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# Money laundering in the banks: The Baltic-Nordic front against financial crime

**A series of bank scandals have overshadowed the reputation of the financial sector in the Baltic and Nordic States since 2018. The collapse of the bank in Latvia and the severe sanctions for banks in and Denmark that had branches in Estonia resulted from their money laundering for Soviet States, mainly Russia. In order to stop this illegal activity, the countries of the region, in addition to taking national actions, have decided to take a common step: involving the International Monetary Fund in the assessment of the risk for financial crime in the region.**

**Genesis.** Thirty years ago, the Baltic States faced the challenge of transforming the banking sector and adapting it to new market economy principles. The first years brought rapid development in this area, particularly in Latvia. This is evidenced by the growing number of banks and the accompanying rise in their competitiveness. For example, in 1995, there were 42 banks in Latvia (including 11 controlled by foreign investors), 18 in Estonia (4 foreign), and 12 in Lithuania (lack of foreign).

At that time, Latvia started to play the role of a regional financial centre, primarily as a transit hub between Russia and other Soviet States. One Latvian bank at the turn of the century even advertised the term "we are closer than Switzerland," which was supposed, on the one hand, to refer to standards guaranteed in Western Europe, and on the other, to offer greater proximity, both geographical and cultural, through, for example, a high percentage of Russian-speaking citizens, to secure banking. As a result, the characteristic of the Latvian banking system, and to some extent also Estonian and Lithuanian, has become a high level of non-resident deposits (NRDs), mainly from Russia, Ukraine, and Azerbaijan. This direction has become even more attractive after the Baltic States joined the European Union, resulting in as many as 50% of deposits in the Latvian financial system coming from non-residents in 2015.

**Business.** Although not every financial transaction carried out by a non-resident is linked to crime, non-resident activity is one of the most common ways of money laundering because of the limited ability to verify the origin of funds in accounts. The practice is to bring money from crime to across national borders (sometimes several) in order to get rid of the traces of illegal activity and put it into legal circulation.

In 2018 the Financial Crimes Enforcement Network (FinCEN) accused the third largest Latvian bank ABLV of allowing such practices. Between 2015-2018 the bank laundered at least EUR 50 million. In addition, it was accused of helping to finance the nuclear program of North Korea. Subsequently, following the decision of the European Central Bank on this matter, ABLV ceased its activities. At that time, Ilmārs Rimšēvičs, president of the Latvian central bank, faced corruption charges, including accepting a bribe in the amount of 100,000 euro from a bank associated with money laundering.

A scandal involving illicit financial operations from Russia was also detected in 2018 in the Estonian branch of Danske Bank, the largest bank in Denmark. In this case, the amount of laundered money was one of the highest in history, with EUR 200 billion passed through the portfolios of non-residents of this branch. Following the disclosure of the scandal, the Estonian government requested the closure of the branch. Ten former employees of the bank were arrested, General Manager of Danske Bank Thomas Borgen resigned, and a former President of the Estonian subsidiary Aivar Rehe was found dead on 25 September 2019.

Estonian branches of Swedish banks Swedbank and the Skandinaviska Enskilda Banken (SEB) were also found to have laundered money. Both have been penalized by Swedish financial supervision for insufficient action against the flow of illegal financing. Swedbank was fined SEK 4 billion, and SEB was fined SEK 1 billion.

**Improvement.** The lack of transparency of the origin and use of non-resident deposits in Latvia – and to a lesser extent in other Baltic States – has been criticized for years by the International Monetary Fund (IMF), the Organization for Economic Cooperation and Development (OECD), and the European Commission. A revision of the rules to strengthen financial supervision was initiated in 2016, and in 2018, when the the scandal in ABLV was revealed, efforts were stepped up to prevent money laundering. As a result, non-resident deposits in Latvia fell to less than 20% in 2019. Equally important, the geographical structure of non-resident participation also changed and no longer dominates more risky non-EU deposits.

The Latvian financial supervisory authority reported that in 2020 banks took important steps to improve internal control and their results have shown success. While in previous years the majority of crimes ended with administrative proceedings and penalties, only a few cases occurred in the summary year. A thorough review of banks was also announced in 2021. The newly established government of Kai Kallas in Estonia announced plans to clean up the image of the State in financial markets by strengthening efforts to make the financial sector transparent.

The Nordic banks also want to improve their image. For example, Swedbank, in a communication published in February 2021, announced the decision to set up a new Baltic subsidiary which will become the owner of the current subsidiaries in Latvia, Estonia, and Lithuania and will provide a more transparent governance structure with a clear decision-making process.

**Collaboration.** The Baltic States, together with the Nordic countries, have decided to engage the IMF to conduct a regional risk analysis of financial crime. It was provided by the Latvian central bank in January 2021, indicating the need to identify potential risks in this area, but also to assess the actions taken so far by the Baltic and Nordic States. Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden are all involved.

Given the interlinkages between the financial systems in the Baltic-Nordic region, in particular the numerous cross-border banking relationships, it seems appropriate to present the IMF's perspective as an independent advisor for anti-money laundering. At the same time, this initiative shows that both national and international steps need to be taken to help identify and stop the flow of illegal funds. The IMF is due to communicate its findings in mid-2022.

**Conclusions.** The timing of the financial system, the reduction of the credibility of financial institutions and the state and the weakening of the international image – and the consequent outflow of legal capital – and the problems of acquiring new investors are just some of the economic consequences of money laundering. They are all the more severe from the point of view of the countries concerned, which are geared toward external capital (especially the Baltic States), with a developed financial sector, which has so far been presented as highly transparent (especially Nordic countries). It should also be stressed that both the number of reported cases of money laundering and their scale, especially in Danske Bank, can undermine confidence in the financial system in the region.

Latvia has been most affected by this problem, and for years now has been seen as a key centre for money laundering by organized crime from Russia and other post-Soviet countries. However, given the link between banking systems in the region and the specific nature of the criminal activity, it may not be sufficient for individual states to act alone. It is therefore desirable to prepare and implement a plan of conduct to reduce the risk of financial crime not only at national but also at international levels. The Baltic and Nordic States seem to see such a need, as demonstrated by the IMF's commitment to financial risk assessment at the regional level.