



FICIL  
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TOMORROW IS  
THE CONSEQUENCE  
OF NOW

Position Paper No. 5

30 May 2019

## **FICIL's Position Paper on Proposals for Improvement on Combating Economic and Financial Crime**

### **1. Executive Summary**

Given the current economic climate, investors are still concerned with issues surrounding the fight against financial and economic crime, such as corruption, shadow economy, anti-money laundering (AML) procedures and timely criminal proceedings. This can affect both the attraction of new investments as well as hinder the growth of existing investment. These risks have been raised in particular through the OECD, MONEYVAL and USA FINCEN over the past few years. The amount of non-residents' money was disproportionately high, which was too large for the Latvian economy.<sup>1</sup>

The outflow of non-resident deposits from Latvia's financial system was exacerbated by the liquidation of ABLV due to its inadequate controls over increased-risk shell company accounts and other high-risk transactions. Therefore, FICIL believes that the process of voluntary liquidation of ABLV has to be transparent and compliant with international standards, as well as fully controlled by relevant state institutions. A thorough and careful investigation into alleged money laundering is necessary to remove the grey-listing risk for Latvia's financial industry.

AML is a global issue, powering the all-encompassing fight against economic and financial crime. In light of the ABLV situation and corruption case of the president of the Bank of Latvia, FICIL is of the opinion that the Government of Latvia should work closely with the European Central Bank and other international institutions with respect to centralised supervision of money-laundering risks within the European Union. Recent money-laundering cases at euro zone banks show that allegedly illegal transactions involved different countries of the bloc, making this a transnational issue, with cooperation among different national authorities necessary.

Efforts by the Government of Latvia to restore the international reputation of the Latvian financial sector are appreciated. Several areas have seen considerable improvement: the ultimate beneficial ownership (UBO) regime and the reporting framework of the Financial Intelligence Unit<sup>2</sup> to name a few. The most important priorities include improving cooperation and information sharing among relevant institutions, strengthening the rule of law as well as eradicating perceptions of impunity. These objectives, along with timely implementation of MONEYVAL recommendations, are key in

<sup>1</sup> MONEYVAL Anti-money laundering and counter-terrorist financing measures Latvia, 2018

<sup>2</sup> <http://www.oecd.org/finance/Combating-Money-Laundering-and-the-Financing-of-Terrorism-in-Latvia-Overview.htm>

dealing with the reputational crisis and advancing Latvian economic growth and prosperity. Sufficient financing and improved cooperation among national institutions such as the Financial Intelligence Unit Latvia (FIU), Economic Police (ENAP), State Revenue Service (SRS) and the Prosecution team is still necessary.

FICIL recognises that the Government has achieved some progress with respect to recommendations included in FICIL's 2018 position paper on combating economic and financial crime. The Government has taken measures to implement and provide a legal and institutional framework that is sustainable, progressive and conforms to international standards regarding AML and combating terrorism financing (CTF). As it stands now, Latvia's inability to implement all MONEYVAL recommendations is evident, so the Government needs to be aware of risk areas and develop an action plan for the coming years.

When it comes to insolvency proceedings, FICIL does not view the study on insolvency and legal protection court cases from 2008-2014 as sufficient. This study pointed to specific judges whose incompetence on matters of insolvency raised concerns of deliberate negligence or suspicion of potential corruption. The same judges, who have already raised concerns, continue to work within the judicial system on cases concerning insolvency proceedings, leading to doubts regarding the impartiality of the court. FICIL believes that the Ministry of Justice, as the responsible institution for the justice system, should draw appropriate conclusions within the framework of the relevant study in order to properly address the shortcomings identified regarding the work of certain judges to prevent similar failures and recurrence of incompetence in the future. It is not possible to restore trust and follow the rule of law within the insolvency system if there are potentially corrupt judges in the courts. In this regard, FICIL supports non-routine evaluation of judges, according to the Council for Judiciary decisions.

Significant improvements have been made in relation to supervision of insolvency proceedings. The regime of insolvency administrators has been strengthened. The Insolvency Control Service has been provided with sufficient resources to fully demonstrate both quantity and quality in its activities.

The key aim of the current Position Paper is to address issues and crimes that are recognised in the National Risk Assessment as generating the most significant amounts of illicit proceeds, i.e.:

1. Money laundering and terrorism financing;
2. Corruption and bribery;
3. Shadow economy and tax crime;
4. Fraud and insolvency.

## **2. Recommendations**

### **1. Anti-money laundering and terrorism financing**

Equal and coherent application of the Law on the Prevention of Money Laundering and Terrorism Financing (NILLTFN) towards all subjects of the law is needed to address the stability and reputation of the financial sector as a whole (private and public sector). A strong focus needs to be placed on the coherence of regulation and the avoidance of overregulation of certain stakeholders, while others are poorly regulated (like real estate companies, pay day lenders, etc.) More attention should be drawn to implementation of laws based on merits rather than procedure. Increased

feedback from state institutions towards entities that hand in reports would increase the quality of these reports in the future.

## 2. Corruption and bribery

Vast improvements are necessary in cooperation with other national (SRS, FIU, etc.) as well as international institutions in the fight against corruption and bribery. Cooperation could foster a more proactive approach, where institutions do not place such a strong focus on whistleblowers and outside reports but carry out a risk-based approach and investigations, paying more attention to high-risk situations, such as large infrastructure projects. Strong focus needs to be placed on high-priority corruption cases, which are important for society: the cases involving the president of the Bank of Latvia, Riga City council and its companies (Rīgas Satiksme), insolvency administrators, etc. are of interest to the wider business environment and society. This would positively affect perceptions of impunity for financial and economic crimes that are currently visible in Latvia.

## 3. Shadow economy and tax crime

A revision of the policy through which the courts apply punishments for tax related crimes is needed, as is improvement in the flow of feedback between judges and the SRS enforcement team about the quality and evidence of financial and tax crimes.

Creation of national legislation for Anti-Fraud Coordination Services (AFCOS) in accordance with Article 3(4) of Regulation 883/2013 is needed to facilitate effective cooperation and the exchange of information, including information of an operational nature, with the European Anti-Fraud Office (OLAF).

## 4. Fraud and insolvency

There are still some areas for improvement in the regulation of insolvency administrators, the legal framework for Legal Protection Proceedings and Insolvency Proceedings of a Natural Person. The rules on insurance of administrators should be modified to ensure adequate coverage in all cases. Legal Protection Proceedings need to introduce a better balance between reorganisation and liquidation, and avoid misuse of these proceedings.

### 3. Rationale for recommendations

#### **Anti-money laundering and terrorism financing**

The government's response to the MONEYVAL report with the Plan of Anti-Money Laundering and Counter-Terrorism Financing Measures through 31 December 2019 demonstrates the will to deal with economic and financial crime and, if successful, could restore some of the reputational damage suffered in 2018. However, there needs to be a long-term strategy to ensure a stable and predictable financial and investment environment in Latvia.

FICIL is of opinion that government must work on a long-term policy plan to address AML/CFT issues. The goal should be uniform enforcement and seamless cooperation across national jurisdictions. Cooperation and consultation with the private sector are important because they will contribute to lower costs, create a level playing field, and promote an accepted global public good from which the marginal benefit to each participant exceeds the cost, and where the incentive and scope for freeriding are small.

A long-term evidence-based strategy for combating economic and financial crime and increasing general compliance should be developed. This strategy shall be based on prevention, enforcement and national and global AML regimes:

**The prevention pillar** has four key elements:

1. Customer due diligence (CDD) is intended to limit criminal access to the financial system and other means of concealing the proceeds of crime;
2. Reporting requirements alert authorities to activities that may involve attempts to launder those proceeds;
3. Regulation and supervision involve implementation of anti-money laundering laws and often specify detailed CDD and reporting requirements, while supervision ensures compliance with laws and regulation by financial institutions and non-financial businesses and activities;
4. Sanctions punish individuals and institutions that fail to implement the prevention regime, in particular with respect to CDD and reporting requirements.

**The enforcement pillar** has four key elements:

1. Information sharing - the government should strengthen public-private partnership in developing AML/KYC tool for information sharing;
2. Investigation – various detection and investigative techniques are used to identify specific instances of money laundering and link each to predicate crimes;
3. Prosecution – if justified by the investigation, the money launderer is prosecuted;
4. Punishment and confiscation – if convicted, the money launderer is not only fined or sentenced to jail time, but the criminal proceeds involved may also be confiscated or forfeited after their blockage or seizure.

**The national and global AML regimes** as they exist today are imperfect because their construction has involved trade-offs between the actual and perceived benefits and costs of expansion, between the co-opting of the private sector and privacy and human rights concerns, between national and international priorities, and between national and subnational priorities and structures.

FICIL is of opinion that with respect to the MONEYVAL report, priority actions for the government involve:

1. prevention measures – the government should take measures to ensure that the AML/CFT Law: 1) extends the understanding of terrorist financing risk beyond screening against “terrorist lists”; 2) facilitates an understanding of money laundering and terrorist financing risks through contributions to and feedback on national risk assessments. Financial institutions, as key players in Latvia’s NILLTF prevention system, have begun to take the appropriate steps, including reviewing their clients’ future cooperation and risk profiles. At the same time, these compliance measures are potentially being taken too far, while other stakeholders are not informed enough regarding the actions needed to implement this law.
2. to the enforcement measures - to systematically prosecute a wider range of money laundering offences, including third party and stand-alone/autonomous money laundering. Government should take order to develop law enforcement guidance, backed up by corresponding training for all judicial stakeholders involved in the prosecution of proceeds-generating offences, on the minimum levels of evidence which the courts may require to establish underlying predicate criminality in a money laundering prosecution under the recently-changed legislation.

Legislators, regulatory bodies and enforcement authorities have long deputised the private sector in the global fight against economic crime. This is especially true for the financial service industry with respect to crimes of money laundering and terrorist financing but also for other industries with respect to corruption, bribery, fraud, tax evasion, insider trading and more. Meanwhile, the Governments' response in fight against the economic crime is somewhat weak and often ineffective. Criminal proceedings must be with the beginning and end! The definition of "the End" FICIL understands the judicial decision with appropriate sanctions, which would prevent further crimes from being committed.

Along with AML/CT issues, FICIL also highlights the problems surrounding corruption and shadow economy. There is a sentiment that no punishment follows corruption, it feels like "there are no benefits for the honest ones in this country".<sup>3</sup> In regards to shadow economy, policy makers have taken steps to mitigate these crimes, however there is still a long way to go, including dealing with corruption on a state and municipality level. Close cooperation among relevant institutions as Economic Police (ENAP), State Revenue Service (SRS), Financial Intelligence Unit Latvia and Corruption Prevention and Combating Bureau (KNAB) is vitally important.

FICIL notes and highly values the Ministry of Justice initiative to undertake a performance audit that assess the efficiency and effectiveness of enforcement institutions of criminal proceedings in Latvia. Such risk assessment will provide a better basis for analysis of the effect of existing measures and where new measures are needed. The performance audit should provide data on how to build strong law enforcement and judicial bodies with the capacity to strengthen investigation and prosecution of economic crimes. Conditions need to be created that allow honest businesses to thrive with clear indications that operating in the grey economy is not beneficial and is punishable. Considering available resources, it is very important to prioritize sectors where a large portion of the shadow economy is concentrated (construction, large infrastructure projects).

### **The field of anti-fraud and insolvency**

The Legal Protection Proceedings, as main instrument for the reorganisation of viable enterprises, do not seem to be fulfilling that function. The number of cases where a plan is concluded is limited, and this suggests that the procedure is used, in many cases, just as a delaying tactic against creditor action. A series of changes would be required to introduce a proper balance between reorganisation and liquidation in insolvency system, facilitating the rehabilitation of viable businesses and long-term growth.

Entrepreneurs tend to lack financial expertise in dealing with financial difficulties. As part of the Legal Protection Proceeding - debts are being restructured, without sufficiently of business restructuring and failing the causes of systemic financial difficulties. In most cases of Legal Protection Proceedings plans are focusing on debt restructuring, but not on the business restructuring. The entrepreneur himself, who is usually prepared by an adviser with a lawyer's qualifications, using financial information provided by the company itself, usually provides the development of a Legal Protection Proceedings plan. Often, the same consultant (lawyer) is the supervisor of the company's Legal Protection Proceedings plan.

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<sup>3</sup> FICIL Sentiment Index 2018