

# Banking sector: clearer, cleaner

**How does the Latvian banking sector look in 2012 from a legal standpoint? We sought illumination on this point from Lauris Liepa, a partner at the full-service business law firm Borenus Attorneys at Law and an expert in banking and finance law.**

**– How has the Latvian banking sector improved in recent years, and from a legal standpoint does it have a clean bill of health in 2012?**

There have been important changes in the sector these last few years. The sector is certainly more structured than it was a decade ago. Among the banks specializing in retail there have been no surprises, and that side of the business appears to be fully transparent. Most are Scandinavian owned and there's more certainty about their ability to perform. In times of greater global certainty there would be no trouble at all, but in these times of shortages of funds the owners need to demonstrate that they have deep pockets.

Retail banks are more stable; the owners are much bigger groups, where the hope is higher that they can survive in times of turbulence. In 2012, as a retail bank customer, I feel confident.

Among smaller, private banks the level of risk is higher. There are more than 10 banks in Latvia that exist to serve the purposes of their owners and are closed to the majority of customers. These private banks appear to be operating well, not seeking publicity, not opening retail outlets. Their niche is investment and private customers.

Capital is fleeing Russian and the CIS countries and Latvia serves as a good place to invest this money, later to be reinvested back into those countries. Thanks in large part to its language capabilities, Riga has become one of the hubs where this cash is concentrated. It is helping to fulfill one of the tasks of the banking industry – to create a financial center for the region.

If it hadn't been for the losses from Krajbanka and Parex, the banking sector would have been profitable in 2011.

**– Is money laundering still as much a concern in Latvia as it used to be?**

Latvia had rather active growth in its banking sector in the 1990s. Inevitably, there were customers who tried to use our still developing banking sector for certain



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transactions that we could today qualify as dubious. In the late 90s, there were indications from international institutions about the rather high levels of risk that our banks were ready to undertake in servicing funds.

A critical moment for the sector came when several rather minor players in the banking market were threatened by the US authorities to close their dollar accounts.

Initiatives on the prevention of money laundering by the global watchdog were immediately implemented by Latvian regulators and also the private sector. The practices were changed, and strong control of payments and clients was introduced by the banks. Part of the non-resident consumer base was ditched.

The third money laundering directive is currently transposed into Latvian legislation and banks are very careful in complying with the requirements. It is a very effective instrument in targeting illicit sources of funds entering Latvian banks. The result? The sector is clean, for the most part, and much more transparent and understandable than it was 10 years ago.

**– Do you think what the Latvian and Lithuanian authorities did regarding Krajbanka was correct from a legal standpoint?**

It's premature to make strong suggestions at this moment. What apparently happened was that the bank's shareholders acted negligently by diverting funds for their own business ventures. The Latvian authorities have launched a criminal case. Let's see what the courts determine.

The bank's management faced a loss of capital. The question was – would the owners have been able to return the capital that went missing? It appears that at that particular moment they may not have been. So the authorities stopped the bank's activities.

It was important to protect the bank's clients at the moment when there was uncertainty about the bank's ability to perform its obligations and a liquidity problem was looming.

The question now is: are there measures and resources to restructure the bank? Restructuring was the best solution in several other cases, such as R gas Komercbanka 12 years ago and Parex two years ago, so we'll have to see if the restructuring proposals would work for Krajbanka.

Krajbanka and its Lithuanian parent, Snoras Bankas, had the same shareholder base. But they were two separate banks. Krajbanka was a much smaller bank, so restructuring there may be easier.

It's a good sign that very professional administrators have been brought in – KPMG, and an experienced attorney, Mr Janis Ozolins. It's their duty to do what's best also in assessing the submitted restructuring proposals.

**– What are the implications of the Krajbanka insolvency for the banking sector?**

The liquidation of a bank of any size has a negative influence. For experienced business clients there is no big difference. But for ordinary customers it can shake people's faith in the banking system, particularly because Krajbanka had a wide private client base.

As we saw with the unfounded rumors targeting Swedbank late last year, a giant can be badly affected just by completely nonsensical statements.

I believe that Swedbank was purposefully targeted during a weekend shortly after the emergency measures with Krajbanka happened. Customers were cautious and the markets still nervous. Of course Swedbank did survive, but the event might have been a learning exercise. We can only speculate about why and by whom.