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CHANGE MANAGEMENT in Latvia's financial sector 2016-2019



Overview of major developments and
statistics

Communications Division

2019

CHALLENGE:

Significant presence of foreign customers

55%
peak

53.3% - August 2006

35.9% - June 2009

(after the crisis, the lowest level in 20 years)

54.8% - March 2015

20%
at present

Mitigation of foreign exchange risk since 2016:

39% - at the end of 2017

20% - at the end of 2018 (-48%)

RISK MITIGATION APPROACH

FCMC raises standard norms
for foreign banks in a timely manner
according to the amount of deposits:

20-40% - liquidity requirement **40%**

40-70% - liquidity requirement **50%**

70% and more – liquidity **60%**



Standard liquidity requirement 30%





- New requirements for financial crime prevention:
 - FCMC's guidelines for the monitoring of politically exposed persons (PEP)
 - Survey of banking customers
 - FCMC's regulations on customer due diligence for high-risk customers
- Enhancement and enforcement of the fines and sanctions mechanism (In December 2015, for the first time a fine of EUR 2 million was applied to a bank in Latvia ([Privatbank](#)); in 2016, [withdrawal of authorisation of Trasta Komerbanka](#); only in Latvia an assessment of [Swedbank](#) was carried out, imposing a fine and requesting the bank to address deficiencies in internal control systems).
- FCMC's public position, P. Putniņš: ***Servicing non-transparent cash flows in Latvia's financial sector will no longer be a profitable business!***
- Latvia's accession process to the OECD as a catalyst: a comprehensive national risk assessment carried out



Establishment of **Compliance Control Department: April 2016**

Up to April 2016: **Financial Integrity Division** as a small unit within the FCMC's Supervision Department



Latvia as OECD Member

December 2015 – the OECD interim report criticises **material deficiencies in the AML/CTF system**

14.04.2016 – positive opinion **confirming the work done by the [Latvian supervisory authorities](#) and the sector in the field of AML/CTF**

Implementation of priority recommendations – qualitative and timely performance, and on **11.05.2016** Latvia receives an invitation from the OECD Council to join the organization

07.09. 2016 – FCMC head receives the **Cabinet's Certificate of Distinction** for **significant contribution to Latvia's successful accession to the OECD**

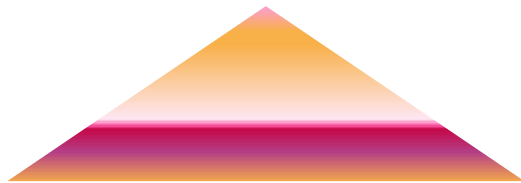
Visit of the USA Vice President Joe Biden

- criticism of non-transparency of Latvia's judiciary
- concerns about the administration of insolvency system
- encouragement of further elimination of corruption
- and cleaning up the banking system.



Joe Biden 23.08.2016:

«Underscoring the progress Latvia has made in tightening regulation of its banking sector and cracking down on money laundering, the Vice President encouraged Prime Minister Kucinskis to take further steps to improve Latvia's investment climate progress.»



**All banks may
continue operations**

**Individual
recommendations**

Independent testing of 12 banks in Latvia was completed by the US consultants - *Navigant Consulting Inc., Exiger LLC and Lewis Baach Kaufmann Middlemiss* using a common methodology in line with the US regulatory standards in the AML/CTF area

Improved FCMC supervisory model, including current international practice

FCMC monitors how the banks implement **recommendation plans**

FCMC presentation

MAIN CONCLUSIONS FROM US INDEPENDENT TESTING:

https://www.fktk.lv/wp-content/uploads/2019/05/ASV_audits_NRD_bankas_PDF_ENG.pdf



Amendments to the Law on the Prevention of Laundering the proceeds from Criminal Activity (Money Laundering) and of Terrorism Financing :

- In the future, the subject of the Law will be obliged to review and update the procedures at regular intervals, as well as carry out an AML risk assessment
- Identifying of legal arrangement will be carried out in line with the FATF recommendations (defined term «individual transactions»)
- Definition of beneficial owner (BO) specified in line with international standards

Based on the shortcomings identified in the inspections and the implementation of internationally recognized practices, **FCMC draws up Recommendations to Credit Institutions for Identifying the “Red Flags” of Suspicious Transactions**

A 30% drop in deposits of foreign customers



- FCMC in collaboration with the US Federal Bureau of Investigation identified in five Latvian banks **indirect circumvention of sanctions regime imposed against North Korea - banks have been penalized and instructed to enhance their internal control systems** ([AS «Baltikums Bank»](#), [AS «Privatbank»](#), [AS «Reģionālā investīciju banka»](#), [AS «NORVIK BANKA»](#), [AS «Rietumu Banka»](#))
- Public position – a stage of fundamental changes in the banking sector is continuing consistently, P. Putniņš: ***«Critical assessment of the customer base by phasing out business relationship with high-risk customers is a priority task. Anyone may only assume the risks that its control system is able to manage.»***

Basel AML Index - Latvia is out of the list of countries where money laundering is a problem of primary concern



- **13.02.2018** – The US Department of Treasury’s Financial Crimes Enforcement Network **FinCEN** issues a **statement on Latvia’s AS ABLV Bank** as a financial institution of primary money laundering concern
- FCMC’s public position, P. Putniņš: «*Supervision of ABLV Bank has been very tight on part of FCMC in particular over the last years – significant remedial work has been done; the fines, largest ones than ever in Latvia, have been imposed on the bank. Investments in internal control systems amount to almost 20 million euro. **These are aftermaths of historical legacy that has happened this year. We always remind the banks that reputational risk in such situations may be transformed in this way.***»

Assessment of the FCMC performance by FinCEN (p. 8): «*In a positive development, since 2015, the FCMC has led significant efforts to reform Latvia’s AML/CFT regulations and enforcement regime. However, as noted in the aforementioned 2014 ECFIN report, positive changes need to be consistently implemented jointly with the banks. The need to improve the institutional capacity remains a long-term challenge due to the complexities of investigating and prosecuting money laundering.*»





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Recent Actions Regarding Latvia's Banking Sector

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Press Statement

Heather Nauert
Department Spokesperson
 Washington, DC
 February 20, 2018

The United States has full confidence that the Government of Latvia will take the necessary steps to uphold the integrity of its banking and financial sector. For many years, we have been working together with Latvia to combat corruption, money laundering, and other threats to international security. Moving forward, the United States supports and will continue to help the Government of Latvia, the Latvian Financial Capital and Markets Commission, and Latvian law enforcement to realize our shared vision of a strong and well-regulated Latvian financial sector.



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EP TAX3 COMMITTEE HOLDS HEARING

26.04.2018 – [European Parliament's TAX 3 Committee held a first public hearing «Combat of Money Laundering in the EU Banking System»](#) (AS ABLV Bank – Latvia's case; Pilatus Bank – Malta's case, Danske Bank un Versobank AS – Estonia's case)

- FCMC presented a new approach – managing the self-cleaning process and risk mitigation
- [FCMC maintains the initiative of a single authority for investigation of financial crimes in Europe](#)

Photo: European Parliament, 26.08.2018

FCMC's delegation: P. Putniņš, G. Romeiko, N. Dambure



PUBLIC POSITION

FCCM Chairman

Pēters Putniņš:

*«We have a problem where the suspicious money comes from to Latvia and where these funds remain after their servicing in Latvia has been declared adverse and Latvian banks have been penalized for that? In the context of an indirect infringement of sanctions **Latvian banks were punished, but this money did not land in Latvia from the moon, it arrived through other European banks, and the money path was widely branched.** We haven't heard about other jurisdictions sanctioning their banks. It is high time to assess the movement of suspicious money in the euro area and **to establish a single authority in Europe that would supervise control of money laundering risk** and ensure investigation like FinCEN in the United States.»* Brussels, European Parliament, 26.04.2018





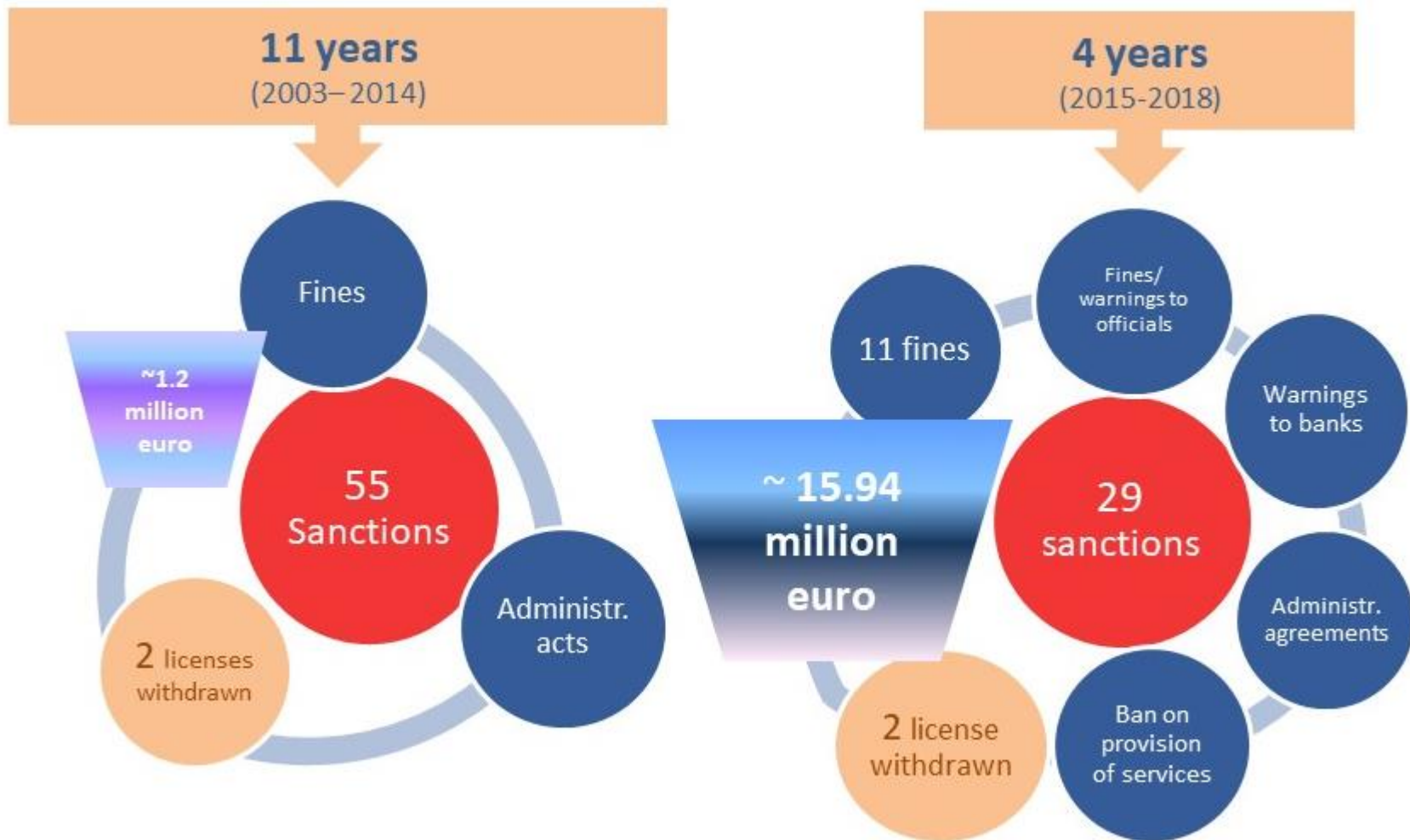
- **12.06.2018: FCMC Board's decision on the legal and constructive voluntary liquidation process of *AB LV Bank***
- Participation in the **development of a methodology for controlling creditors' money** (Ernst&Young)
- 06.03.2019: [FCMC Board approves a methodology for screening customers](#) (approved also by the Control Service and discussed with *FinCEN* colleagues)
- FCMC position, P. Putniņš: «***The process of change management in the Latvian banking sector is in its final phase. There is no more reason to consider that Latvian banks focus their business on handling foreign customers' money. The dominance of domestic and European Union countries' deposits is obvious - 91% .»***
- [TAX3 Committee's return visit to Riga](#) on 31.08. 2018 to assess the transformation of the Latvian banking business, encouraging to continue processes

FCMC in the context of Moneyval Report 2018

Part of the recommendations within the FCMC competence at the time of issuing the report have been implemented

- It is noted that **FCMC shows the highest understanding of financial crime risks** in the financial sector
- Contrary to the FCMC's consistent approach to risk mitigation, risk appetite in the supervised sector changes slowly
- FCMC's supervisory approach **is based on the risk assessment**
- FCMC identifies threats of money laundering according to a detailed breakdown (shell companies, payment institutions, e-money institutions, fiduciary credits, etc.)
- **FCMC has appropriately imposed significant penalties on so-called foreign customer banks** in Latvia for failing to identify beneficiaries and to introduce adequate internal control systems
- FCMC demonstrates proactive supervision approach and active involvement in international cooperation

CHANGES - SANCTIONS





FINES AND CORRECTIVE MEASURES

2014
Joining the euro
area/sanctions
disclosure

Total : 70 000 euro fine
on 1 bank;
2 warnings to banks.

2015
Before the
accession to the
OECD

**Total: 2.4 million
euro** fines on 4 banks;
Fines to 4 bank board
members ~ **145 000 euro**;
2 warnings to 1 bank.

ABLV Bank

2016

Latvia's accession
to the OECD 01.07.

+ 6 million euro
invested in the
development of
control systems

**Total: 5.96 million
euro** fines to 4 banks;
Business restrictions and
withdrawal of
authorisation of 1 bank;
1 bank banned to provide
services in Latvia.

2017

**+ 12.5 million
euro**
should be invested in
enhancing control
systems by 2020

**Total: 3.5 million
euro** fines to 5 banks
(incl. for
circumvention of
North Korea sanctions
regime, in cooperation
with FBI);
Public warnings to 3 bank
officials.



- In three years, the Latvian banking system has been **at 10 billion** of foreign customer money, while **payments in the US dollars have shrunk 26 times**
- In August 2018, banks ceased their business with shell banks banned in Latvia
- CIS customer exposure reduced to 5 - 6%
- **FCCM reported** to the Financial Intelligence Unit about suspicious transactions totaling **EUR 2 billion** (2016-2019)
- FCCM's **finances imposed on financial institutions have increased by 16 times**: in 11 years – EUR 1.2 million, in 4 years – EUR 16 million
- 02.2019 – **new business models of 12 small-sized banks** approved

STABILITY IN THE SECTOR

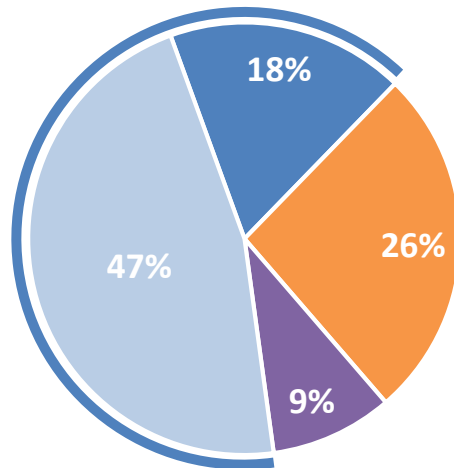


AT PRESENT: European and domestic customers

2015

~65%

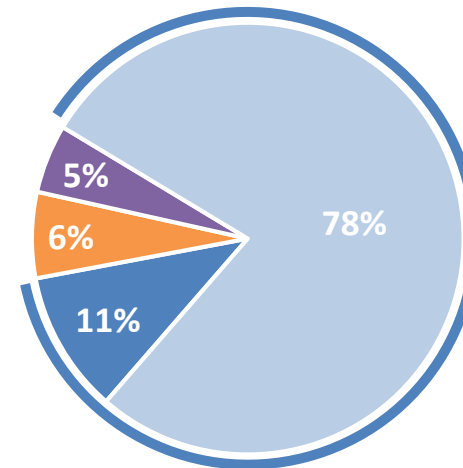
Domestic and
EU deposits



2018*

~90%

Domestic and
EU deposits



■ EU

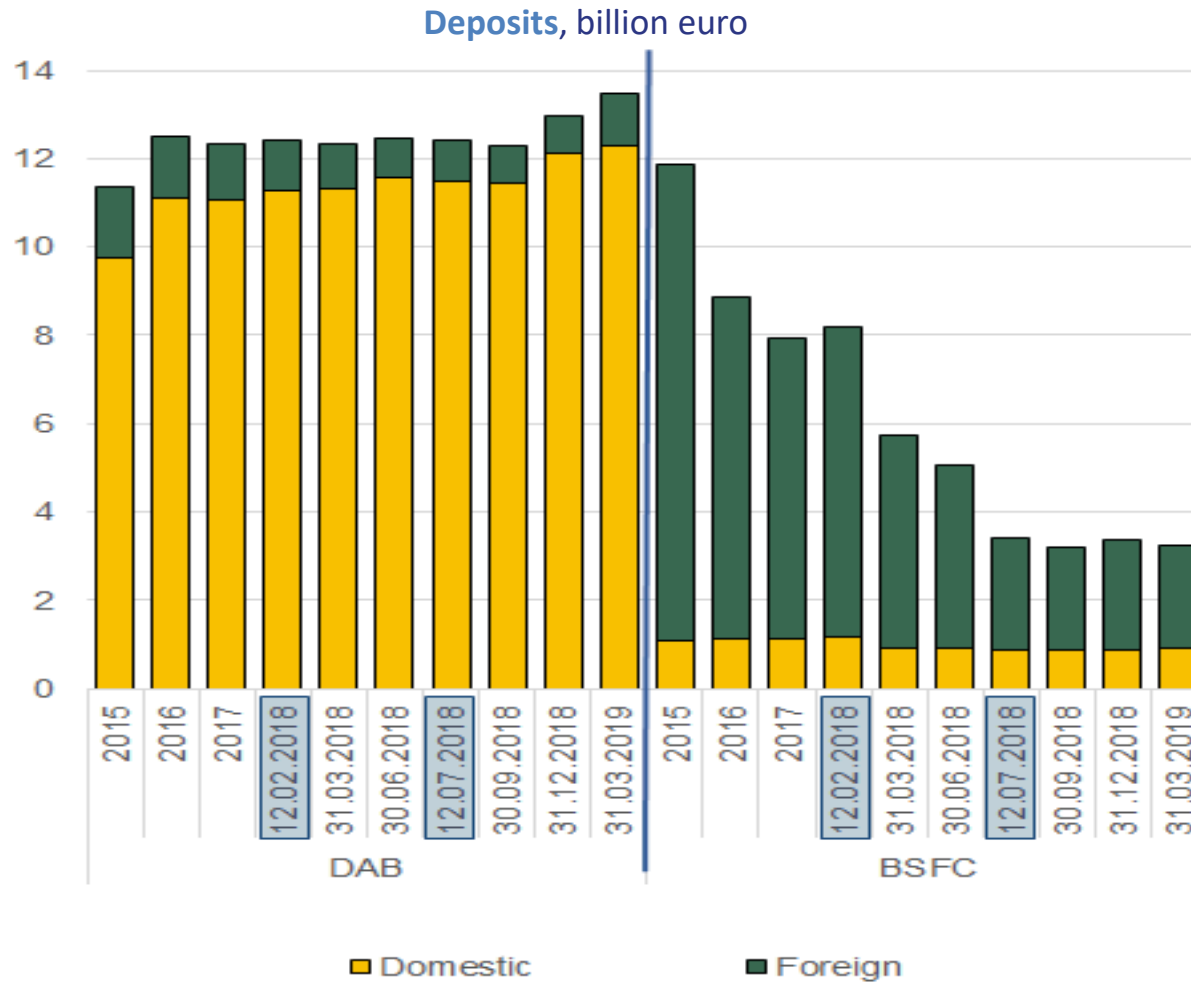
■ Other

■ CIS

■ Latvia



RISK MITIGATION IN DEPOSITS



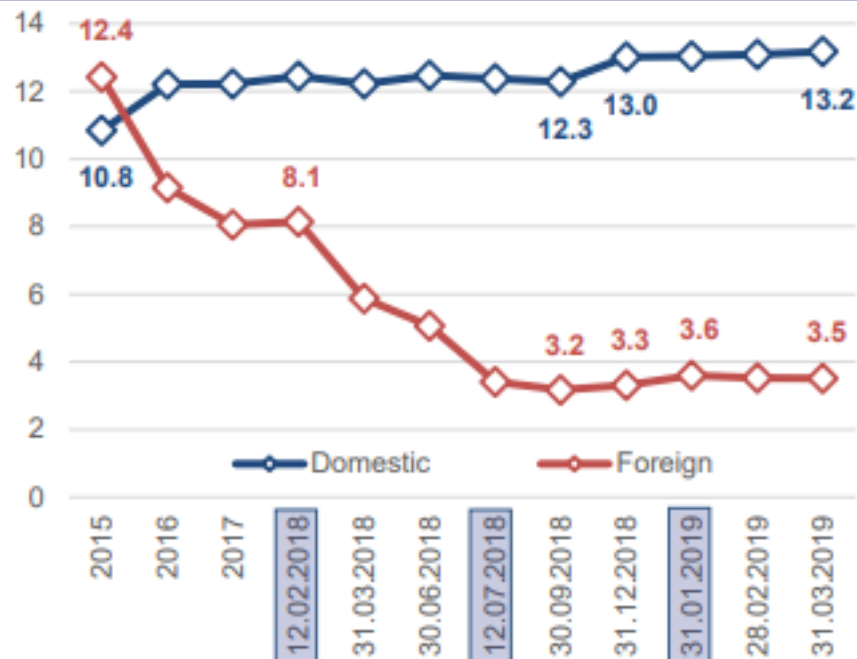


CHANGES: FOREIGN DEPOSITS

Key indicators

	2015	March 2019	Change
Deposits, incl. (EUR billions)	23.3	16.7	-28%
Domestic	10.8	13.2	+22%
Foreign	12.4	3.5	-72%
Share of foreign deposits	53.4%	21.1%	-32 pp

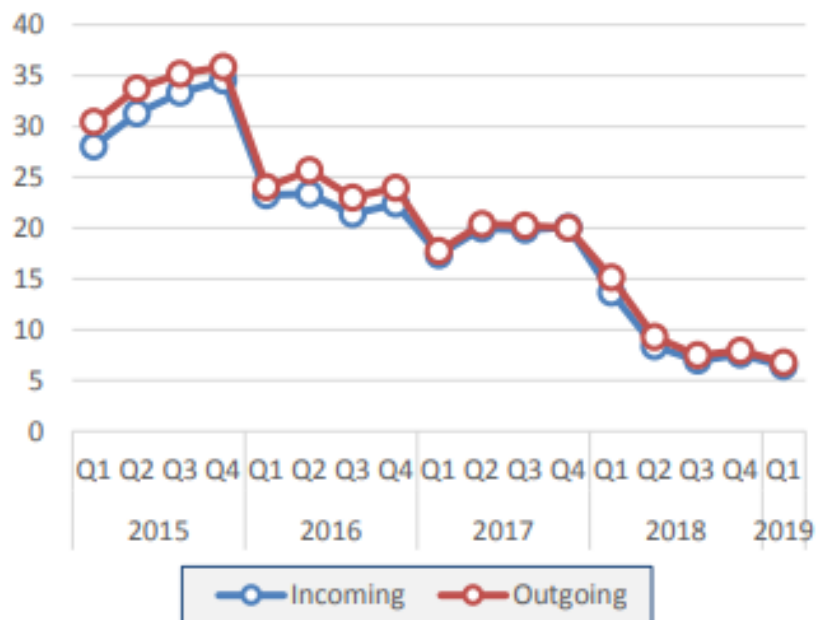
Deposits (EUR billions)



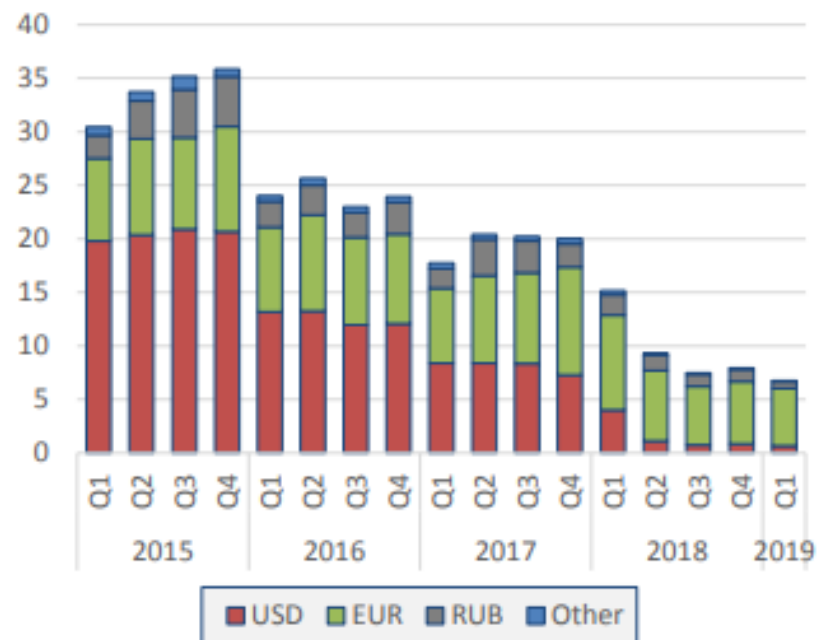


CHANGES: PAYMENTS

Foreign clients' payments* (EUR billions)



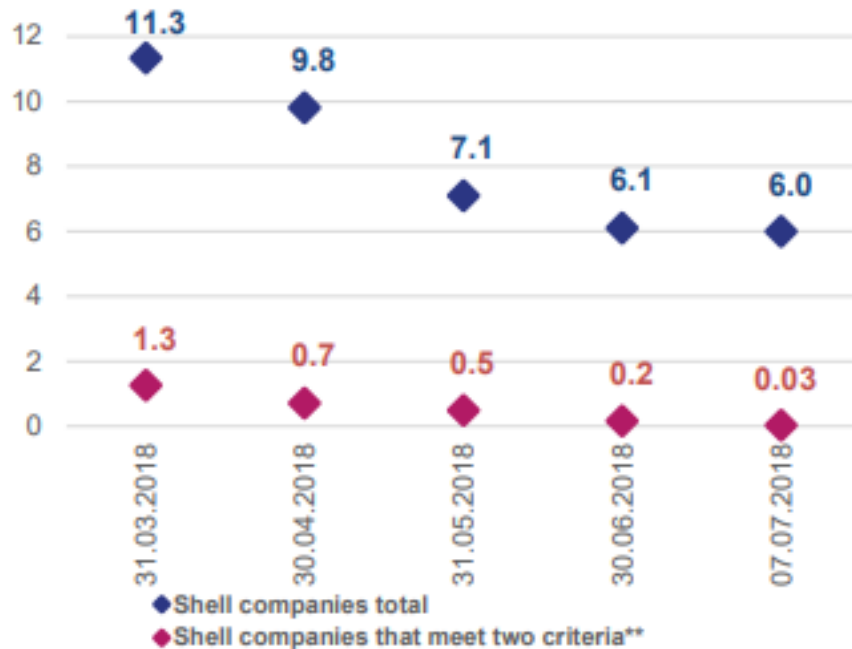
Foreign clients' outgoing payments* (EUR billions)



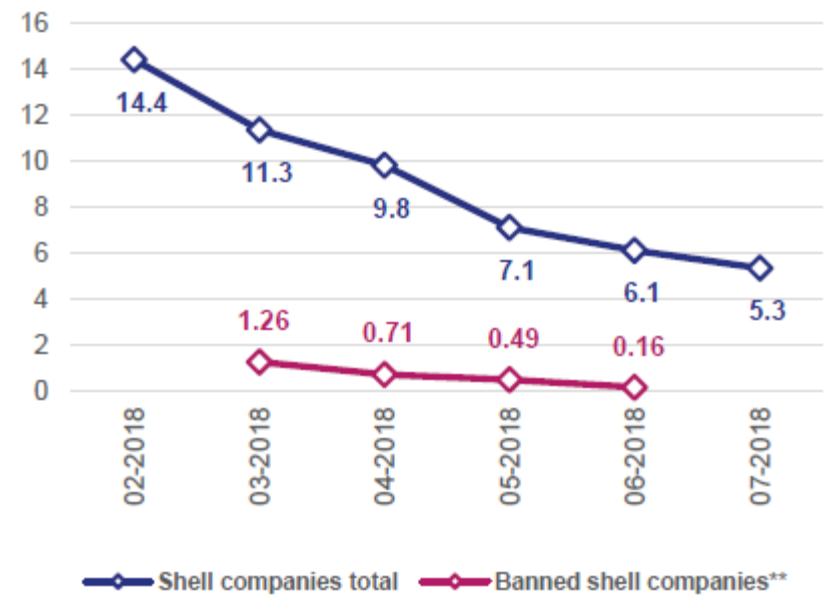


CHANGES: SHELL COMPANIES

Share of shell companies' deposits*, %

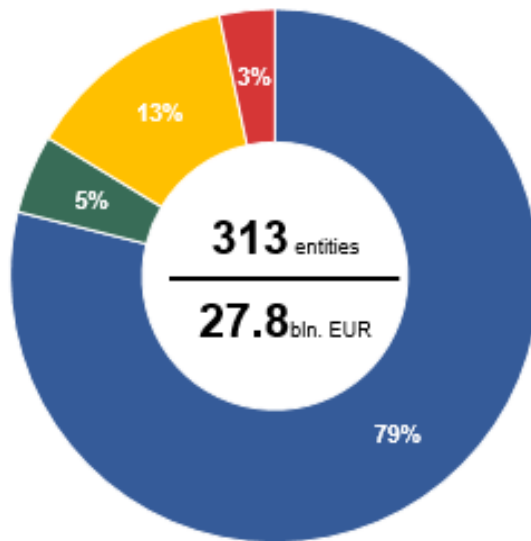


Share of shell companies' deposits*, %



Entities under FCMC supervision

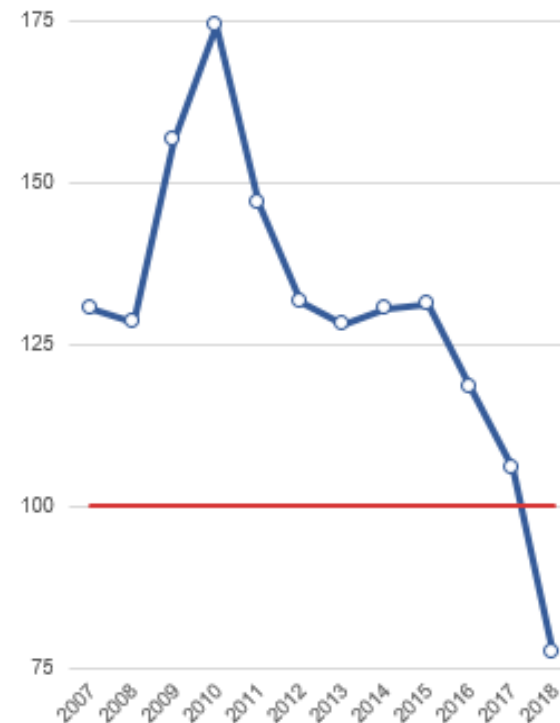
FCMC supervised entities*
in terms of assets, %



- Banks and foreign bank branches
- Insurance companies and foreign insurance companies branches
- State pension scheme investment plans
- Other

* End of 2018

Banking sector assets to GDP, %





*FCMC Chairman **Pēters Putniņš**:*

*«There are certainly not many countries where banks would be capable, in such a peaceful and controlled manner and in a limited period of time, of reaching such a turning point. We have no longer any reason to talk about the uncontrolled flow of risky foreign money in Latvia. With changing geopolitical and security challenges worldwide, the screening filter through which our banks went through was even finer than we thought before. Mitigation of past risks has been done by releasing the country of undue reputational risk, and understanding of business approaches has been jointly pushed into another channel. **As a result of this transformation, the two Latvian banking groups will merge, and there will be no more specific foreign customer banks in Latvia.**»*



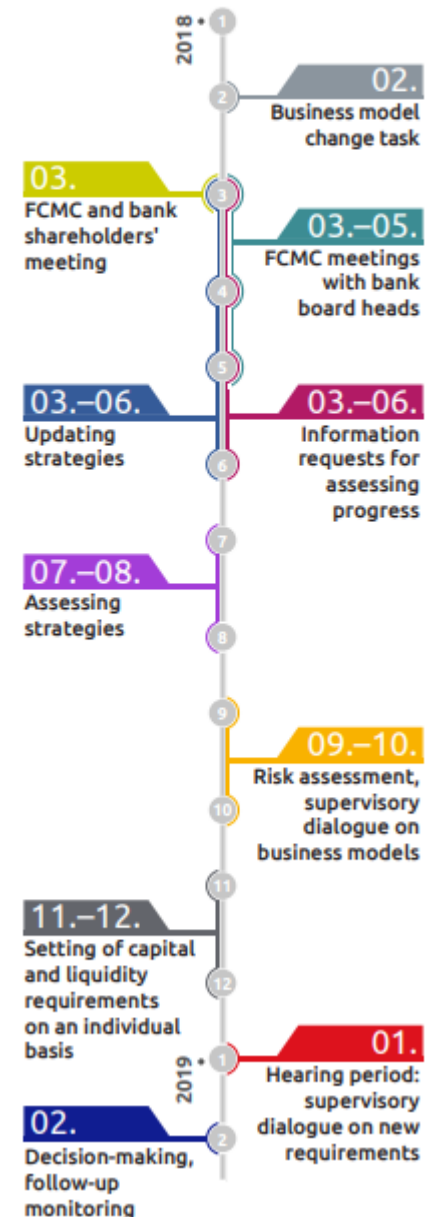


NEW BUSINESS MODELS

- Change of target markets – LV and EU
- Reduction in high-risk customer segment ~ 5%
- Opt out of fast lending business as a key business element
- Alternative business lines and services
- De-risking process

✓ **RESULT:**

Model is viable, sustainable and profitable
(assessed over 1-3 year period)





BUSINESS MODEL OPTIONS

Focus on:
LV&EU
~5% CIS
customers
6% other

New customers from LV and EEA
Lending to different customer segments/types of credit
Financing projects
Investment services
Investment service development /
Asset management

Development of digital services:

E –commerce
FinTech services



RISK ASSESSMENT APPROACH

Reinforced FCMC's control continues:

- Profitability, capital adequacy, AML/TF risk level
- Supervision on a solo basis and risk appetite assessment
- Customer compliance control (CIS segment, customer groups, SIA and their BO, incl. inspections of shell companies for characteristics indicating the banned characteristics)

Bank self-control is ensured:

- Risk profile of existing/new customers
- Compliance of transactions with the new business model

NB! The share of foreign deposits continues to shrink in Latvian banks also in Q1 2019.



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THANK YOU!

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Kungu ielā 1, Rīga LV 1050, tālr.: +371
67774800

fktk@fktk.lv | www.fktk.lv