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Position Paper No.7

# Foreign Investors' Council in Latvia Position Paper on Combating Financial and Economic Crime

16 September 2021



# Executive Summary

The Foreign Investors' Council in Latvia (hereinafter – FICIL) has noticed and highly appreciates Latvia's commitment to fighting financial and economic crime, raising this issue as one of the priorities of Latvia's economic development. The government declaration places particular emphasis on promoting co-operation between the judiciary, the prosecutor's office and investigative bodies in line with the identified corruption risks. FICIL considers such a position to be vital, as the prevention of corruption is always a precondition for strengthening the rule of law and improving the investment climate. Corruption harms general economic growth and hinders the country's development by negatively affecting good governance, increases inequality and can cause instability, as well as does not go unnoticed in the assessments of various international organisations about the attractiveness of the investment climate in Latvia.

In the context of combating financial and economic crime, FICIL welcomes the establishment of the Economic Court. The work of this court is associated with high expectations of foreign investors both in the effective prosecution of financial and economic crimes and in the resolution of complex commercial disputes. Moreover, the role of investigations and prosecutions is also important in preventing economic and financial crime. Achieving a fair regulation within the criminal law in the fastest and most effective way depends primarily on the effectiveness of pre-trial criminal proceedings, as well as the quality of state prosecution in court. FICIL's observations show that the systemic issues are most evident in the pre-trial criminal proceedings.

According to FICIL's observations, the effectiveness of financial and economic crime investigations and prosecutions has not improved significantly in recent

years. Also, during the last few years, it has not been possible to change the public's negative view on the feeling of impunity that exists among the perpetrators of the crimes in question. In 2021, FICIL has looked with concern at a number of criminal cases of corruption, which have caused widespread public response and have resulted in either an acquittal or the termination of criminal proceedings in a case that has been under investigation for years. Failure to bring large-scale corruption cases to justice, to achieve the inevitability of punishment for the crime committed undermines public confidence in the effectiveness of the judicial system.

At the same time, FICIL emphasizes that convictions in any criminal case of financial and economic crime must not become the goal in and of itself for the State. Everyone has the right to the full and effective defence of his or her rights at all stages of criminal proceedings. At the same time, however, the State has a duty to take all necessary measures to ensure that all officials involved in criminal proceedings have access to all the necessary technical, knowledge and advisory resources to be able to bring cases to a fair outcome within a reasonable time. Under a risk-based approach, the focus of resource use should potentially be on cases of larger scale.

Latvia must ensure that in situations where such "headline-making" criminal proceedings are delayed for objective reasons, accused persons are acquitted or criminal cases are terminated, the public is provided with comprehensible information and an explanation of the grounds and reasons for the respective legal solution. Otherwise, such settlements could create a sense of impunity for perpetrators of illegal activities and for society as a whole, which could, accordingly, undermine any efforts to improve the situation in the prevention of financial and economic crime.



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### Executive Summary



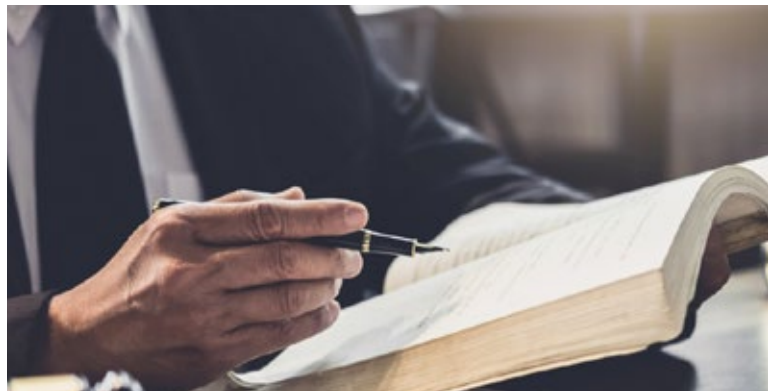
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# Recommendations

## Measures to reduce the shadow economy

There is no single solution to the problem of shadow economy and “envelope” wages. Looking at the different motivations of entrepreneurs and people to pay an “envelope” salary, it is necessary to complete a cause analysis. Profiling of companies and people should also be carried out to find out the source of cash flow, which should not appear in the company under normal circumstances. It is important to look for causality and identify clear key performance indicators (KPIs), such as how to determine the effectiveness of measures to reduce the shadow economy in a particular business sectors.

## Prevention of financial and economic crime

Based on the report of the State Audit Office on the audit of factors hindering the investigation and prosecution of economic and financial crimes published in December 2020, FICIL makes the following recommendations:

- ▶ Auditing of initiated cases.
- ▶ Distribution of initiated and to be initiated cases across different regions according to the qualification and competence of officers.
- ▶ Regular, centralised monitoring of staff workload in various institutions.
- ▶ Concentrating resources on investigating financial, economic and corruption crimes, following a risk-based approach and identifying high-risk projects (such as large-scale public procurement).

- ▶ Publicly available data analysis - by attracting financial analysts with appropriate technical support (remuneration and analytical tools), evaluating the effectiveness of the financial and economic crime investigation and prosecution system, implementing key performance indicators (KPIs) and monitoring their achievement.
- ▶ Development of common guidelines and processes to promote a common understanding and interpretation of the provisions of the Criminal Law and the Criminal Procedure Law among all officials involved in criminal proceedings.
- ▶ Timely and effective completion of criminal proceedings, including termination if the probability of conviction of a person appears to be low.
- ▶ In situations where criminal proceedings, which have caused widespread resonance, are protracted, accused persons are acquitted or criminal proceedings are terminated, the public is provided with fully comprehensible information and an explanation of the rationale and reasons for the legal solution.
- ▶ Simplification of procedures, standardisation in simpler and smaller-scale criminal cases, decriminalisation of minor criminal offenses.
- ▶ Increasing the responsibility of the supervising prosecutor to play a leading role in the investigation of complex criminal proceedings.

## Effective prevention of corruption

FICIL calls on the public sector to conduct a data-driven analysis to identify current corruption trends, to identify the most effective steps to reduce corruption, assess the effectiveness of anti-corruption measures and determine the country's progress in the field of anti-corruption. At the same time, FICIL calls for the strengthening of law enforcement capacity to facilitate the prosecution of corruption-related criminal proceedings of public importance.

## Protection of *bona fide* purchasers in criminal proceedings

FICIL calls on the government to continue an active discussion, involving experts from the public and private sectors, in order to find solutions for improving the mechanisms for protecting the interests of *bona fide* purchasers in criminal proceedings. For example, a solution such as compensation for damages to *bona fide* purchasers who have relied on the principle of public credibility while the state takes over the right of claim against the perpetrators of the crime should be considered. Effective solutions can be found by analysing the experience of other countries in protecting the interests of *bona fide* purchasers.

## Prevention of money laundering

Following the successful activities so far in the field of Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), Latvia should use its good international reputation by actively participating in the establishment of the European Union Anti-Money Laundering Agency (AMLA) and ensuring that at least partial operation of the agency's structural units takes place in Latvia. This way the major financial sector "overhaul" that took place over the last few years can be further highlighted and Latvia can be shown as a best practice example for other countries. At the same time, work needs to continue on improving the AML/CFT framework, with a stronger focus on international competitiveness.

## Prioritisation of predicate crimes committed in Latvia

FICIL calls on the government and the Financial Intelligence Unit (FIU) to make the prevention of money laundering and the freezing of funds resulting from criminal offenses committed in Latvia, including in connection with tax evasion, a top priority of law enforcement agencies and in particular of the FIU. With the current focus on seizing of proceeds of crime committed abroad and the inability to focus comprehensively on Latvia's predicate crimes due to a lack of resources, the interests of Latvia's law-abiding companies are suffering.

## Application of requirements of the AML/CFT law to services provided within a group of foreign investor companies

In order not to unreasonably place foreign investors in a disadvantaged situation compared to local companies, FICIL proposes to change the wording of Section 3, Paragraph six of the AML/CFT Law, allowing its extension to such groups of companies whose members are not registered in the Register of Enterprises of the Republic of Latvia.

## Examination of seized property cases in the shortest time possible and systematisation of court practice in proceedings concerning criminally acquired property

In FICIL's view, in order to promote a favourable investment climate, it is necessary to ensure that, in cases where company funds are frozen and seized, they are returned to the company as soon as possible if the legal origin of the funds is established. It must be ensured that in cases of financial and economic crime involving seizure of property, the maximum terms specified by law are not applied. At the same time, FICIL also recommends the development of a body of case law in proceedings concerning criminally acquired property.

# Rationale for recommendations

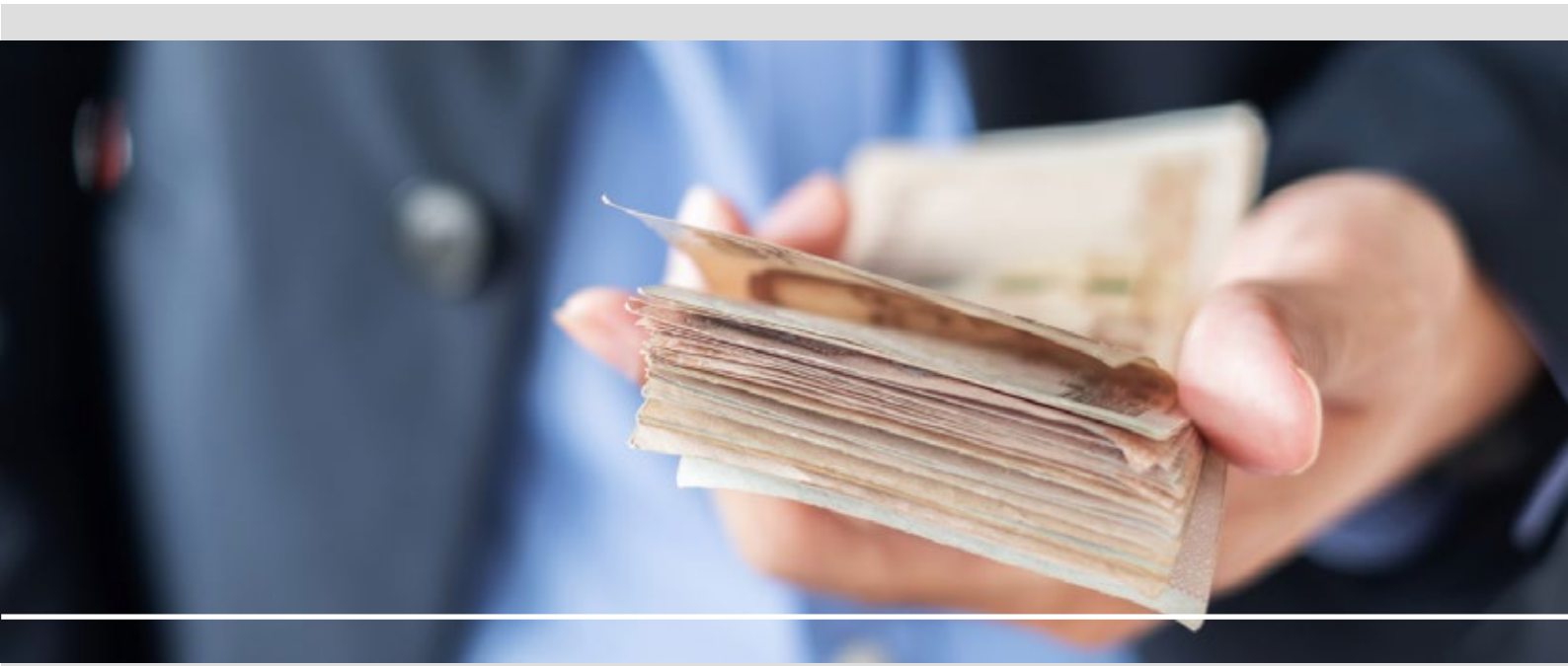
## Measures to reduce the shadow economy

In the context of the shadow economy, one can often hear businesses and society in general voicing their reservations and opinions about distrusting the state, dissatisfaction with the services provided by the state, etc. In essence the quality of the service provided by the state is difficult to assess, often this is based on personal opinion, not thorough analysis - for some it is good, but for others it is completely opposite. It is understandable that a full ban on cash payments is not possible, as such payments will always exist and must be taken into account in certain day-to-day household services. There are sectors where it may be practically impossible to completely eradicate envelope wages, such as cleaners, nannies, berry pickers or small economic operators, and this would not be linked to the level of trust in the state. FICIL has repeatedly heard the opinion among its members that "in Latvia the probability of being caught and/or punished for tax evasion or fraud is low." FICIL reiterates that penalties for tax evasion should be unavoidable and should include publishing the case files and providing information on the parties involved.

In addition to the inevitability of penalties, the State Revenue Service (SRS) should seek solutions by increasing resources for the processing of reports,

including anonymous reports, analysing available data, providing substantive response to possible crimes in the shadow economy. FICIL calls for consideration to be given to extending prevention measures to tackle the shadow economy, including upon receipt of a report on a suspicious transaction from the subject of the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing. For example, on transactions related to tax evasion, the SRS (without tipping off) could send a warning to the person or company about an increased risk of money laundering or shadow economy, as a result of which the SRS would be able to apply a policy of "consult/warn first." Given the weak public awareness of money laundering prevention, warnings would create preventive surveillance: the first time results in a warning, the next time - a penalty. At the time of receiving warning, the offender should be required to undergo appropriate anti-money laundering training. The same procedure could be applied by the SRS when performing regular tax administration services and encountering signs of tax evasion.

In FICIL's opinion, the SRS would need to increase its capacity to work with the data already at their disposal, improving the SRS EDS platform, monitoring and



communicating with its customers, making it clear that active monitoring is taking place. The SRS has currently created segmentation tools for legal entities and individuals, but in FICIL's view, more active communication would be needed on how this tool is used to reduce shadow economy. Also, extra attention should be given to improving the public sector's communication with the society regarding the benefits of paying taxes. We believe that individuals and companies should be able to clearly and understandably see the link between the taxes paid and the benefits they receive.

### **Prevention of financial and economic crime**

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The extensive audit of the State Audit Office on the factors hindering the investigation and prosecution of economic and financial crime was performed as a comprehensive study, involving high-level foreign and Latvian experts. FICIL is convinced that a clear awareness of the shortcomings of the financial and economic crime prevention system is an important step in improving the system's effectiveness. However, it will be crucial to fully address the issues identified in the State Audit Office's report. In this context, FICIL welcomes the implementation plan included in the State Audit Office's report approved by the Crime Prevention Council on 15 April 2021. In FICIL's view, there are three main lines of action: a) reducing the burden on the judiciary, the prosecution and the investigative authorities; (b) removing the obstacles to the investigation and prosecution of financial and economic crime; (c) improvements in the functioning of the prosecution.

Given the limited resources, FICIL considers that the primary short-term solution is to audit and redistribute cases by region, thus clarifying the true workload of the system and optimising the use of resources according to the competence of specific officers. The identification of cases with a low probability of conviction should also allow for the timely and effective termination of such cases without creating an artificial additional burden on investigators. In addition, in FICIL's opinion, financial and economic crimes need to be given priority in the activities of law enforcement agencies, concentrating the widest resources of the agencies, including appropriate financial, technical, infrastructure and advisory resources.

In order to ensure the fastest possible procedure, it is also necessary to promote a common understanding of investigators, prosecutors and judges on the interpretation of the norms of the Criminal Law and the Criminal Procedure Law. This is particularly important with regard to the standard of proof in criminal proceedings for financial and economic crimes, as well as the use of evidence. FICIL agrees with the State Audit Office and the Ministry of Justice that the prosecutor's office should play a leading role in the development of such guidelines, however, investigators, judges and legal scholars should also be involved in the development of such guidelines. External experts (not only law scholars, but also financial experts and other professionals in the field) should be involved in the study of certain practical issues.

At the same time, there is a need to improve law enforcement agencies' communication with the public to reduce the sense of impunity for financial and economic crime. First, there is a need for regularly updated and publicly available information on the objectives set by investigators and the prosecution, the steps to be taken and key performance indicators (KPIs). Secondly, there is a need to provide the public with full and easy-to-understand information in situations where investigations in publicly known cases are terminated.

Regarding the quality of investigation process, one of the most effective means of improving the quality of financial and economic crime investigations is to significantly increase the involvement of the supervising prosecutor in investigating these types of crimes from the beginning of criminal proceedings. In a situation of limited resources, it is necessary to define priority categories of criminal offenses in which supervising prosecutors would perform this function of active participation. A standardised approach based on established investigative schemes could be sufficient for the investigation of legally simpler offenses. However, increased prosecutorial resources should be devoted to priority crimes to be investigated, which clearly include large-scale financial and economic crimes.

## Effective prevention of corruption

FICIL would like to commend the public consultation organised by the Corruption Prevention and Combating Bureau (KNAB) in the spring of 2021 on the development of an anti-corruption action plan, during which the proposals of non-governmental organisations were received and evaluated, and most of them were taken into account or partially taken into account.

In the draft anti-corruption action plan, the measures are organised to achieve five sub-objectives:

- 1) ensure a human resources management policy that prevents motivation for corrupt actions;
- 2) improve the internal anti-corruption control system;
- 3) reduce tolerance for corruption;
- 4) ensure the inevitability of punishment for violations of the law;
- 5) limit the power of money in politics.

However, to ensure that the development and implementation of the plan does not remain a formal measure, it is also necessary to analyse and monitor data on the effectiveness of anti-corruption measures in order to assess their impact and progress in preventing corruption. It would also help to assess the resources needed for specific activities and put strong emphasis on achieving results. FICIL draws attention to the fact that the feeling of impunity for corruption offenses, as reflected in the 2020 Corruption Perceptions Index, has still not been reduced. In FICIL's view, progress will not be possible without convictions in criminal proceedings of major importance to society.

The violations detected by KNAB so far show that the highest corruption risks are related to public procurement, which also include co-financing from the European Union. The largest procurements are carried out in Riga, where the leading public administration institutions and capital companies are located. However, a significant part of the funding has been spent on procurements also in the regions of the country. In the informative report on the current issues of investment of the EU's Cohesion Policy funds until August 2019, the Ministry of Finance indicated that 65% of all ineligible expenditures in the first half of 2019 were found in municipal projects - mainly for violations of procurement norms<sup>1</sup>. Taking into account the above, FICIL, similarly to its 2020 position paper, draws the Government's attention to the need for KNAB's involvement and direct supervision in the implementation of nationally important construction projects, such as Rail Baltica.

## Protection of *bona fide* purchasers in criminal proceedings

The protection of *bona fide* purchasers in criminal proceedings is an issue that already affects and will certainly continue to significantly affect the interests of investors in the future, for example, when purchasing and developing real estate. The practice of taking away the investment objects from *bona fide* investors, who often relied on public records and carried out in-depth research before purchasing them, poses a significant threat to attracting new investment. FICIL, as in its 2020 position paper, draws the Government's attention to the need to strengthen the protection of *bona fide* purchasers in criminal proceedings.

FICIL welcomes the amendments to the Criminal Procedure Law adopted by the Saeima on 4 March 2021, which stipulate that if the property recognised as criminally acquired is immovable property belonging to the state, it is left in the possession of the *bona fide* purchaser if its property rights are fixed in the public register. However, these amendments to the law regulate a very narrow range of cases, which unfortunately do not cover most situations when investors' rights are threatened. In most cases, the possibility of taking criminal action against perpetrators cannot be considered an effective remedy for *bona fide* purchasers due to the length of criminal proceedings. The inability to rely on public register entries, risking a direct loss of investments made, must clearly be considered as an obstacle that may hinder the attraction of foreign investments in Latvia and hinder the development of business in general.

## Prevention of money laundering

In 2018-2020, the achievements of the Latvian government in the field of AML/CFT clearly demonstrated Latvia's commitment and ability to take decisive action to restore the reputation of the Latvian financial sector. Latvia proved that it is able to implement all the necessary recommendations in a short time to improve the effectiveness of the system by implementing the necessary reforms in financial sector supervision and receiving a positive assessment from international experts. In 2020, Latvia was the first *Moneyval* member state and the second country in the world to receive the highest marks of technical compliance in comparison to other countries. Such an assessment should be used as a message to the international community, for example, by offering its active participation in the establishment of the EU Anti-Money Laundering Agency (AMLA) and ensuring that at least partial operation of the agency's structural units takes place in Latvia.

<sup>1</sup> Operational strategy of the Office for the Prevention and Combating of Corruption.  
Available: <https://www.knab.gov.lv/lv/knab-darbibas-strategija>





In order to avoid having to undergo another “overhaul” of the financial system, Latvia must not stop at the current achievements and work must continue on the improvement of the AML/CFT regulation. In this context, FICIL would like to highlight the numerous strategic analysis studies and guidance materials developed by the Financial Intelligence Unit (FIU) in 2020 and the Financial and Capital Market Commission’s Handbook *Recommendations for Establishment of AML/CFT and Sanctions Risk Management Internal Control System and Customer Research*, which provide detailed explanations and recommendations to law subjects based on best practices in the field of AML/CFT. Following the rapid closure of non-resident accounts in 2018-2019, data indicates an increase in the total number of newly opened accounts during the last year. This shows the ability of market participants and customers to adapt and implement solutions that meet the new requirements in their operations. However, FICIL believes that the work on improving the AML/CFT framework should not only assess compliance with international AML/CFT standards and requirements of related organisations, but should also take into account the regulation in other neighbouring countries in order to maintain competitiveness. Without deviating from the current high standards of AML/CFT regulation, Latvia must also continue the work and create a regulation that would provide advantages over other countries in attracting new investors.

### **Prioritisation of predicate crimes committed in Latvia**

Over the last three years, in accordance with FIU, large amounts of financial assets have been frozen in Latvian credit institutions, and these amounts have continued to grow steadily. According to publicly available information, almost all assets initially frozen by the FIU, seized in various criminal proceedings and subsequently seized by court decisions originate abroad. Thus, the Latvian financial system has been used to launder the proceeds of predicate crimes committed abroad.

FICIL certainly welcomes the efforts of the Government and the FIU to rid Latvia’s financial system of criminal proceeds coming from abroad. However, from the perspective of foreign investors who have invested in Latvia, it is primarily important to focus on the prevention of money laundering that has arisen as a result of criminal offenses committed in Latvia (for example, tax evasion, bribery, fraud, etc.). By committing criminal offenses in Latvia, perpetrators gain an unfair advantage in relation to those companies who act legally and in accordance with the principles of good commercial practice. Such situations are directly detrimental to fair competition, putting unfair businesses in a better position than fair ones.

The central purpose of committing financial and economic crimes is to obtain economic gain. By effectively combating the proceeds of crime, it is possible to significantly reduce the number of financial and economic crimes. The FIU is undeniably the most effective and qualified agency in identifying proceeds of crime and analysing the related criminal activity.

### **Application of requirements of the AML/CFT law to services provided within a group of foreign investor companies**

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FICIL draws the Government's attention to a problem which requires considering amendments to the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing (hereinafter - the Law). This problem is related to the excessively broad scope of the Law, recognising as subjects of the Law also companies that have issued loans to other companies within their own group, as well as companies that provide accounting, real estate intermediation or management services to the group of companies.

At the beginning of 2021, the Saeima reviewed extensive draft amendments to the Law. During the review of the draft amendments, among other things, the issue of narrowing the scope of the requirements of the Law regarding companies belonging to one group was considered. In view of the above, in February and May 2021, FICIL addressed the Saeima Defence, Internal Affairs and Corruption Prevention Committee with its proposals for the improvement of the regulatory framework. Unfortunately, FICIL's proposals did not receive support, but FICIL still believes that the current practice imposes an excessive administrative burden on foreign investors without actually reducing the risks of AML/CFT.

The amendments to the Law of 15 June 2021 narrowed the range of subjects of the Law in connection with the provision of financial services only within a group of companies or to members of a cooperative society. At the same time, the proposal not to apply the requirements of the Law to outsourced accounting services, if the main commercial activity is not related to such services, did not receive support in the third reading, despite being supported by the commission in the second reading.

FICIL welcomes the legislator's efforts to reduce the administrative burden on companies by preventing situations in which companies are recognised as subject to the Law if they provide financing only within a group of companies. However, Part 6 of Section 3 of the Law, supplemented by the amendments of the Law of 15 June 2021, unreasonably restricts the application of this

legal norm in relation to foreign investors. The wording contained in said legal norm that a group of companies to which the exception "consists only of persons entered in the Register of Enterprises of the Republic of Latvia, branches or their representative offices - residents of a Member State" precludes the application of this exception to situations where a group of companies includes not only persons entered in the Register of Enterprises, but also companies registered abroad, including Member States of the European Union.

At the same time, FICIL draws attention to the fact that companies of foreign investors often belong to groups of companies that include not only European Union companies but also third countries with high anti-money laundering and anti-terrorist and anti-proliferation standards (such as the United States). In FICIL's opinion, the failure to apply the exception of Part 6 of Section 3 of the Law to such groups of companies will unreasonably worsen the position of foreign investors in comparison to groups of companies registered only in Latvia or the European Union. FICIL expresses a conceptually similar comment regarding the prerequisite that the exception can only apply to cases where the beneficial owners of the members of the group and the persons holding a position in their executive body are residents of a Member State.

FICIL believes that the exception to receiving the status of a subject of the Law if the services are provided only within a group of companies should apply not only to financial services, but also to accounting, real estate intermediation and management services provided by one company group to other group companies.

### **Examination of seized property cases in the shortest time possible and systematisation of court practice in proceedings concerning criminally acquired property**

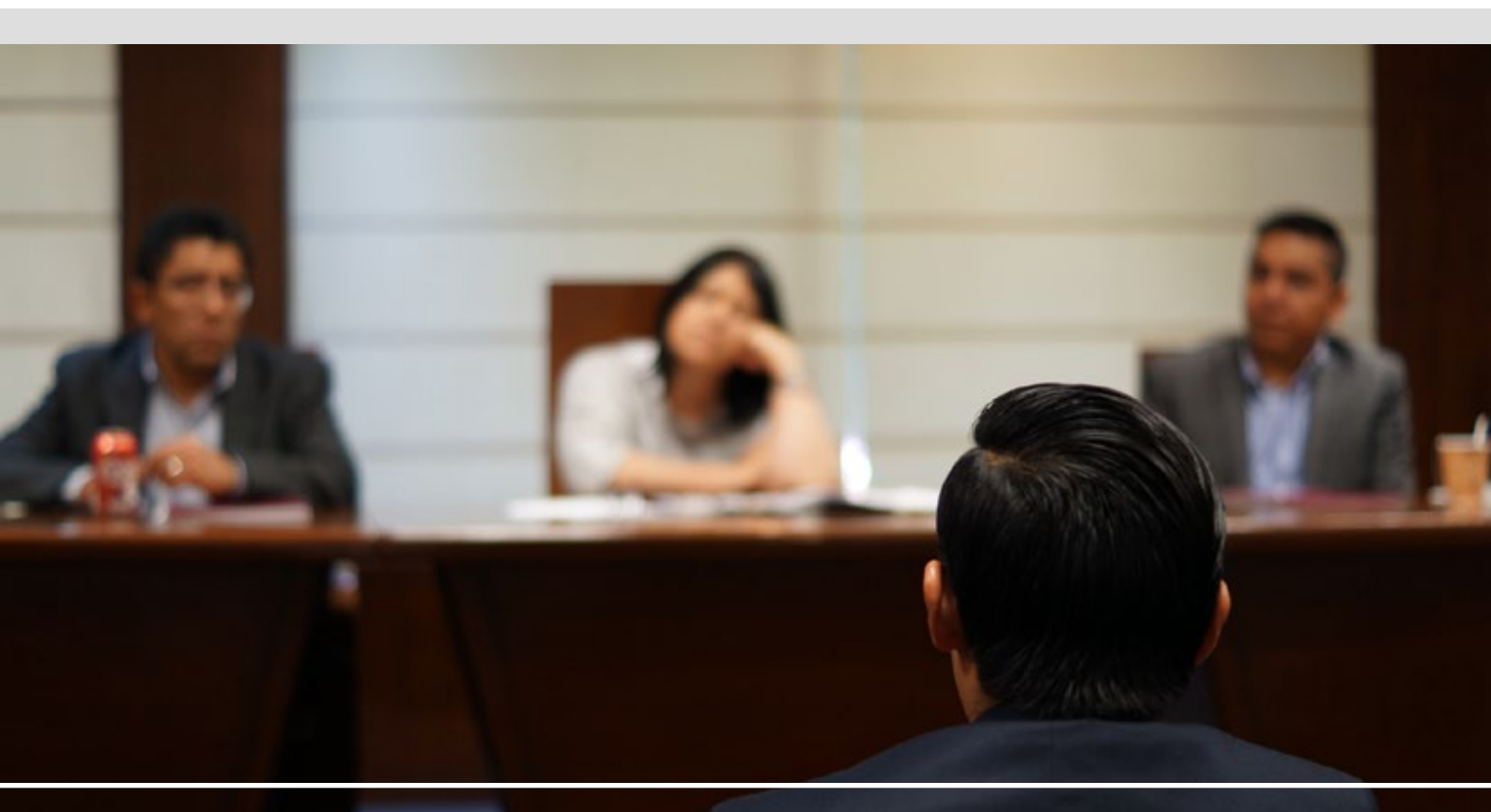
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In recent years, large amounts of funds have been frozen and seized under FIU and law enforcement agencies' orders. At the same time, FICIL believes that it is important to resolve ownership issues in criminal proceedings as soon as possible by seizing the proceeds of crime or returning the seized assets to the possessors of legal origin. In pre-trial criminal proceedings, cooperation, and dialogue between the owner of the property (proving the legal origin of the property) and the investigator (verifying the circumstances) is especially important. If necessary, the supervising prosecutor should be actively involved in this cooperation by giving instructions to the person leading the proceedings. Shortening the time for investigation should not be based on simple and formal evaluation of the submitted documents, thus transferring all

responsibility for the outcome of the case to the court in the proceedings for criminally obtained property.

The Criminal Procedure Law currently provides for a long maximum period for the seizure of property (twenty-two months for particularly serious crimes, with an extension of up to nine additional months). In FICIL's view, law enforcement agencies must do their utmost to ensure that property issues in financial and economic crime cases are resolved without using the statutory deadlines. In addition, time limits for extending the seizure of property should be permissible only in exceptional cases provided for by law. The judge should comprehensively and critically assess whether the person conducting the proceedings had not delayed them and ensure that faster completion of the proceedings was not possible only because of the particular complexity of the case.

Proceedings concerning criminally acquired property, which are often applied in cases of financial and economic crimes, in accordance with Chapter 59 of the Criminal Procedure Law, are considered in two court instances - the first instance and the appellate instance. Accordingly, in these very important cases, the aspects related to the resolution of property issues are not considered in the cassation procedure. In addition, the proceedings regarding criminally acquired property are considered in a closed court session, as a result of which, according to Section 28<sup>2</sup> of the Law on Judicial Power, only the introductory part and the operative part of the decision are generally accessible, while court rulings are not published. In such a situation, developing a compendium of Supreme Court case law or guidelines would be an effective means of promoting uniform and correct case law.





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FICIL is a non-governmental organisation that unites 38 largest foreign capital companies from various industries, 10 foreign chambers of commerce in Latvia, French Foreign Trade Advisers and Stockholm School of Economics in Riga. The goal of FICIL is to improve Latvia's business environment and overall competitiveness in attracting foreign investment, using the experience and knowledge of its members to provide recommendations to Government and state institutions.

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