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Latvia Sees Good, Bad as Russian Money Haven

By The Moscow Times

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ABLV bank chief Ernest Bernis **Ints Kalnins**

RIGA, Latvia — Offshore funds flowing from crisis-hit Cyprus have helped boost bank deposits in Latvia, strengthening the small Baltic state's position as an offshore banking center for neighboring Russia and other former Soviet states.

Nonresident deposits are nearly 50 percent of total bank deposits, a record high, and Latvia's location next to Russia is its key advantage. It has drawn funds from businesses as well as rich individuals who see it is as a stable proxy for Western banks, with the added attraction that Russian is widely spoken.

Regulators are keeping a wary eye on the development because Latvia, which aims to adopt the euro in 2014, suffered a deep crisis after the crash of a bank with heavy nonresident business in 2008, and some of its banks have been implicated in alleged money laundering.

"The same way we export logistics services, we also export financial services," Kristaps Zakulis, chairman of the FKTK banking sector regulator, said in an interview, referring to ports, railways and transit traffic. "We are close to that eastern market. We can speak the same language with them, not to mention all the historical nostalgia."

A European Union source said Latvia had improved supervision of its banks after a crisis that lopped 25 percent off its output from 2008 to 2010, and the country is now attracting funds as a gateway to the EU and potentially to the eurozone, which Latvia wants to join.

Latvia was part of the Soviet Union for 50 years but broke away with its Baltic neighbors in 1991 to regain independence. It joined the European Union and NATO in 2004.

Latvia and Russia still have differences, particularly about history and the rights of a large Russian minority, but business links have stayed. That includes banks set up to cater to the financial needs of rich Russians and other former Soviet peoples.

"There are signs that some of the money and business, which until recently were at the Cypriot banks, have moved to Latvia," said Baiba Melnace, a spokeswoman for the Latvian Association of Commercial Banks.

FKTK data show that while domestic deposits fell between the end of 2010 and July 2012, nonresidents' deposits have risen 25 percent to a record 5.8 billion lats ($10.8 billion).

In contrast, data from Cyprus, which suffered from Greece's woes and has requested a bailout, show that bank deposits by businesses resident outside the EU fell from 13 billion euros in August 2011 to just over 11 billion euros ($14.33 billion) in August this year.

The coincidence is striking, but it is not possible to determine whether the hot money leaving Cyprus is flowing into Latvia.

Latvia increased its attractiveness for foreign depositors by passing a law in 2009 allowing anyone who invests 100,000 lats ($187,700) to get a residency permit.

The measure was aimed mainly at Russian clients, for whom a residency permit would allow them to move more freely around the EU, but it also prompted interest from Chinese and Indian investors, newspaper Diena reported.

While the growth in deposits is good news for banks, which say it will help an economy still recovering from a deep depression, the banking sector has had its problems.

Latvian banks have been implicated in money laundering in the past or had crises due to fast-moving foreign money.

The 2008 failure of Parex Bank, which had a lot of nonresident business, was one reason Latvia had to take an International Monetary Fund bailout, which entailed austerity measures that contributed to a cumulative 25 percent economic contraction between 2008 and 2010.

Money-laundering allegations arose afresh this month, when prosecutors launched a probe into whether banks handled funds from alleged tax fraud in Russia.

"There are potential risks in that business of nonresidents," Zakulis said. "The money can leave at a sign of instability, which also hurts our reputation. It also can attract some questionable capital, and our job is to make sure that those who work in this nonresident business recognize the risks."

But Zakulis said Latvia has strong laws and good banking practices to make sure banks do not aid money laundering.

The EU source said Latvia had indeed made strides in boosting supervision of the bank sector after the crisis.

A nation of 2 million people, Latvia boasts 29 banks, down from 61 in 1993. Scandinavian banks — Swedbank, SEB, and Nordea — dominate the retail market, while nonresidents are served by often small boutique banks.

Several Russian banks have offices in the Baltic states.

A study by an association representing smaller banks catering to nonresidents said the industry contributed between 2 and 3 percent of gross domestic product.

ABLV Bank is the largest locally owned bank by assets and the fourth-largest overall, behind the Scandinavian outfits.

At its head office in downtown Riga, well-dressed men walk past one bodyguard outside and another inside the building.

Clients are greeted with futuristic lamp stands and artsy armchairs and are served in a private meeting room.

"Working with foreign clients, being a financial center, it's not just beautiful offices, expensive cars, tasty coffee and smart clients," ABLV chief executive Ernest Bernis said. "It also carries with it a large degree of responsibility."

He predicted growth in the sector, in part due to the crisis in southern Europe.

Some remain wary, given the open borders in the European Union, which means money can flow freely.

"This means that our system of defense against dirty money is only as good as the weakest country," said Rosie Sharpe, of London-based Global Witness, which campaigns against corruption and conflict based on natural resources.

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