

Latvia and Money Laundering

An Examination of Regulatory and Institutional Effectiveness in Combating Money Laundering

Andrew Bowen and Mark Galeotti

In the wake of the Cyprus bailout, illicit financial flows and money laundering have shown their systemic threat to the stability of not only the Eurozone but the international financial system. Great attention is being paid to countries anti-money laundering efforts and on the stability of their banking sectors. This attention has increased with the entry of Latvia to the Eurozone as its banking sector is being used to launder illicit capital. Long a centre for capital from Eurasia, and the scene of multiple instances of financial malfeasance, great attention has been placed on its efforts to reform its regulatory and oversight capabilities. Despite the improvement, Latvia continues to experience large amounts of capital from Eurasia and is the continued scene of money laundering efforts. We examine the efforts of the regulatory institutions to combat money laundering and of the use of the banking sector for illicit purposes. We find that while there has been significant improvement in the regulatory capabilities of authorities, Latvia continues to be a locale for the laundering of capital from Eurasia and that without continued institutional improvement the situation is unlikely to change.



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Introduction

With Latvia's entry into the Eurozone as its 18th member in January 2014, the question of the country's will and capacity to regulate its own financial sector has raised considerable unease within the EU. It is generally acknowledged that the country has made efforts to reinforce its anti-money laundering (AML) and regulatory institutions.¹ In particular, Latvia has made a concerted effort to reform its economy to prevent another dramatic economic downturn of the kind that it experienced post-2008. However, the country remains a bridge between the economies of Russia and the other post-Soviet states and Europe and the world's financial systems. With that position has come a role as a key money laundering nexus, too, and one that potentially has both economic and political implications. The EU Commission noted that while Latvia was ready to join the Eurozone, 'Going forward, close monitoring of financial stability risks, readiness to adopt further regulatory measures if needed and determined implementation of anti-money laundering rules will remain key.'²

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There are certainly grounds to suspect that Latvia is still reluctant to openly commit itself to combating the abuse of its banks to move and launder criminal profits. For example, it has emerged that more than \$63 million (USD) passed through Latvian banks in connection with the massive fraud since known as the "Magnitsky Affair." However, the only action taken has been a fine of €140,000 euros (\$188,000) imposed by the Latvian Banking Regulator – Financial and Capital Markets Commission (FCMC) – against a bank that they have refused to publicly identify. Since then, Latvian financial institutions have been used to handle money for a range of controversial deals, ranging from weapon shipments to Syria³ to facilitating the corrupt purchase of oil rigs by Ukraine for \$150 million more than they were worth.⁴ The continued exploitation of the Latvian banking sector poses problems not only for the small country but also for the EU and the wider international community as well.

The Council of Europe's money laundering monitoring committee, MONEYVAL, in its last assessment noted Latvia's improved regulatory mechanisms

Since the 3rd round report Latvia has improved the supervisory regime, transposing into the new AML/CFT law both the pro-

visions of the third European Union (EU) AML/CFT Directive (2005/60/EC) and its Implementing Directive (2006/70/EC).⁵

The authorities have a financial intelligence unit to receive and analyse suspicious transactions, the Office for Prevention of Laundering of Proceeds derived from Criminal Activity under the Prosecutor's Office. Despite the presence of internationally acceptable standards of anti-money laundering institutions, though, Latvia continues to see significant instances of money laundering and the exploitation of its financial systems by illicit financial flows. This work examines the exploitation and use of the financial sector for illicit purposes and the effectiveness of the Latvian anti-money laundering efforts. The focus is not only to examine the nature of money laundering in Latvia but also to consider why it continues despite the implementation of internationally recognized mechanisms of anti-money laundering controls.

Banking Sector Overview

There are several unique features of Latvia's economy and banking sector. The first is the structure of the banking sector itself. The largest banks in the country are Nordic owned banks such as Swedbank, SEB and Nordea, which together control 40% of the banking assets in the country.⁶ These banks primarily serve the domestic market and are closely supported by their foreign parent institutions.⁷ As such, many of the remaining banks serve as so-called "boutique" banks serving the large non-resident clientele.⁸ But the designation boutique is a misnomer, especially when one considers that non-residents account for 49% of total deposits – roughly \$10 billion of the \$20 billion held in deposits.⁹ By comparison, the non-resident rates in Switzerland and Cyprus are 43% and 37% respectively.¹⁰ Since 2010, non-resident deposits have increased by 32% and Foreign Direct Investment from Russia has increased by 32.5%, from €268.6 million to €356 million euros over the same period.¹¹ The largest independently owned bank, ABLV, sees a large portion of its business in non-resident deposits and has been implicated in several money laundering scandals.¹² The example of ABLV demonstrates the demarcation between the Nordic held banks, serving the domestic market, and the "boutique" banks, serving primarily the non-resident market.

However, as a result of the mismatch between maturities and deposits that led to the near meltdown of the Latvian economy in 2008,

the Financial and Capital Markets Commission (FCMC) now requires banks serving high levels of non-resident deposits to maintain greater liquidity and capital adequacy ratios. This is to prevent the rush to withdraw deposits, its impact and to lessen the potential for any mismatch between liquidity and maturing securities (the minimum ratio is 8% but the average is 17.2% according to the FCMC).¹³ In 2009 Latvia witnessed a credit crunch that amounted to 5% of GDP.¹⁴ This led to the nationalisation in late 2008 of Latvia's largest domestically held bank Parex, which accounted for 14% of all banking assets.¹⁵

Latvia also has an attractive tax regime, providing significant incentives for the formation of corporations or holding companies within the country. Currently there is a 15% corporate tax rate, with the EU average standing at 23.5% and Cyprus's at 12.5%.¹⁶ Additionally, there is no tax on foreign profits earned via dividends or stock sales and profits can be transferred tax free. From 2014, holding companies will also no longer have to pay taxes on interest or licensing fees that they pay to their parent companies, essentially allowing companies to divert all their profits to the holding companies which then repatriate almost all of the profits, tax free, back to their parent company in the form of licensing and patent fees. This enables shell companies and corporations to move their money easily throughout the world's financial system and to evade taxes. With its incorporation into the Eurozone, this ability will be compounded as Latvia is granted unlimited access to the rest of the zone's banking and financial sectors, with the additional benefit of insurance in the form of ECB guarantees.

The presence of large non-resident deposits is also facilitated by the geographic, ethnic and linguistic connections with Russia and the CIS. The Latvian state-owned air carrier, Air Baltic AS, operates daily direct flights to such places as Baku and Tashkent making Riga an easily accessible destination. Additionally, located next to Russia on the Baltic, Latvia enjoys close ethnic and linguistic ties with its larger neighbour. It has the largest Russian ethnic minority among the Baltic States, 25%, and 37% speak Russian as their first tongue.¹⁷ Oligarchs such as Roman Abramovich and Mikhail Fridman, along with the likes of Vladimir Pronichev, the Deputy Director of the FSB, are known to visit the country; particularly the resort town of Jurmala that hosts a pop festival geared towards Russia's super rich.¹⁸

Other than the close connections to Russia and the CIS, Latvia also has a very attractive residency permit programme to attract investors.

Investors are able to gain five year residency permits based on the level of investment. Real estate investment requires a minimum 50,000 to 100,000 Lat (\$95,000-\$191,000) investment, depending on location. Those who buy Latvian equities are required a minimum 25,000 (\$48,000) Lat investment. Over 7,000 people have been granted such permits, 75% of whom are Russian.¹⁹ The permit allows access to the Schengen area and requires that each holder spend only one day per year in Latvia to maintain the permit.²⁰ The programme was initiated in 2010 to attract capital back into the country, and since its inception has brought \$600 million into the country, with another \$2.3 billion projected to be brought into the country by 2015.²¹ This has led to many rich and wealthy Russians buying property and vacationing in the country. Alleged crime figures²² and former Bank of Moscow president Andrei Borodin,²³ who is wanted by Moscow in connection with a \$443 million money laundering scheme, are just some of the examples of the people who have had residency permits revoked by Latvian authorities.

With Latvia joining the Eurozone in 2014, there were worries that Latvia was similar to Cyprus and would expose the already troubled Eurozone to another potential destabilising bailout. While there are considerable similarities to Cyprus, Latvia maintains a relatively healthy balance sheet when compared to Cyprus and the rest of the Eurozone. Latvia's banking sector to GDP is a modest 133%, far lower than Cyprus pre-crash at 900% or even the Eurozone average of 357%. Additionally, the banking sector makes up a relatively small percentage of the overall economy, just 3% of GDP, contrasted with 9% for Cyprus.²⁴ Despite the healthier banking sheets, Latvia's experience in the wake of 2008 and the Parex nationalisation shows that it is not immune from the same kind of threats that destabilised countries with larger banking sectors.

Non-Resident Deposit Banking Institutions

With the presence of large and well-funded Nordic banks dominating the retail and domestic lending sectors, domestic banks have turned to attracting non-resident deposits and business. Despite the higher capital ratios required for banks with large non-resident deposits, domestic banks such as Rietumu and ABLV seek non-resident business as their source of growth.

Due to the increased oversight and rules regarding capital ratios and liquidity, Latvia has become marketed as a stable and secure financial

location that allows for easy access to the rest of the EU. The mechanisms instituted after the financial crash of 2008 serve to assure investor's that Latvia will not experience another dramatic downturn nor turn into a Cyprus. This has enabled the domestically held banking sector to market their services to those in Russia and the former soviet sphere, which are looking for stable and legally protected banking services. Elites from Eurasia want to ensure that their holdings can be secure, and legally protected, away from the prying eyes of their home countries and rivals.

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With the acceptance of Latvia into the Eurozone, banking connections and transfers became much easier. Yet, despite this acceptance, domestic banks are not concentrating on opening subsidiaries or banking offices in Frankfurt or Paris. Instead, they are focusing on opening offices in Eurasia to court non-resident deposits. The three largest domestic banks, Rietumu, ABLV and Citadele, all rely heavily on non-resident deposits.²⁵ All three have numerous subsidiaries and offices in a variety of Eurasian countries: Rietumu has only one office in Paris, but eight in Russia, one in Belarus, two in Ukraine and one in Kazakhstan, Romania, Armenia and Azerbaijan; ABLV has four locations in Russia, two in Ukraine, and one office in each of Belarus, Kazakhstan, Azerbaijan, Tajikistan and Uzbekistan; Citadele has one location in each of Germany and Switzerland, but two in Russia, Ukraine and more in Kazakhstan, Azerbaijan, Moldova and Belarus. These banks also advertise their services for non-resident investors. On the front page of its website, Rietumu advertises its ability to help clients obtain a residency permit and that it, 'automatically guarantees free movement of persons within the Schengen area, currently consisting of 25 European countries.'²⁶ ABLV markets its ability to provide a customer with remote account management, 'We offer you a selection of effective tools to independently control and manage your capital, providing the opportunity for quick access to banking information anywhere, at any time.'²⁷ Exemplifying this pursuit of Eurasian business, ABLV and Rietumu Banks have attended several conferences in Odessa aimed at courting business with the Ukrainian and Russian shipping industries. These events were put on by individuals and firms that have been tied to arms smuggling with such names as "Maritime Days in Odessa" and "Practice of Maritime Business 2011."²⁸

The importance of domestic institutions is because upon examination of documented instances of money laundering and/or illicit financial flows centred in Latvia, the banking institutions at the centre are almost always domestic banks with primarily non-resident deposits. Of the \$63

million relating to the Magnitsky fraud laundered through Latvian banks, all six banks were domestic institutions. The concentration of illicit activities among domestic banks leads to questions over whether those institutions are truly implementing stringent anti-money laundering (AML) regulations and over the authorities monitoring of those banks.

EU Concerns and Latvian Governmental Responses

Money laundering is a global crime with implications that reverberate across the traditional conception of a nation-state's sovereign borders.²⁹ Despite the threat, many times tax havens or other financial locales find it difficult to equate the negative potential of money laundering with economic development and the influx of capital, licit or illicit.³⁰ Countries, especially developing or emerging nations, are fearful of instituting too stringent regulatory mechanisms that will limit the influx of capital and business, thus negatively impacting their growth and economic outlook. The rationale for limited monitoring and regulation is especially persuasive when the immediate effects of money laundering are hard to discern and often are not felt in the country the money transited. As such, the international AML regime has largely been imposed through coercion by the international community and developed nations.³¹ The threat of reputational harm and isolation from the global financial network was the founding rationale behind the Financial Action Task Force (FATF)³² NCCT (Non-Cooperating Countries and Territories) list that singled out countries which were failing to implement standard mechanisms to prevent money laundering. The same can be said of the insistence by the Eurozone that Latvia increase its institutional efforts to combat money laundering. Thus, Latvia has had to balance increasing its AML mechanism to satisfy Eurozone demands, while not negatively impacting banks relying on non-resident deposits. The pressure from supranational organizations and the desire to not be singled out as a risk-prone country was a significant motivating factor behind Latvia's recent efforts to improve its institutional mechanisms to combat money laundering.

As noted in the most recent MONEYVAL review, Latvia has improved its institutional and legal framework to combat money laundering. Latvia is in compliance with the EU's Third Anti-Money Laundering directive as well as with EU directives regarding AML efforts.³³ Despite the im-

provements though, Latvia has been either unwilling or unable in many instances to take action against revealed instances of money laundering and financial malfeasance. With the revelations that six Latvian banks laundered the proceeds from the \$230 million Magnitsky fraud, the FCMC fined only one bank the maximum fine of 100,000 Lats (\$192,244.84) and publicly refused to name it to, 'ensure financial stability.'³⁴

In response to accusations that Latvia has weak financial and money laundering controls, and that its entry into the Eurozone will only increase the ease with which illicit Eurasian money can flow into Europe, many high ranking Latvian officials have vigorously defended its policies and efforts. Aivis Ronis, the former Latvian Foreign Minister and Ambassador to NATO and the US, recently voiced Latvia's position, stating:

We understand the higher standard applied to institutions in Russia's orbit. That's why our banks' anti-money-laundering standards are among the most rigorous, praised by everybody from the International Monetary Fund to the U.S. Treasury to Moneyval, the Council of Europe's anti-corruption unit. We welcome the bright light shined by the euro: It represents yet another chance to prove that Latvia, now the EU's fastest-growing economy, is a stable place for Western investment, and a nation that is proud to help build Europe's future.³⁵

It is correct that Latvia has nominally increased the rules and regulations regarding property Due Diligence and Know Your Customer for banking institutions inside the country. Likewise, Latvia has certainly established the organisational infrastructure expected of a modern anti-money laundering regime. One of the basic components is a Financial Intelligence Unit (FIU) tasked with analysing and monitoring suspicious transactions and activities, maintaining communication with law enforcement agencies and foreign counterparts and overseeing persons subject to AML regulations. Latvia created its FIU, Office for Prevention of Laundering of Proceeds derived from Criminal Activity, in 1998, reporting to the Prosecutor General. It is also monitored by an advisory board that helps to draw up recommendations, oversee methods and coordinate cooperation with those institutions subject to AML regulations. The Prosecutor General chairs the board and it consists of representatives from the FIU, Ministry of Finance, Ministry of Interior, Ministry of Justice, Bank of Latvia, FCMC, Association of Commercial Banks, Association of Insurers, Sworn Notaries Council, Sworn Auditors

Association, Council of Sworn Advocate, Supreme Court and the State Revenue Service.³⁶ Meanwhile, the implementation of private sector AML efforts is overseen by the Financial and Capital Markets Commission (FCMC), an autonomous agency. Its purview is the examination of institutions compliance and internal AML controls. The FCMC has the authority to fine banks for inadequate controls and does have the ability to revoke banking licenses.

However, the presence of regulations and structures alone is not enough to ensure the proper protection of the financial sector from exploitation. Commensurate with regulations is effective enforcement by authorities and the imposition of penalties should it be found that regulations are not being followed. Here Latvia's record is less impressive, as corruption and weak penalties combine to undermine the formal compliance regime. For example, when it comes to sanctioning banks, the inability of the FCMC to levy large fines compared to the vast amounts of capital transiting banks contributes to the limited utility of the threat of sanction.³⁷ Since 2006, the FCMC has imposed the maximum penalty six times, and each time has refused to name the bank in question.³⁸

Furthermore, Latvia continues to experience significant corruption and a large "shadow economy," which the U.S. State Department estimates at 30%.³⁹ Powerful oligarchs continue to influence Latvian politics, and many politicians, including the mayor of Jurmala, have been convicted of corruption and bribery in recent years.⁴⁰

Of considerable concern to the Eurozone has been the sale of residency permits to investors. While not unique to Latvia – Spain, Portugal, the UK, and France among other EU countries also have them – the influx of Russian and Eurasian investors have caused considerable concern, especially due to the fact that 98% of applicants are granted permits.⁴¹ As described before, the residency permits have brought significant amounts of capital into the country. Despite the amount of money the programme creates, authorities have recently proposed limiting the number of visas granted to around 900 per year in response to accusations over the scheme's abuse. The wife of fugitive Kazakh banker Mukhtar Ablyazov, who is wanted in connection to a multi-billion dollar fraud in Kazakhstan, was found living in Rome on a Latvian residency permit, for example.⁴²

The difficulty regarding assessing the effectiveness of the Latvian monitoring and regulatory regime is that there are no reliable statistics on the number of suspicious transaction reports that are passed by institutions to the FIU. Moneyval, in its latest report, stated,

The statistics kept by the Latvian authorities are not always comprehensive and do not contain all the necessary data for an accurate analysis of effectiveness. No reliable statistics are maintained with respect to the total number of STRs and UTRs received, as the authorities only track the total number of transactions and not the total number of reports. This makes it difficult to analyze the effectiveness of the reporting system and of the FIU's analytical work, especially with regard to disseminated cases to the LEAs [Law Enforcement Agencies].⁴³

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The lack of reliable data further obfuscates Latvian enforcement efforts. A key aspect of the international money laundering standards is the reliance on private institutions to report any suspicious transactions to the country's FIU. The absence of reports makes a priori enforcement or intelligence gathering impossible and measures can only be taken if the crime becomes exposed.

Incidents and Case Studies

There are a range of ways in which Latvia has developed a role within the shadow economics of the post-Soviet states. It has become a convenient locale for elites – eager to minimise their home states' control over their assets – can park or move funds away. Its banking system can be used for tax evasion. Latvia has also been used to launder criminal money and again transfer it to secure and discreet jurisdictions. After all, the search for stable banking is of importance to elites in post-soviet nations due to the capricious nature of many of the countries' legal systems and the states use of financial intelligence as a means of control by the political elites.⁴⁴ Due to the potential that the state will attempt to threaten their wealth to ensure their political support, or that a change in government could lead to their indictments, many in the former Soviet states desire to send their capital to more a stable, both politically and legally, locale.⁴⁵ Additionally, it is often hard to introduce their wealth into the global financial system due to the underdeveloped or insulated nature of many of the banking sectors in post-Soviet countries.⁴⁶ Due to Latvia's developed banking, political and legal structures, it remains an attractive locale that provides the necessary stability for the entry of post-Soviet states elite's capital into the wider financial system.

The threat of extortion or charges by members of the government and security services is of considerable concern to business and political elites.⁴⁷ The threat that *kompromat*, or compromising material used to

blackmail, could be used to create charges against these elites has contributed to the desire to move, at least some, of their holdings to more secure locales away from the oversight of politically motivated legal structures.⁴⁸ In August 2013, fugitive Kazakh banker Muhktar Ablyazov was arrested at his palatial villa in the south of France in connection with an Interpol arrest warrant.⁴⁹ Mr. Ablyazov stands accused of a \$6 billion fraud from Kazakhstan's BTA Bank. Claiming he was a victim of political persecution for challenging the rule of Nursultan Nazarbayev, he was charged by Kazakh prosecutors of an attempt at 'seizing power by inciting civil strife and hatred.'⁵⁰ He fled to London in 2009 and was granted political asylum in 2011. However, he was found in contempt of court by the High Court of England and Wales for failing to disclose the true value of his assets.⁵¹ The court documents reveal that Ablyazov passed at least \$1 billion dollars through the Latvian bank Trasta Kommercbanka AS.⁵²

Due to the corrupt nature of many of the states that makeup the post-Soviet sphere, the threat of rapid political and social change threaten the activities and holdings of the elite. Therefore, in order to secure their holdings, elites transfer their capital, through complex and interconnected legal structures, to various and stable banking locales. However, the direct transfer of their funds to locales in the west may bring increased scrutiny from large and effective financial regulatory services because of the high money laundering risk rating that countries in the CIS have. By first routing their capital through Latvia, with a lower risk rating and better reputation, elites can circumvent some of the increased scrutiny over their transactions. In 2010, the President of Kyrgyzstan, Kurmanbek Bakiyev, was overthrown in a revolution. Shortly after the revolution, the new authorities charged that the largest bank in the country, AsiaUniversalBank (AUB), was allegedly the scene of large scale corruption and money laundering. The management of the bank and other associates included the then President's son, Maxim Bakiyev, suggesting a close relationship between the bank and the country's political and economic elites.⁵³ Subsequent reports place Latvia and its banking institutions at the centre of a large transfer of capital out of the country just before the revolution. The anti-corruption NGO Global Witness discovered that AUB used shell companies to allegedly launder \$64 million of embezzled state funds, but also saw billions more pass through the bank to shell companies, many of which were publicly said to be dormant or never

filed account information before dissolving.⁵⁴ The report cites two shell companies, which were owned or registered out of the British Virgin Islands and Belize, used to transfer some \$31.7 million from accounts at AUB to other accounts in Latvia.⁵⁵ The transfers were always under \$1 million and were listed as payments for “cold-rolled hot dipped galvanised pre-painted metal products,” despite the fact that the companies had listed themselves as dormant – not conducting any business – and failed to report activity before dissolving.⁵⁶ The suspicious nature of the transfers leads to questions regarding the banks anti-money laundering practices, especially relating to due-diligence and know your customer principles, and of the oversight by regulators.

Latvia’s banking and regulatory regime is attractive for businesses in Eurasia thanks to its close location, friendly banking environment and low tax regime, which also provides valuable opportunities for tax evasion. By routing or integrating some of their business practices in Latvia, many businesses can significantly reduce their tax burdens, thus increasing their profits. In the recent court battle between Russian Oligarchs Boris Berezovsky and Roman Abramovich (Berezovsky had gone into exile after falling out with Putin and later committed suicide; Abramovich was Berezovsky’s former partner but remained close to Putin), the latter admitted that he and two of his subsidiary companies had used a Latvian bank – Latvian Bank of Trade – to allow Sibneft (one of the largest oil producers and refiners which was bought by the Russian state owned giant Gazprom in 2005, re-naming it Gazprom Neft) to evade taxes and gain \$300 million in profits in 2000 alone.⁵⁷ Subsidiaries were sending money out of Russia to an account held by a Panamanian company, Palmex S.A., for payments on the purchase of heavy equipment. These payments were subsequently cancelled and returned to Latvian Bank of Trade, effectively parking the profits outside the reach of Russian tax authorities.⁵⁸

Indeed, Latvia has become so attractive to clients from the post-Soviet sphere that corporate service providers, businesses that specialise in setting up accounts and companies in different nations and jurisdictions, advertise the advantages of doing business in the country to them on their webpages.⁵⁹ Some state their mission as providing: ‘professional assistance for the incorporation and further maintenance of companies in tax-exempt jurisdictions as well as in other countries.’⁶⁰ Along with paying: ‘maximum attention to providing reliable and trustworthy

corporate services to entrepreneurs in CIS countries, and historically cooperates with professional services providers and other clients in these countries.⁶¹ These companies provide numerous services and published a fee schedule on their websites, but one of their key services is the opening of banking accounts.⁶² One corporate service provider notes that the final choice of country is up to the client, but states: ‘specialists can point to some factors of great importance to the entrepreneur that make the commercial banks in the Republic of Latvia especially attractive among the worldwide banking family.’⁶³ The provider then continues to then list numerous reasons why Latvia is the location of choice to open bank accounts: ‘Latvia is the financial centre of the Baltics;’ ‘Latvian banks have great experience and a high degree of specialism in services for clients from both Eastern and Western countries;’ ‘Latvian banks allow for the remote control of their accounts from anywhere in the world;’ ‘the use of multi-currency accounts, whereby customers can keep a great amount of different hard and soft currencies in the same account;’ ‘Latvian banking legislation makes no distinction between local and foreign companies—the procedure for opening an account at a Latvian bank is no more complicated for a foreign company than it is for a local one.’⁶⁴

These advertisements illustrate the level to which the Latvian banking sector is viewed as a key locale for the creation of shell companies and accounts to transfer and hide capital. The various rationales and benefits to opening of accounts in Latvia demonstrate the level to which perceived launderers can utilise the sector for their various needs and situations. It is clear that despite the improvements made to Latvia’s institutional AML mechanisms, it is still regarded as one of the most attractive points for the transfer of wealth from post-soviet states into the wider global network.

Additionally, Latvia has gained a reputation as a locale that can be utilised to launder money. A released Wikileaks cable from the U.S. Embassy in Turkmenistan stated: ‘Some also suspect that, despite the Baltic countries’ ascension to the EU, Baltic banks are not following anti-money laundering procedures, since many Turkmen citizens have Baltic bank accounts.’⁶⁵ The statement is integral to understanding the perceived, as opposed to actual, efforts of Latvian authorities to combat money laundering. While it is clear that the authorities have taken steps to combat the problem, perceptions lag behind realities, and Eurasian elites still see Latvia as a good place to launder capital.

Contributing to this perceived reputation as a laundering hub is the revelation that Iran had attempted to bypass sanctions through a Latvian bank despite no long standing or significant Iranian connections to Latvia.⁶⁶ A released State Department cable reveals that in 2010, a Treasury Delegation went to Latvia to consult the Latvian authorities over attempts by Iranian held interests to circumvent EU and U.S. sanctions in 2008.⁶⁷ The cable states that Latvian authorities pledged to investigate the incident and that during subsequent investigations two more attempts by Iran to manipulate the financial system were uncovered. However, while the Latvian authorities did examine and block the transactions cited by Treasury, along with two other transactions possibly connected to Iranian entities, beyond that no action was taken. It may well be that no laws had been broken, but the point is that even the Iranians saw Latvia as a place able to facilitate the movement of hidden or illicit capital. The cable went on to state, ‘However, despite the strong steps Latvia has taken to address money-laundering in the last few years it remains a problem in Latvia and various nefarious persons abuse its financial system.’⁶⁸

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Beyond that, Latvian banks, primarily domestic banks serving the non-resident market, have been implicated as central figures in the activities of several criminal enterprises. In 2009, the US Securities and Exchange Commission filed a complaint against Rockford Funding Group LLC.⁶⁹ The SEC alleged that Rockford Group had misrepresented itself as ‘a leading private equity firm equipped with an \$800 million pipeline of investments’ but was in fact a Ponzi scheme⁷⁰ that bilked investors of \$11 million. The complaint alleges that Rockford Group transferred a total of \$3,244,743 from its accounts in the U.S. to subsidiary accounts at four separate banks in Latvia.⁷¹ The listed reasons were to pay for “cooling systems,” “construction equipment,” and “electronic systems.” However, the complaint notes that these payments were for equipment ‘unrelated to Rockford Group’s claimed investment business.’⁷² The fact that none of the banks discovered the unusual and unrelated nature of payments commensurate with Rockford Group’s supposed business dealings is evidence that even the basic Due Diligence and Know Your Customer AML assessments, which would have noticed that the payments were for goods unrelated to their business, were either not taken or simply ignored.

Latvia has also played an integral role in one of the most famous tax fraud cases, the Magnitsky Affair, in which \$230 million dollars was fraudulently stolen from the Russian treasury by using the stolen

identities of three companies owned by the investment firm Hermitage. These fraudulent companies applied for, and received, a total of \$230 million dollars in tax refunds from the government. This scheme involved high-level members of the Russian government and law enforcement. Of the \$230 million, a little over \$63 million is alleged to have passed through accounts at seven Latvian banks. Six Latvian banks⁷³ are documented as having received slightly more than \$19 million from two Moldovan firms.⁷⁴ The money transferred from the Moldovan companies was sent to accounts held by shell companies from Panama, New Zealand, Seychelles and the UK. Additionally, \$43 million were transferred from Russia to an account at another Latvian bank.⁷⁵ The funds were transferred to accounts held by companies owned or directed by Latvian citizens who have been linked to other companies involved in weapons trafficking, fraud and other crimes.⁷⁶ The law firm for Hermitage, in its complaint, detailed the transactions listed above and wrote to the Latvian authorities stating that

Indicators of laundering include the pattern of large transactions moving in and out of these accounts from companies established in jurisdictions that have minimal oversight of the companies that have no visible commercial activity, that involve high-risk jurisdictions, and that appear structured to evade oversight.⁷⁷

Other than the single fine, no other regulatory action has been taken. This demonstrated how integral Latvia has or had become as an intermediary between Russia and the international financial network. By sending proceeds to accounts in and through Latvia, the perpetrators were able to reduce their chance of scrutiny and detection by both western financial institutions and regulators themselves.

Latvia has also been the scene of an alleged corruption scheme involving Ukraine's state owned oil and gas company, Naftogaz Ukrainy. In March 2011, Chornomornaftogaz, a subsidiary of Naftogaz Ukrainy, sought to buy offshore oil rigs, ostensibly aimed at increasing Ukraine's energy security and tapping into reserves in the Black Sea Shelf. Chornomornaftogaz purchased an oilrig from a UK shell company for \$400 million. However, that same rig was purchased from Norwegian drilling company, Seadrill, for only \$248.5 million.⁷⁸ The disparity in price between the sale from Norway to Ukraine has received immense scrutiny, especially because of a similar deal in October 2011 where Chornomornaftogaz stated that it had bought a similar oil rig for \$400 million and

involved the Riga Shipyards to make engineering modifications, except the Norwegian seller stated it had actually sold it for \$220 million. On the March 2011 deal, Chornomornaftogaz paid the \$400 million through an account at a domestic bank in Latvia.⁷⁹ Due to its opaque and questionable nature, Latvian authorities launched an investigation into the deal in May 2012, while freezing the accounts at the Latvian bank held by the UK shell company.⁸⁰

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Summary

As MONEYVAL, the EU and even the US have noted, Latvia has dramatically increased its oversight and regulatory capabilities, not only since its independence in 1991, but since the 2008 global financial crisis and as part of its recent efforts to join the Eurozone. The country has successfully transitioned from a centrally-planned Soviet republic into a stable, financial and banking centre that recently entered the Eurozone. Latvia has successfully met all the requirements for entry, and saw its acceptance as a chance not only to grow its economy but to increase its connections with the rest of Europe.

Despite the desire to integrate with the rest of Europe, though, it still remains a significant transit jurisdiction for Eurasian capital. Latvia has, and continues to provide the political and business elites of Eurasia the ability to disguise the true origin of their capital and to ease its entry into the wider global financial network. By acting as an intermediary, the country, so reliant on non-resident deposits, remains an integral node in the facilitation of capital from the unstable political and financial post-Soviet nations to more stable locales around the globe. Additionally, because of the welcoming nature of the non-resident banking sector, Latvia continues to play an integral role in various criminal schemes and activities which rely on the exploitation of its banking sector. The irony is that it is the very stability and protection afforded by Latvia's banking sector that is integral to the ability of criminals and corrupt politicians to conduct their various questionable activities.

Going forward, the issue is not whether Latvia has been used by foreign elites for tax avoidance, criminal activities or laundering, but rather, whether the authorities have the capabilities, support and incentive truly to tackle the flow of illicit capital through their financial system. Domestic banks serving the non-resident sector do not want to see their

business threatened, and any increased scrutiny could further impact their interests. So long as membership of the Eurozone was still under question, then this provided considerable incentive for over Latvia to increase its AML efforts. The fear must be that once this leverage is no longer being applied, the enforcement and regulatory improvements will start to atrophy. Whether the authorities are able to increase their enforcement or start to revert to lax oversight and enforcement will dictate their position among the nations of the Eurozone.



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- with foreign offices in Ukraine, Russia and Lithuania <www.multibanka.com/en_lv/about/contact/representations> (accessed 14 November 2013).
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