May 26, 2005

Mr. William Fox
Director
Financial Crimes Enforcement Network
PO Box 39
Vienna, Va. 22183

Submitted via E-mail: regcomments@fincen.treas.gov

Re: Notice of proposed rulemaking -- Financial Crimes Enforcement Network (FinCEN), Treasury—RIN 1506-AA82

Dear Director Fox:

VEF Banka (VEF) submits these comments in response to the Notice of Proposed Rulemaking (NPRM) to supplement the April 28, 2005 comments submitted on our behalf by Steven Rubin of the Law Offices of Breschel & Rubin, LLP and Dennis Foreman of Dudinsky & Associates.

At the outset, we again state our strong objection to the process being followed by FinCEN in this matter. The United States Treasury Department (U.S. Treasury) and FinCEN must have known that severe harm would be inflicted on VEF's reputation as a result of the simple publication of the allegations contained in the NPRM. Nevertheless, neither the U.S. Treasury nor FinCEN ever contacted VEF in any way prior to the issuance of the NPRM. In fact, **VEF learned about the NPRM by reading press reports.** No questions or concerns were posed to VEF, and VEF had no opportunity to address any perceived problems prior to the NPRM. This is not only arbitrary and capricious, but is counterproductive to the intent of the Patriot Act to encourage cooperation from financial institutions to counter money laundering and other improper activities.

We can only conclude that the action was intended to be punitive because it was undertaken in a manner designed to inflict maximum harm on VEF. This impression is reinforced because VEF's attempts to open a dialogue with FinCEN since the issuance of the NPRM have been rebuffed. Instead, VEF's letter of April 28 and subsequent meetings between VEF representatives and FinCEN have been more in the nature of monologues where VEF has made presentations and received little or no response from FinCEN. Moreover, FinCEN has made clear that all of these communications must be regarded as public and has not offered VEF the opportunity to clear up any factual misunderstandings that must, of necessity, require disclosure of financial information that

must be kept confidential under both Latvian and U.S. law.[1] Had FinCEN contacted VEF directly or through its Latvian counterpart before taking this drastic action, these misunderstandings could have been resolved and corrective action taken. Furthermore, FinCEN could possibly have obtained useful information and collateral damage to VEF could have been limited. Sadly, FinCEN appears to have chosen a course designed to destroy VEF before giving it any real opportunity to be heard. Nevertheless, in an effort to preserve its business and the reputations of VEF, its officers and employees, VEF offers the following additional comments.

VEF's record of cooperation with anti-money laundering efforts

VEF has an outstanding record of complying with both US and Latvian authorities in taking action against suspicious or illegal activities. Several examples of past VEF actions are illustrative:[2]

- In March 2002, VEF received a fax from a U.S. bank about an attempt to transfer US$599,614.82 onto payment cards of VEF accounts belonging to two British citizens. According to the U.S. bank, these actions constituted fraud. VEF blocked the cards of these two persons, as well as the account of another British person who was connected to them. The Latvian banking authorities were notified of these actions.

- In August 2003, a VEF account belonging to a Romanian citizen received funds from persons from other countries as payment for various products obtained on the internet website www.escrowexperts.com. After conducting an investigation, VEF determined that the activity of the client showed indicia of fraud. The received sums were not accepted by VEF and were returned with appropriate comments. This action prevented the theft of about US$60,000. Following this action, VEF received numerous letters of gratitude from people who would otherwise have been victims of this fraud.

- Twice, once in December 2004 and once in February 2005, the Kontroles Dienests, Noziedzîgi Iegûto Lîdzeklu Legalizâcijas Novêrđanas Dienests (KD),[3] the Latvian Financial Intelligence Unit (FIU), was sent information

[1] FinCEN's position is hard to understand. The Administrative Procedure Act's prohibition on ex parte communications does not apply to informal, "notice and comment" rulemaking. An agency is allowed to engage in informal, off the record discussions with the affected person or party so long as no prejudice results. *See* Bender, Administrative Law, vol. 3 section 15.06[2] (2004); *see also Western Union Int'l, Inc. v. FCC*, 568 F.2d 1012, 1019 (2d Cir. 1977), *cert denied*, 436 U.S. 944 (1978); *Southwest Sunsites, Inc. v. FTC*, 785 F.2d 1431, 1437 (9th Cir. 1986). It is hard to see how anyone would be prejudiced by permitting off the record discussions of confidential account information when those discussions are necessary to resolve issues and misunderstandings.

[2] In accordance with Latvian law, the bank cannot publicly disclose the names of accountholders. Of course, VEF would be pleased to provide these identities to the U.S. government through appropriate Latvian banking authorities in accordance with Latvian Law.

[3] Control Service - Office for Prevention of Laundering of Proceeds Derived from Criminal Activity.

about a Belizean company. The company was a VEF client that, in the period from May 28, 2004 through February 15, 2005 deposited US$1,481,627.00 in cash into its account. The funds were later transferred to other nonresident companies. Based upon its own review of the account, VEF closed the account in February 2005.

- In January 2005, VEF received several requests from other banks demanding a return of money transferred from their clients into the accounts of a VEF accountholder that was a Panamanian company. After analyzing the account, VEF concluded that the company was involved in deals that were not completely transparent. On January 20, 2005, VEF blocked the company's account, and froze US$25,411.29. VEF sent appropriate notification to the KD. On March 18, 2005, VEF received a letter from the KD that stated that the KD "[did] not find proof of the existence of criminal activity."

- On March 19, 2004, VEF received a KD order that stated that in September 2003 certain unnamed persons copied the information of clients of a British bank. These persons, using the information and the internet passwords of the bank, stole assets from accounts of clients, which were then transferred through Western Union to an Estonian company, and from there to the VEF accounts of three British Virgin Island companies. The KD ordered that these accounts be blocked and requested information about the business activity and monetary flow of the clients. As soon as VEF received this order, VEF froze the accounts with funds of €10,045.04 and US$141,361.77. At the request of VEF, lawyers representing the three British Virgin Island companies provided documentation relating to the funds. These documents and all of the bank's information on the companies' accounts were provided to the KD. Under Latvian law,[4] a bank can only freeze an account on its own initiative for 45 days; after that time, the account can only remain frozen under orders from the KD. In this case, at the end of the 45-day period no further orders concerning the freezing of these accounts were received from the KD, and VEF was forced to reinstate the accounts of these companies. Nevertheless, VEF decided on its own to close the accounts of these suspicious companies.

- Since the implementation of the anti-money laundering law in the Latvian Republic on January 6, 1998, VEF has sent 125 reports of suspicious and unusual transactions to the KD. Thirty-six of these reports concerned nonresidents. These reports were filed annually as follows:

  1998—11(4 nonresidents)
  1999—47(11 nonresidents)

[4] Article 17 of the "Law Concerning the Prevention of Legalization of Items Received by Criminal Means."

2000—24(6 nonresidents)
2001—5(2 nonresidents)
2002—14(6 nonresidents)
2003—4 (1 nonresident)
2004—8(2 nonresidents)
2005—12(4 nonresidents)

It is important to recognize that all of the actions enumerated above, among others, were taken by VEF **before** the NPRM was issued. [5]

Present voluntary cooperation with the U.S. Government

On May 5, 2005, VEF received direct notice from the U.S. Securities and Exchange Commission (SEC) that a Temporary Restraining Order had been issued in an SEC case involving a VEF accountholder. VEF immediately and voluntarily took action to freeze the account, asking only that the SEC communicate with VEF through appropriate U.S. and Latvian banking authorities as soon as possible. VEF instructed its Washington representatives to communicate to the SEC its willingness to cooperate with U.S. authorities, but explained its inability under Latvian law to freeze the account for more than 45 days. On May 16, 2005, a letter from the SEC thanked VEF for its cooperation and gave notice about a Preliminary Injunction issued in the same case.

We want to stress that VEF has, on every occasion, reacted affirmatively and immediately to each issue of concern raised by Latvian and U.S. officials. As described in the examples above, VEF also has initiated action on its own, when appropriate and has always met the requirements of Latvian and E.U. law. Indeed, despite the NPRM, neither Latvian nor E.U. officials have initiated any action against VEF.

VEF anti-money laundering procedures

The NPRM raises questions about VEF's procedures to verify the nature of the business of its account holders. Because FinCEN did not ask VEF for any of this information **before** issuing the NPRM, FinCEN failed to comprehend the seriousness with which VEF takes its responsibilities. Despite that, and in an effort to provide both Latvian and U.S. authorities with the greatest possible assurances of its good faith, VEF has undertaken a comprehensive overhaul of its anti-money laundering program, even replacing some of its officers and employees who were responsible for the program. These measures are more fully set out in my May 23, 2005 letter to FinCEN and its attachments,[6] but are summarized here for convenience:

- VEF requires new account holders to state their occupation and describe their business. VEF then verifies the authenticity of documents provided *by the client and analyzes the declared beneficiary of the company*

[5] With the exception of some of the 2005 SAR reports.

[6] The attachments are translations from the Latvian language. We can provide certified translations if needed.

(whether the person named is the identified and true benefactor). VEF then performs diligence regarding the client, including information obtained from the internet, the occupation of the client and the business of its partners to whom the client most often transfers money.

- Available documents (contracts, accounts, etc.) are verified for compliance with the transactions that the client has completed. If any transaction that is completed by a client is incomprehensible or suspicious, which means it does not correspond to the occupation of the client, the client is assigned a "high risk status." The client is then requested to provide additional documents that explain or confirm the transactions. A VEF department manager or employee completes the inquiry over the phone, by the internet, e-mail or post. Transactions by clients with "high risk status" are monitored every day. In the bank's operating system, "WALL," clients with "high risk status" have a special coding which allows the bank to monitor the client's transactions at all times. If the transaction does not correspond to the occupation of the client identified by the bank, the transaction is either blocked or cancelled.

- If the client does not provide VEF with the required documents and explanations, the account is frozen until such information is provided.

- If the occupation of the client is suspicious or the client is intentionally concealing his occupation and this is revealed, a report is sent to the board member responsible for Anti-Money Laundering stating that the client's occupation is questionable and that the bank should take appropriate action, such as reporting the suspicious activity to Latvian authorities and terminating all business with the client.

- VEF has a file for every client of VEF that contains all the documents that VEF has received, including, but not limited to, a description of the client's business, debit and credit cards, a copy of the client's passport, other documents that are required by VEF, an analysis of the client's occupation, printouts of information from relevant internet sites, and the business of the client's partners.

Allegations in the NPRM

As noted in the comments submitted on April 22, most of the "facts" underlying FinCEN's money laundering concerns in the NPRM do not involve VEF. Instead, they characterize U.S. concerns about the Latvian financial system in general.[7] Since the United States has chosen not to designate Latvia as a jurisdiction of primary money laundering concern under 31 U.S.C § 5318A, we question why these allegations are

[7] We note and endorse the separate comments submitted to FinCEN by the Latvian regulatory authorities that take issue with a number of statements in the NPRM.

relevant to an action directed at a specific institution other than to bolster an otherwise weak case.

The following is a summary of the case FinCEN attempts to make against VEF. After briefly describing VEF and its business, the NPRM makes the following statements in two short paragraphs:[8]

> *VEF offers confidential banking services for non-Latvian customers. In fact, VEF's Web site advertises, "VEF Banka guarantees keeping in secret customer information (information about customer's operations, account balance and other bank operations). It guarantees not revealing this information to third person except the cases, when the customer has agreed that the information can be revealed or when it is demanded by the legislation of the Republic of Latvia."*

All banks offer their customers confidential services; it is the essence of financial privacy. What is wrong with the statement on VEF's website? It correctly states Latvian law (which is consistent in this regard with U.S. law) that VEF will only reveal a customer's financial information when authorized by the customer or as required by law. Surely, FinCEN is not suggesting that there is anything wrong with this practice.

> *Another section of VEF's Web site lists documents (from countries frequently associated with money laundering activities) that are required to open a VEF corporate bank account.*

VEF's web site does not have such a list of documents. At one time, it provided a list of documents that could be used to open an account, but that list did not refer to documents from any specific country. In an effort to attract business, VEF contracted with various agents to advertise VEF on other web sites, and some of these sites offered services to establish businesses and accounts and may have referred to a specific country's documents. VEF terminated all of these relationships earlier this year.

> *According to the bank's financial statements, a large portion of the bank's deposits comes from private companies.*

While this may be true, VEF is unaware of any guidance that suggests that this is an indication of money laundering.

> *Less than 20 percent of these deposits are from individuals or companies located in Latvia. A large number of foreign depositors or a large percentage of assets in foreign funds are both indicators that a bank may be used to launder money.*

This too is correct, but omits the fact also found in VEF's financial statements that on December 31, 2004, 68.96% of VEF's account holders were Latvian residents. As of

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[8] 70 Fed. Reg. 21370-71 (April 26, 2005).

May 15, 2005, 91.8% of the account holders were resident in Latvia. It also fails to take into account the historic development of the Latvian financial system and those of its Baltic neighbors. Only 14 years ago, Latvia was a part of the highly centralized economy of the Soviet Union. Even today, many of the Latvia's economic ties remain strong with other parts of the former U.S.S.R. Because the Baltic states offer relatively stable banking services and because many Baltic bankers speak Russian and understand the business practices of companies in the former Soviet Union, many businesses in the region prefer to deposit their funds in Baltic banks for wholly legitimate reasons. Latvia is particularly attractive because it has had a remarkably stable currency. Most, if not all Baltic banks have a very high proportion of foreign deposits. VEF is not unusual in this regard and has by no means the highest proportion of non-resident deposits. Indeed, VEF is aware of at least two other Latvian banks that have non-resident deposits amounting to well-over 90% of their total deposits. While such a high proportion of non-resident deposits might be an indicator of money laundering in some jurisdictions, we question its blanket application to the Baltic States in the absence of any in-depth analysis of the development of these still young financial systems and the nature of the depositors themselves.

> *Additionally, approximately 75 percent of the bank's fee income and commissions are generated from payment cards and money transfers, both incoming and outgoing, from correspondent banks.*

Given the nature of Baltic banking as explained in the preceding paragraph, it should not surprise anyone that banks in this region obtain a significantly higher proportion of their fees from funds transfers than might be the case with their U.S. counterparts. While such a factor might give FinCEN a reason to ask VEF for further explanation, it surely does not justify issuing the highly damaging NPRM without first communicating concerns to VEF.

> *The bank's dealings with foreign shell companies, provision of confidential banking services, and lack of controls and procedures adequate to the risks involved, make VEF vulnerable to money laundering and other financial crimes. As a result of the significant number of credit and debit transactions involving entities that appear to be shell corporations banking at VEF, some U.S. financial institutions have already closed correspondent relationships with VEF.*

As previously noted, VEF has continually strengthened its anti-money laundering program and believes that if FinCEN were to visit VEF it would be very favorably impressed with the controls in place. VEF acknowledges that it has dealt with shell companies in the past, although it has taken steps to severely limit or eliminate such dealings. It notes, however, that shell companies can and often are established for legitimate purposes in many jurisdictions, including the United States. In this regard, the FinCEN rule is confusing because it seems to equate "shell companies" with "shell banks." VEF recognizes that shell banks have long been viewed as highly vulnerable to money laundering activity and VEF does not knowingly do business with shell banks.

Finally, no U.S. bank has closed its correspondent relationship with VEF because of VEF's business with shell companies. Prior to the issuance of the NPRM, only one U.S. bank had ever closed a correspondent account with VEF and that was the Bank of New York. It is our understanding that the account was closed as part of a broad reduction of correspondent relationships resulting from the Bank of New York's own difficulties with U.S. anti-money laundering authorities.

Elsewhere in the NPRM,[9] FinCEN sets out the following more specific, yet still vague, allegations concerning VEF:

> *VEF is being used to facilitate or promote money laundering and other financial crimes. Proceeds of illicit activity have been transferred by shell companies with no apparent legitimate business purpose to or through correspondent accounts held by VEF at U.S. financial institutions. As already stated, criminals frequently use shell companies to launder the proceeds of their crimes. A significant number of companies, organized in various countries including the United States, have used accounts at VEF to move millions of U.S. dollars around the world.*

There is no way to know what this allegation refers to. Earlier, we relayed a number of specific instances in which VEF took action on suspicious accounts. Below, we respond to additional allegations. It is the type of innuendo reflected by this language in the NPRM that is so disturbing. If FinCEN has specific facts, it should set them out and not make such sweeping statements. If, as we suspect, it thinks it has information that it cannot disclose publicly, that is all the more reason to have raised its concerns earlier in a confidential manner through the well-established channels of communication from one FIU to another.

> *In a four-month period, VEF initiated or accepted on behalf of a single shell corporation over 300 wire transfers totaling more than $26 million, involving such countries as the United Arab Emirates, Kuwait, Russia, India, and China.*

To the extent that VEF has been able to identify these transactions from the descriptions presented, it continues to believe that these are related to a legitimate business customer of VEF. It will, of course, gladly respond to specific requests for information submitted by the U.S. through the appropriate Latvian authorities.

> *In addition, for a two-year period, VEF transferred over $200 million on behalf of two highly suspect corporate accountholders, which is a substantial amount of wire activity for VEF's size.*

This description appears to relate to the SEC investigation in which VEF has been fully cooperative. If our assumption is correct, we note that substantial portions of the U.S.

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[9] 70 Fed. Reg. 21371-72 (April 26, 2005).

banking system also seem to have been abused in this fraudulent scheme. It is unclear to us what, if any, actions have been taken against similarly situated U.S. institutions.

> *Many of the private shell companies holding accounts at VEF lack proper documentation of ownership, annual reports, and the reason for the business transactions, while other companies had no listed telephone numbers.*

As noted above, VEF has held accounts for shell corporations but has been engaged in an aggressive program of weeding out companies that appear to have no legitimate business. Several examples of VEF's actions to close the accounts of such businesses are set forth earlier in this letter.

> *Several accountholders at VEF have repeatedly engaged in a pattern of activity indicative of money laundering.*

As expressed in our April 28 comments, we continue to have serious concerns with the vagueness of an allegation such as this. If it refers to anything beyond those transactions mentioned in the NPRM, VEF has no way of rebutting it.

> *[S]everal VEF accountholders are linked to an international Internet crime organization that has been indicted in federal court for electronic theft of personal identifying information, credit card and debit card fraud, and the production and sale of false identification documents. The defendants and their co-conspirators commonly sent and received payment for illicit merchandise and services via money transfers or digital currency services such as "E-Gold" or "Web Money" transfers. As discussed below, Web Money purportedly holds an account at VEF.*

We remain uncertain about this allegation. It could refer to one of the matters discussed above where VEF has already cooperated fully with Latvian authorities. We note that the allegation refers to "several VEF accountholders," but that in referring to the specific transactions is oddly silent on whether the "commonly sent payments" were actually sent to VEF. Finally, it is odd that FinCEN should state, "Web Money purportedly holds an account at VEF" (emphasis added). That is yet another fact that could easily have been verified confidentially through a properly formulated inquiry to Latvian authorities and VEF. In this public proceeding, however, VEF is precluded from disclosing any information about any such account.

> *One reason that Internet financial crime groups are interested in opening accounts at VEF is that the "Visa Electron" card associated with a VEF account has no limit on the amount of money that can be withdrawn from an ATM. The ability to make limitless ATM withdrawals is an essential component to the execution of large financial fraud schemes typically associated with carding networks.*

Again, FinCEN could have cleared up this concern simply by communicating with VEF. In fact, as explained in our April 28 comment, VEF bank cards have strict limits on the amount that can be withdrawn in a given period. Under Latvian law the limit is US$80,000 per month. VEF imposed a lower limit of US$60,000 per month, which it has recently lowered to US$15,000 per month. Moreover, in reviewing its records, the largest ATM withdrawal in one month was US$31,000. Unfortunately, FinCEN has again relied on unverified rumor. VEF reiterates its willingness to cooperate with FinCEN on credit card and other issues.

> *In addition, the U.S. government has reason to believe that individuals who wish to obtain a Web Money Card will be issued a card linked to a sub-account from Web Money Card's main account at VEF.*

VEF is hampered in its ability to address this claim because it cannot publicly disclose particular entities' accounts at VEF and because it does not understand the allegation.

> *Criminals who have applied for, obtained, and used Web Money Cards claim that VEF requires a notarized copy of a photo identification document to open an account. The legitimacy of these documents and the notary stamp, however, are reportedly never verified by VEF. Given the level of sophistication of many of these criminals, obtaining high-quality fraudulent identification documents, including a fraudulent notary's stamp, is not a difficult task.*

This, too, is a difficult allegation to rebut because it is vague. FinCEN is apparently relying on criminals to smear VEF, but provides no clue as to who these criminals might be or why it finds their statements credible. While it is true that, like all Latvian and many other financial institutions, VEF has accepted notarized copies of identification documents it was unaware that this was not a normal business practice. It is unclear why FinCEN would think that it never verifies such documents. Obviously, if VEF had reason to suspect forgery or falsification it would, like any other bank, make appropriate inquiries before accepting the identification as legitimate. Again, this concern also could easily have been resolved through an appropriate communication before the NPRM was issued.

> *Through Web Money's accounts at VEF, these online criminal groups have used VEF.*

What can be said about such a conclusory and accusatory statement? We cannot discuss publicly anything about a Web Money account at VEF and, as far as it is aware of any suspicious activity, VEF has taken appropriate actions, some of which are detailed above, to deal with them.

Conclusion

VEF has a proud heritage and, until issuance of the NPRM, a well-earned reputation of integrity. Descended from what in the United States would be regarded as an employee "credit union" of a Soviet-era appliance manufacturer, VEF was one of the first commercial banks licensed by the Latvian government in 1992. For several years following the reestablishment of Latvian independence, the government deposited the nation's gold reserves with VEF,[10] in further recognition of VEF's reputation for honesty. Just last year, the business magazine "Biznes & Baltija" rated VEF as one of the best banks in the region. All of this has now been placed in jeopardy by the NPRM.

Given its history and its strong record of compliance and cooperation with Latvian anti-money laundering initiatives, the many problems with FinCEN's allegations about VEF, and the lack of any contact by the U.S. government with VEF prior to the issuance of the NPRM, VEF remains puzzled by the proposed rule.

Nevertheless, VEF reiterates its desire to cooperate with U.S. authorities, in accordance with the laws of Latvia and the European Union. VEF wants to be an example to other financial institutions in Latvia in tightening its procedures and working with and encouraging the Latvian government to enact new legislation to fight money laundering and the illicit activities that stem from it. To this end, VEF invites officials from the U.S. Treasury Department to travel to Riga as soon as possible to meet directly with VEF officials to discuss improved procedures and cooperation.

VEF believes that it is in the interest of both the U.S. and Latvian governments to encourage cooperation by banks such as VEF, rather than punish them by issuing NPRMs that are based on inaccurate, incomplete or false information.

In the same press release announcing the NPRM, Treasury announced that the advisory against Ukraine had been "lifted after Ukrainian authorities took subsequent and aggressive steps to address the concerns and risks identified in the 311 action." If this is the Treasury standard, then I believe VEF has met or even exceeded it. If Treasury does not yet agree, I pledge my continued personal involvement in meetings and discussions with Treasury officials in Riga or Washington to agree upon needed changes. I urge Treasury to withdraw its proposed rule as quickly as possible to minimize any further harm it may cause.

Sincerely,

Aleksejs Durandins
Chairman of the Supervisory Council
Of the JSC "VEF Banka"

[10] The Latvian gold reserves were returned to Latvia in 1992 from France where they had been held throughout the period of Soviet occupation.