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"Baltic International Bank": we have to work hard to convince the low-risk or medium-risk customers not to leave the Latvian banking system

The government supported the amendments to the Anti-Money Laundering and Counter Terrorist Financing Law (AML/CTFL) developed by the Ministry of Finance (MF) providing for the strengthening of the financial system by reducing high risk transactions with high-risk customers which are shell companies and meet the specific criteria. That is, if a legal entity is not connected with real business activity as well as neither prepares nor submits financial statements, it allows said legal entity to transfer funds hiding ML/TF behind it. The Prime Minister has also expressed hope that the Saeima will promptly consider the above amendments to the law. In his interview to the national information agency LETA, Viktor Bolbat, Member of the Management Board, Deputy Chairman of the Management Board of Baltic International Bank, tells about how matters stand in terms of shell companies, how changes in laws are to be evaluated as well as whether the low-risk customers will also leave the Latvian banks.



What impact do the decisions to reduce the number of risk category customers, including shell companies, in the Latvian banking sector have on your bank's activity?

This process is, in fact, understandable and adequate. We are still a relatively young democracy, a new financial system that goes through a certain phase of lessons. Only in 2015-2016 did we become aware and started talking at the national level about what a shell company really is, and only then further steps were taken.

In terms of Baltic International Bank, it was neither a surprise nor news for us. Already in 2016, the bank began to reduce its risks, and 70% of customers were reviewed by the Risk Committee which assessed risks in the field of AML and other risks. The deposit base was, in fact, reduced by half. Then the attention was not so focused on shell companies; the issue was about the risk as such and reduction of its level. The same is happening now, i.e. the standards change but the essence remains the same. You have to know what your customer does. If the customer does not explain this, we try to break from such a relationship – we did it in 2016, and we do it now. And this is not only the present day's issue.

The industry definitely needs a clear definition of which customers are classified as high risk among non-residents or international customers. Unfortunately, risks in the field of AML exist in all customer circles. If you work with money, there is no escaping from the risk anyway. Therefore, it is very good that now efforts are taken to clearly define why among non-resident customers shell companies are classified to be of a higher risk. Each risk has its own signs. And this does not necessarily mean that the reason was an attempt to avoid paying taxes or intention to launder money. Nevertheless, there are signs of potential risk. This is the same when during the credit risk assessment the company's negative equity is considered a sign of insolvency but this does not mean that the risk will become real and insolvency will occur.

That is why we believe that we are ready for change and will continue to further reduce the level of risk in our customer portfolio. In 2016, we selected about 1,000 customers for audits which is 70% of our customer base. We terminated cooperating with 616 customers, including we stopped working with 302 customers on the initiative of the bank. In 2017, we stopped cooperating with another 606 customers, but this time it was basically the customers' initiative since the bank revised its Fee Schedule and introduced new money laundering detection rules. Also, in our banking strategy, we have clearly stated our intention to reduce the payment business and become more focused on capital management, work on complex solutions. Customers who needed cheap payment services have already closed their accounts.

I think it is important that here in Latvia, namely in the financial sector and at the state level, we have a clear understanding and a more accurate definition of what customers are categorised as high risk, and the possibility to reduce the number of such customers in the financial sector must be given. If we are talking about the form – be it 45 days or six months – I will allow myself not to give explicit evaluation as to which would be adequate. My experience shows that 45 days is neither enough to start nor to finish something good. Therefore, I think that it is necessary to determine, at the national level, not only what customers are classified as high-risk but also the real time to make the changes required.

Nevertheless, if much has already been done at Baltic International Bank, do you have any cause for concern? How much more do you have to do?

We did quite a lot. However, the degrees of customer risk differ, and not only shell companies are customers with a high level of risk. We were working for two years to adapt our internal control systems and other processes to what is the average level of risk in the portfolio. Now we are focused on the specific layer of customers, i.e. shell companies. Indeed, in the international business this really is the most risky layer of customers. At the end of the last year, it accounted for 11% of our customers and 28% of the balance. These are the customers whom we have identified as shell companies based on at least one of the criteria.

So far, we have been focused on the reduction of USD transfers from shell companies since risks may be many-sided. Our exposure to dollar transactions of shell companies was 3% which really is the minimum indicator. Besides, our goal is to reduce the number of payment services as such. In comparison with 2016, the reduction in 2017 was 40%.

This is what we have been working on in the recent years. If the law-maker said 'Well done but this should be closed in a month!', we could not but be worried. It is necessary to limit the share of the most risky customers. It's clear! Concern is triggered by the fact that the rhetoric on the part of the state representatives started with information about the need to reduce the number of all foreign customers in Latvia to 5% of the total portfolio of the banking sector customers; within a few weeks, we reduced unwanted customers to shell companies. Financial sciences say that specific risks are typical of each group of assets and liabilities. The decision on further actions can be made depending on the level of the risk. But you cannot speak about the group. This is part of the same story as when mortgage lending was banned because of the problems which arose with that during the crisis.

Every bank, every license holder should always (rather than now, yesterday or tomorrow) be ready to prove to the regulator that it is coping with the average risk assumed by it. Beneficial owners should always be verified. This requirement has been in place at all times!

What additional measures do you currently implement? Do you require your customers to once again prove the origin of their funds?

First, we continue doing what was started two years ago, i.e. we perform customer research, we are careful with those knocking at the bank's door. We want to additionally develop asset management services. The problem is that we have reduced the risky share of business but it will take many years to increase the volume of new services.

As for the customer research, we pay special attention to potential customers as well as to the outgoing payments of high-risk customers and shell companies which we still have in our bank. Of course, we also assess the number of customers that can fall into the category with which the law-maker may forbid any cooperation whatsoever.

What could this number be?

At present, a shell company may be characterised by the combination of factors as follows: it does not carry out real business activity and is registered in a country in which submission of financial statements is not mandatory. It means that you cannot understand what the customer deals with, and it cannot even submit a report. Each banker in Latvia communicates with such customers, explains that the signs of a shell company have been identified and that the accounts will probably have to be closed. It is also necessary to observe the customer's reaction. There are customers who claim that they will not explain anything, take their money and leave, and there are customers who submit documents confirming that their company is not a shell company. Likewise, there are customers who say that they do not yet know what they will do.

If, according to the characteristics I have mentioned above, we identify that a company is a shell company, we will have to close the accounts. If you do not know what your customer does, the level of tolerance to it is zero. Therefore, I cannot now tell you the exact figure. For instance, I cannot say that we will close the accounts of 11% of the customers who, at the end of the last year, met at least one sign of a shell company since this does not mean that these two signs are characteristic of these customers. At the same time, we carry out stress tests in the event if we will have to close the accounts of all 11% of the customers. In reality, this should not happen but we will be ready for this.

Is there excitement among the customers who will not be affected?

In fact, I would like to talk about the customers who are classified as low-risk and just get this exciting information from newspapers. Baltic International Bank has been working for 25 years, and we have customers to whom we have been providing our services for 20-25 years. Regulations and standards have changed at all times so the customers are already accustomed to change. In addition, most of the customers are also the customers of other banks. For them, the disclosure requirements are not unexpected.

Lately, we have been getting a lot of phone calls from our customers – both because of what they have read about the situation with ABLV Bank and about other events in Latvia. When the officials first reported on the need to reduce non-resident business to 5%, our customers from Estonia, Great Britain and the holders of deposits from Germany called us. People are calling, people are worried about what will happen next. This is very dangerous for the banking business. Over time, we could hear more accurate rhetoric from the government officials. Nevertheless, our work now is to clarify the situation also to the customers who should not worry at all. Unfortunately, people are worried about what is happening in the Latvian financial sector. All in all, during one week there were daily negative headlines about Latvia in the Financial Times. Of course, all kinds of consultants warn all our international customers that their funds are located in the risk area and they should pay attention to it. This causes customer anxiety. At the same time, I would like to say that customers who do not have cause for concern do not leave our bank.

Does this mean that in this crisis situation the actions of state officials were inadequate or incorrect?

We will be able to give a proper assessment of everything only afterwards. I believe that the time to assess the consequences has not yet come because the situation keeps developing. Rhetoric has changed and acquired a more constructive form. Of course, it is difficult to name what we heard at the beginning a well managed crisis communication. But I am inclined to believe that people want to get to the bottom of the matter, to understand what we are fighting with. Can money be laundered? Of course, not! Can laws be violated? Of course, not! Therefore, I do not want to see someone coming out and confessing that the Latvian financial sector has been doing something like that for 25 years. This is a matter of self-esteem! Communication is now well established. However, it is necessary to be able to act so as not to question ourselves and everything that was done before.

We live in Europe where the freedom of movement of people and the freedom of movement of capital are two of the four fundamental freedoms. We have customers in many countries, and they all read the Financial Times. The ability to manage a crisis situation without simultaneously questioning the entire industry is worthy of respect. This should be the goal. For instance, the balance of Baltic International Bank is 300 million euro. This is a big business but a small bank. Therefore, it is very difficult to manage any abrupt changes. Because of one headline, people may have to work overtime for several months.

What are your forecasts? Can part of the customers who are not categorised as problematic leave the Latvian banking system because of the widespread concern caused?

Statistics show that there are customers leaving the Latvian banks. It is still difficult to say how many of them are those whose backs we would be glad to see and how many of those whom we would like to keep. However, we see that money is being transferred away.

Transferred where?

Both to the countries of the European Economic Area and beyond it.

To Cyprus?

Also to Austria, Liechtenstein, Switzerland, and Cyprus.

That is, to all countries not part of the European area?

To different countries, actually. There are also those who transfer money to Switzerland, Luxembourg, and Singapore where there is a very serious customer assessment system. Therefore, we can say that the low-risk and medium-risk customers transfer money to these countries.

Consequently, if you asked whether customers will be leaving the Latvian financial system, the answer would be 'yes, they will'. Although I do not believe that this will be an irreparable loss. Nevertheless, we will have to work hard to convince the low-risk or medium-risk customers not to leave the Latvian banking system.

In terms of the crisis situation management mentioned above, it always happens that a crisis reveals things that were not done before its onset. For instance, the lack of a common strategy in the sector. Ten the so-called non-resident banks did not appear in Latvia just yesterday. If there were a common strategy which we are striving for in the financial sector, we could talk about it in a crisis situation. This only indicates that the industry development strategy should be both in the financial sector and the national economy in general. It may help overcome the next crisis situation.

How do you see the future of ten banks that serve non-resident business in Latvia? Will everyone survive the current situation?

As a responsible banker, I will not make any forecasts. I can only talk about Baltic International Bank. What is happening now, in terms of scale, is an unprecedented case – this applies both to ABLV Bank and to what happened next. One thing is clear: the amount of deposits and the size of assets in the Latvian banking sector will decrease. Paper does not refuse ink, but at the same time in several banks there are people losing their jobs

because the amount of work is reduced virtually in all processes of these banks. At the time when we will be able to say that the situation has been overcome, the industry will certainly look different. How exactly, I do not want to predict.

In terms of Baltic International Bank, in the recent years we have already passed through a very complicated process of change. We believe that managing assets and creating added value for our customers is a niche that we would like to occupy. At the same time, we have customers ready to assume credit risk – not to buy property but participate in a transaction that credits the purchase of property. We are developing this kind of services. We have also credited the purchase of property in the UK; we have partners, infrastructure there. Baltic International Bank has developed the strategy until 2030 part of which was the joining of the bank's team by me and other colleagues. Certainly, the events that took place during the last few weeks have caused additional stress but we keep the path.

Have you submitted the business strategy requested by the regulator?

We presented our vision to the regulator, and communicate with it on the regular basis. We have not received the final assessment yet. I believe that we succeed in negotiating constructively, and this is precisely because much of what we now include in the plan has long been envisaged and implemented since the beginning of 2016. Thus, we are only talking about the degree, speed, and form since the content already exists. Well, for instance, we received the regulator's permission to work on the organisation of corporate bond issues in which only specific restrictions were imposed on customers. We already had all of that was in our strategy.

Does it mean that in the near future you plan to issue additional bonds?

This will be in our asset management model. If any of our customers decides to lend his or her money to someone instead of keeping them on deposit, it would be possible to do that by using corporate bonds as a tool. Thus, the borrower will not borrow from us; instead, we will be an agent which will evaluate this enterprise and lend funds together with any investor by virtue of issuing bonds. This was already included in our banking license but the bank has never done this before. Now, the regulator has agreed to clarify this point in our license, and it will become possible in the future. I will not hide that the regulator has also put forward its own conditions regarding the fact that we are only talking about the Latvian or Baltic issuers. In addition, this is not the condition of the regulator alone. We also do not see that the bond issue organization would be our business in which one Russian company issues bonds and the other Russian company buys them. At present, we already have a list of Latvian enterprises which, in our opinion, could borrow in such a manner on more favourable terms. We will help enterprises to issue bonds, and potential investors – to find the best investment opportunities.

How much are the companies interested in this?

We are a small bank and a small team – we do not need 1,000 issues to make this business interesting for us. But I will say that the interest in the level of our ambitions is very high. Quite definitely, this market as such is rather small, and bank loans will always be the basis of mobilisation of financial resources. If a person needs money for business, the first thing that comes to his or her head is a loan. In turn, the issue of bonds already requires a certain amount, and there are amounts below which it is senseless to even think about that. However, if we are talking about the mobilisation of financial resources in the amount exceeding five million euro, then, under certain conditions, bond issue may prove to be a more convenient or even cheaper instrument. There are also a number of companies whose business consists of placement of funds.

Within what period can you reorient from the previous business model of the bank to a new one and return the former volumes of activity?

There is no unambiguous answer about what we consider the former volume. We are also focused, for instance, on the bond business. Therefore, our goal is to prove to customers that in asset management we are as capable (if not even more capable) as those already offering this service to them. In the asset management business, there are rarely customers hearing about this service for the first time in their life. That is why, the main struggle is to prove that we are able to render this service very well.

How do you make them interested?

We have always been a niche bank. Last year, we were joined by the people from Swedbank, SEB Bank, Rietumu Bank and other companies. We create a team that can serve customers as good as in Zurich. We really believe that there are specialists in the Latvian financial industry who are able to meet the customer's requirements much better and faster than in many places in old Europe. For instance, we have recently discussed why one of our London customers is with us rather than with some other bank. The reason is that within two months we are able to do what HSBC does within six months. Having lost this ability, we will be out of this business. If customers are interested in speed, we must be able to ensure it. Our advantage is that we are a small and compact organisation able to make quick decisions. We belong to private shareholders and we do not need to build investor relationships on the stock exchange.

Does it not scare you that in future the recent events in the Latvian financial industry could become a big stumbling block in the finding of new customers? For instance, you turn to a potential customer in Sweden, and its chief opens Google and the first thing he or she finds there is that there are hardly flattering articles in the Financial Times. Why should he or she be motivated to cooperate with the Latvian bank?

We have already talked about the fact that a crisis situation reveals the things that had not been done before its onset. This is a similar question. It is quite evident that up to 2016 the strategy of public relations of Baltic International Bank was to not particularly spread outward, not to be advertised. However, if someone comes out and declares loudly that 'You are doing this wrong!', it would be very difficult to refute it publicly, especially if no one knew much about you before that. So, now we have become more open and we want to be more open. We'd better make mistakes than not talk about ourselves as a result of which wrong conclusions will be made about us.

Therefore, yes, today Google already is a stumbling block which must be overcome. In addition, everything is interconnected in the financial industry. It is very likely that someone reading the Financial Times or other information that can be googled will decide that this time is not the right time for cooperation regardless of the fact that the offer of the Latvian bank will be better and cheaper than that of its current financial service provider. This is a problem that everyone should work on.

At present, a lot is talked about the so-called non-resident banks. How have the problems affected the Latvian financial system in general, and also Swedbank, SEB Bank or Citadele?

Everything is interconnected. This is how the world financial system works.

I'm pretty well versed in the model of Swedish banks and what one would expect from Stockholm. A good thing is that Standard and Poor's and Moody's said they maintained the previous credit ratings. Otherwise, it could be a black day for Stockholm. The Baltic banks are part of their business. And this part is not so small to be ignored. In addition, all banks with foreign capital represented in Latvia, except for Citadele, are listed on the stock exchange. The events around their most important subsidiary banks are monitored on all major exchanges. In this plane, this undoubtedly worries all banks.

If we talk about Latvia, all these banks have a rather wide circle of customers. What would happen if, under the influence of all these problems, the people of Latvia lined up at ATMs with their payment cards?

By this I want to say that in our world everything is interconnected. That is why, all this has an indirect impact on these banks to the very least.

Baltic International Bank decided to increase its capital by six million euro. When will this happen given that some time has already passed?

Last year, the bank operated at a loss. We refused to transfer money of risky customers which led to a significant reduction in commission fees. In turn, revenue from the services by which we want to replace them is not so great yet. We also make additional savings.

The decision to increase capital is based on two considerations. First of all, it is necessary to ensure that the bank is well capitalised to meet the tasks set by us. Secondly, if you operate at a loss, you need to increase your capital. The decision was therefore made, whereas payments towards the increase in the capital are made gradually. Once the latest circumstances will have been assessed and the auditors will have confirmed the report for the previous year, the capital will be increased.

Are there any changes in the composition of shareholders planned?

No, there are not.

LETA, 12.04.2018, Anete Skurbe, Inguna Ukenābele