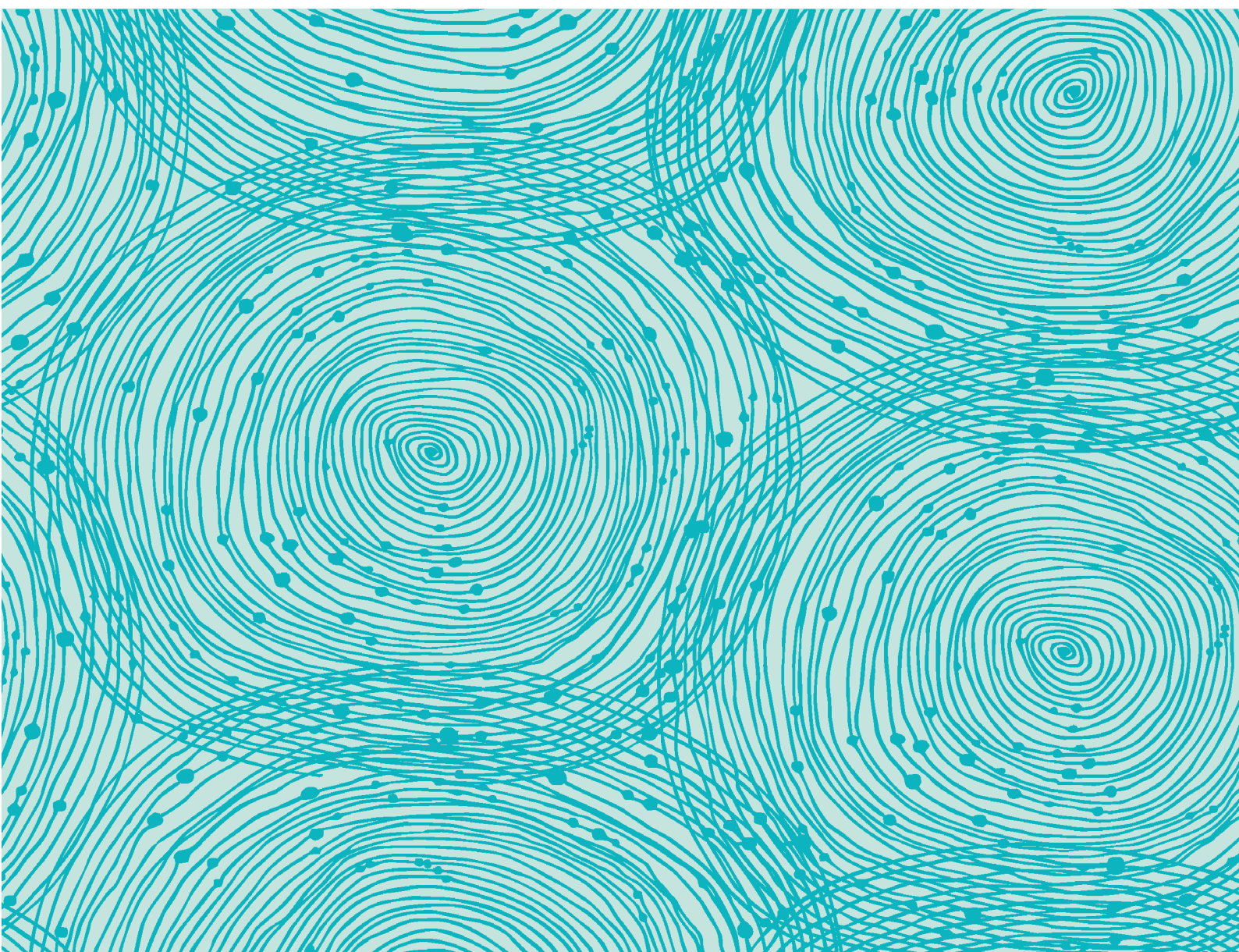


## OVERVIEW

# Combating Money Laundering and the Financing of Terrorism in Latvia

Enhancing robustness of supervisory and control mechanisms for prevention of financial system abuse



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## Introduction

Every country has a duty to combat money laundering and to prevent terrorist financing or any other threats that can compromise the integrity of the international financial system. A robust and resilient anti-money laundering and combating of terrorism financing (AML/CFT) regime is the first step towards being able to implement effective legal, regulatory and operational measures.

This overview presents recommendations made by the OECD in relation to Latvia's efforts to strengthen its AML/CFT supervisory and control systems and to support its reporting to the Financial Action Task Force (FATF). The review conducted by the OECD at Latvia's request, addresses certain key recommendations in Moneyval's July 2018 Mutual Evaluation Report (MER) of Latvia. The review also covers the institutional setting of the Financial and Capital Market Commission (FCMC) and the Financial Intelligence Unit (FIU) as relevant to their AML/CFT roles, and, where relevant, on recommendations of the OECD's Working Group on Bribery in International Business Transactions (WGB).

The review focuses on six key areas: the ultimate beneficial ownership (UBO) regime, targeted financial sanctions (TFS), the reporting framework of the FIU, domestic coordination/cooperation and the FIU's status, AML/CFT supervision and control by FCMC and its AML functions, and detection, investigation and prosecution of money-laundering (ML) offences and international cooperation.

## Ultimate beneficial ownership (UBO) regime

No further major legislation is needed in Latvia to ensure that the authorities have access to beneficial ownership (BO) information on legal persons, and definitional issues have been resolved in relation to UBOs as a result of the amendment to the AML Law. However, there is one consequential change to the AML Law needed, already identified by the Latvian authorities, that would ensure that BO information in the Enterprise Registry (ER) is kept up to date.

### *Shorter-term recommendations of high priority*

- The competent authorities should produce statistics showing the numbers of Latvian limited liability companies (LLCs) which have had their BO assessed and recorded in the ER, along with an estimate of when this process will transition to a "steady state" (*i.e.*, all backlogged information has been gathered, verified and recorded).
- In accordance with the National Action Plan, supervisory authorities should perform targeted verifications, and apply penal sanctions/warnings to financial institutions and designated non-financial businesses and professions (FIs/DNFBPs) for their failure to perform or duly perform customer due diligence (CDD), with particular attention to the UBO due diligence.
- Latvia should collect statistical data demonstrating that BO information in the ER has been regularly updated in accordance with the AML Law, and corrected as per the modification to the law. The FIs/DNFBPs and the ER/Commercial Register competent authorities should be required to provide the sector AML supervisors

with progress reports indicating whether prescribed BO information has been obtained and whether there are any issues remaining in the implementation of the processes. This will enable the AML/CFT supervisors to ensure that FIs/DNFBPs are complying with the new obligation to notify the ER in the mid-term.

*Recommendations of a mid-term nature*

- FIs/DNFBPs should record the information obtained on BO of foreign entities in the Account Register. FIs/DNFBPs should periodically update the authorities on the implementation of this requirement.
- The bill amending the AML Law that obliges FIs and DNFBPs to notify the ER where BO information collected by them on Latvian entities varies from that contained in the ER should be introduced and passed by Parliament.

## Targeted financial sanctions (TFS)

The amendments to the Sanctions Law now provide a broad and clearer administrative application of TFS for both terrorist financing (TF) and proliferation financing (PF), where all natural and legal persons must freeze assets, including in relations to all TF/PF for both international and EU-level TFS.

However, authorities do not appear to be working sufficiently in a whole-of-government coordinated way, as is generally expected under the FATF Standards, at the policy level, for supervision and for criminal enforcement of TFS. Furthermore, the authorities do not seem to have a clear understanding of the FATF requirements regarding TFS which primarily relate to preventive measures to be implemented administratively, and are not clearly separating these from what authorities would need to do in the case of a (criminal) violation of sanctions and any possible criminal investigations (of TF or PF) cases.

*Shorter-term recommendations of high priority*

- Clearly address the “without delay” standard set by FATF in implementing TFSs by ensuring the delays inherent in the EU designation process are addressed. Further amendments to the Sanctions Law appear to be necessary to ensure that the delay can be minimised to a matter of hours, or eliminated in Latvia.
- Put in place a legal requirement for FIs and DNFBPs to report to competent authorities any assets frozen in relation to relevant United Nations Security Resolutions (UNSCRs), including attempted transactions. Such reporting could be made to law enforcement authorities (LEAs) as well as to regulators or the FIU, and the information should be shared among relevant competent authorities.
- Identify one competent authority to be responsible for communicating designations immediately as they are made by the United Nations Security Council, to implement an effective mechanism for designation without delay. An obvious choice would be the Ministry of Foreign Affairs (MoFA) which could take advantage of its existing communication network. The role of supervisors and the FIU in enforcing TFS sanctions needs to be clarified as well.
- Ensure that all Latvian supervisors, and in particular FCMC, are in a position to start the supervision of the improved TFS system by 1 May 2019.

- Clarify, in practice, the role of supervisors in enforcing the administrative preventive TFS measures for FIs and DNFBPs vis-à-vis the role of LEAs and FIU in a potential (criminal) violation or circumvention of sanctions, and document the necessary internal procedures for supervisors (for on-sites) and for LEAs/FIU. This should include reconsideration of the special freezing powers of FIU in relation to its implementation of TFS preventive measures versus other general powers and procedures in relation to investigation of criminal cases.
- Taking into account Latvia's new requirements for TFS risk management and internal control, all supervisors should work together with MoFA to ensure clear and consistent guidance to implement the basic rules-based preventive measures for sanctions implementation (*e.g.*, search for names and report on hits as per the FATF Standards) and the additional measures expected for the new TFS risk management and internal controls. This should include:
  - Develop guidance for FIs and DNFBPs that may be holding targeted funds or other assets on their obligations in taking action under freezing mechanisms. For example, guidance to determine, on a continuous basis, whether they are in possession of targeted funds or property, and if they are, how to report this to competent authorities.
  - Complete the procedures for de-listing and unfreezing assets, and for accessing frozen funds for basic expenses of listed persons and update the MoFA website as needed.
  - Clarify measures expected from FIs and DNFBPs in situations of possible sanction circumvention or violation which would be of a criminal nature, including the role of FIU and LEAs in such circumstances, and if funds need to be frozen under appropriate judicial proceedings.
- Establish as soon as possible a formal committee to discuss and coordinate all relevant issues related to TFS to ensure a whole-of-government approach.

*Recommendations of a mid-term nature*

- Develop and operationalise a full mechanism to implement domestic sanctions and to consider third-party requests for designations. One option is to leverage the proposed TFS coordination body to support the necessary Cabinet work for designations.

## Reporting framework of FIU

The unusual transaction reports (UTR) regime should be amended to retain the objective threshold reports for transactions with subjective elements of suspicion being removed and amalgamated with the existing suspicious transaction report (STR) provisions. This would create a clearly defined delineation in reporting types (noting that guidance would be required to explain that a given transaction may require the submission of both a cash transaction and a suspicious transaction report).

The creation of a dedicated team of analysts in FIU with a special focus on the high priority/risks cases would assist in advancing these with the necessary priority. Doing so is likely to improve the quality of referrals to LEAs and allow for the focused enrichment of

the existing intelligence in these cases in collaboration with the State Police or Corruption Prevention and Combating Bureau (KNAB) and under guidance of the Prosecutor General's Office (PGO).

While the FIU has been given new responsibilities, no forward-looking plan of action with specific implementation milestones and deadlines related to improving the understanding by reporting entities (REs) of risks has yet been completed.

*Shorter-term recommendations of high priority*

- Amend the UTR regime to be a threshold-based transaction reporting requirement only and harmonise its subjective elements of suspicion with the existing STR regime requirements.
- FIU and supervisors should work together to identify weaknesses in filing quality STRs and apply sanctions when necessary. In this respect, the FIU should keep supervisors regularly informed about low quality STRs from specific REs.
- The FIU should complete its internal policies and procedures for prioritising money laundering cases to better support investigative priorities of LEAs.
- After consultation with REs and supervisors, the FIU should provide more detailed and specific guidance on reporting STRs and provide appropriate “red flag” indicators. The FIU should develop illustrative typologies of money laundering and terrorist financing as part of its guidance to enhance the quality of STRs.

*Recommendations of a mid-term nature*

- As it introduces its new IT tool, FIU should update its policies and procedures for its operational analysis and dissemination to LEAs that are risk-based and undertake staff training for it.
- FIU should conduct strategic analysis and strengthen public-private partnership for information sharing.
- The FIU, with the assistance of KNAB, should consider developing alerts for internal purposes that assist the FIU analysts in identifying early indicators of corruption and foreign bribery.
- The FIU should consider creating a dedicated team within its analytical division that closely cooperates with LEAs on high priority cases.
- Continuation of the parallel reporting system between the FIU and tax administration, provided it is delivering useful information to the SRS and that the information is being used effectively, is merited. Nevertheless, the need for improved joint work between the FIU and SRS, in order to leverage STR information into analysed intelligence, should continue.



## Domestic coordination/cooperation and the FIU's status

The FIU faces competing priorities, including new responsibilities for national coordination, with limited resources. The FIU has new powers from 1 January 2019, so the extent to which it can effectively execute its current power and then leverage its new powers and roles will be essential given its central role in AML/CFT. FIU should establish its vision and mission, its strategy for next three years, and annual operational objectives for all its corporate and operational activities, in consultation with partners and staff. This should also include a review of its corporate structure to support new functions and assess all positions and skills needed.

It is not clear what coordination role the Ministry of Interior (MoI) is expected to have in practice in relation to the FIU and given its overall new responsibilities for the Latvian AML Law. For example, one could expect the MoI to have a whole-of-government coordination function at the policy level for the AML/CFT or this could be given to the FIU. Under either approach, collaboration between the FIU and MoI would be required to ensure effective national coordination.

While assessing inherent risks of Latvia, more actions should be taken to ensure that all competent authorities are part of the review process, and discuss and approve, by consensus, the final National Risk Assessment (NRA) analysis and the actual results/ratings. It would greatly improve a shared understanding of the risks and national ownership and support for the results if the process of the NRA is fully inclusive of all AML/CFT competent authorities.

Detailed operational action plans for all of the AML/CFT competent authorities should be developed in line with the National Action Plan and the actual updated NRA results (irrespective of whether a NRA report is completed or not) so their implementation and updates can be monitored (*e.g.*, on a quarterly basis), with regular reports to senior management, and Cabinet (and to the FIU's Advisory Board (ABCS) and the Financial Sector Development Board (FSDB) as needed).

### *Shorter-term recommendations of high priority*

- Clarify the roles and responsibilities of the FSDB and ABCS, in particular given private sector participation in both which precludes them from being the government's national policy and operational coordination committee.
- The respective roles of the MoI and FIU in terms of policy coordination for the overall AML/CFT system should be clarified, including for the development of domestic policy (including the National Action Plan), supporting the competent authorities, and coordination of Latvia's representation at Moneyval. This should include discussions on the establishment of a coordination unit within the FIU and/or MoI to support the national coordination efforts.
- Given the new role of the MoI, it should discuss with the FIU what this role means in practice and how both authorities will work together to support national coordination.
- For the next update of the NRA, ensure that all competent authorities review, discuss and approve, by consensus, the final NRA analysis and actual results/ratings in relation to inherent risks.

- Seek senior-level management approval of the NRA results early and prior to the drafting of the actual NRA report, to ease and accelerate the drafting and final approval process.
- Review and update as needed the Latvian National Action Plan taking into account the updated NRA results for inherent risks, and monitor and report to Cabinet on implementation on a regular basis
- The guidelines on prioritisation of ML cases need to be further improved by more clear, qualitative criteria of high-priority cases for LEAs, and revision of the frequency to review the priorities.

*Recommendations of a mid-term nature*

- Outreach to FIs and DNFBPs on the updated NRA results (inherent threats and vulnerabilities) should continue and be led by each supervisor, in coordination with the FIU. This should include guidance on how to leverage the NRA for the implementation of the risk-based approach (RBA) by the private sector.
- Undertake training for all competent authorities on the application of a RBA to ML/TF, including how to integrate the NRA results into their activities and how to conduct strategic analysis and further risk assessment that could feed into the national policy development process and operational activities.

## **AML/CFT supervision and control: FCMC's functions and supervisory cooperation**

The Compliance and Control Department (CCD) of FCMC displayed the highest level of understanding of ML/TF threats and vulnerabilities of the competent AML/CFT authorities in Latvia. Given that FCMC supervises the highest risk sector for AML/CFT, it is imperative that FCMC's objectives and legal protection is sufficient to ensure that it can carry out its supervisory duties and responsibilities in a timely and appropriate manner.

FCMC should improve its accountability to the government by better coordinating its AML/CFT strategic and operational planning. This would better feed into the National Action Plan, as well as ensuring its execution of its AML/CFT role can be timely and better coordinated.

Given the issues FCMC has experienced in relation to making timely supervisory AML/CFT decisions and its ongoing concerns over its funding, Latvia should consider a comprehensive review of how best FCMC can execute its AML/CFT role as well as strengthening its governance. CCD of FCMC has the experience and knowledge to be the knowledge-base for all AML/CFT supervisors, and this should be a key consideration.

*Shorter-term recommendations of high priority*

- The objective/functions of the FCMC should be reviewed to ensure that AML/CFT supervision is recognised as a priority for FCMC, and FCMC can continue to appropriately address the ML and TF risks in the banking sector as well as provide leadership in developing the supervisory methodology.
- FCMC should consider ways to better support CCD, given its key role in Latvia's AML/CFT supervision. This includes better integrating AML issues into its governance process, by, for example, inclusion of the director of CCD into the



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Board, and considering an additional reallocation of resources as needed to support and strengthen the CCD's capacity to address the inherent risks of Latvia.

- Accountability mechanisms of FCMC should be strengthened to ensure that FCMC is accountable to its oversight ministry, *i.e.*, MoF, to ensure that FCMC's operational and strategic *ex ante* planning reflects wider financial sector policy considerations, including ML/TF risks. This should entail annual approval of its strategic planning as well as discussions on other operational issues and legislative planning fully taking into account the Basel Core Principles on Banking Supervision.
- A framework should be established to facilitate coordination of AML/CFT supervisors, which could take the form of a supervisory council. It should be a priority of a supervisory council and its member FI/DNFBP supervisors to ensure the various supervised entities have the required measures in place to apply UNSCR sanctions on TF and PF in the FI/DNFBP sectors. A process of regular monitoring and reporting on sanctions by all supervisors/self regulatory organisations (SROs) should be implemented.

*Recommendations of a mid-term nature*

- To ensure adequate and stable funding of FCMC that appropriately reflects the changing structure, composition and risk profile of its financial sector, Latvia should review, among other things, the scope and methodology of its fee assessment to ensure that effective supervision and regulation can take place in all areas of its mandate, including AML supervision.
- To further improve the timeliness, appropriateness and risk-sensitivity of administrative sanctions, Latvia should ensure that FCMC's administrative sanctions regime, as well as its wider supervisory enforcement framework, is transparent, predictable and the procedure is accountable. The administrative sanction regime should include more actions that can be taken, taking advantage of the available supervisory enforcement actions. In addition, better linking the risk scoring of the NRA with the administrative sanction regime may assist to ensure a coherent strategy within Latvia.
- Latvia should consider a comprehensive review of the status of FCMC, including the legal protection of its supervisors, to ensure that financial supervision, and particularly AML/CFT supervision, is carried out in a robust framework and supervisory decisions can be made in a timely and appropriate manner fully taking into account the Basel Core Principles for Effective Banking Supervision. Consideration should be given, among others, of leveraging existing institutions and knowledge-base, and maintaining the leadership of FCMC in AML/CFT supervision.

## Detection, investigation and prosecution of money-laundering (ML) offences and international cooperation

The most important sources allowing the detection of money laundering include filings of STRs by (non-) FIs to the FIU, reporting in the (mass) media responding to complaints filed with investigative journalists, requests for mutual legal assistance, ongoing criminal investigations for other criminal offences, which may be the predicate offence to money laundering, reporting by whistleblowers, referrals from other (domestic or international) authorities, law enforcement intelligence, complaints filed to LEAs, and information received from confidential informants and cooperative witnesses. All avenues should be pursued for better detection of ML cases.

In the course of an ongoing criminal investigation, indications for money laundering activities that are (in-)directly related to the criminal offences under investigation are frequently found. In such cases, a financial investigation should systematically be carried out in parallel to the investigation of the criminal offence under investigation. In many cases, financial investigations are necessary to develop evidence against sophisticated, high-level criminals with a view to dismantling transnational and/or organised crime networks.

The complexity of investigating predicate offences, which are predominantly trans-national in character, often lies in obtaining a correct understanding of the *modus operandi* that has been used in relation to the criminal behaviour to commit the predicate offence on the one hand and the different, albeit related, behaviour concerning the laundering activities on the other hand. It is especially in this context that in-depth analysis needs to be done of both the financial transactions and the entities through which invoices have been issued to make the transactions appear legitimate.

To prove a stand-alone crime, it needs to be proven to the court that certain assets or funds were criminally obtained. Just like in other money laundering cases, the investigation is likely to start with the detection of a suspicion of money laundering. At the outset, it may not be clear whether the suspicion will lead to a case of stand-alone money laundering or not, and law enforcement will thus need to remain open to both options.

### *Shorter-term recommendations of high priority and WGB process*

- Prosecutors responsible for the supervision of the investigation and prosecution of money laundering should review the progress of the investigations on a regular basis, reflect together with its law enforcement partners on steps needed to advance the investigation, and pro-actively seek advice from other enforcement authorities.
- Prosecutors should play a leading role in developing guidance on effectively investigating cases of money laundering as well as the required evidence that needs to be obtained.
- The summaries of the existing case law and prosecutorial practice foreseen for 2019 should be finalised prior to the adoption of the anti-money laundering guidelines so that their outcomes can be included in the guidelines that are currently being drafted. The guidelines should be drafted in a uniform and consistent manner, using the same definitions and concepts as in Latvian criminal law and criminal procedure.

- The Latvian authorities should ensure consequent and dedicated monitoring of the media, to ensure that indications of potential money laundering cases are identified at an early stage. Identified suspicions should be accompanied by appropriate follow up actions to secure intelligence and evidence in a timely manner.
- For requests for mutual legal assistance (MLA) in criminal matters, central authorities should alert each other to indications of money laundering contained in incoming (passive) requests for MLA from abroad and that may lead to the opening of new criminal investigations. The IT system they have at their disposal should contain red flags for such cases.
- Latvian authorities should clarify that confidential information can be shared between LEAs for detection and investigative purposes. The existing coordination group under FIU should be further formalised and developed.
- In order to successfully investigate and prosecute complex cases of economic crimes, including bribery, corruption, fraud and the related money laundering, LEAs should employ well trained and experienced financial experts. Parallel financial investigations should be systematically conducted, particularly in serious and complex proceed-generating and ML cases, with the involvement of financial and other relevant experts. Financial investigative teams should be provided with access to financial and other relevant information, as well as being properly and periodically trained. Comprehensive statistics on financial investigations should be maintained.
- The guidelines on the investigation of money laundering should be complemented by examples of potential sources for the detection of money laundering, types and characteristics of money laundering (*e.g.*, self-laundering, third-party laundering, stand-alone money laundering), parallel financial investigations, types of evidence related to high-risk predicate and ML offences, investigative strategies and techniques, inter-agency and international cooperation.
- The use of money laundering as a stand-alone offence should be reserved for cases in which the predicate offence cannot be determined or evidence of the predicate offence cannot be produced.
- When investigating a suspicion of stand-alone money laundering, fair trial principles need to be fully respected and the suspect needs to be granted the opportunity to defend against the allegations.
- A criterion should be adopted in relation to the required degree of certainty in establishing that the assets in fact do not have a legal origin.

*Recommendations of a mid-term nature*

- LEAs should establish close coordination and cooperation with each other both at domestic level as well as with their international counterparts. Existing barriers for sharing information between authorities at domestic level should be minimised and mutual updates on investigative progress should take place on a regular basis.

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