



# THE FIGHT AGAINST MONEY LAUNDERING IN LATVIA AND SWEDEN

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*The common denominator in all transnational criminal activities is money laundering, the process by which the proceeds of illegal activities are converted into means for legal investments. The fight against money laundering means combating large scale crime. The World Bank and the International Monetary Fund (IMF) estimate that shadow transactions amounted to between US\$6.5 trillion and US\$9 trillion, equaling 20-25% of total global GDP. On the other hand, the United Nations International Drug Control Program (UNDCP) assesses the annual turnover from the entire criminal market to be around US\$1500 billion. This Policy Brief summarizes the proceedings of the Workshop on Money Laundering organized by the Institute for Security and Development Policy, and the Riga Stradins University, Latvia, held May 28, 2010.*

## Financial Intelligence Units in Latvia and Sweden

Globally, there are approximately 180 national Financial Intelligence Units (FIU) which are increasingly cooperating with one another. The Swedish and Latvian FIUs are both working on collecting and investigating illegal economic activities. Their work focus mainly on money acquired through large scale illegal schemes, such as drug trafficking, which directly implies high levels of organization. Cooperation between FIUs through information exchanges or joint training is crucial. The Swedish and Latvian FIUs, as well as those in the European Union (EU), cooperate closely in order to track transactions which are suspected to be made for the sake of funneling illegal proceeds into the legal economy. This work is facilitated by a harmonization of legislation in the EU (Law on the Prevention of Money Laundering and the Financing of Terrorism) and through the adoption of the Warsaw Convention (2005) by the Council of Europe. However, FIUs in the EU still experience large difficulties in cooperating with countries outside of the Union, most prominently Russia.

## The Latvian FIU

The Latvian FIU was established in 1997, and is an integral part of the Ministry of Finance. The Latvian FIU has four

prosecutors with special prerogatives who are supervised by a prosecutor general appointed for a five-year term.

Currently, the Latvian FIU has 20 employees, who investigate about 4,000 cases of suspicious economic activities every year. This is similar to Latvia's northern neighbor Estonia, with 5,000 cases. However, these figures are rather modest compared to neighboring Lithuania's 3.5 million reports (2007). In comparison, this is as many reports as the FIUs in Russia or the United States receives annually. However, the number of reports is not an indicator of the success of a country's fight against economic crime, because many cases consist of smaller money laundry operations that distract FIUs from operations being carried out by major organized crime groupings.

Latvian authorities saw a need for reform in 2004 and in 2005, when the government created a council to combat money laundering, with the prime minister and the prosecutor general among the board members. It was a move by the government that was appreciated by economic crime fighters, who had been alarmed about the deteriorating situation for a long time. In 2005, 52% of all deposits to Latvian bank accounts was made by non residents, and over 100,000 accounts were shut down. One of the many measures taken by the council was the creation of an account register, that was provided to the FIU by banks operating in Latvia. Individuals often opened several accounts: one for legal work and one for illegal activities. Today, banks are



obliged to send an updated version of their account register to the FIU.

The most significant action by the council was the adaptation of three priorities.

The first priority is to freeze the transfer of illegal capital on a large scale. Since the adaptation of this priority, the Latvian FIU, in close cooperation with national banks, has created a successful system for obstructing money laundering. Banks have the right to freeze accounts/transactions whenever economic crime is suspected. Since this measure came into effect, banks have been obliged to report incidents to the FIU, which in turn has 60 days to investigate the case before taking action. The FIUs have the right to prolong the investigation period by an additional 45 days if it can produce solid evidence that a crime has been committed.

This is a right vested in FIUs globally. However, countries differ as to the amount of time given to FIUs for prolonging the freezing of assets during an investigation. The Estonian FIU can prolong the freezing of assets for 90 days, whereas some other countries only extend investigations by three days. The Latvian FIU has consequently used its right to freeze assets for a full 45 day period since 2006. In 2006, there were 125 orders to freeze accounts totaling 12.8 million LVL. In 2007, the FIU issued 94 orders totaling 6.5 million LVL. Bank clients have the right to appeal these decisions, but rarely use this right.

The second priority focuses on large scale money laundering. Large scale money laundering is realized through multiple smaller transactions. This is due to the fact that it is easier to get away with smaller transactions, since they are not detected by switch systems. In Latvia, the method of using multiple smaller transactions in money laundering operations has been identified in several cases amounting to ca 5-6 million LVL, where a few thousand LVL have been transferred at a time. The Latvian FIU estimates that a large scale scheme, defined as having a value of at least one million LVL, involves at least ten people. A case in 2008 demonstrated that such operations can be carried out by as many as 120 persons. Since one of the guiding principles of the Latvian FIU is to work against large scale schemes, this has resulted in an increasing number of such cases (9 in 2006, 17 in 2007, 23 in 2008, and 22 in 2009). In May 2010, 23 cases had already been registered. The annual average of case files produced is 150.

The third priority is to increase cooperation with other countries, in order to compile reports for the Latvian Law Enforcement, built on reliable intelligence. Building this solid base of information is crucial to obtaining a legal right to monitor accounts, as stipulated in the Latvian Law on Credit Institutions. If serious misconduct is found, the FIU has the right to freeze money, but not to confiscate it. Confiscations of assets are made by law enforcement.

## Trend and Tendencies

Latvian courts can confiscate assets on behalf of the state. Since 2006, the Economic Crime Unit has had approximately 20 cases of this nature, with the total confiscated sums ranging from 1.3 million to 9.1 million euros. There is a decreasing tendency for money to come from abroad for laundering purposes. Contrary to the general public perception, shaped by excessive media attention, Latvia is more frequently used as a transit corridor for money rather than as a base for laundering. There is strong evidence that the destination for such money are the South Pacific countries, especially Australia. Still, many small to medium scale economic crimes continue to involve Latvian accounts. There is a concern over the influx of money to Latvian accounts from individuals in Eastern European states, such as Ukraine. There is also well grounded suspicion within the economic police that these credit card holders are in fact criminals, who use this method in order to launder their illegal money.

## The Swedish FIU

Unlike the Latvian FIU, which is part of the Ministry of Finance, the Swedish FIU is part of the national criminal police. The FIU has 20 employees, of a total of 205 staff members who work at the criminal intelligence unit of the Swedish National Police. They deal with asset investigations, environmental crimes, and counterfeiting.

A new method for reporting was made mandatory for Swedish banks with the Swedish Money Laundering Act (2009). Banks have to report to the FIU suspicious transactions involving money laundering or suspected terrorist financing. Nowadays, Swedish banks monitor account holders from the moment they open up their accounts. There is a manual of criteria on which banking staff are briefed. The



FIU has built up an electronic system for reporting, so that banks can log into a safe website in order to report suspicious activities. Previously, banks were faxing these reports; this has significantly improved the quality of reports that the FIU receives. The Swedish Money Laundering Act also makes it mandatory for other businesses, such as auction companies and real estate firms, to report misconduct.

The number of reports to the Swedish FIU has increased; from 1994 to 2008 reports increased from 420 to 13,048. This positive result has been somewhat inaccurately attributed to an array of factors, e.g., the Money Laundering Act, but in reality the FIU has been flooded with reports from one actor. Serious misconduct by the Swedish financial institution Forex Bank motivated its management to direct their employees to report even the slightest suspicious moves, which caused the increase in the number of reports.

## The Role of the Private Sector

Information given to the FIUs plays a crucial role in fighting economic crime. The EU's Third Money Laundering Directive, which was implemented in Sweden in 2009, brought about a welcomed expansion in the number of private sector actors that were obliged to report suspected money laundering. According to this law, there is a requirement to check the identity of people who wish to enter into a business relationship, or carry out a transaction of 15,000 Euros or more. There is also an examination and information liability act for businesses, so that that they must scrutinize transactions that there is reason to believe money laundering. They must report such transactions to the Swedish Financial Intelligence Unit.

The Anti Money Laundering Act has several flaws. According to the Swedish National Council for Crime Prevention, only 94 out of the approximately 400,000 companies covered by the act had reported transactions. In 2009, real estate firms which globally have high turnovers of cash, reported only four incidents of suspicious activities to the Swedish authorities. There are a number of underlying reasons for this low turnover, according to the Council. First, some businesses have no contact with economic criminals. Second, large scale purchases such as real estate cannot be done in cash, due to costs. For this reason, real estate firms do not encounter incidents that would justify a report to the FIU. Third, some businesses perceive reporting as some-

thing imposed on them, with little useful results. There is a widespread view that the FIU does not have enough time to check all the reported incidents, due to the large number of incoming reports. This decreases the interest of private actors to spend resources on writing reports.

However, the problems linked to the system of reporting to the Swedish FIU should not overshadow its positive features. Recently, the media has published reports about economic crime in branches considered sound, which has focused the need to be on the alert regarding possible economic misdeed. In 2009, the Swedish currency exchange and bank Forex was involved in shady activities, which created enormous bad publicity for the company. Few companies want to be associated with activities such as money laundering and organized crime; the Forex case was a wakeup call for such companies. There is a general sense of justice and a desire to obey the law, in order to avoid any possible economic sanctions.

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*The opinions expressed in this Policy Brief are those of the author and do not necessarily reflect the views of the Institute for Security and Development Policy or its sponsors.*

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## A Financial Crisis in Latvia? (Summary)

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One of the topics discussed during the workshop was the issue of whether organized crime had worsened Latvia's financial situation during the global recession. Weaknesses in Latvia's anti-money laundering and combating the financing of terrorism regimes (AML/CFT) have exacerbated the state of the country's economy during the financial crisis. There are three main areas of money laundering in Latvia: 1) money laundering related to non resident deposits; 2) money laundering in the real estate sector; and 3) money laundering related to foreign direct investments.

Withdrawals of capital from accounts are often made on the basis of fear of devaluation, to evade income tax, etc. In a world where capital flows are managed globally, investments made by non residents are more volatile and mobile during times of recession. If the presumption is that foreign deposits will be withdrawn in times of crisis, then Latvia was already in a vulnerable situation, since approximately 40% of its total deposits consisted of foreign capital by the time the global recession began (Figures 1 and 2). After the crisis, the percentage of non resident deposit began decreasing radically, which caused sharp moves that exacerbated the liquidity crisis. Some banks collapsed, including Parex, where 60% of its deposits belonged to non residents.

Money laundering in the real estate sector and operated by individuals is linked to organized crime, played part in exacerbating the financial crisis in Latvia. The assertion of heavy involvement by organized crime in the real estate sector is based on evidence found at the micro and macro levels. On the micro level, many cases related to money laundering, murders, and corruption in connection with Latvia's real estate market, indicates large involvement by organized crime in this sector. At the macro level, money laundering in the real estate sector has affected prices. Investments made by organized crime are more volatile, and thus more prone to withdraw from the market when a crisis hits. Therefore, the significant drops in real estate prices (Figure 3) can be partially attributed to money laundering by organized crime. However, real estate bubbles occurred in much of Europe during this period, and therefore it is difficult to estimate the relative impact.

Figure 1. Non-Resident Deposits

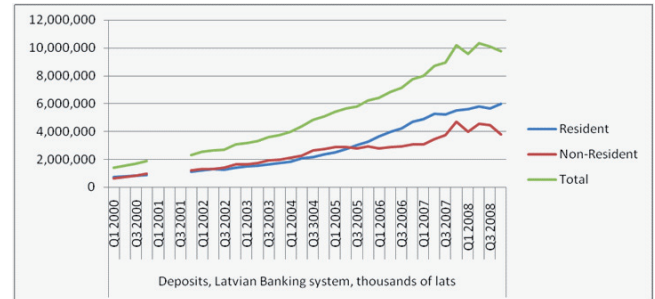
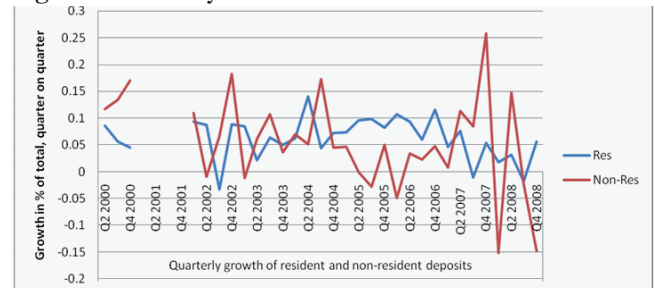


Figure 2. Volatility of NR: Macro Level



NR: Sensitive to external shocks (6.6%/1.5% vs. 6.7% vs. 9.1%), more volatile (8.9% vs. 4.1%), and more demand deposits.

Figure 3. Real Estate: Macro Level

