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The FICIL's Position Paper on Proposals for the Improvement of Combating Economic and Financial Crime

1. Executive Summary

As a jurisdiction with significant international reach, Latvia has an overarching responsibility to ensure that the activities of its finance and business sectors do not create or facilitate economic and financial crimes. Such crimes are harmful to individuals and to other countries on many different levels and are also damaging to the best interests of Latvia.

This has been particularly noticeable recently, as Latvia has experienced one of its worst reputational and, potentially financial, crises that has explicitly revealed the severity and impact of unresolved issues in relation to the non-effectiveness of anti-money laundering, anti-fraud, anti-corruption and other measures that the FICIL has addressed for years.

The FICIL recognises that the government has achieved certain progress in respect of recommendations included in the FICIL's position paper on combating economic crimes in 2017. Overall, the challenges of economic crimes have received much greater attention from the government during the last months compared to the previous period. Unfortunately, this has been mostly due to external pressure, e.g. from the OECD, MONEYVAL, GRECO and finally - US FINCEN, and not because of the government's persistent work towards improvements. The progress, therefore, cannot be regarded as sufficient compared to the scale and impact on the Latvian and global economy of the economic crimes committed domestically and abroad. Little progress has been made in achieving the three KPI's that the FICIL set last year in the area of economic and financial crimes.

This year the FICIL's proposals for effective combating of economic and financial crimes are based on four pillars which are:

- 1) Strategy;
- 2) Cooperation;
- 3) Funding; and
- 4) Framework

In particular, they are focused on those crimes that are recognised in the National Risk Assessment as generating the most significant amounts of illicit proceeds, i.e.:

- 1) Corruption and bribery;

- 2) Shadow economy and tax crime, and
- 3) Fraud and insolvency.

2. Recommendations

Efforts to combat economic crimes must be made in several areas and at different levels. based on four pillars:

- 1) Strategy – a long-term, risk and evidence-based strategy for combating economic and financial crimes and increase of general compliance should be developed.
- 2) Cooperation – relationship, level of cooperation and information-sharing between relevant public-sector authorities and with the private sector domestically and internationally should be improved.
- 3) Funding - the resources allocated to the building of institutional capacity and improving the skills of investigators, prosecutors and judges specialising in economic and financial crimes should back up the statements on combating economic crime as one of the government's priorities. As a positive step in this direction, the establishment of the Proceeds from Crime Confiscation Fund must be noted.
- 4) Framework - a strong legal and regulatory framework that is in line with the international standards and that helps remove the benefits from crime and pro-actively identify and pursue offenders of those crimes that are recognised in the National Risk Assessment as causing the most significant threats of money laundering, i.e. corruption and bribery, shadow economy, tax crime, and fraud, should be established.

Recommendations in the field of anti-money laundering and terrorism financing.

1. To ensure that the Latvian Office for Prevention of Laundering of Proceeds Derived from Criminal Activity (FIU) plays a more active role in the fight against money laundering and becomes a central point of coordination for anti-money laundering activities in Latvia.
2. To ensure that the termination of a large volume of banking customer relationships does not negatively impact upon law-abiding entrepreneurs.
3. To quantify the potential impact on the Latvian economy due to de-risking activities in the banking sector and take such information into account when developing changes to Latvian AML policy and legislation.

Recommendations in the field of anti-corruption and bribery.

4. To improve the understanding of corruption by intensified collaboration with the public and private sectors.
5. To increase the efficiency and effectiveness of law enforcement agencies and court systems to ensure corruption is punished thus breaking the cycle of impunity, or freedom from punishment or loss.
6. To reduce the corruption and conflict of interest threats in high risk domestic sectors, i.e. public procurement and distribution of EU funds; municipalities, especially in the field of construction and licencing, judiciary and policing, thereby improving the business environment.
7. To promote integrity across the public and private sectors.

Recommendations in the field of shadow economy and tax crime.

8. To ensure cooperation between the SRS and Insolvency Administration in development of a strategy for tracing and preventing operations of empty companies that form 60% of all insolvent companies;
9. To increase the government's overall analytical ability of data on fictitious/shell companies;
10. To reduce the illicit trade of excise products, in particular, cigarette smuggling to contribute to a decrease of the shadow economy in Latvia.

Recommendations in the field of anti-fraud and insolvency.

11. To continue comprehensive improvements of the insolvency system by focusing on judges, prosecutors and others involved in abuse of the insolvency system;
12. To increase the recovery rate of creditor's claims from the present level below 40% to at least 60% and decrease the cost of the insolvency process that currently exceeds twice the recovered funds. In addition, the phenomena of the scale of late insolvency cases which impede the creditor's recovery rate should be analysed and eliminated.
13. In addition to the existing supervisory system, to establish a parallel mechanism for strengthening the reliability of individual administrators by requiring appropriate insurance or other means of civil liability of administrators that has a clear correlation to the size of the entity administered.

3. Rationale for recommendations

Last year the FICIL stressed that efforts to combat economic crimes must be made in several areas and at different levels.

This year we continue to emphasise the need for a clear strategy on fighting economic crime that would allow the provision of guidelines and propose targeted measures in reducing the scale of economic crime. We raised concerns about the lack of priorities that leads to ineffectiveness and untimely prosecution and adjudicating of cases. We also re-emphasise that identifying and preventing economic crime is too important a priority to be as tightly budget-constrained as it is, *inter alia*, we repeat our recommendation to allocate appropriate resources to decrease the overload of involved personnel and to improve the quality and timeliness of the combating of economic crime, including allocation of appropriate physical and technical infrastructures. We also stressed that general preventive work, synergic cooperation with the private sector and building trust in the general public are core objectives to proactively fight the persistent economic and financial crimes.

The FICIL notes and highly values the progress in the work of the Economic Police (ENAP) and KNAB (the Corruption Prevention and Combating Bureau of Latvia) in the investigation of high-scale corruption and economic crime cases related to insolvency issues. We also welcome the activities of the Insolvency Administration for their consistent work improving the supervision of insolvency administrators and the State Chancellery for its continued efforts to convince the legislator to adopt the Whistleblowers' Law. The FICIL also welcomes the establishment of the Proceeds from Crime Confiscation Fund that was suggested by the FICIL in its previous recommendations.

Despite the abovementioned improvements, the private sector has not yet experienced much benefit from it. In contrast, recent attention by the international community to Latvia's capacity to fight crime has caused a very questionable reaction by the government that again imposed new costs and unclear, fragmented and unpredictable regulatory requirements on the private sector, rather than appropriately funding law enforcement agencies and other public sector agencies involved in fighting

economic and financial crimes. In the context of tackling economic and financial crimes, this dynamic is imposing enormous costs on the private sector, systemic duplications of effort across each regulated entity and supervisors, and – ultimately – will have a limited effect on the underlying crimes.

A long-term, risk and evidence-based strategy for combating economic and financial crime and increasing general compliance should be developed. Such strategy should be based on aggregate data on threats and risks posed by economic crimes to Latvia, including the nature and scope of these crimes, i.e. the volume and destination of outgoing and incoming flows of funds in the financial sector; data about the origins of beneficial owners of assets managed or funds held in Latvia; the growth and development of convertible virtual currency in Latvia and globally and, more generally, cybercrime etc.

It is of crucial importance to involve the industry to identify how Latvian authorities can capture, collate and analyse the required data. This will ensure that better information is available for the overall understanding of economic crime. Thus, we re-emphasise a need for establishment of a partnership with the business community to disseminate information on crime and its prevention in order to raise awareness and knowledge on money laundering and terrorist-financing threats.

We note, however, that using public/private partnerships in the fight against financial and economic crimes should not be considered a resource-free exercise for the public sector. While it can be tempting to rely on private sector intelligence capability in major financial institutions, there is a danger of ‘outsourcing’ law enforcement responsibilities which cause a strategic risk if the central analytical capability of such partnership is not adequately resourced and if law enforcement agencies do not have the means to take financial intelligence on to achieve prosecution.

The reliance ‘in the system’ on private sector compliance spending to respond to the challenges of financial crimes also raises aberrant incentives to drain law enforcement agencies of skilled investigators who are, quite rationally, offered higher salaries to work for regulated entities.

The FICIL is of the opinion that substantial mind-set changes are needed and the government must significantly go beyond law enforcement and criminal justice to tackle the risk factors that cause crime, because it is more cost-effective and leads to greater social benefits than the standard ways of responding to crime. We should remove the benefit out of crime. If used to their full potential, the existing measures for depriving criminals of the proceeds of their crimes would not only make their criminal conduct meaningless, but also reduce the funding available for further criminal enterprises and allow identified victims to be compensated. In parallel to the resources allocated to the building of institutional capacity, improving the skills of investigators, prosecutors and judges specialising in economic and financial crime should also be increased.