

## Bank of the Underworld

Liberty Reserve was like PayPal for the unbanked. Was it also a global money-laundering operation?



Jake Halpern: May 2015

In the fall of 2011, the U.S. Secret Service orchestrated a sting operation. The target was a Vietnamese man named Hieu Minh Ngo. Investigators believed he was a big-time identity thief who sold packages of data known as “fullz,” each of which typically included a person’s name, date of birth, mother’s maiden name, Social Security number, and e-mail address and password. Criminals could buy fullz from Ngo for as little as eight cents and then use them to open credit cards, take out loans, or file for bogus tax refunds. They could also pay Ngo for access to a vast database of people’s personal records.

As part of the operation, an agent attempted to buy the identities of hundreds of U.S. citizens. In such illegal transactions—be they for drugs, guns, or stolen identities—finding a payment system that both sides trust can be tricky. Cash is safest because it leaves no record. But handing over a briefcase stuffed with bills isn’t an option when the parties are on opposite sides of the planet. Ngo suggested an alternative. In an e-mail to the agent, he offered simple instructions: “Please pay to our LR: U8109093.”

The eight-digit code was Ngo’s account number. LR stood for Liberty Reserve, a digital currency somewhat similar to bitcoin. Users could buy LRs, as they were known, for \$1 apiece and use them to pay anyone else who had a Liberty Reserve account. They could also store their money in the system. It was, in effect, a bank, a digital currency, and a payment method in one. For criminals like Ngo, the appeal of dealing in LRs was anonymity. Whereas traditional banks require you to provide at least one official form of identification, Liberty Reserve didn’t verify users’ identities. All they needed was an e-mail address.

The U.S. government eventually arrested Ngo and charged him with 15 crimes, including substantive wire fraud and identity theft. He had allowed nearly 1,400 criminals to access a database containing the personal information of 200 million U.S. citizens—almost two-thirds of the population. Ngo pleaded guilty to wire, identity, and computer fraud and is due to be sentenced next month. It was a big win for the Secret Service, which is charged with safeguarding our financial infrastructure, and for the U.S. Attorney’s Office. But officials had an even more ambitious plan in the works.

U.S. authorities had begun to notice that suspects in unrelated investigations were using Liberty Reserve to move dirty money. They had come to believe that it was a central hub for people engaged in credit-card fraud, identity theft, investment fraud, computer hacking, child pornography, and narcotics trafficking. It was, in their estimation, the underworld's payment method of choice—a system designed to help criminals make untraceable transactions.

And they wanted to shut it down.

The allure of going after Liberty Reserve was undeniable. In theory, it was an even bigger target than Silk Road, an online marketplace that sold illegal goods—an Amazon for the criminal world, until the FBI busted it in 2013. After all, why go after lone actors like Ngo, or even an entire marketplace, if instead you could find a way to destroy the very currency that bad guys around the globe appeared to be using?

At the heart of the government's probe were two crucial questions: How many criminals were using Liberty Reserve? And had they hijacked the system, or were they the intended users?

The underworld is a realm that thrives on paranoia. On May 24, 2013, criminals across the globe had good reason to panic: they couldn't access their Liberty Reserve accounts. Rather mysteriously, the company's Web site had stopped working. There were no explanations, no "We're experiencing technical difficulties" notices. The home page simply redirected to a blank screen.

Those who bothered to investigate further learned that the domain name for that blank page was controlled by a nonprofit organization called the Shadow server Foundation. Its own Web site featured a faceless man in a dark hat and declared: "The Shadow server Foundation gathers intelligence on the darker side of the internet. We are comprised of volunteer security professionals from around the world." It appeared that the Liberty Reserve Web site had been taken down, at least temporarily, by a team of pro bono crime fighters.

By evening, a group of "carders"—cybercriminals who specialize in selling stolen credit-card numbers—had gathered online at a secure forum known as carder.pro to discuss the situation. According to Damon McCoy, a George Mason University professor who studies cybercrime, such forums are not open to the public; you must apply to join the discussion. "They vet you to make sure you are a good criminal," he told me.

Despite not being able to access their accounts, some of the carders remained hopeful. "LR will be back and give everyone triple their account balance," one wrote. Another, who called himself "Ninja," offered a standing \$1,000 bet that Liberty Reserve would soon resume operating. But most seemed worried. Rumors and speculation flew about Liberty Reserve and its creator, Arthur Budovsky.

p3rito: I don't know if LR will back or no I don't know if owner was arrested or no.

**Zeus197:** I think no real arrested and LR will come back.

**PiraX:** Maybe this circus was created by fucker LR onwer to run away whit all our money and start anohter project.

**ochov:** I agree. he runaway with the money.

**Roger:** Why would he need to create any drama, if he wanted to run away, he could just run, and there would be nothing you could do about it.

One member wrote, rather smugly: “I don’t keep even a penny for long period on virtual currencies. Coz I trust nobody.” This remark seemed to get right at the crux of the matter. Liberty Reserve was a financial system, like all others, built on trust. In buying into the system, users were trusting that the people running it would operate fairly and protect their interests.

And the system that Budovsky built had inspired confidence. At one point, Liberty Reserve had more than 1 million users. Their faith was key. After all, this wasn’t just an electronic payment system Budovsky was operating. It was a currency, too. In theory, he could have “printed” as many LRs as he wanted, and used the money to line his own pockets. Or he could have made off with all the funds in users’ accounts. For the system to work, they had to feel safe. In effect, they had to believe in Budovsky.

Now that Liberty Reserve was frozen, and fortunes stood to be lost, users around the globe began frantically searching the Internet in the hope of gleaning a clue about Arthur Budovsky. Everything seemed to hinge on who this man was and what his intentions were.



One summer night in 2006, Budovsky heard a loud knock on his front door. “A SWAT team came in,” he says. “They screamed, ‘Where is the money and where are the weapons?’” (Clay Rodery)

Over the past several months, I corresponded with Budovsky by e-mail and met him twice in person. I also met his mother, Irina, who told me she felt from the start that her son was exceptional. When he was born, in 1973, Irina was living in Kiev, the capital of Ukraine, where she worked as a bookkeeper at a factory that made washing machines. Irina separated from her husband, Victor Budovsky, when Arthur was just 2 years old, and she and her only child grew very close. “He was not only a son, he was my friend—my best friend,” Irina told me. Arthur was always an unusual boy, she said: serious, bookish, and uncomplaining.

Irina got married again, to an engineer named Anatoly, and in 1990, when Budovsky was 17, the family emigrated to the United States. They settled in the Borough Park section of Brooklyn. It was a Hasidic neighborhood, and Budovsky was initially puzzled by the people he saw in the streets: flocks of somber-looking men always dressed in black suits. For a while he thought he was witnessing a succession of funerals, and wondered why his neighbors seemed to be dying in droves.

Budovsky briefly attended Abraham Lincoln High School, in Brighton Beach, but then dropped out. Not long afterward, he had a nervous breakdown. Irina told me doctors diagnosed him with “outside phobia”—whenever he ventured onto the street, he was overcome with dizziness and nausea. His mother said that for two or three years, Budovsky refused to step outside the apartment. (Budovsky insists it was just nine months.)

While he was holed up, Budovsky’s parents used their savings to buy him a computer. “It was around \$2,000 — for us it was crazy money,” Irina said. Almost immediately, Budovsky took it apart. Irina walked into his room, saw the mess, and expressed her horror. To her amazement, he quickly reassembled the machine. “He sat with the computer 24 hours a day,” Irina said.

Budovsky’s fear of the outside world gradually diminished. He began working as a computer consultant, starting with just a few individual clients and eventually helping small businesses set up their networks. He also reconnected with an acquaintance named Vladimir Kats, a Russian immigrant from St. Petersburg. They had met while working at a day camp for kids, not long after Budovsky arrived in the United States.

Budovsky described Kats to me as willful, smart, lazy, and extremely libertarian. Kats also had a dark side. In 2013, he would plead guilty to receiving child pornography. This came as no surprise to Budovsky. “The right for everyone to possess child pornography was always a strong and unshakable belief of his,” Budovsky told me. This belief, he said, was part of Kats’s larger conviction that government oversight was not just undesirable, but wrong.

Budovsky told me he disapproved of Kats’s affinity for child porn, but the two young men nonetheless became close friends. They shared a love of computers and in the early 2000s became interested in the emerging world of digital currencies. The pioneer of this field was, oddly enough, a radiation oncologist from Florida named Douglas Jackson. In 1996, Jackson had launched e-gold, the world’s first truly successful digital currency. Jackson had envisioned e-gold as being free of government regulation, and immune to the ups and downs of the financial markets, because it was backed by actual gold, in the form of bars stored in vaults.

Budovsky and Kats were intrigued by what Jackson was doing, and in 2002 they bought an online currency exchanger known as GoldAge and set about expanding the business. GoldAge was a middleman—if you wanted to convert dollars to e-gold, or vice versa, you needed to use such an outfit. Budovsky and Kats took a commission of 2 to 4 percent on every transaction, and, according to a subsequent indictment, they converted tens of millions of dollars.

**The way Budovsky tells it, he envisioned Liberty Reserve as PayPal for people around the world who don’t have bank accounts or credit cards.**

Budovsky said he felt that he was at the vanguard of a revolutionary way of banking. But trouble was brewing. After the September 11 attacks, U.S. authorities grew increasingly concerned that money transmitters, such as check-cashing businesses and wire services, offered terrorists and other criminals an easy way to move money. So when Congress passed the Patriot Act, in 2001, it included provisions to make prosecuting money transmitters easier, especially if they failed to get a government-issued license. It was unclear how these rules applied to digital currencies and exchangers, though, and Budovsky never applied for a license.

One summer night in 2006, at 4:30 a.m., he heard a loud knock on his front door. Groggily, he rose from his bed and asked who it was. A voice on the other side of the door said that his car was parked improperly and had to be moved. "I opened the door, and a SWAT team came in," Budovsky told me. "They screamed, 'Where's the money and where are the weapons?' I said I had no weapons and the money was in my wallet. They thought I was being sarcastic, but I wasn't."

Budovsky was indicted by the Manhattan district attorney for operating a money-transmitting business without a license. He was given five years of probation.

A year later, the federal government indicted Douglas Jackson, the radiation oncologist, and the other principal operators of e-gold. According to the indictment, e-gold's database had records of criminal activities its users were engaged in—with such notations as "child porn," "scammer," and "CC fraud." Jackson contested the charges but ultimately pleaded guilty to operating an unlicensed money-transmitting business and conspiring to engage in money laundering. He served no jail time. E-gold was allowed to continue functioning under stricter requirements, but it lost users and eventually shut down.

The digital-currency boom seemed to be on the wane. Budovsky, however, had already begun working—with some help from Kats—on a digital currency of his own. The way Budovsky tells it, he envisioned Liberty Reserve as PayPal for the unbanked. Americans have come to rely on PayPal as a safe and easy way to buy things on the Internet. There's just one catch: you need a credit card or bank account. For people the world over, this is a nonstarter. By some estimates, as many as 2.5 billion people don't have credit histories or bank accounts with verifiable balances. They are effectively shut out of the modern economy.

Budovsky told me that he just wanted to build a better, faster, easier payment method. "The current banking system has not invented anything new for quite some time, while the world and technology have moved on," he said. "This made me think, What can be improved?" His goal was to keep it simple. Users would go through exchangers to buy LRs, just as they had in order to buy e-gold. Liberty Reserve would take a 1 percent commission on all transactions made within its system. For an additional "privacy fee" of 75 cents, users could hide their account number when sending LRs, making the transfer untraceable.

Liberty Reserve's most obvious competitor was bitcoin, which launched in 2009 and is called the first decentralized digital currency because it is maintained by volunteers around the world who verify and record transactions in a public ledger. Many libertarians have embraced bitcoin as a way to break—or at least circumvent—government's stranglehold on currency. The downside of bitcoin, from a user's perspective, is that its value fluctuates wildly. Liberty Reserve was designed to be more stable: LRs were pegged to the U.S. dollar. What's more, Liberty Reserve was run as a for-profit venture, with headquarters in Costa Rica.

Budovsky says he chose Costa Rica simply because he had visited on vacation and fallen in love with the place: "I quickly became a victim to the stunning beauty of the country, the friendliness of its residents, the whole *pura vida* concept of life," he told me. "Anyone who has been to that magic country can understand what I am saying."

## How Liberty Reserve Worked:

1

Users could sign up for a Liberty Reserve account without providing any official identification. All they needed was an e-mail address.



2

To make a deposit, users had to buy LRs through a third-party money exchanger.



3

Users could transfer LRs to other accounts within the system. Liberty Reserve charged a 1 percent transaction fee. For an extra 75 cents, users could hide their account number, making the transfer untraceable.



4

To get money out of Liberty Reserve, users had to again go through a money exchanger, converting LRs back into regular currency.

As it turned out, in 2006, when Liberty Reserve was incorporated, the country was teeming with entrepreneurs, thanks to lax regulations and the fact that companies based there did not have to pay taxes on profits earned outside the country. David Boddiger, the editor of an English-language news site based in Costa Rica called The Tico Times, told me that in the mid-2000s, Costa Rica had struggled to rein in online gambling and Ponzi schemes. “It probably seemed like the perfect environment to set up this type of business,” he said. “There’s no military; it’s a small, democratic country with underfunded and understaffed law-enforcement agencies and an inefficient justice system.”

Costa Rica was also increasingly known as a place where dirty money could be cleaned. The country’s geography—with drug producers to the south and their customers to the north—was ideal for money launderers. According to Global Financial Integrity, a nonprofit that monitors international money laundering, Costa Rica exported \$5.4 billion in laundered money in 2006, equivalent to 24 percent of its GDP. By 2012, that number was up to \$21.6 billion—a whopping 48 percent of GDP. Ólger Bogantes Calvo, the deputy director of the country’s anti-narcotics enforcement agency, told me that the government simply never has the funds, manpower, or materiel to fight the criminal elements it faces. “Realistically, [the criminals] will always be a step ahead,” he said.

Of course, none of this proves that Budovsky had nefarious intentions. Costa Rica was, in theory, just a tropical paradise with low taxes and minimal government interference—an ideal habitat for a pair of pioneering tech nerds. Neither Budovsky nor Kats spoke Spanish fluently, though, so they teamed up with a local named Ahmed Yassine Abdelghani, who oversaw

the day-to-day operations of Liberty Reserve. Abdelghani was a naturalized Costa Rican citizen originally from Morocco. According to several people who knew him well—including Budovsky—he was temperamental, violent, and prone to heavy drinking. One former employee told me that Abdelghani often walked around the office brandishing a blackjack and that he once threatened to kill a man for failing to deliver some company uniforms on time. (Abdelghani is at large in Costa Rica and could not be reached for comment.)

By 2010, Liberty Reserve was gaining tens of thousands of new accounts each month. The company soon looked the part of a successful tech start-up. It had more than 50 employees in departments including human resources, accounting, marketing, and legal, and provided around-the-clock customer service and technical support. Liberty Reserve’s headquarters were in the same office park in San José, the capital, as branches of Hewlett-Packard, Procter & Gamble, and Western Union. The company housed its servers in the Netherlands and employed programmers in Ukraine. Its customers, of course, were everywhere.

**The element of surprise would be crucial: authorities needed to act before the main players had a chance to take their money and run.**

At least some users were legitimate businesspeople. One of them was Mitchell Rossetti, an entrepreneur based in Texas whose company, ePay-Cards.com, sells prepaid credit cards with small balances to customers around the world. Many of his customers couldn't use PayPal, because they didn't have bank accounts or credit cards, and he didn't like that PayPal would let people dispute a charge after they'd bought one of his cards. PayPal would demand a refund, and Rossetti would be out the money. "This is why we went to Liberty Reserve," he told me. "All payments were final." He also appreciated the multiple layers of encryption anytime he logged in. "It was very well thought-out."

Even as Liberty Reserve grew into a thriving tech company, Budovsky was furtive about his involvement. "Arthur was never to be mentioned in public or referred to as a person that belonged to the company," a former employee told me. "We were asked to call him Eric Paltz. That was his business name. Even his business cards would say Eric." Budovsky told me he used that pseudonym only in e-mails, and that others at Liberty Reserve used it too. But he added that his own name was a liability for the company. In the wake of the GoldAge debacle, the Associated Press had described him as a money launderer. (He was convicted only of transmitting money without a license.) As a result, he says, he had to distance himself from the company.

And he did.

Budovsky says he sold Liberty Reserve to Abdelghani soon after the company launched, and that he then worked for the company as a contractor, helping to make the networks run. U.S. investigators would later allege that Budovsky always controlled Liberty Reserve, and that he used surrogates to open bank accounts or file corporate paperwork. Budovsky told me he simply wanted to avoid the tiresome burdens of ownership. "I like to create and sell," he said. "Office jobs are not for me." Whatever his intentions were, the practical effect was that he had no real legal ties to the company. On paper, at least, he was just another tech contractor.



Budovsky was arrested in Spain on May 24, 2013. Authorities apprehended other Liberty Reserve employees the same day, and seized all of the company's files and computers.

For Budovsky, life in Costa Rica was good. He worked long hours and says he never went to the beach, because of a "skin condition"—his mother had had skin cancer and he feared the sun. But he liked cars, and his collection came to include a Jaguar and a Mercedes. He lived in a spacious home in the hills outside of San José and hired a maid who also prepared his meals. He liked photography and art, and on one occasion, he attended a charity auction—known as the CowParade—where life-size statues of cows sold for as much as \$7,500 apiece. He bought three of them to decorate his house.

It's unclear to what extent Vladimir Kats shared in Liberty Reserve's profits. Budovsky says that Kats never came to Costa Rica or contributed to the company in any meaningful way. In 2009, Kats and Budovsky had

a falling-out, and Budovsky says that he gave his old friend a six-figure gift—a kind of unofficial severance—and that after this, Kats had nothing to do with Liberty Reserve. (Kats’s lawyers did not respond to requests for comment.)

When he wasn’t working, Budovsky occasionally spent time with a Costa Rican woman named Yesenia Valeria Vargas. Vargas, who was in her mid-30s, supported herself and her three young daughters by selling empanadas at a food stand in front of an immigration office. She told me she and Budovsky were introduced early in 2008 by one of her regular customers, who happened to be an immigration lawyer. “He said to me that he had a man who wanted to marry me.”

In the months following their introduction, they went on dates. Communication must have been difficult, because Vargas doesn’t speak any English and Budovsky doesn’t speak much Spanish, but apparently they managed. As she told me in Spanish, through a translator: “In the time when we were going out, as friends, he explained to me his situation and told me he wanted to stay in Costa Rica, and so he wanted to marry. I said yes. We were in love.” They wed in June 2008.

Vargas described her husband as “a gentleman” in every way. Each month, he sent her 200,000 colones—roughly \$380—to help support her. Given how they met, I asked her whether they had a romantic relationship. “Yes, we had sexual relations, if that’s what you’re asking me,” she said. “Yes, of course, that is what is expected of a married woman.” But while Budovsky claims Vargas and her children lived with him, she said that in all their time together, she never even set foot in his house. Instead, she said, they met at hotels.

Vargas gleaned very little about Budovsky’s past or what he did for work. “He was very reserved about his personal matters,” she said. Among the things Budovsky never told her was that a couple of years after they wed, he also married a Dutch man named Gleb Pavlukhin, with whom he shared a home in Holland, where Liberty Reserve’s servers were housed. Here again, Budovsky’s and Vargas’s accounts diverge: he says he divorced her before marrying Pavlukhin, but there is no record of the divorce in Costa Rica, and Vargas told me that as far as she knows, they’re still married.

Budovsky insists he didn’t marry Vargas simply to get Costa Rican citizenship, which would have been illegal. Theirs was a personal relationship, he told me, without elaboration. But becoming a full-fledged Costa Rican did offer Budovsky a certain measure of protection from the U.S. government, as Costa Rica’s constitution bans the extradition of its citizens. (Though there are exceptions to this rule, they are extremely rare.) In 2011, Budovsky severed his ties with the United States altogether by renouncing his citizenship. According to government reports, he told U.S. immigration officials that he was developing new “software” that “might open him up to liability in the U.S.”

Budovsky claims that Liberty Reserve always planned to operate according to the local laws. He points to the fact that in 2008 the company began the process of applying for a money-transmitting license from Costa Rica’s financial regulatory agency, known as SUGEF. To ensure that this process went smoothly, the company hired a respected Costa Rican banker, Marco Cubero, as its general manager.

Cubero, in turn, hired an anti-money-laundering compliance officer named Sylvia Lopez—an experienced banking official. This was a SUGEF requirement. Perhaps the most important requirement, however, was that Liberty Reserve had to create a Government Administrative Area, or GAA, within the company’s

computer system. This was, in essence, a window into the company's inner workings, a way for Lopez to monitor transactions so she could report suspicious activity to the government.

Liberty Reserve did create a GAA, but it was hardly a model of transparency. In June 2010, one of Liberty Reserve's tech experts sent an e-mail, in Russian, to several people in the company, including Budovsky, about how the GAA would work. The system would allow the Costa Rican government to "view a few statistics," the e-mail said, but the "majority of these statistics are going to be fake." (This e-mail was later captured by U.S. investigators. Budovsky claims it was mistranslated.) It appears that neither Cubero nor Lopez knew about these fake statistics. According to U.S. investigators, Cubero resigned from Liberty Reserve in March 2011, in part because Budovsky hadn't given him access to the company's complete database. Lopez went further, reporting the company for suspicious activity.

Budovsky admits that the GAA didn't reveal a completely accurate picture of the company's finances, but he has an explanation: taxes. "The only thing that was changed was the total revenue for Liberty Reserve," he told me. "We showed that we were making more money from Costa Rican accounts than we actually did. It was easier for the books and for Victor, the accountant."

Liberty Reserve's troubles with Cubero and Lopez were soon compounded by a more serious problem. Budovsky told me that in early 2011, a Dutch policeman visited the company that hosted Liberty Reserve's servers in the Netherlands. Budovsky says he heard that the policeman claimed to be assisting in a U.S. investigation. According to Budovsky, Liberty Reserve then hired a private detective in the United States to find out whether the company was, in fact, under investigation by a federal agency. The detective reported that he could find no proof of this. Soon after, Liberty Reserve moved its servers from Holland to Costa Rica—a cost-saving measure, Budovsky says.

The private investigator, it turns out, didn't do a very good job. Back in the U.S., a major federal investigation was indeed under way. On November 18, 2011, the Treasury Department's Financial Crimes Enforcement Network sent out a notice to its member financial institutions, warning them that Liberty Reserve was "currently being used by criminals to conduct anonymous transactions to move money globally."

Budovsky says he never saw this notice. But government investigators believe he did. They say it is no coincidence that just 10 days later, Liberty Reserve aborted its efforts to get a Costa Rican money-transmitting license. The company's new general manager wrote a letter to the authorities explaining that Liberty Reserve was being sold to a buyer in Europe and would cease its business activities in Costa Rica.

Budovsky told me that the buyer was in Cyprus—another country with lax banking laws. In 2013, when the European Union was debating whether or not to bail out the Cypriot government, many EU members objected. As *The Wall Street Journal* reported at the time, "The little island won't get a cent until it wrestles with a long-standing issue: money laundering."



*Budovsky says he sold Liberty Reserve soon after it launched and thereafter was just a tech contractor. Prosecutors believe he always controlled the company.*

Little did Budovsky realize, but the Secret Service had been keeping an eye on Liberty Reserve since at least 2010. As part of its investigation, agents tested just how carefully Liberty Reserve vetted its users. An agent tried opening an account with the name “Joe Bogus” and an address of “123 Fake Main Street” in “Completely Made Up City.” The agent also named the account “ToStealEverything” and wrote that it would be used for “shady things.” He encountered no problems, and the account was soon functional.

By 2011, a Secret Service agent who was a member of the multiagency Global Illicit Financial Team (GIFT) had suggested that Liberty Reserve would make a good target for the group. GIFT was created to investigate multinational financial-crime cases, especially those involving organized-crime syndicates. The team draws its members from the Secret Service, Immigration and Customs Enforcement, and the IRS’s Criminal Investigation Division. The group soon set its sights on Liberty Reserve.

By the government’s assessment, the Liberty Reserve investigation is one of the largest money-laundering probes ever conducted. Classic money-laundering schemes involve businesses that run largely on cash—tanning salons, car washes, casinos—where the dirty money simply mixes in with the clean. In the age of global finance, though, money laundering typically involves shell companies and offshore bank accounts. Liberty Reserve appeared to be a key component in the process—a conduit for criminals to move money across borders without leaving a trace.

In going after Liberty Reserve, the element of surprise would be crucial: authorities needed to act before the main players had a chance to take their money and run. Even more important, authorities would need to seize Liberty Reserve’s servers before anyone could destroy the data they held. The servers were the holy grail. They contained information on all 1 million users and their 5.1 million accounts—evidence that might incriminate not just those running Liberty Reserve but any criminals who used the system. Such sensitive information can often be sabotaged remotely, with the click of a button.

The GIFT investigation revealed that Liberty Reserve had never shut down in Costa Rica. Instead, it had continued operating with a pared-down staff in office space also used by another company Budovsky owned. But apparently an exit plan was under way. According to U.S. investigators, Budovsky and his

associates had begun emptying the company's bank accounts in Costa Rica, transferring millions of dollars first to a shell account in Cyprus and then to another one in Russia. Ultimately, U.S. officials believe, Budovsky dispersed Liberty Reserve funds into more than two dozen bank accounts in Hong Kong, China, Morocco, Australia, and Spain. At the urging of the United States, Costa Rican officials seized roughly \$20 million of Liberty Reserve's money.

Budovsky denies that he was trying to drain the company's coffers; he says the funds were wired to Cyprus because the company was transferring assets to its new owner. What's more, he says, Liberty Reserve's move to Cyprus was delayed precisely because so much of its money had been seized. In any case, Budovsky remained safe from U.S. authorities as long as he stayed in Costa Rica. But, as one U.S. investigator told me, officials simply had to be patient. "Everyone travels," he said. "Especially if they have money."

Budovsky, in fact, traveled all the time. He had two other tech businesses—one specializing in IT services and the other in encryption—that were based in Europe and required his presence. But it was a vacation, a 10-day trip to Morocco in May 2013, that led to his undoing. He had a layover in Madrid on his way home. As soon as the plane landed, Budovsky told me, "I saw cars and agents outside the plane window."

Minutes later, Budovsky says, he was answering questions from two American law-enforcement officials. "They told me that the case against me was big and—if I would talk—some people from the United States would fly here. I said, 'I'll talk, but I will need legal counsel to be present.' They said, 'I guess you are not serious.' They tried this twice more on the tarmac." He was then taken to a prison by Spanish authorities. Among the items he was carrying, authorities would later discover several debit cards that were linked to bank accounts in Cyprus containing roughly \$3.5 million.

Meanwhile, authorities apprehended other Liberty Reserve associates, including Vladimir Kats, who was arrested in Brooklyn. A team of U.S. and Costa Rican officials raided Budovsky's home and Liberty Reserve's offices, seizing all of the company's files and computers. Another team surprised Budovsky's husband, Gleb Pavlukhin, at home in Holland. "They entered my house with an enormous battering ram and 12 detectives," Pavlukhin told the Dutch press.

U.S. authorities seized the domain name for Liberty Reserve and redirected it to an IP address belonging to the Shadowserver Foundation. Liberty Reserve's home page became the blank screen that puzzled and panicked the carders. Shadowserver, it turns out, often works with law-enforcement agencies around the world. Liberty Reserve users were so enraged by Shadowserver's participation that one of them launched a cyberattack that took down the organization's Web site.

The arrests occurred on May 24, 2013, the Friday before Memorial Day. Over the next three days, there was little news of what had happened. Liberty Reserve users fretted, despaired, and hypothesized. Then, on Tuesday, Preet Bharara, the U.S. attorney for the Southern District of New York, called a press conference. "Today, we announce charges in what may be the largest international money-laundering case ever brought by the United States ... allegedly [involving] a staggering \$6 billion in criminal proceeds," he said. Bharara unveiled a lengthy indictment against Budovsky, Kats, Abdelghani, and several other current and former Liberty Reserve employees. He called Liberty Reserve "the bank of choice for the criminal underworld."

Liberty Reserve's servers revealed that roughly 600,000 of the company's 5.1 million accounts were registered to users who said that the United States was their home country. These users had conducted transactions amounting to at least \$200 million. Prosecutors argued that Liberty Reserve had facilitated money laundering on a massive scale and that at least some of this activity had occurred in the U.S. The government had the legal toehold it needed to pursue Budovsky abroad.

**Budovsky's mother received a call from his lawyer in Spain. "Your son has disappeared from prison," he told her.**

Prosecutors analyzed approximately 500 of Liberty Reserve's biggest accounts, which constituted 44 percent of its business. The government contends that 32 of these accounts were connected to the sale of stolen credit cards and 117 were used by Ponzi-scheme operators. All of this activity flourished, prosecutors said, because Liberty Reserve made no real effort to monitor its users for criminal behavior. What's more, records showed that one of the company's top tech experts, Mark Marmilev, who was also arrested, appeared to have promoted Liberty Reserve in chat rooms devoted to Ponzi schemes.

"Thousands of criminal websites relied on Liberty Reserve as their payment processor of choice," prosecutors argued in a memo submitted to the U.S. District Court for the Southern District of New York. "These websites predominated the sources of Liberty Reserve's online traffic and generated billions of dollars in transactions run through the company's system." Prosecutors dismissed the idea that many legitimate businesses used Liberty Reserve. After the takedown, they noted, users were encouraged to contact the U.S. Attorney's Office in Manhattan if they wanted their money back. According to prosecutors, only 35 people did so.

Of course, none of this evidence could be used against Budovsky in a U.S. court so long as he remained in Spanish custody. After being arrested at the Madrid airport, Budovsky spent the next year and a half fighting U.S. efforts to extradite him. Then, this past October, Budovsky's mother received a call from his lawyer in Spain. "Your son has disappeared from prison," the lawyer told Irina. Two days passed without any news.

According to Budovsky, during this time he was let go and then effectively kidnapped by U.S. authorities. "I collected my things and was taken to the release-processing area of the prison," he told me. "They said, 'These police officers will escort you—you are free, but you must register at the local police precinct.'" At the precinct, he says, he was handed over to the Secret Service and flown to the United States on a commercial Delta flight. Aboard the plane, Budovsky recalls, the agent did him the courtesy of removing his handcuffs.

One of the lawyers representing Budovsky was Bart Stapert, an extradition specialist based in Amsterdam. Stapert told me that because no one had informed him when his client would be extradited, it was impossible for him to lodge an appeal with the European Court of Human Rights. In fact, Stapert didn't learn about Budovsky's fate until his client was en route to New York. According to Stapert, the U.S. government requested that he forfeit his fees for the case—insisting that the money Budovsky had paid him was tainted—a move that forced him to drop Budovsky as a client. (The Manhattan U.S. Attorney's Office denies that the government petitioned Stapert to forfeit the fees.) Once on U.S. soil, Budovsky was assigned a court-appointed lawyer; he is scheduled to face trial this fall. If found guilty, he faces up to 30 years in prison.

In January, I visited Budovsky at the Metropolitan Correctional Center, a federal jail in downtown Manhattan. I wanted to see him in person, after months of corresponding, and I was eager to hear his response to the charges against him, which he had seemed reluctant to discuss over e-mail. We met in a closet-size room with cinder-block walls and an improbable poster with a photo of a tree and the phrase “Unless you try to do something beyond which you have already mastered, you will never grow.” I waited for some time until, finally, a man in a brown jumpsuit appeared. He was about 5 foot 10 and slightly pudgy, with a buzz cut and a faint beard. “Hello,” he said in a soft, almost timid manner. “I’m Art.”

He held a thinly bound book, approximately 80 pages long. Only it wasn’t really a book—it was an index of all the evidence being used against him, much of it gathered from Liberty Reserve’s servers. All told, the discovery in this case exceeds 52 terabytes of data—if it were printed out, it would consume about 2.5 million trees’ worth of paper. The task of sifting through it all has fallen to Budovsky and his one court-appointed lawyer. “At this rate,” he said, “it will take me 18 years to go through.”

I spent five hours with Budovsky, talking about the charges against him. He contested all of them—starting with the accusation that he had been operating as an unlicensed money transmitter. He said there hadn’t been a clear requirement for administrators of digital currencies to register with the Treasury Department as money transmitters until the government issued detailed guidelines in March 2013—just two months before his indictment.

He makes a valid point, but clear guidelines didn’t exist in the mid-2000s, either, when the government went after GoldAge. What’s changed is that in the past few years, cybercrime has become a top concern for the United States. Budovsky seems to have assumed that the authorities wouldn’t pursue him to the ends of the Earth for not getting a license.

Budovsky also disputed that so many of the company’s biggest accounts were owned by carders and Ponzi-scheme operators. In fairness, Ponzi schemes are not always easy to detect. After all, Bernie Madoff ran his scheme for years before anyone caught on. “How can they know for certain?” Budovsky asked me. “Did they prosecute these companies? Did they find these companies guilty in court?”

As Budovsky tells it, Liberty Reserve took compliance seriously and even ran its own undercover operations. This, he says, explains why Mark Marmilev appeared to be promoting Liberty Reserve in Ponzi-scheme chat rooms. Both Budovsky and Marmilev have said this was all part of a covert investigation in which Marmilev pretended to be a criminal so that he could identify the true crooks and Liberty Reserve could lock their accounts.

Budovsky said the government may have found a handful of bad actors within Liberty Reserve’s client base, but they constituted just a small fraction of the 1 million users. He scoffs at the government’s claim that Liberty Reserve laundered \$6 billion. Michael McDonald, a 27-year veteran of the Criminal Investigation Division of the IRS, is skeptical of this claim as well. McDonald now works as a private consultant on anti-money-laundering investigations, and he says that prosecutors—those from New York in particular—love to boast that their investigations are the biggest. So far, he says, prosecutors have yet to provide a breakdown of “specified unlawful activity” by Liberty Reserve users—in other words, detailed proof accounting for all \$6 billion. This proof, of course, may well come out at trial.

**Budovsky told me authorities had missed the real culprit, the greatest enabler of criminal activity:  
Western Union.**

Perhaps the biggest problem for Budovsky is that four of his co-defendants—Kats, Marmilev, a tech worker named Maxim Chukharev, and Azzeddine El Amine, who is alleged to have been Budovsky's deputy—have already pleaded guilty. They have conceded that the company violated U.S. law by operating without a license from the Treasury Department. And they have admitted, to varying degrees, that they knew criminals were using the system. Chukharev has been sentenced to three years in prison and Marmilev to five years. A lawyer involved with these proceedings told me that Kats and El Amine, who have not yet been sentenced, will likely testify against Budovsky at trial. Their testimony may be the prosecution's coup de grâce.

Toward the end of my visit to the prison, Budovsky suggested that the authorities had missed the real culprit—the greatest enabler of criminal activity. "I have asked everyone in prison: How do you move money?," Budovsky said. "Two ways: cash in suitcases and Western Union. There's no verification required for up to \$900 with Western Union." (Officials from Western Union dispute this characterization, saying that under certain circumstances, they require ID for wire transfers of any amount.) "It is a gold mine," Budovsky told me. "That's what people say."

And he may be right.

Brian Krebs, a former Washington Post reporter who now runs a cybersecurity blog, [krebsonsecurity.com](http://krebsonsecurity.com), told me that of all the money-laundering tools available to criminals, none is more widely used than Western Union. "And it's based on technology that has been around for over 160 years," he said.

Still, there's no denying that digital currencies provide an easy way for criminals to move money across borders. (It's worth noting that Silk Road—the online criminal marketplace—operated almost entirely with bitcoin.) If the case against Liberty Reserve proves anything, it's that the U.S. is increasingly serious about policing the realm of digital finance. It remains unclear, however, how much is gained by destroying a single currency. Tom Kellermann, the chief of cybersecurity at TrendMicro, an IT-security company, told me he doubts that shutting down Liberty Reserve will be the deathblow to cybercrime that U.S. authorities envisioned. There are simply too many similar services, he said, and too many powerful groups that want to use them—from crime syndicates to the Islamic State. "The anti-money-laundering effort is failing," he told me.

That was apparent in 2013, in the days right after Liberty Reserve was taken down. As many of the criminals at [carder.pro](http://carder.pro) were panicking about their money, one of them (who went by "Absynthe") tried to restore a measure of calm. Indeed, Absynthe gave what can only be described as the criminal's equivalent of a Saint Crispin's Day speech. At 2:33 a.m. on May 28—just hours before Preet Bharara held his press conference—Absynthe typed these words:

First of all, for those who [have] big money [stuck] in LR, dont be anxious ... thinking about the possibility to loose your money. Thats will cause unnecessary pain. Give a good kiss your wife/girlfriend or your son if you have. Give a time for your mind. Live your life whatever be the future of this money ... If still thinking that you have no where to run: IF we lost, (I said IF, we have nothing concrete yet) we lost a place to KEEP money, not the way to MAKE money. Keep that in mind. The show MUST GO on.

\*\*\*\*\*