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Lithuania economy briefing:

Lithuania tightens up the anti-money laundering measures

Linas Eriksonas

China-CEE Institute

Kiadó: Kína-KKE Intézet Nonprofit Kft.

Szerkesztésért felelős személy: Chen Xin

Kiadásért felelős személy: Huang Ping

1052 Budapest Petőfi Sándor utca 11.

+36 1 5858 690

office@china-cee.eu

china-cee.eu

Lithuania tightens up the anti-money laundering measures

On 28 October the Government approved the central bank's proposal, which has been in preparation for some time, to set up the competence centre for the prevention of money laundering. The centre would be co-founded by the Ministry of Finance, the Bank of Lithuania and the commercial banks operating in Lithuania. The concerned law enforcement agencies, including the Financial Crime Investigation Service under the Ministry of the Interior, the Department of Police, the State Tax Inspectorate and the General Prosecutor's Office, will take part in the activities of the anti-money laundering centre. As announced, the centre will carry out the following tasks: sharing of information about the typologies of money laundering and terrorist financing, researching and assessing the legislative basis to improve the prevention system, strengthening the respective competencies of the employees working in the financial sector and publicising the results of the preventive measures taken in Lithuania to decrease the risk of money laundering.

Below is a brief outline of the main issues which made the adopted anti-money laundering measures timely and relevant, given the period of the economic uncertainties which might arise as a fallout of the second wave of the COVID-19 pandemic. It will try to explain how these measures relate to the latest policy trends in the EU, which call for a higher level of transparency in the banking sector.

Initially, Lithuania has had a thorny experience with the banking sector in the country, which involved a series of bankruptcies and the criminal charges brought against the bankers. In January 2020, the General Prosecutor's office concluded an epic six-year investigation into suspected large-scale embezzlement at the now-defunct bank, which was declared insolvent in 2013. The damages subject to compensation were estimated at 370 million euros. The investigation also looked into suspicions of abuse of office, laundering of criminally gained assets, and setting up and managing companies used as the cover for unlawful activities. The latest estimates put the extent of the alleged financial fraud at over 40 million euros. According to the information released by the Financial Crimes Investigation Service, the illegitimate funds were laundered via the accounts of 80 companies and individuals and used to acquire real estate assets.

According to the World Economic Forum's assessment, the soundness of banks in Lithuania, which was at a record low in the years 2013-2014, reached he EU average only in

2019. According to the 2019 Global Competitiveness Report, financial market development in Lithuania is scored 58.3 out of maximum 100 and is ranked 75th of 144 analysed economies in the world, while the soundness of banks Lithuania is scored 5.1 out of 10, which brings the country only to the 66th place globally. The main aspects which drag down Lithuania in the international ratings are related to the lower levels of market capitalization, insurance premiums, availability of domestic credit to the private sector as well as higher than the EU average level of non-performing loans. Notably, in 2019 the consolidated assets of the banking sector in Lithuania comprised only about 30 billion EUR, about two-third of the nominal GDP (48,4 billion), while, for example, Estonia's, having consolidated banking assets have been until 2019 on the same level as the nominal GDP and only in 2019 exceeded the nominal GDP by a third (37 billion and 28 billion, respectively).

The deficiency of the more readily available working capital for the companies as well as other actors of the market creates a demand for the financial resources and their use with higher levels of efficiency, creating a space for innovation. The emergence of the financial technologies (FinTech) sector in Lithuania over the last few years attest to that. The year 2019 became a watershed year with the number of FinTech companies reaching more than 200, covering all segments of fintech, including payment technologies, persona; wealth management technologies (wealthtech), regulatory compliance technologies (regtech)and digital identity technologies, insurance technologies (insurtech), digital banking, and blockchain. Lithuania has taken up the 4th place in the FinTech global ranking, according to the 2019 Global Fintech Index, where it is noted that the key areas of Lithuania's FinTech leadership are in payments, lending and banking. The sector reported a 31 per cent growth over the last year and now employs about 3400 specialists in finance and IT. Five specialised baking licenses were issued, offering lower initial capital requirements for challenger banks.

Payment and remittance have become the main growth segment within the Fintech startup ecosystem. Other fast-growing market segments include financial software, digital banking, online investment, peer-to-peer lending and consumer lending. All these developments point out towards increased needs for the financial transactions at higher speed and with less red tape attached than traditional high-street banking.

In addressing the increased risks as related to a widening possibility and sophisticated channels for financial transactions from the third countries to the EU, the European Banking Authority (EBA) recommended the creation of a single set of rules for governing anti-money laundering. The EBA is responding to a call for advice issued by the European Commission, which on 7 May adopted the action plan for a comprehensive Union policy on preventing money laundering and terrorism financing, and sets out how the EU legal framework needs to boost to tackle vulnerabilities linked to divergent national approaches.

A more coordinated and centralized approach has been considered, following the money laundering scandals in Latvia and Estonia during the period 2017-2018. During that period 200 billion euros flowed through the Estonian branch of one of the main Nordic banks. The case is regardless as one of the largest money-laundering instances reported to-date. In September the leaked files of the US Financial Crimes Enforcement Network (FinCEN) showed that, allegedly, during the period 2000-2017, around 70 million US dollars went through the Lithuania accounts of several banks which resulted from the alleged money laundering activities.

In response to these revelations amidst the growing FinTech sector, Lithuania started tightening the controls of the financial transactions already in 2018. The Financial Crimes Investigation Service (FNTT) declared a more robust approach in launching pre-trial investigations whenever the origin of money seemed dubious and claimed that last year it received 4 million euros in extra revenue thanks to the stepped-up efforts.

The Bank of Lithuania argues that Lithuania does not provide a high-risk case for potential money laundering. It is based on the assumption that the money laundering occurs from bank accounts set up by foreign legal or physical persons. The share of non-resident clients in Lithuania is one of the lowest in the EU: non-resident deposits in Lithuania account for 2,5 per cent of total deposits, while loans to non-residents – only 1,8 per cent of total loans. Hence, the central bank has concluded that "the risk of money laundering and terrorist financing in Lithuania is not high".

However, because of "the intensifying international financial relations and technological innovations", the Bank of Lithuania has announced the increased efforts in building up the supervision capacities. Thus, the central bank has established the Anti-Money Laundering and the Countering of the Terrorist Financing Division and the Electronic Money and Payment Institution Supervision Division to support its routine tasks in preventing the fraud: performing financial institution inspections, reviewing procedures and documents, providing consultations to potential and existing market participants.

Lithuania has fully endorsed the position of the European Commission to introduce the coordinated approach in tackling the money laundering by effective implementation of existing rules, by the introduction of a single EU rulebook and the EU-level supervision, by providing a support and cooperation mechanism for financial intelligence units. More, the country has taken the initiative to show leadership in this policy domain.

On 1 October, the Bank of Lithuania convened an international, online conference on anti-money laundering and the countering the terrorist financing. In his keynote speech the Chairman of the Board of the Bank of Lithuania, Vitas Vasiliauskas, mentioned that "although no serious breaches have been reported in Lithuania's financial system, this context affects the whole region, especially in terms of reputational risk". Lithuania's central bank has been until recently promoting a very open and business-like approach to welcoming the innovation in the financial sector and, for example, has endorsed the creation of a regulatory sandbox for Fintech along the lines of the one introduced by the Monetary Authority of Singapore (MAS).

At the same time, it followed the example of MAS in setting up the similar procedures and structures for anti-money laundering and the countering of terrorist financing. In following the example of Singapore in financial regulation Lithuania has been more than keen on finding the right balance between the zeal for regulation and freedom to innovate in financial services.

Thus, the head of Lithuania's central bank admonished the conference participants that an "overly tight regulation, zero tolerance for any risk, and the prospect of harsh sanctions can result in de-risking. That is when financial institutions terminate business relationships with clients to avoid, rather than manage, risk…If taken to an extreme, de-risking can result in increased financial exclusion. It may also bring higher risk transactions out of the regulated system into more opaque, informal channels, and become even harder to monitor. In other words, de-risking poses an important risk to our financial systems."

The announced establishment of the competence centre for the prevention of money anti-laundering in Lithuania as the pilot initiative in the EU is a direct response to the EU-wide call to step up efforts in anti-money laundering measures. At the same time, it aims to minimize de-risking by facilitate the financial ecosystem development through closer cooperation with stakeholders to increase the reputation and trust.

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