



Cabinet of Ministers
Republic of Latvia

Latvian Financial Sector Update

No 1. 10 August 2018

Latvia is committed to continuous innovation, full transparency, and robust anti-money laundering (AML) compliance across its financial sector. Today we introduce this fortnightly newsletter that will provide a regular update on the transformation of the Latvian financial sector, including the latest programmes, initiatives, and legislative processes that are driving reforms in Latvian banking and finance.

Message from the Government



It is essential that we take the necessary steps to transform the Latvian financial sector and restore its reputation as a safe and trustworthy place to do business. My government is committed to ensuring an open and regular exchange of information between the financial sector, the business community, the international partners, and us. We have already taken important steps to resolve issues affecting our financial services sector. High-risk transaction business has stopped, and we are fully committed to driving forward our reforms for as long as it takes to achieve genuine and lasting change to restore trust in Latvia as an international banking and finance centre.

Māris Kučinskis
Prime Minister of Latvia

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Financial Sector Transformation

Change Management in the banking sector

Current situation:

Current banking performance indicators show that the Latvian banking sector is stable. Banks that previously focused primarily on servicing foreign customers are undergoing business model change in accordance with EU, USA, and OECD goals and under Financial and Capital Market Commission (FCMC) supervision.

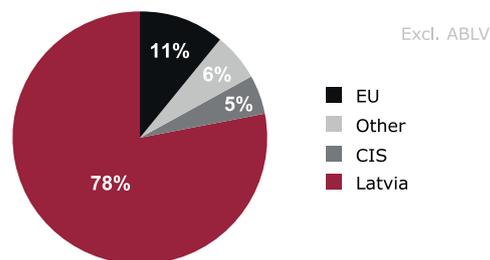
Deposits held by foreign customers continue to decrease substantially (53.4% in 2015 vs. 21% in 2018). This is the lowest level seen for 20 years, and the latest projections forecast that this decline in foreign deposits will continue.

Anti-money laundering and combating the financing of terrorism (AML/CFT) medium-term goals (1.5 – 5 years):

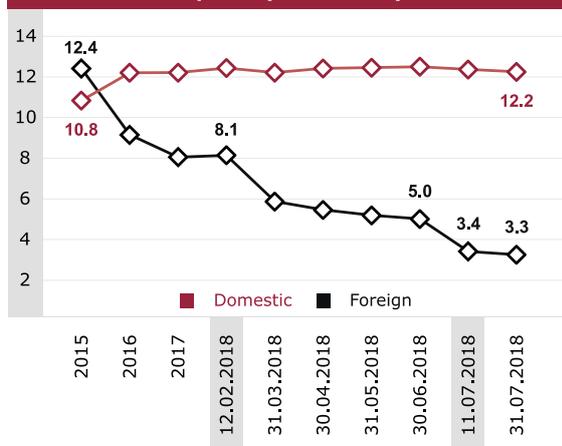
- Share of Commonwealth of Independent States (CIS) deposits – 5%
- Fully-restored correspondent relationship with USA banks.

Key indicators			
	2015	JULY 2018	Change
Deposits, incl. (EUR billions)	23.3	15.5	-33%
Domestic	10.8	12.2	+13%
Foreign	12.4	3.3	-74%
Share of foreign deposits	53.4%	21.0%	-32 pp

Geographic structure of deposits (30.06.2018.)



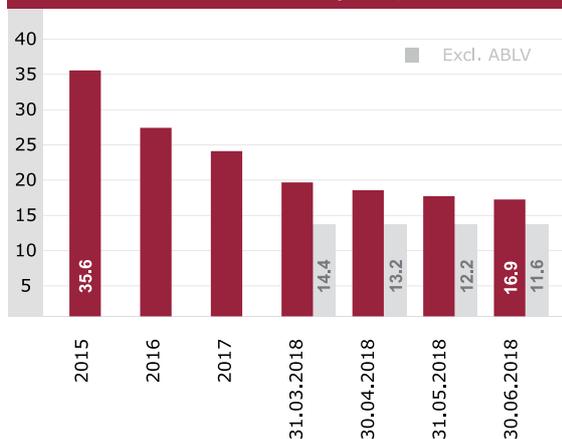
Deposits (EUR billions)



Share of foreign deposits, %



Share of non-EU deposits, %



February 12th, 2018 – FINCEN proposes special measures against ABLV Bank

July 11th, 2018 – ECB revokes license of ABLV Bank !

Source: FCMC

⚠ Actions taken:

- Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing came into effect on 9 May 2018, imposing an obligation to cease business relations with companies bearing at least two characteristics of shell companies within 60 days. The rate is now 0.03%, significantly down from the 1.3% in March this year.
- Banks are currently required to assess thoroughly the risk profile of all clients and are obliged to refuse dealing with businesses that are overly risky. Changes in the banking sector discontinuing service for overly risky clients started already at the end of 2017, before legislative obligations came into force. Each bank is required to take on only a level of risk that can be managed by its internal control systems, in accordance with AML requirements.
- On 1st July, Latvian banks submitted fully-developed and approved business strategies to the FCMC. These plans are currently under evaluation and conclusions will be given in Autumn 2018.
- The FCMC is observing Latvian reform processes, reviewing the latest data, and is giving consultations to banks.

Increasing conformity with anti-money laundering and anti-terrorism financing.

The Financial Sector Development Council (FSDC) and the Prime Minister are undertaking a combined effort to identify further measures for sustainable development of the finance sector. Measures have been packaged into the Financial Sector Development Plan 2017–2019 to tackle money laundering and improve the reputation of Latvian financial services. There are 23 measures in total, divided into four groups:

- Measures to be implemented urgently to enhance risk-based supervisory measures and ensure a more rapid revision of the high-risk business models.
- Capacity building of supervisory, controlling and investigatory authorities.
- Additional measures to increase the speed of the banking sector business model transformation process.
- Improvement of information exchange mechanisms among the financial sector, the Government, the public sector, and law enforcement.

More information and the update on current fulfilments can be found [on the Ministry of Finance website](#)

Q1 Banking sector key indicators

The latest figures show capitalisation and liquidity ratios as well above minimum requirements. Return on Equity (ROE) and Return on Assets (ROA) of the Latvian credit institutions are exceeding the EU average. In 2017, ROE was 9.1% (when adjusted for one-off events) versus the EU average of 6.1% (EBA Risk Dashboard Q4 2017).

Bank performance indicators, %	31.03.17.	30.06.17.	30.09.17.	31.12.17.	31.03.18.
Common Equity Tier 1 ratio	18.63	19.40	21.25	19.26	19.99
Liquidity coverage ratio	367.89	364.56	314.83	313.45	264.25
Loan to deposit ratio	72.29	73.95	73.41	71.25	78.83
Return on Equity (ROE) *	12.51	9.87	8.70	7.61	11.00
Return on Assets (ROA) **	1.43	1.13	1.02	0.90	1.32
Cost to income ratio ***	50.54	57.07	57.23	58.97	58.23

Source: [FCMC](#)

* Annualised profit/loss for the reporting period to average equity (data on branches of foreign banks not included in the calculation of indicator)

** Annualised profit/loss for the reporting period to average assets

*** Expenses over income (administrative expenses + amortisation of intangible assets, depreciation and disposal of fixed assets)/(net interest income + dividend income + net commission and gain/loss arising from dealing in financial instruments + result of financial instrument revaluation + other ordinary income - other ordinary expenses + financial assets available for sale negative revaluation reserve)*100

AML Risk Management & Compliance

Progress in combatting money laundering and financing of terrorism

More effective investigation and prosecution

The fight against money laundering, proceeds from criminal activity, and asset recovery continues to be a high priority for the Latvian police in 2018. In recent years, Latvian authorities have made significant efforts to strengthen investigations and since the end of 2017 investigations of several criminal cases were completed and handed over for prosecution. These included money laundering cases involving bank employees, several "money mule" cases, and cases on "defrauding luxury cars and VAT". During the first six months of 2018, arrests on alleged proceeds from crime cases has led to seizures to the value of €24.5 million, and €1 million has been recognised by courts as being proceeds from criminal activity .

Better access to information on beneficial owners

Just five months since the start of operation to create a beneficial ownership (BO) register, considerable progress to disclose BO information has been reached. Ahead of schedule, some 70% of the 10,000 Limited Liability Companies with legal persons in shareholding has submitted information about their BO. The presumption that people identified as legal shareholders are in fact their BOs is confirmed by the fact that almost 92% of the newly-registered Limited Liability Companies have indicated the same person for both items.

Public-private information sharing platform established

Driven by increased cooperation between law enforcement entities and large international banks, a special task force for financial crime investigation was launched at the beginning of May 2018. This public-private information sharing platform was established following amendments to AML/CTF law that enables financial institutions to better identify risk and focus on high priority issues. The information platform will help the Latvian Office for Prevention of Laundering of Proceeds Derived from Criminal Activity (FIU) and law enforcement agencies (LEA) by providing critical information that supports efforts aimed at disrupting money laundering and other financial crimes.

The FIU, in close coordination with law enforcement, will convene regular briefings with financial institutions to exchange information on illicit finance threats, including targeted information and broader typologies. Operational briefings under this new programme will begin in the coming weeks.

Strengthened framework for targeted financial sanctions proliferation (PF)

Amendments have been adopted in the Law on Sanctions that aim to improve the legal framework for PF TFS. These address various issues highlighted in the Mutual Evaluation Report (MER) and include:

- A widened scope of persons subjected to PF TFS obligations, including an explicit provision that all natural and legal persons are subjected to the provisions of the law.
- Additional powers to the FCMC, the State Revenue Service and Consumer Rights Protection Centre to impose administrative sanctions and other measures for violations of regulatory enactments governing the requirements for internal control system and sanctions risk management regarding PF TFS.
- FIU included in the regulatory body for export controls (Export Control Committee).
- FIU given powers to freeze funds permanently in cases of PF TFS.

Assessment of national money laundering/terrorism financing risks

An in-depth analysis of Latvian money laundering risks was completed in June 2018. The aim of this initiative was to identify, inform, and plan anti-money laundering initiatives. A simplified customer due diligence (SDD) tool and guidelines have also been developed to allow regulated entities apply SDD measures in situations where the business relationships are considered low risk.

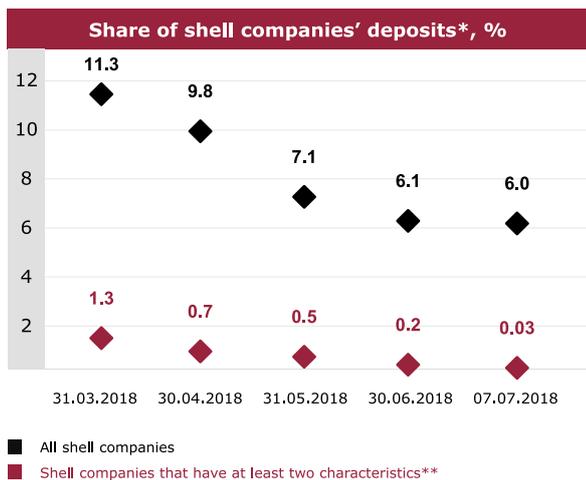
The drafting of amendments to the National terrorism financing risk assessment and draft of PF National Risk Assessment (NRA) has begun in cooperation between the FIU and the police. Methodology, guidelines and proposal for amendments to AML/CTF Law has been adopted to facilitate the gathering, management, and analysis of statistics for risk assessment purposes.

Read more about NRA [on the Ministry of Finance website](#).

Moneyval process

The fifth round of the Latvian Anti-Money Laundering and Terrorist Financing Prevention System - carried out by experts from the Council of Europe's MONEYVAL Committee in accordance with international FATF standards - has now concluded. For the first time both the technical compliance of the system and the system's efficiency were assessed. Within the framework of the evaluation, recommendations have been made to improve the system. These recommendations have formed a valuable road map for eliminating deficiencies, and many of these are already underway. The full report will be available to the public this autumn.

Discontinuing service to high-risk shell companies



Source: [FCMC](#)

High-risk shell companies are far more likely than other entities to take part in money laundering, terrorism financing, and the transfer of illicit funds and criminal proceeds. Latvian banks have therefore discontinued the service of high-risk shell companies and their share in bank deposits has shrunk to just 0.03% (July 7th, 2018), predominantly, this being the balance of blocked cash in the outgoing flow. In accordance with amendments to the Law on the Prevention of Money Laundering and Terrorism Financing (the AML law), Latvian banks were obliged to cease business relations with companies bearing at least two characteristics of shell companies by July 7th. More information [on the FCMC website](#).

* FCMC estimate, based on the information obtained during monitoring process, excluding ABLV.

**1) Lack of proof of real economic business activity (of no economic value); 2) lack of requirement to submit annual financial statement.

Controlled liquidation of ABLV Bank

On 11th July, the European Central Bank (ECB) made the decision to revoke ABLV Bank's license to operate as a credit institution, following a recommendation by the FCMC. This has led to the liquidation of ABLV Bank.

The ABLV Bank liquidation procedure is underway and is being conducted rigorously to prevent the circulation of illicit funds. A comprehensive system has been established to ensure that no money is paid out before extensive checks have been made to the origin of funds. Pay outs will be completed when FIU and FCMC is satisfied that funds are being paid to legitimate entities. This process is being made at pace, with additional forensic accountants drafted in to help with the work. For more information on the control mechanism set up by the FCMC, as well as its enforcement and supervision plan, see detailed steps [on FCMC website](#).

Indicators as of 30th June 2018:

- Guaranteed deposits paid by Citadele bank - 45%, € 213.34 million
- Assets recovered in June by liquidators – € 11.943 million
- Liquidation costs in June – € 1.995 million (€ 1.824 million salaries & severance pay paid to the bank's employees)
- Assets € 2.38 billion
- Capital & Reserves € 321.42 million
- Deposits € 1.602 billion
- Subordinated liabilities € 139.802 million
- Ordinary securities issued € 299.833 million

Financial sector development

Remote identification of customers

On 3rd July, the Latvian Cabinet of Ministers adopted regulations on the remote identification of clients. These new rules govern how financial institutions can sign up new clients without them having to attend a bank branch and identify themselves in person. The regulation will make doing business with Latvian institutions far easier, and boost Latvia's competitive edge internationally, while AML risks are still tightly controlled.

There are currently four remote identification methods:

- **Universal and secure methods, suitable for a wide range of businesses and individuals** –
1) secure electronic signature 2) video identification via video interview through a special application or site, with encrypted connection, answering questions and presenting a personal identification document.
- **Methods for low-risk and limited-volume transactions (mainly in Latvia, the Baltics or elsewhere in the EU)** – 3) bank payment, through which a service provider identifies the customer; 4) taking self-portrait photos and sending a personal identification document.

Read more about the remote identification regulations [on the website of Association of Latvian Commercial Banks](#).

SRS access for foreign investors

Latvian State Revenue Service (SRS) has made significant improvements to help foreign investors in Latvia, focusing on an individual approach and high-level service standards. Every major overseas investor will now be assigned a consultant by SRS to help them do business in Latvia. More information is now online, with the SRS website updated with an ["Invest in Latvia"](#) section where entrepreneurs can find information about taxes and services provided by SRS. More information is available [on the Ministry of Finance website](#).

The Baltics' first FinTech accelerator ends successfully

The first FinTech accelerator in the Baltics, hosted by Swedbank, has come to a successful end. Some 10 financial technology start-ups with founders from nine countries have been developing their business within the accelerator programme over the course of three months. In addition to an intensive mentoring programme, the accelerator participants also received €20,000 for further development of their company.

Contributing Institutions



Cabinet of Ministers
Republic of Latvia



State Chancellery
Republic of Latvia



Ministry of Finance
Republic of Latvia



Ministry of
Foreign Affairs
Republic of Latvia



Financial and Capital
Market Commission

Office for Prevention
of Laundering of Proceeds
Derived from Criminal Activity



Association
of Latvian
Commercial Banks

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