criminal background from the People's Republic of China. Videos taken during this sting operation showed the President of the Cypriot House of Representatives, as well as a member of the House, offering their good services to facilitate and speed up the process. Faced with public outrage, both politicians have stepped down from their position, though they both deny any wrongdoing. Their resignation has not stopped the avalanche of reactions, which have finally led to the suspension of the CIP, effective November 1, 2020. Interestingly, there have been immediate calls in favour of revamping and reinstating the program voiced by real estate developers and other industries that were benefiting from investments in the last decade.

These press revelations and the latest evaluation of the Cypriot AML framework (Council of Europe/MONEYVAL, 2019) have raised legitimate concerns over the design and implementation of AML safeguards in the CIP. A report put together by Cyprus's Auditor General has identified possible abuses of power in granting Cypriot citizenship to dozens of investors, including executives of a casino project (Audit Office of the Republic of Cyprus, 2020). Among several other disquieting findings, the report identifies 'possible intervention of the former Minister of Interior in order to speed up the examination time of certain applications [...] There has been a clear discrimination for 23 of the applications on which there are "Instructions by the Minister of Interior to speed up the process"'. The report also has identified instances of applicants having failed to submit a clear criminal record certificate and cases where 'the origin of money from abroad was not adequately ensured'. In other instances, family members of foreign applicants have been granted naturalization 'without this being provided for in the relevant Law' [5]. Finally, the Auditor General laments 'the absence of satisfactory control mechanisms that would reduce the possibility of fictitious investments'. The report, published despite an interdiction by the Attorney General of Cyprus, has brought about an institutional wrangle between the latter and the Auditor General, who declared that 'transparency is the main enemy of corruption. [...] Corruption rates are falling and instead of increasing transparency, we are trying to prevent [the Auditor's General Office] from publishing its reports'.

Was the CIP scandal a case of insufficient safeguards, wilful blindness or state-enabled money laundering? It is evident that safeguards had been poorly designed and implemented. There may also have been politicians, financial intermediaries and real estate developers who kept themselves intentionally unaware of facts knowledge of which would make them liable to criminal or civil prosecution. Carefully designed and rigorously implemented safeguards would have prevented instances of misuse of the CIP and, ultimately, averted the suspension of the program in these disconcerting circumstances. The shocking revelations on the scale of the problem, the inadequacy of control mechanisms, and the involvement of senior policy makers in the CIP scandal imply that the government of Cyprus needs to refrain from re-establishing a flawed legal framework. Otherwise, its conduct would amount to wilful blindness or even state-enabled money laundering. This observation applies to other EU Member States, which need to apply the lessons learnt from the CIP scandal and work to mitigate the significant risks of money laundering, corruption and tax evasion in CBI/RBI programs.

5. The Reaction of the EU and the Way Forward: Enhancing Compliance and Control Mechanisms at the EU Level

In the immediate aftermath of the CIP scandal, the European Commission launched an infringement procedure against Cyprus and Malta under Article 258 of the TFEU, arguing that their investment schemes undermine the essence of EU citizenship, which cannot stem solely from pre-determined payment or investment. As vividly stated by the President of the Commission, Ursula von der Leyen, in the 2020 State of the Union Address, 'European values are not for sale' [6]. The lack of genuine links between applicants for citizenship and the Member States granting citizenship is, for the Commission, problematic (European Commission, 2020) and calls into question the schemes' compatibility with the principle of sincere cooperation and status of EU citizenship under Article 4(3) of the TEU and Article 20 of the TFEU, respectively. The Commission further argues that golden passport schemes have implications for the EU as a whole. Indeed, 'when a Member State awards nationality, the person concerned automatically

becomes an EU citizen and enjoys all rights linked to this status, such as the right to move, reside and work freely within the EU, or the right to vote in municipal elections as well as elections to the European Parliament. As a consequence, the effects of investor citizenship schemes are neither limited to the Member States operating them, nor are they neutral with regard to other Member States and the EU as a whole' (European Commission, 2020). Following the formal pre-litigation phase, these matters can be taken ultimately to the European Court of Justice, which will ultimately judge the compatibility of the Cypriot and Maltese investment schemes with EU law.

We argue that in addition to this infringement procedure, a new and robust EU framework has to be developed, one which deals with the problem in general and addresses shortcomings in norm setting and supervision. A first option would be for the European Commission to formulate guidelines for member states for their RBI/CBI programs. A second option would be to adopt a binding instrument and to harmonize key aspects of the process for granting EU residency and citizenship. This new EU instrument would enhance transparency and due diligence obligations for government officials and private entities, in particular the members of the golden visa industry, which need to implement the risk-based approach (RBA) consistently and rigorously.

The RBA, as developed and monitored by the Financial Action Task Force (FATF), involves an assessment and an understanding of money laundering and terrorism financing risks at several levels, including state authorities and the private sector. This understanding must evolve into the adoption and implementation of appropriate AML measures by the individuals, entities, or market segments involved. By applying the RBA, the EU and its Member States should take into consideration the money-laundering and corruption risks of RBI/CBI schemes and vigorously evaluate the program as a whole, as well as the risk profiles of applicants. This exercise should be conducted regularly, in the form of recurrent reassessments. It should also consider the risks to the entire EU's area of freedom, security and justice (AFSJ), not only those to the host country. The EU Supranational Risk Assessment (SNRA), conducted by the European Commission, should be used as a reference document in this context (European Commission, 2019b), as well as the work of the FATF on RBAs.

With this in view, the EU and its Member States should reformulate the RBI/CBI schemes and the key aspects of the process for granting residency and citizenship. It should consider these specific aspects:

(i) Verifying the accuracy and veracity of applications and documentation is the quintessence of AML compliance in RBI/CBI schemes. To prevent conflicts of interest, the legislator should entrust this task not solely to private entities, but to a public authority, which should have the administrative capacity, resources, and functional independence to resist informal interventions by senior government officials. The relevant documentation must be maintained and made easily accessible for audits, eventual exchanges of information and administration of criminal investigations. This would ensure accountability, even if evidence of corruption, money laundering or other criminal activities is uncovered at a later stage. To further enhance the prevention and detection of misuses of RBI/CBI schemes, EU Member States should establish mechanisms for receiving reports, in particular from whistle-blowers, as well as a mechanism for reviewing cases according to the RBA analysis (Transparency International, 2018).

(ii) All phases of the decision-making process and the authorities involved in granting golden passports and golden visas should be subject to rigorous safeguards and oversight, in line with the RBA. Due diligence should translate into in-depth police and security checks, covering

pending civil or criminal proceedings. The applicant's sources of income and the relationship of these sources to his/her volume of wealth should also be subject to verification. When wealth is disproportionate, the application should be rejected, and further action needs to be taken, such as the filing of a suspicious activity report with the competent financial intelligence unit, also making use of available international cooperation mechanisms (Pavlidis, 2020b).

(iii) Due diligence must focus both on the applicant and on his/her family members, who enjoy reunification rights under the EU Family Reunification Directive [7]. Under the current practice, EU countries do not apply enhanced due diligence to family members of successful applicants (European Commission, 2019a), which increases security risks and has allowed criminals to circumvent checks and safeguards by having their spouses or children apply for passports or visas and by subsequently benefiting themselves from the provisions on family reunification.

(iv) Effective, proportionate, and dissuasive sanctions should deter the abuse of the golden passport and golden visa schemes. Sanctions could be of an administrative nature (revoking citizenship and residency rights) and/or criminal nature (criminal proceedings for money laundering, confiscation of investment, etc.). For its part, the EU should promote mechanisms of international collaboration to facilitate the exchange of information between national authorities involved in RBI/CBI programs. Such information exchanges, with the assistance of Europol, would help identify suspicious cases, individuals posing corruption risk and rejected applicants that reapply to other jurisdictions.

(v) To increase the transparency of the process, the competent administrative authorities should publish, *at a minimum*, official data on the approved and rejected applications. So far, available relevant statistical information is very limited, creating an opaque market that needs more transparency. In a more advanced model, information on the names of successful applicants could also be published to official statistics. Such a dissemination of personal data can be justified by a strong public interest (i.e., the need to enhance transparency of a process that has so far been opaque and prone to corruption).

(vi) In addition to introducing common rules for key aspects of the RBI/CBI schemes, the EU should take into consideration the external dimension of the problem. In this context, the EU could resort to blacklisting and impose additional controls and increased due diligence for travel documents or passports from third countries that systematically misuse RBI/CBI schemes. The EU should also work together with the Council of Europe and the OECD to increase transparency by developing common standards on tax evasion through investment migration, as well as by enhancing the exchange of information (criminal records, suspicious activity reports, etc.) with third countries in investment migration cases.

6. Concluding Remarks

The suspension of the CIP has been a supply-side measure, while the demand of rich investors for golden passports and golden visas has not weakened. Not surprisingly, other jurisdictions are stepping in to fill the gap, not only EU Member States, but also EU candidate countries, such as Montenegro, the investment scheme of which promises visa-free access to the common Schengen travel zone (Peel, 2020). If RBI/CBI schemes in EU Member States are not terminated altogether as inherently flawed, then a common and comprehensive approach is needed at the EU level for the regulation and supervision of such programs.

The legal standards set by the FATF constitute an appropriate response to money-laundering risks (Pavlidis, 2020a), but the EU needs to introduce further common rules and safeguards because investment migration and national RBI/CBI schemes have implications for the EU as a whole. The new EU common rules should be based on a thorough risk-based assessment of the RBI/CBI schemes in compliance with FATF standards. By harmonizing due diligence obligations, safeguards for transparency and accountability and mechanisms for supervision and sanctions, the EU must ensure that it does not become a ‘haven’ for illicit proceeds and that EU citizenship is not granted to third-country criminals cloaked as well-thought-of investors.

Notes

1. Section 3 (5) of the Saint Christopher and Nevis Citizenship Act, 1984
2. US Immigration Act of 1990, Pub.L. 101-649
3. At the time that the Cyprus Investment Program was suspended, the Registry of Service Providers contained 611 natural and legal persons (lawyers, law firms, real estate developers, etc.).
4. Census Bureau Law, No 141(I)/2002, sections 110-113.
5. Census Bureau Law, No 141(I)/2002, section 111A, subparagraph 2, which pertains to foreign investors, not their family members.
6. State of the Union Address by President von der Leyen at the European Parliament Plenary, Brussels, 16 September 2020
7. Council Directive 2003/86/EC of 22 September 2003 on the right to family reunification (OJ L 251, 3.10.2003)

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