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Comparative analysis of the national law of Latvia and Germany in regard to AML/CTF: a threat of reputational risks as a driver of strengthening of control over the financial sector

BACHELOR THESIS

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DECLARATION OF HONOUR:
I declare that this thesis is my own work, and that all references to, or quotations from, the work of others are fully and correctly cited.

……/Anna Mežale/

RIGA, 2021

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Abstract

The thesis aims to analyse the nature of differences between the national law of Latvia and Germany in regard to anti-money laundering with respect to the financial sector, as well as the correlation between current national law and the development of the anti-money laundering and counter-terrorism financing systems of Latvia in Germany with profiles of both countries by using a qualitative comparative interdisciplinary method. As such, to provide an analysis of the national law of Latvia and Germany, three particularly important aspects of the anti-money laundering system in regard to the financial sector have been selected – risk-based approach, identification and criminalization. To achieve this aim, an analysis of the concepts at international and European Union is provided, as well as the current national law of Latvia in Germany in regard to these concepts. To determine a link between the current national law and the development of anti-money laundering systems of both countries, an analysis of profiles of both countries and events surrounding the development of anti-money systems of both countries are analysed, where the author reaches the conclusion, that existing differences between Latvian and German law are present in connection to the most vulnerable fields of the financial sectors of both countries.

Keywords: AML, financial sector, Latvia, Germany, risk-based approach, identification, criminalization.

Summary

Money laundering and terrorist financing have been and remain important issues today. If earlier the development of anti-laundering and counter-terrorist financed systems was desirable for the further development of the country, in particular, the financial sector of countries, today, their constant addressing and improvement of the anti-money laundering and counter-terrorism financing system is a necessity to maintain at least the current level of development of countries. A reactive approach to the problem no longer works, which leads to a constant strengthening of the system in order to avoid scandals that could have a negative impact on the country and impede its further development, as it can be seen, in particular, in the case of Germany and Latvia as analysed in this thesis.

The thesis "Comparative analysis of the national law of Latvia and Germany in regard to AML/CTF: a threat of reputational risks as a driver of strengthening of control over the financial sector" examines selected key anti-money laundering and counter-terrorism financing concepts – risk-based approach, identification and criminalization at the international, European Union and national level. The national level is presented by the legislation of Latvia and Germany. The thesis addresses differences existing between international and European Union law, as well as differences existing between the national law of Latvia and Germany.

The thesis consists of three Chapters that cover both theoretical and practical aspects of the topic. The work is based on the qualitative comparative interdisciplinary analysis.

The first Chapter provides an overview of the risk-based approach, identification and criminalization at the international and European Union level. The chapter is divided into three sub-chapters. The first sub-chapter addresses an overview of the development of world practice in relation to anti-money laundering and counter-terrorism financing as a whole, prominent international organizations and treaties that serve as the core of the international practice to address risks posed by money-laundering and terrorism financing, as well as issues related to the legislation. The second sub-chapter addresses the interplay between the European Union and international efforts in regard to anti-money laundering and counter-terrorism financing. In particular, the necessity, reasons and legal basis of the European Union to take action in the area are analysed. The third sub-chapter is divided into three parts. The first part analyses the EU competence in regard to anti-money laundering and counter-terrorism financing. In this regard, the obligations of the European Union as a legal person before other international organizations, obligations of the Member States before the European Union and other international organization, as well as legal basis of the European Union to legislate in the area analysed. The second part provides an outlook of the legal framework of the anti-money laundering and counter-terrorism financing system of the European Union. The third part addresses the development and current meaning of the key concepts of the anti-money laundering and counter-terrorism financing framework of the European Union, which consists of the risk-based approach, identification and criminalization.

The second Chapter provides an analysis of the current minimum requirements set in the national law of Latvia and Germany of key elements important for the financial sector of the risk-based approach, identification and criminalization. In particular, the risk-based approach addresses risk-increasing and risk-decreasing factors, identification addresses general customer due diligence, simplified due diligence, enhanced due diligence, beneficial

owners and politically exposed persons, while criminalization mainly analyses the transposition of the latest anti-money laundering directive into the national laws of Latvia and Germany. To provide this analysis, mainly a grammatical method of legal interpretation is used while a number of different legal instruments of Latvia and Germany are analysed.

The third Chapter analyses profiles of anti-money laundering and counter-terrorism financing systems of Latvia and Germany in regard to the financial sector. The third chapter is divided into three sub-chapters. The first two sub-chapters provide analysis of Latvian and German risk profiles, competent authorities, development of the anti-money laundering and counter-terrorism financing systems, as well as their current anti-money laundering and counter-terrorism financing systems and regulatory framework. In particular, a number of money-laundering cases are illustrated together with the followed legal incentives in both countries. International and national reports are provided to identify the relationship of changes in the system with preceding event and cases. To analyse and assess changes in the system, different international rankings are used. The third sub-chapter provides an analysis of identified connection in Latvia and Germany between current anti-money laundering national law with development of the system and surrounding it events, its scale and reasons.

In conclusion, the answers to the initially asked questions are provided where a summary of the comparison of the minimum requirements in regard to key elements crucial for the financial sector of the risk-based approach, identification and criminalization set in the national law of Latvia and Germany is provided, as well the nature of their difference and reasons for it are provided based on the discoveries made throughout the research.

Table of Contents

INTRODUCTION

Money laundering (hereinafter referred to as the "ML") and terrorism financing (hereinafter referred to as the "TF") constitute a significant threat that endangers the international community as a whole and each country separately. While efforts to combat it were taken all around the globe for the past years, mainly under auspices of the various international organizations in order for the efforts to be a common action, nevertheless the risk present today remains high and constantly requires new legal actions to be taken. Despite all efforts and measures taken so far to combat risks posed by ML, new ML scandals continue to occur all around the world, affecting even countries with the most advanced anti-money laundering (hereinafter referred to as the "AML") and counter-terrorism financing (hereinafter referred as the "CTF") systems.

It becomes clear that a continuous improvement of AML/CTF laws is necessary for stable economic growth and market development. A poorly-developed AML/CTF system not only makes the country's market more vulnerable to organized crime but can also entail international sanctions, which ultimately can greatly complicate or impede not only the functioning of the market in the country, not only slow down the development of the economy but also, slows down the development of the country as a whole. A constant need of improving the AML/CTF system is not a recommended action, but inherently a must. Although in theory it is suggested that international law in relation to ML is soft law, nevertheless, the risks associated with non-compliance are often assessed so great that, in fact, compliance becomes a mandatory prerequisite for the further development of the country. As it was precisely noted by the Head of the Latvian Financial Intelligence Unit, Head of the Latvian delegation to Moneyval and FATF Ilze Znotina:

> The ability to establish an effective control and surveillance mechanism that prevents from exploiting financial system for criminal activity is the responsibility of every state. It is a matter of national reputation, self-respect and honour[1].

Given the complex nature of the legal order in regard to ML, however, due to the extensive part of the European legislation in the area of money laundering being in the form of directives that set only minimum requirements for the countries, member states can adopt stricter rules than those required at the European level. It means that despite the European Union (hereinafter referred to as the "EU") attempts to harmonize the law, Member States (hereinafter referred to as the "MS"s) however are not built the same and there is a possibility for comparison of the differences between MSs and potential reasons for this. In particular, as most of the ML scandals arise in the financial sector, any laws related to the regulation of the financial sector are especially important, while any changes in them can reflect the state of the country's financial market, its vulnerabilities and shortcomings.

[1] Daiga Holma, "Kariņš: The overhaul of Latvia's financial sector supervision has been a resounding success – we have re-established the reputation of our country and created a strong and robust anti money laundering system", *Cabinet of Ministers Republic of Latvia*, January 21, 2020. Available on: https://www.mk.gov.lv/en/article/karins-overhaul-latvias-financial-sector-supervision-has-been-resounding-success-we-have-re-established-reputation-our-country-and-created-strong-and-robust-anti-money-laundering-system. Accessed May 10, 2021.

Despite the advancement of German system in the fight against ML, the country is often at the center of international scandals in connection with ML. Recently, Latvian system has also been criticized for the poorly addressed risks inherent in Latvia's risk profile. As a consequence, both countries have begun to pay more and more attention to their system and are tightening the scope even more than is required at the European level. Thus, the analysis of these two countries and their practices, as well as the experiences surrounding these practices, is very essential in understanding the improvement of systems based on countries' risk profiles and their vulnerabilities.

Therefore, the aim of this work is to analyse AML/CTF national laws of Latvia and Germany to determine how they differ, the nature of differences following from development of AML/CTF systems of both countries and their correlation with profiles of both countries. To achieve this aim, the author selects risk-based approach, identification procedure and criminalization as essential elements of the AML/CTF system and analyses these concepts at different levels – international, European and national, as well as provides an overview of the development of German and Latvia AML/CTF systems in respect to the financial sector.

Methodology

This paper consists of three chapters. The author of this thesis uses qualitative comparative interdisciplinary analysis in order to determine the differences of national laws of Latvia and Germany and existence of the link between development of the AML/CTF systems of Latvia in Germany with profile of both countries.

In the first part of the work, the author uses both horizontal and vertical micro comparative method and deploys different methods of legal interpretation to analyse the correlation of international law and EU law in regard to AML, as well as sets a framework for further analysis of national laws between countries, where three key elements of the AML/CTF systems are analysed – risk based approach (hereinafter referred to as the "RBA") identification procedure and criminalization.

In the second part of the work, the author uses a horizontal micro legal comparison method by mainly resorting to the grammatical interpretation method to analyse the differences currently existing between German and Latvian national law.

To integrate into the topic an interdisciplinary approach, the third chapter is based on both vertical and horizontal micro comparative analysis where country profiles of Germany and Latvia are analysed with respect to the development of their AML/CTF systems, circumstances surrounding it and current AML/CTF framework.

To achieve the aim of the work, the author uses legal acts, cases, amendments to the law over time, reports issued by local and international authorities and international rankings. To justify the findings, the author uses such secondary sources as articles and interviews. Given the aim of the work, the author limits the work to the analysis of the key defining elements of RBA, identification procedure and criminalization of special importance for the financial sector.

Research Questions

1. How minimum requirements set in Latvian and German AML/CTF law differ?
2. What is the link between development of the AML/CTF systems of Latvia and Germany with their country profiles?

1 THE AML/CTF FRAMEWORK AT INTERNATIONAL AND EU LEVEL

Recently, the world community has begun to pay special attention to the problems of organized crime, including in relation to ML and TF. This not only demonstrates the recognition of the existence of the problem and its magnitude, but also suggests that collective action aimed at combating organized crime is necessary to effectively reduce risks and reduce the magnitude of consequences. Moreover, by action not only preventive measures are understood, but also punitive ones. This chapter therefore is devoted for describing and analysing development and general international approach to key concepts of AML/CTF, as well as the correlation of international law with the EU law.

1.1 A GLOBAL WAR AGAINST ML/TF

First international efforts to counter ML emerged back in 1989 in the G7 summit where фт inter-governmental body to combat ML/TF, the Financial Action Task Force (hereinafter referred to as the "FATF"), was established. The FATF was intended to help national authorities harness the intelligence value of financial transactions by declaring its "40 recommendations" known as "best practices" and "international standards". In 2001, following the terrorist attacks of September 11, the FATF expanded its mandate to deal with TF issues by creating the Eight (later expanded to Nine) Special Recommendations on TF. The FATF Recommendations received widespread acknowledgment by states and international organizations worldwide.

Nowadays, the FATF compromises 37 member jurisdictions and two regional organizations[2], ensuring by that a co-ordinated global response to combat ML, TF, and the proliferation financing (hereinafter referred to as the "PF"), and other related threats to the integrity of the international system[3]. While all countries cannot take identical measures to counter threats of ML/TF, the FATF Recommendations set merely a standard which countries should seek to implement through measures adapted to their particular circumstances. Despite the Standards are recognized as a soft law tool, its range and power however should not be underestimated. The FATF not only inspired already existed international organizations to join the fight against ML/TF, but led to the creation of new organizations.

In Europe, in 1997 the Council of Europe established a monitoring body nowadays known as the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (hereinafter referred to as the "Moneyval"), which task is assessing compliance with the international standards (FATF) to counter ML/TF, the effectiveness of their implementation, and making recommendations to national authorities in respect of necessary improvements to their systems. Similar actions to combat ML/TF threats were taken all around the world by creating regional FATF-style

[2] FATF. Members and Observers, available on: https://www.fatf-gafi.org/about/membersandobservers/. Accessed May 10, 2021.

[3] *e.g.*, corruption and tax evasion, *see* FATF. *International Standards On Combating Money Laundering and The Financing of Terrorism & Proliferation The FATF Recommendations*, updated October 2020. Available on: http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html. Accessed May 10, 2021.

bodies[4]. However, the existence of regional bodies did not prevent other international organizations and national authorities from establishing their own units to deal with ML/TF issues[5]. Despite a soft law nature of the international response to the ML/TF, few hard law tools were nevertheless adopted by the United Nations (hereinafter referred to as the "UN") such as the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances on 1988, the UN Convention against Corruption (hereinafter referred to as the "UNGAC"), also known as the Vienna Convention, and the U.N. Convention against Transnational Organized Crime (hereinafter referred to as the "UNGTOC"), also known as the Palermo Convention, as well as other regional and international conventions.

Despite a wide range of measures used to counter ML/TF, nowadays a current policy in this field is being criticized as ineffective[6]. However, scholar opinion on this matter is diverse – some call for a stronger action to be taken in this direction to achieve visible results[7], while others claim that even with the existed policy a normal course of business and functioning of the market is slowed down, hence a current policy should be rethought to become softer but yet efficient[8]. Along with economic considerations, however, legal, social and political issues are often used among scholars in analysing role and impact of AML/CTF policy[9]. Since the first international efforts against ML/TF were taken, a debate whether a modern liberal society shall sacrifice for the sake of a global war to reduce risks of ML/TF has been present.

1.2 THE INTERPLAY BETWEEN THE EU AND INTERNATIONAL EFFORTS IN REGARD TO AML/CTF

For the EU as an economic union, ML/TF risks are of special importance hindering the functioning of the market and economic development of the Union and its MSs. A first coordinated action at the Community level was introduced back in 1991 when Council Directive 91/308/EEC (hereinafter referred to as the "1AMLD") was introduced. At that time,

[4] The Caribbean Financial Action Task Force (CFATF) established in 1992, the Asia/Pacific Group on Money Laundering (APG) established in 1995, the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLGT) established in 1999, the Financial Action Task Force of Latin America (GAFILAT) established in 2000, the Inter-Governmental Action Group against Money Laundering in West Africa (GIABA) established in 2000, the Task Force on Money Laundering in Central Africa (GABAC) established in 2000, the Middle East and North Africa Financial Action Task Force (MENAFATF) established in 2004, the Eurasian Group on Combating Money Laundering and financing of terrorism established in 2004. *See supra* note 2.

[5] *e.g*., *inter alia*, efforts by the International Monetary Fund (IMF), World Bank (WB), Wolfsberg Group, The Basel Committee on Bank Supervision, and Egmont Group.

[6] *See* Ronald F. Pol, "Anti-money laundering: The world's least effective policy experiment? Together, we can fix it", *Policy Design and Practice*, Volume 3: pp. 73-94, December 1, 2018, accessed May 10, 2021, doi: 10.1080/25741292.2020.1725366.

[7] Fabian Maximilian Teichmann, "Money-laundering and terrorism-financing compliance – unsolved issues", *Journal of Money Laundering Control*, Volume 23, Issue 1: pp. 90-95, Bringley: Emerald Publishing Limited, 2020, accessed May 10, 2021, doi:10.1108/JMLC-02-2018-0014.

[8] Joras Ferwerda, "The Effectiveness of Anti-Money Laundering Policy: A Cost-Benefit Perspective", *The Palgrave Handbook of Criminal and Terrorism Financing Law*, edited by King C., Walker C., Gurulé J., pp. 317-344. London: Palgrave Macmillan, Cham, 2018, accessed May 10, 2021, doi:1007/978-3-319-64498-1_14. *See also* Cătălin Davidescu, "Preventing and Combating Money Laundering and the Finance of Terrorism. Possible Improvement Solutions", *Review of General Management*, Volume 28, Issue 2: pp.102-110. Bucharest, 2020. Available on EBSCO. Accessed May 10, 2021.

[9] *See* Leonardo Sergio Borlini and Francesco Montanaro, "The Evolution of the EU Law Against Criminal Finance: The 'Hardening' of FATF Standards within the EU", *Georgetown Journal of International Law, Bocconi Legal Studies Research Paper No. 3010099* (2017), accessed May 10, 2021, doi.org/10.2139/ssrn.3010099.

however, no direct reference to the international standards was provided. However, all adopted later AML Directives contained a direct reference to the 40 Recommendations of the FATF, introducing by that a constant close reflection on international developments in the area[10]. However, despite the EU aspirations to set high standards for itself in the field, for the EU legal system following the prominent judgement of the European Court of Justice in *Internationale Handelgesellschaft* in 1970[11], where fundamental rights were recognized as general principles of the EU legal system, it was promising to be challenging[12]. It is important to underline that the FATF Recommendations are non-binding in its nature, however with existing sanctions regime for non-implementation[13]. The FATF Recommendations however serve as a reference in many other international instruments, including the UN Security Council Resolutions, which eventually increase the importance of the FATF standards despite non-binding nature[14]. Special attention should be given to the Security Council Resolution 2255 where in the measures under the 10th point the Security Council strongly urges all MSs to implement the comprehensive international standards embodied in the FATF's revised Forty Recommendations[15]. Thus, a need for Community action was present not only because of domestic considerations to protect the domestic market from rapidly growing concerns about organized crime, but also because of emerging international obligations before the international community to which the EU or its MSs are contracting/member states[16]. As a result, most of the EU AML/CTF legal instruments, in particular EU AML Directives, provide reference to the FATF Recommendations reflecting all recent changes and implementing them in the EU legal order.

1.3 THE AML/CTF FRAMEWORK AT THE EU LEVEL

International law in essence creates obligations for international actors (states, organizations[17]) upon signing any treaty to ratify and hence incorporate norms into their own legal space. In turn, actors by incorporating relevant norms into their own legal space create obligations for subjects of the legal space and of the legal norms. This legal order establishes the link between international obligations of international actors before the international community to perform their obligations by adopting relevant legal acts which ultimately affect the subjects of legal space in general and specific subjects of legal norms in particular.

[10] *See* the 14th preambular paragraph of the 2nd Money Laundering Directive (Directive 2001/97/EC of the European Parliament and of the Council), the 5th preambular paragraph of the 3AMLD, the 4th preambular paragraph of the 4AMLD, 12th preambular paragraph of the 5AMLD, 3rd preambular paragraph of the 6AMLD.
[11] Judgement in *Internationale Handelgesellschaft mbH* v. *Einfuhr- und Vorratsstelle für Getreide und Futtermittel*, Case 11/70, ECLI:EU:C:1970:114.
[12] Later the judgement was addressed by the Treaty of Lisbon giving the fundamental rights a primary law status in the EU.
[13] Marco Arnone, Leonardo Borlini, Francesco Montanaro. "Regulating Criminal Finance in the EU in the Light of the International Instruments", *Yearbook of European Law 36(1) (2017)*, (Oxford University Press: 2018), pp. 553–598.
[14] *Ibid.*
[15] Security Council Resolution 2255 (December 21, 2015). The Security Council repeated this exhortation in December 2015. Security Council Resolution 2253 (December 17, 2015). Available on: https://www.undocs.org/S/RES/2255(2015). Accessed May 10, 2021.
[16] Not only the FATF Standards and the Security Council Resolutions call states for transposition of certain obligations into EU legal order, but also other international and regional conventions, such as, *e.g.*, the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism.
[17] If it is generally allowed pursuant to establishing document of the organization and the rights and obligations granted to the organization in other international bodies.

Therefore, for the purpose of further analysis of the national law of Latvia and Germany, it is first necessary to analyse the AML/CTF framework at the EU level.

1.3.1 THE EU COMPETENCE IN REGARD TO AML/CTF

Firstly, it should be noted that the EU itself is not a member of the FATF, however the European Commission is. Secondly, not all of the EU MSs are members of the FATF. However, in regard to the Council of Europe, all 27 EU states are members of the Council of Europe, while the EU is neither a member nor observer. Despite this, the EU still signs and ratifies some of the Council of Europe conventions[18]. It means, that the EU as a legal person has obligations before the FATF, while not all MSs have these obligations before the FATF separately from the EU, which is practice suggests indirect obligations of some MSs before the FATF through the EU[19]. In case of the Council of Europe, although the EU is not a member of the organization, it nevertheless signs some of its conventions. However, given the fact that EU MSs are members of the Council of Europe and also may sign its conventions, in practice it entails a risk of duplication of legislation through the obligations of the EU before the Council of Europe and obligations of the MSs before the Council of Europe and the EU.

Furthermore, the EU engagement in AML/CTF is best defined through Article 4(1) and Article 4(2)(a) as a shared competence by AML/CTF being a matter of internal market which is confirmed by the 13th preambular paragraph of the Regulation (EU) 2019/2175:

> (…) [t]he prevention and countering of money laundering and of terrorist financing is a shared responsibility of Member States and Union institutions and bodies, within their respective mandates. They should establish mechanisms for enhanced cooperation, coordination and mutual assistance, fully utilising all the tools and measures available under the existing regulatory and institutional framework.

The idea of the shared competence is supported by the initial reference to Article 114 TFEU in the preambles of EU AML Directives, which provides the Parliament and the Council a right through ordinary legislative procedure adopt measures for the harmonization of law in the Member States to establish a functioning of the internal market, based on objectives specified in Article 26 TFEU. Thus, the ultimate objective of the AML/CTF legal instruments remains the enhancement of market integration. The concept of a shared competence defined in Article 2(2) suggests, that both the Union and the MSs may legislate and adopt legally binding acts in that area. However, the MSs are allowed to exercise their competence to the extent that the Union has not exercised its competence. This concept, therefore, suggests that AML/CTF laws among MSs are not necessarily the same as MSs are allowed to come up with stricter rules than those suggested at the EU level. In other words, the EU legislation provides a minimum threshold to be met by MSs, however, it does not prevent them from additional national regulations in the area unless they contradict the EU regulations. Bearing this in mind, inevitable differences among the member states in the AML/CTF field can be expected.

[18] Council of Europe. Treaty list for the EU, available on: https://www.coe.int/en/web/conventions/search-on-states/-/conventions/treaty/country/1. Accessed May 10, 2021.

[19] While accountability for compliance and non-compliance of the FATF standards by EU members exists only before the EU and not before the FATF.

1.3.2 EU LEGAL FRAMEWORK OF AML/CTF SYSTEM

The EU legislation in regard to AML/CTF is introduced in secondary source laws in a form of regulations and directives. While regulations do not require to be implemented into national law and have a direct effect, according to Article 288 of the TFEU[20], directives, in general, do not have a direct effect, which means that MSs are responsible for the implementation of the guidelines set in the directives into national law, providing by that a vertical effect[21]. The decisive part of the EU legislation in regard to AML/CTF is introduced in a form of directives (currently six) attempting to harmonize national laws among MSs in the area. While harmonization is a different task than uniformity, nevertheless there are some regulations aimed at unifying some of the efforts aimed at combating ML/TF. In addition, the EU legislation also has some Council decisions strengthening the overall EU AML/CTF framework and cooperation among MSs in the area.

1.3.3 KEY ELEMENTS OF THE EU AML/CTF FRAMEWORK

For the purpose of this work, as the EU Directives present the main basis for differences existing in the national laws of MSs due to the fact that directives set merely a set of goals and MSs are free to decide how exactly those goals should be implemented, only the EU Directives further in this chapter are going to be analysed as well as their correlation with the FATF standards. While differences may be found in regard to any element of the AML/CTF system, only three key elements set in in the EU AML Directives and their correlation with the international obligations are going be analysed, such as RBA, identification procedure and criminalization. Addressed issues in regard to each element are selected by their relevance to the financial sector, in order to lay down the ground for further analysis of the national law of Latvia and Germany.

1.3.3.1 RISK-BASED APPROACH

RBA is an important aspect of the AML/CTF regulatory policy. Since the FATF adopted its 40 revised Recommendations in 2012, RBA became a central overarching requirement to the effective implementation of the recommendations as opposed to the 2003 Recommendations where RBA was supposed to be applied only in certain cases. In the "FATF Guidance for Risk-Based Approach for The Banking Sector", a definition of RBA is provided as follows[22]:

> [a] risk-based approach to AML/CFT means that countries, competent authorities and financial institutions, are expected to identify, assess and understand the ML/TF risks to which they are exposed and take AML/CFT measures commensurate to those risks in order to mitigate them effectively.

[20] The direct effect of the EU regulations was later confirmed to be "complete" by Judgment in *Politi s.a.s.* v *Ministry for Finance of the Italian Republic*, Case 43-71, ECLI:EU:C:1971:122.

[21] However, in certain cases the Court of Justice recognises the direct effect of directives in order to protect the rights of individuals. Therefore, the Court laid down in its case-law that a directive has direct effect when its provisions are unconditional and sufficiently clear and precise and when the EU country has not transposed the directive by the deadline (Judgement of 4 December 1974, Van Duyn). However, it can only have direct vertical effect; EU countries are obliged to implement directives but directives may not be cited by an EU country against an individual (Judgement of 5 April 1979, Ratti), quoted in EUR-Lex, The direct effect of European law, available on: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=LEGISSUM%3Al14547. Accessed May 10, 2021.

[22] FATF. Guidance for A Risk-Based Approach for The Banking Sector, 2014, p. 6. Available on: https://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf. Accessed May 10, 2021.

In other words, RBA presupposes that some components of the AML/CTF system - especially regulation, compliance, and control - should be framed in light of the risks that they are intended to address[23]. The FATF provides, that this approach should be an essential foundation for efficient allocation of resources across the AML/CTF regime. However, the FATF does not provide a definition of the term "risk" which may lead to inconsistences and problems with application in practice. The World Bank Group, however, in its guideline in 2014 defined "risk" as a "combination of the likelihood of an adverse event (hazard, harm) occurring, and of the potential magnitude of the damage caused" (the incident itself, the number of people affected and the severity of the damage for each).[24] It is suggested therefore to understand risk as the product of "magnitude" (which itself is the combination of the severity of the effect and of the numbers potentially affected) and "likelihood"[25]. The same definition is provided by the Commission in its Risk Assessment and Management Guideline[26]. In other words, RBA should be understood as a quantitative methodology that will not eliminate the risk; however, it will enable the understanding of risks with the aim of mitigating the impact which requires identification of risk factors, classification and scoring[27].

Additionally, the FATF provides, that where countries identify higher risks, they should ensure that their AML/CTF regime adequately addresses such risks. At the same time, where countries identify lower risks, they may decide to allow simplified measures for some of the FATF Recommendations under certain conditions. While there is no universally agreed and accepted methodology that prescribes the nature and extent of RBA, it is up for the financial institutions and designated non-financial businesses and professions (DNFBPs)[28] to decide on the methodology they want to use based on the analysis of the risk and the risk management framework[29]. RBA, therefore, suggests a very important implication to the AML/CTF by shifting a part of the responsibility for defining the risks and developing countermeasures onto the private institutions and professionals involved. Thence, the FATF periodically issues guidelines for RBA for various relevant parties involved.

In the EU, RBA was first used in the Directive 2005/60/EC (hereinafter referred to as the "3AMLD"). In the Report of the Commission to the European Parliament and the Council, the Commission underlined the importance of RBA and expressed concern about the necessity to broaden the application of the RBA following the FATF Recommendations

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[23] Borlini and Montanaro, *supra* note 9, p. 1040.

[24] Florentin Blanc, Ernesto Franco-Temple, *Introducing a risk-based approach to regulate businesses: how to build a risk matrix to classify enterprises or activities*, Nuts & bolts Washington, D.C.: World Bank Group, 2013, p. 1. Available on: http://documents.worldbank.org/curated/en/102431468152704305/Introducing-a-risk-based-approach-to-regulate-businesses-how-to-build-a-risk-matrix-to-classify-enterprises-or-activities. Accessed May 10, 2021.

[25] *Ibid*, p. 2.

[26] European Commission. Risk Assessment and Management, p. 2. Available on: https://ec.europa.eu/info/sites/info/files/file_import/better-regulation-toolbox-15_en_0.pdf. Accessed May 10, 2021.

[27] Karima Touil, "Risk-Based Approach: Understanding and Implementation. Challenges between risk appetite and compliance", *ACAMS Today* (2016), p. 3. Available on: https://www.academia.edu/41674919/Risk_Based_Approach_Understanding_and_Implementation_K_Touil. Accessed May 10, 2021.

[28] The FATF Recommendations 2012 list casinos, real estate agents, dealers in precious metals and precious stones, lawyers, notaries, other independent legal professionals and accountants, trust and company service providers. The 5th AML Directive, however, in addition to the list provided by the FATF in article 2 lists auditors and other persons trading in goods to the extent that payments are made or received in cash in an amount of EUR 10 000 or more, whether the transaction is carried out in a single operation or in several operations which appear to be linked.

[29] Touil, *supra* note 27, p. 4.

issued in 2012. It was therefore an outcome of the Directive 2015/849 (hereinafter referred to as the "4AMLD") which provided an even more detailed concept of RBA and with the Directive 2018/843 (hereinafter referred as to the "5AMLD") going beyond the minimum requirements set out in the FATF Recommendations by deploying flexible requirements with a view to lightening the burden on market participants and facilitate delivery of regulatory actions[30].

As a result, in Articles 6-8 of the 4AMLD, a more targeted RBA using evidenced-based risk assessments to be conducted by the Commission and member states was introduced, whereas both shall conduct periodic assessment of ML/TF risks affecting the EU Internal Market and relating to cross-border activities, as well as receive guidance by the European Supervisory Authorities (ESAs) in a form of the "joint opinion"[31]. The underlying rationale for it was that in order to strengthen AML/CTF regulations and policies, risk factors in the overall European and national context "macro risk assessments" should be performed, as opposed to those related to specific situations "micro risk assessments"[32]). It should be emphasized, that due to the nature of the EU directives, all EU Directives leave room for countries to design their own RBA and to decide on the degree of risk-based measures that may be applied by obliged entities. In this respect, the Deloitte study reported that a wide diversity of national measures can complicate cross-border compliance[33]. In the preamble of the 5AMLD, RBA, however, was recognized to be not sufficient enough to allow for the timely detection and assessment of risks. While the RBA remains to be the key in the current framework, it was suggested to ensure that certain existing customers need to be monitored on a regular basis (ongoing due diligence)[34].

Despite the existence of another approach in the AML/CTF policy, a rule-based approach, the EU's AML policy mainly focuses on RBA defining key elements of the RBA to be applied both by the Member States, authorities involved in supervision, and by the institutions and persons responsible for applying AML/CFT rules (hereinafter referred to as the "obliged entities"). It is therefore suggested that taking into consideration various risks of the enterprises is of utmost importance, while a rule-based approach is used as a supplementary tool.

There are mainly four steps of RBA: identify the risk factors, perform an assessment of risk, understand the impact of the risk (risk appetite and risk tolerance), and develop and deploy strategies to address risk, including reporting suspicious activities to the respective Financial Intelligence Unit (hereinafter referred to as the "FIU"). The whole process of collecting information is related to the identification procedure to be discussed further. Nonetheless, for RBA to implemented, different types of data may be collected as related to the areas of risks such as type of customer, geographic area, and particular products, services, transactions or delivery channels. In practice, each of these factors assists in defining the

[30] Borlini and Montanaro, *supra* note 9, p. 1039. *See also* Mark Pieth and Gemma Aiolfi, Anti-Money Laundering: Levelling the Playing Field, Basel Institute on Governance, (Janruary, 2003) pp. 13-14. Available on: https://baselgovernance.org/publications/working-paper-1-anti-money-laundering-levelling-playing-field. Accessed May 10, 2021.
[31] Article 6(5) of the 4AMLD.
[32] Borlini and Montanaro, *supra* note 9, p. 1041.
[33] Report from the Commission to the European Parliament and the Council on the Application of Directive 2005/60/EC on the Prevention of the Use of the Financial System for the Purpose of Money Laundering and Terrorist Financing. Available on: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52012DC0168. Accessed May 10, 2021.
[34] 24th preambular paragraph of the 5AMLD.

weightage (weighted risk level) by listing each component and attributing a rating that will allow the risk rating[35]. In evaluating risk rating, risk appetite or risk tolerance of the financial institution in order to determine whether the institution is ready to tolerate such level of risk instead of suspending further or existing relationship with a customer. While risk appetite and risk tolerance are important aspects of the work of the financial institution which determines the establishment of the relationship with customers, it is subject to unstable political, social, and economic factors and hence can be changed anytime if the situation so requires.

The 4AMLD in its Annex I provides a non-exhaustive list of risk variables that obliged entities shall consider when determining to what extent to apply customer due diligence measures[36], while Annex II provides a non-exhaustive list of factors and types of evidence of potentially lower risk and Annex III – of potentially higher risk. It is noted that countries should adopt at least these requirements.

It can be concluded that RBA has a double effect: it makes the regulation more flexible and intensifies the responsibilities of obliged entities. Although these subjects, under the supervision of public regulators, design and implement a model of AML/CTF controls, obliged entities may bear legal consequences for a wrongful implementation of the AML/CTF controls or for inaction in case if the suspicious transaction has gone through the financial institution without being noticed or inappropriately assessed.

1.3.3.2 IDENTIFICATION PROCEDURE

The core of the AML/CTF policy's preventive measures and RBA is an obligation of the financial institution to perform the identification process of their clients. The identification process (also referred to as KYC or due diligence) is a critical function in RBA whose task is to identify and assess risks posed by the client. The FATF addresses the need for due diligence process in its 10th Recommendation, providing that financial institutions should be required to undertake CDD measures when any of the following applies:

(i) establishing business relations;

(ii) carrying out occasional transactions if the transactions is above the applicable designated threshold (USD/EUR 15,000) or the transactions are wire transfers meeting certain conditions[37];

(iii) there is suspicion of money laundering or terrorist financing;

(iv) the financial institution has doubts about the veracity of adequacy of previously obtained customer identification data.

Moreover, financial institutions should be prohibited from keeping anonymous accounts or accounts in obviously fictitious names. However, countries may determine how they impose specific customer due diligence (hereinafter referred to as the "CDD") obligations, either through law or enforceable means. Further, the FATF provides what CDD measures consist of:

(a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data or information.

[35] Touil, *supra* note 27, p. 6.
[36] The purpose of an account or relationship; the level of assets to be deposited by a customer or the size of transactions undertaken; the regularity or duration of the business relationship.
[37] Set out in the interpretive note to recommendation 16 (wire transfers). Available on: https://www.cfatf-gafic.org/index.php/documents/fatf-40r/382-fatf-recommendation-16-wire-transfers.

(b) Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner, such that the financial institution is satisfied that it knows who the beneficial owner is. For legal persons and arrangements this should include financial institutions understanding the ownership and control structure of the customer.

(c) Understanding and, as appropriate, obtaining information on the purpose and intended nature of the business relationship.

(d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.

FATF provides that if the financial institution is unable to comply, it should not open the account, commence business relations or perform the transactions, or terminate the business relationship, as well as consider making a suspicious transactions/activity report (hereinafter referred to as the "STR"s and "SAR"s) in relation to the customer. However, countries may permit financial institutions to complete the verification as soon as reasonably practicable following the establishment of the relationship if ML/TF risks are effectively managed and this is essential not to interrupt the normal conduct of business. Additional measures for specific customers and activities, such as Politically Exposed Persons (hereinafter referred to as the "PEP"s), Correspondent Banking, (Ultimate) Beneficial Owners (hereinafter referred to as the "UBO"s) and others are addressed by the FATF too. However, it should be noted that the FATF Recommendation set only direction and minimum standards in regard to specific issues, while side-issues and more precise interpretation should be adopted by the countries.

In the EU, the concept of the KYC/CDD was introduced by the 3AMLD in Article 8 and was later enshrined in the 4AMLD in Article 13. The EU definition of CDD goes beyond what is required by the FATF and in Article 11 of the 4AMLD provides additional requirements for persons trading in goods when carrying out occasional transactions in cash amounting to 10,000 EUR or more, and for providers of gambling services when carrying out transactions amounting to 2,000 EUR or more. Additionally, the 4AMLD in Article 3(6) widens definition of UBO. In particular, it suggests, that in the case of corporate entities UBO is a natural person who controls the company directly or indirectly through ownership of sufficient percentage of the shares or voting rights or ownership interest in that entity, including through agreements, or is shareholding 25% plus one share or an owns interest of more than 25 % in the customer held. In case there are doubts, it is not possible to identify UBO or after having exhausted all possible means and provided there are no grounds for suspicion, the obliged entities shall keep records of the actions taken in order to identify the beneficial ownership.

The EU law, however, in Article 12 of the 4AMLD provides, that CDD can be partially avoided (the extent is determined by countries) if all conditions in relation to electronic money are met. In particular, they include:

a) the payment instrument is not reloadable, or has a maximum monthly payment transactions limit of EUR 250 which can be used only in that Member State;

b) the maximum amount stored electronically does not exceed 250 EUR[38];

[38] However, a MS may increase the maximum amount to 500 EUR for payment instruments that can be used only in that MS.

c) the payment instrument is used exclusively to purchase goods or services;

d) the payment instrument cannot be funded with anonymous electronic money;

e) the issuer carries out sufficient monitoring of the transactions or business relationship to enable the detection of unusual or suspicious transactions.

However, the abovementioned derogation is not applicable in the case of redemption in cash or cash withdrawal of the monetary value of the electronic money where the amount redeemed exceeds 100 EUR.

While FATF requires financial institutions are required to maintain, for at least five years, all necessary records on transactions, both domestic and international, to enable to comply with information requests from competent authorities. The same applies to all records obtained through CDD measures, the EU law goes beyond and as provided in Chapter 5 of the 4 AMLD, obliged entities may further retain data for a period not exceeding additional five years if there are circumstances indicated by the national law allowing the obliged entities to do that.

An important implication of the 4AMLD is that KYC process is divided into three levels, each corresponding to the risks posed by the customer's background. In addition to the already known CDD, there is Simplified Due Diligence (hereinafter referred to as the "SDD"), stipulated in Section 2 of the 4AMLD, and Enhanced Due Diligence (hereinafter referred to as the "EDD"), stipulated in Section 3 of the 4AMLD.

4AMLD provides, that SDD can be used when areas of lower risks are identified, on contrary to the EDD – where areas of higher risks are identified. The Directive provides, that persons from specific third-countries identified by the Commission, PEPs, UBOs, as well as other risks identified by MS or obliged entities, are considered to be as higher-risk factors.

Pursuant to Directive 2006/70/EC, PEPs are "natural persons who are or have been entrusted with prominent public functions[39]," as well as their immediate family members[40] and their associates, as long as they share the beneficial ownership of legal entities or have any kind of close business relationships. The status of PEP ceases to apply one year after the end of an individual's time in office.

According to the European Council, constant strengthening of rules on CDD "reflect the need for the EU to adapt its legislation to take account of the development of technology and other means at the disposals of criminals[41]."

1.3.3.3 CRIMINALIZATION

AML is the task of preventing the process of ML as a whole, in all its phases. The international AML framework is generally built to introduce common preventive rules,

[39] Article 2(1) of the Directive 2006/70/EC provides, that prominent public functions include heads of State, heads of government, ministers and deputy or assistant ministers; members of parliaments; members of supreme courts, of constitutional courts or of other higher-level judicial bodies whose decisions are not subject to further appeal, except in exceptional circumstances; members of courts of auditors or of the boards of central banks; ambassadors, chargés d'affaires and high-ranking officers in the armed forces; members of the administrative, management or supervisory bodies of State-owned enterprises. Positions can be of domestic and international level, as well as community level.

[40] *Ibid*, article 2(2) provides, that immediate family members include the spouse; any partner considered by national law as equivalent to spouse; the children and their spouses or partners; the parents.

[41] European Council Press Release IP/15/187, Money laundering: Council approves strengthened rules, April 20, 2015. Mentioned in Borlini and Montanaro, *supra* note 9, p. 1042.

however, common measures concerning punishment for breach are included in the framework as well. The third FATF recommendation provides the inclusion as criminal offenses of a wide array of predicate offenses for ML, including "all serious offences" and obliges countries to criminalize it on the basis of the UNGAC and UNGTOC, which widen the obligation to TF and the PF[42].

Accordingly, in the fifth recommendation, countries should criminalize on the basis of the Terrorist Financing Convention (UNCFT), also known as the UN Convention on the Suppression of Terrorist Financing, not only the financing of terrorist acts but also the financing of terrorist organizations and individual terrorists even in the absence of a link to a specific terrorist act or acts. Countries should ensure that such offenses are designed as ML predicate offenses[43]. The 36-40 Recommendations oblige states to adopt effective international cooperation measures in the criminal field, namely mutual legal assistance (hereinafter referred to as the "MLA") requests for the taking of evidence, extradition, penalty execution, decisions of confiscation, and extinction of ownership[44]. States are also required to take immediate steps to implement all necessary and relevant treaties and conventions.

Similar to the UN, Council of Europe and FATF, the EU has developed AML/CTF policy that is predicated on prevention and criminalization. While the EU was the first regional organization to adopt a comprehensive AML/CTF regulatory framework, due to EU member states' significant competence in criminal matters, criminalization turned out to be more problematic than prevention[45]. Due to this, the EU approach in the 1AMLD was first to prohibit illicit activities rather than criminalize them, however, the Directive also contained a provision urging MSs to take respective actions to criminalize ML. It led to the problem that under the EU law, there was no uniform definition of the criminal offense nor a harmonized sanctions system[46]. The Council Framework Decision 2001/500/JHA provided the first common requirements with regard to criminalization of ML. However, due to enforcement gaps and obstacles to cooperation between the competent authorities present, there was a necessity to adopt another legal act.

As a result, the fourth preambular paragraph of the recently adopted Directive (EU) 2018/1673 (hereinafter referred to as the "6AMLD") confirmed that the Decision was not comprehensive enough and not sufficiently coherent to effectively combat ML. However, a need to adopt the 6AMLD was present not only to address shortcomings of the Decision, but also to address other emerging issues in the form of a separate directive dealing specifically with the criminalization issues. Although the 6AMLD was a big step for the EU to improve its AML/CTF system and further harmonize the area, even after the 6AMLD was implemented the problem of a lack of a pan-European definition of ML has remained, which continues to bring inconsistencies in the implementation the EU AML/CTF Directives in domestic legal systems[47]. It is claimed that since the 6AMLD is a directive, it *per se* tends only to harmonize the definition while leaving room for the countries to provide stricter rules, while another EU legal instrument, regulation, could provide a uniform and binding for all definition. In practice, a lack of a uniform definition may lead to persistent disagreement about the identification of predicate offenses that might jeopardize the cross-border

[42] FATF, *supra* note 3, p. 12.
[43] *Ibid*., p. 13.
[44] *Ibid*, pp. 27-30.
[45] Borlini and Montanaro, *supra* note 9, p. 1030.
[46] Arnone, Borlini, Montanaro, *supra* note 13, p. 16.
[47] Borlini and Montanaro, *supra* note 9, p. 1031.

enforcement of ML criminal rules[48]. It is also important to highlight a trend present in the EU law to constantly broaden the understanding of the ML/TF and subjects of the law, going beyond the international standards.

The legal basis for the criminalization of the ML/TF is enshrined in Article 83 of the TFEU, which provides a specific legal basis for the adoption of EU secondary legislation aimed to fight "particularly serious" crimes "having a cross-border dimension resulting from the nature or impact of such offences or from a special need to combat them on a common basis" (known as "Eurocrimes"). This allows the EU to set common criteria concerning criminal offenses and establish the appropriate sanctions. Eventually, this served as a legal basis for the 6AMLD whose scope and subject-matter stated in Article 1 provides that this Directive establishes minimum rules concerning the definition of criminal offences and sanctions in the area of ML following the need to reflect the FATF Recommendations as well as to comply with the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism as stated in the third preambular paragraph of the Directive. In the previous Directives, however, Article 83 was never invoked, instead, as it was provided earlier, Article 114 TFEU constituted a legal basis for all Directives, whose task was to harmonize the rules following the increased risk of ML and financial crimes stemming from deeper market integration in the EU.

In particular, a recently adopted 6AMLD in Article 2 provides a direction to set a definition for criminal activity as being offences in the terrorism, trafficking in human beings and migrant smuggling, sexual exploitation, illicit trafficking in narcotic drugs and psychotropic substances, illicit arms trafficking, illicit trafficking in stolen goods and other goods, corruption, fraud, counterfeiting of currency, counterfeiting and piracy of products, environmental crime, murder, grievous bodily injury, kidnapping, illegal restraint and hostage-taking, robbery or theft, smuggling, tax crimes relating to direct and indirect taxes, extortion, forgery, piracy, insider trading and market manipulation, cybercrime, and participation in an organised criminal group and racketeering. The Directive obliges MSs to ensure that these criminal activities are punishable by deprivation of liberty or a detention order for a maximum of more than one year or, as in case if MSs have a minimum threshold for offences in their legal systems, any offence punishable by deprivation of liberty or a detention order for a minimum of more than six months.

Additionally, Article 3 lists ML offences that should be punishable as a criminal offence if there are proves indicating an intentional nature of the behaviour. Article 4 continues, that aiding and abetting, inciting and attempting an offence must be punishable as a criminal offence. Principles for penalties for natural persons are listed in Article 5, including criminal penalties being effective, proportionate and dissuasive. Moreover, according to Article 7 (1), legal persons can be held liable for any of the aforementioned offences, acting based on a power of representation of the legal person, or an authority to take decisions on behalf of the legal person, or an authority to exercise control within the legal person. Liability of legal persons does not preclude criminal proceedings from being brought against natural persons who are perpetrators, inciters or accessories in any of the criminal offences mentioned earlier. A lack of supervision or control by a person acting based on the rights mentioned in

[48] European Commission. *Indicative Roadmap for a Proposal to Harmonize the Criminal Offence of Money Laundering in the EU* (October 2012). Available on: http://web.archive.org/web/20150928114057/ec.europa.eu/smart-regulation/impact/planned_ia/docs/2013_home_006_money_laundering_en.pdf. Accessed May 10, 2021.

Article 7(1) which made possible the commission of any of the offences referred earlier does not prevent legal persons from being held liable. Article 8 provides a list of sanctions for legal persons[49]. Article 10 lists conditions in which countries are obliged to establish its jurisdiction over the offences.

As observed above, the EU legislation provides only for a minimum degree of harmonization of the constitutive elements and penalties for crimes. As a result, countries are allowed to present stricter rules in this regard as provided in the 6AMLD.

[49] Including exclusion from entitlement to public benefits or aid, temporary or permanent exclusion from access to public funding, including tender procedures, grants and concessions, temporary or permanent disqualification from the practice of commercial activities, placing under judicial supervision, a judicial winding-up order, temporary or permanent closure of establishments which have been used for committing the offence.

2 LATVIAN AND GERMAN AML/CTF MINIMUM REQUIREMENTS

Beforehand, an analysis of minimum requirements of RBA, identification and criminalization was provided based on the international legal acts and their incorporation into the EU legal area. This chapter hence addresses minimum requirements of the main constituting elements relevant to the financial sector of RBA, identification and criminalization laid down in the national AML/CTF law of Latvia and Germany. For the purpose of this chapter, the main focus is made on differences between Latvian and German law rather than on similarities.

The governing and general AML/CTF law in Latvia is the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing[50] (hereinafter referred to as the "NILLTPFN"). While for Germany, the main source of the AML/CTF law is Money Laundering Act[51] (hereinafter referred to as the "GwG").

2.1 RISK-BASED APPROACH

This sub-chapter focuses on the analysis of two constituting elements of RBA – risk decreasing factors and risk-increasing factors, which form the core of RBA and ultimately create differences between the identification procedure of Latvia and Germany.

2.1.1 RISK DECREASING FACTORS

German law in essence repeats risk decreasing factors suggested by the 4AMLD with the only exception that for geographical risk factor it elaborates that effective AML/CTF system and combat of ML/TF means prevention and detection[52]. In this respect, NILLTPFN in Section $11^{1}(4)(1)$ requires however efficient systems for the prevention of ML/TF, which on the one hand, mentions a notion of efficiency, unlike Germany, but on the other hand, elaborates on that only as related to prevention.

In general, NILLTPFN significantly changes and widens requirements to risk decreasing factors suggested by the 4AMLD. In addition to what is required under the EU Law in regard to risk-mitigating factors, NILLTPFN limits customer and geographical factors harder than suggested by the 4AMLD – as such, other MSs do not present a decreasing geographical risk factor.

While the 4AMLD provides that public administration or enterprises shall be risk decreasing factor, NILLTPFN in Section 26(2)(1) provides, that only *Latvian* [emphasis added] administration and state-controlled enterprises characterised by a low risk of ML/TF/PF may represent a risk decreasing factor. With respect to the requirement of public companies listed on a stock exchange and subject to disclosure requirements (either by stock exchange rules or through law or enforceable means), which impose requirements to ensure adequate transparency of beneficial ownership) as provided by the EU law, NILLTPFN in Section 26(2)(2) instead of it mentions that only a merchant whose stocks are admitted to

[50] Noziedzīgi iegūtu līdzekļu legalizācijas un terorisma un proliferācijas finansēšanas novēršanas likums (Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing), (July 17, 2008). Available on: https://likumi.lv/ta/en/en/id/178987-on-the-prevention-of-money-laundering-and-terrorism-financing. Accessed May 10, 2021.
[51] Germany. Money Laundering Act, (October 12, 2018). Available on: https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Gesetz/GwG_en.html. Accessed May 10, 2021.
[52] *Ibid.,* Annex.

trading on a regulated market in one or several MSs can be regarded as a risk mitigating factor.

In regard to insurance premiums, Section 26(4)(1) of NILLTPFN elaborates on "law premium" in regard to life insurance policies and provides that annual insurance premium may not exceed 1,000 EUR[53], or if the single premium does not exceed 2,500 EUR[54]. In relation to insurance policies for pension schemes, Section 26(4)(2) provides that only *lifelong* [emphasis added] pension insurance contracts meeting other criteria specified by the law may serve as a risk decreasing factor. Instead of a case serving a risk decreasing factor where pension, superannuation or similar scheme that provides retirement benefits to employees, where contributions are made by way of deduction from wages, and the scheme rules do not permit the assignment of a member's interest under the scheme, Section 26(5) of NILLTPFN provides that only a private pension fund is entitled to conduct the SDD in relation to contributions to pension plans if the customer cannot use the abovementioned contributions as a collateral and cannot assign them, and in relation to such contributions to pension plans which are made by way of deduction from wages.

In addition, Section 11^1(4)(5) provides that a risk mitigating factor is also the customer - natural person - who uses only the principal account within the meaning of the Payment Services and Electronic Money Law, which in essence significantly limits a minimum provided by the 4AMLD in respect to products, services, transactions and delivery channels.

The Financial and Capital Market Commission (hereinafter referred as to the "FCMC")[55] and Federal Financial Supervisory Authority (hereinafter referred as to the "BaFin")[56] are supervisors of the financial sectors of Latvia and Germany respectively, which provide guidelines on addressing of risk for financial institutions and other possible risk decreasing factors.

2.1.2 RISK INCREASING FACTORS

High risk arises in particular in regard to the customer (a contracting party of the obliged entity or UBO is PEP, a family member or a person known to be a close associate or a natural or legal person domiciled in a high-risk third country), in regard to the product, service, transaction or delivery channel, and in regard to geolocation.

While differences in the determination of UBOs and PEPs are going to be addressed further, it should be noted in regard to high-risk this countries, that as both countries are subject to delegated acts (*i.e.* delegated regulations) of the European Commission, in particular, both countries rely on the determination of the European Commission on high-risk third countries – Section 12^1 of NILLTPFN and Section 15(3)(1)(b) of GwG. In addition to what the European Commission determines as high-risk third countries, Section 15(3)(3) of

[53] Or is in a foreign currency which according to the exchange rate to be used in accounting at the beginning of the day of executing the transaction is not more than 1,000 EUR.
[54] Or is in a foreign currency which according to the exchange rate to be used in accounting at the beginning of the day of executing the transaction is not more than 2,500 EUR.
[55] FCMC. *Regulations on the Establishment of Customer Due Diligence, Enhanced Due Diligence and Risk Scoring System*, December 1, 2019. Available on: https://www.fktk.lv/en/law/general/fcmc-regulations/. Accessed May 10, 2021.
[56] BaFin. Interpretation and Application Guidance in relation to the German Money Laundering Act (*Geldwäschegesetz* – GwG), May 2020. Available on: https://www.bafin.de/SharedDocs/Downloads/EN/Auslegungsentscheidung/dl_ae_auas_gw2020_en.pdf?__blob=publicationFile&v=1. Accessed May 10, 2021.

GwG provides, that high risk arises in cases where specific obliged entities[57] are in cross-border correspondent relationships with third-country respondents or, if the obliged entities identify a heightened risk, with respondents from a country in the EEA. Other than that, German law does not provide anything in addition to high-risk third countries. Section 11(3)(2) of NILLTPFN provides that high risk also arises if the customer or its UBO is affiliated with a higher risk jurisdiction, under which falls not only a high risk third country identified by the European Commission, but also a country or territory with high level of criminal offences as a result of which proceeds from crime may be obtained, a country or territory on whom to financial or civil legal restrictions have been imposed not only by the UN and the EU, but also by the USA, a country or *territory* [emphasis added] which provides financing or support to terrorist activities or in the territory of which such terrorist organisations operate that are included in lists of countries or international organisations recognised by the Cabinet which have prepared lists of persons suspected of engaging in terrorist activities or in the production, storage, transportation, use or distribution of weapons of mass destruction, a country or territory which has refused to cooperate with international organisations in the field of prevention of ML/TF/PF.

German law, unlike Latvian law, provides in Section 15(3)(2) of GwG that a high risk also arises if the transaction, in relation to comparable cases is particularly complex or large, or follows an unusual pattern, or has no apparent economic or lawful purpose.

All other not mentioned risk increasing factors in the national law of both countries correspond to the minimum requirements laid down in the 4AMLD. The FCMC[58] and BaFin[59] provide guidelines on addressing risk for financial institutions and other possible risk increasing factors.

2.2 IDENTIFICATION

This sub-chapter provides the analysis of five constituting elements of the identification procedure – CDD, SDD, EDD, UBOs and PEPs, which are essential for the identification procedure.

[57] Credit institutions as defined in Section 1(1) of the Banking Act *(Kreditwesengesetz, KWG*), with the exception of the institutions and companies specified in Section 2 (1)(3-8) of the KWG, and German branches *(Zweigstellen)* and branch offices *(Zweigniederlassungen)* of credit institutions domiciled abroad, financial services institutions as defined in Section 1(1a) of the KWG, with the exception of the institutions and companies specified in Section 2(6)(1)(3-10, 12) and Section 2(10) of the KWG and German branches and branch offices of financial services institutions domiciled abroad, payment institutions and electronic money institutions as defined in Section 1(2a) of the Payment Services Supervision Act and German branches and branch offices of comparable institutions domiciled abroad, financial companies as defined in Section 1(3) of the KWG which are not covered by no. 1 or no. 4 and whose principal activity corresponds to one of the principal activities specified in Section 1(3)(1) of the KWG, or to one of the principal activities of a company designated by statutory order under Section 1(3)(2) of the KWG and German branches and branch offices of such companies domiciled abroad, insurance undertakings as defined in Article 13 no. 1 of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (OJ L 335 of 17 December 2009, p. 1) and domestic establishments of such undertakings domiciled abroad, insofar as they offer life insurance activities covered by this directive, offer accident insurance with premium refund or grant money loans as defined in Section 1(1)(2)(2) of the KWG, insurance intermediaries as defined in Section 59 of the Insurance Contract Act *(Versicherungsvertragsgesetz)* insofar as they broker the activities, transactions, products or services covered by no. 7, with the exception of the insurance intermediaries operating under Section 34d(3) or (4) of the Industrial Code *(Gewerbeordnung),* and German establishments of such insurance intermediaries domiciled abroad.

[58] *Supra* note 55.

[59] *Supra* note 56.

2.2.1 GENERAL CUSTOMER DUE DILIGENCE

The main source for due diligence requirements in German law can be found in Part 3 of GwG, while in Latvian law in Chapter 3 of NILLTPFN. Already in the beginning of each legal act a first striking difference is notable in regard to the conditions in which performance of CDD is required. While German law in section 10(3) precisely reflects the EU requirements, NILLTPFN however in Section 11(1)(2)(b) goes further and in addition to the EU requirements provides that CDD is needed to be performed also even in cases where the amount of transactions or the total sum of several seemingly linked transactions is 15,000 EUR or more or is in a foreign currency which according to the exchange rate to be used in accounting at the beginning of the day of executing the transaction is equivalent to or exceeds 15,000 EUR. Thus, unlike in German law, Latvian law provides that by the transaction are also understood several seemingly linked transactions, as well as Latvian law, addresses the issue of foreign currency and the moment of time in which it has to be calculated in case the transactions involves the use of a foreign currency.

In regard to ash transactions, NILLTPFN in Section 11(3) provides, that CDD is needed in cases when the subjects of the law engaged in the trade of goods, as well as in intermediation or provision of other types of services within the scope of an individual transaction and if the payment is made in cash or cash for such transaction is paid into the account of the seller in the credit institution in the amount equivalent to or exceeding 10,000 EUR[60], regardless of whether such transaction is executed as a single operation or as several mutually linked operations. Unlike in Latvian law, Section 10(4) and Section 10(6) of GwG provide that only traders of goods, payment institutions and electronic money institutions[61], agents[62], electronic money agents[63] and independent businesspersons who distribute or redeem the electronic money of a credit institution[64] are subjects to provisions related to the cash transactions. In particular, all of them except traders of goods have to fulfil the general due diligence requirements when in providing payment services they accept cash[65] (in addition to the requirement where they are obliged to fulfil CDD), while traders of goods need to fulfil due diligence requirements for transactions involving cash payments or receipts of at least 10,000 EUR and regardless of any derogation, exemption or threshold set forth in this or other Acts, when facts exist that indicate that the property connected to a transaction or business relationship is the object of ML or the property is associated with TF. Thus, in a plain language, while Latvian law obliges all subjects of the law to conduct CDD in case where the transaction is equivalent to or exceeds 10,000 EUR in cash is carried out, German law provides a narrower approach to cash transactions – there are only several subjects of the law falling under the requirements related to cash transaction, however, all of them (except traders of goods for whom a threshold of 10,000 EUR is in place with exception when there are indicators of ML/TF) are to fulfil CDD requirements when they accept cash.

While neither of the EU Directives nor the FATF Recommendation address the issues of a foreign currency cash purchase, Section 11(2)(c) of NILLTPFN nevertheless provides,

[60] Or in a foreign currency which according to the exchange rate to be used in accounting at the beginning of the day of executing the transaction is equivalent to or exceeds 10,000 EUR.
[61] Section 1(2a) of the Payment Services Supervision Act *(Zahlungsdiensteaufsichtsgesetz)* and German branches and branch offices of comparable institutions domiciled abroad.
[62] *Ibid.,* Section 1(7).
[63] *Ibid.,* Section 1a(6).
[64] *Ibid.,* Section 1a(1)(1).
[65] *Ibid.,* section 1(2).

that due diligence is needed before foreign currency cash purchase or sale transaction is executed the amount of which or the total sum of several seemingly linked transactions exceeds 1,500 EUR[66]. There are no similar requirements at all in German Law.

In regard to exceptions for the performance of due diligence, GwG in Section 10(3)(3) provides, that due diligence to be performed regardless of any derogation, exemption or threshold set forth in this or other Acts, when facts exist that indicate that the property connected to a transaction or business relationship is the object of ML or the property is associated with TF. NILLTPFN in this respect provides a broader idea laid down in Section 11(1)(5): "(due diligence to be performed) if there are suspicions of ML/TF/*PF or an attempt* [emphasis added] of such actions".

Unlike in Germany, Latvia has a provision that allows subjects of the law to not continue due diligence in certain cases. Section 11(6) of NILLTPFN provides, that if the subject of the Law has suspicions regarding ML/TF and there are grounds to believe that the further application of customer due diligence measures may reveal the suspicions of the subject of the Law to the customer, the subject of the Law has the right not to continue the CDD, but to report a suspicious transaction to the FIU of Latvia[67].

In regard to recording and retention requirements, both Latvian and German law repeat the wording of the 4AMLD and provide that an additional time period of up to five years can be set for retention of data. NILLTPFN in Section 37(3) provides that it is possible in case it is requested by the respective bodies[68] upon assessing the necessity, commensurability, and justification of further storage, in order to prevent, discover, or investigate the ML/TF cases. In the case of Germany, GwG in Section 39(2) provides that whenever the FIU issues an order opening the file, additional time period up to five years can be granted to review the data. However, in this case, the consent of the Federal Ministry of Finance is required as well as the Federal Commissioner for Data Protection and Freedom of Information[69] . Moreover, German law provides, that the additional time period needed for review should be proportionate.[70]

Latvian law, unlike German law, in Section 27^1(1) provides a possibility for subjects of the law to exempt from the application of individual customer due diligence[71]. In particular, it is possible after all conditions (which are stricter than provided in the EU law) in relation to transactions with electronic money mentioned in Section 27^1(1-3) are met[72] and a

[66] It is, however, not clear according to the law whether the sum of 1500 EUR is allowed to go without due diligence. Notably, a wording used in the law in regard to the sum is a general problem of NILLTPFN. While other sections (*e.g.* Section 10(3)(2)(b) provides that the sum may be equivalent, it is therefore suggested, that all legal norms laid down in NILLTPFN where reference to the amount of money does not include "equivalent to" but contains only "exceeds" should be systematically interpreted in favor of excluding provided amount of money from the requirements laid down in the legal norm.

[67] However, in its report for the Financial Intelligence Unit of Latvia the subject of the Law shall also indicate the considerations forming the basis for the conclusion that the further application of customer due diligence measures might reveal the suspicions of the subject of the Law to the customer.

[68] The Financial Intelligence Unit of Latvia, the supervisory and control authority, the body performing operational activities, including the State security authority, upon instruction of the investigating institution, the Office of the Prosecutor, or a court.

[69] Original name of the institution is *Bundesbeauftragter für den Datenschutz und die Informationsfreiheit*.

[70] As such, it should be based on the purpose of the storage and the type and importance of the matter; distinctions are to be made based on the purpose of the storage and the type and importance of the matter.

[71] Referred to in Section 11^1.

[72] As such, a monthly payment transactions maximum limit and the maximum sum electronically stored by the electronic money holder does is 150 EUR (instead of 250 EUR as provided in the EU law), as well as it is added that the subject of the Law shall that the same person may use a limited number of payment instruments which

low risk is determined. GwG instead provides in Section 10(7) that agents[73], electronic money agents[74], independent businesspersons who distribute or redeem the electronic money of a credit institution[75] whenever they are involved in issuing electronic money shall perform only requirements of Section 10(1)(1) and Section 10(1)(4) of GwG (identification of the customer)[76].

2.2.2 SIMPLIFIED DUE DILIGENCE

The main difference between Latvian and German approaches to SDD requirements laid down in Section 26 of NILLTPFN and in Section 14 of GwG is the way countries address subjects of the law. Section 26(2-6) and Section 26 of NILLTPFN list both general and targeted (for a special subject of the law) situations and requirements in which subjects of the law are entitled to conduct SDD, however after all appropriate and relevant measures were taken to determine and assess the risk. Moreover, with respect to the credit and financial institutions, Section 26(7) provides that a supervisory authority of the financial sector shall determine the requirements for simplified customer due diligence, as well as may determine additional risk reducing factors that are not specified in the law. In the case of Germany, Section 14(1) of GwG allows everyone to conduct SDD after obliged entities established that a low risk is present with regard to customers, transactions and services or products. This illustrates one of the main differences between Latvian and German approach to SDD – while Latvian law provides specific circumstances to be present in order to be entitled to perform SDD, as well as provides risk reducing factors and circumstances in which performance of SDD is not allowed, German law does not provide any circumstances but only provides risk reducing factors. Unlike in Latvian law, Section 14(4) of GwG allows the Federal Ministry of Finance (with respect to all subjects of the law) to designate types of cases that can present a lower risk of ML/TF.

Within the meaning of SDD according to Section 26(1) of NILLTPFN, SDD opens a possibility for obliged entities to conduct due diligence by performing only customer identification within the scope corresponding to the nature of the business relationship or individual transaction and the level of ML/TF risks. Similarly, Section 14(2) of GwG provides, that where SDD requirements may be applied, obliged entities may reduce the extent of the measures to be taken to fulfil general due diligence requirements to an appropriate extent and in particular, by way of derogation from sections 12[77] and 13[78], carry out the verification of identity on the basis of other documents, data or information which originate from a credible and independent source and are suitable for the purpose of verification.

correspond to the conditions referred to in this Section. The derogation is not applicable in the case of buying out of the value of electronic money with cash or withdrawal in cash the amount bought out or withdrawn in cash accordingly exceeds 50 EUR (instead of 100 EUR as provided in the EU law).

[73] *Supra* note 62.

[74] *Supra* note 63

[75] *Supra* note 64.

[76] However, they are subject to Section 25i (1) of the KWG, as well as Section 25i (2) and (4) of the KWG apply *mutatis mutandis.*

[77] Identity verification, authorisation to issue regulations.

[78] Identity verification procedures, authorisation to issue regulations

2.2.3 ENHANCED DUE DILIGENCE

The main provisions and requirements in regard to EDD are laid down in Section 22 of NILLTPFN and Section 15 of GwG. While both legal instruments specify that EDD is performed in addition to CDD, the approach in determining risk factors vary. Section 22(1) of NILLTPFN lists measures that are to be included in EDD, if any provision listed in Section 22(2) is applicable. The wording of German law, however, is different: Section 15(2) of GwG provides, that EDD needs always to be performed whenever a high risk of ML/TF is determined[79]. Moreover, GwG provides, that obliged entities may determine the specific extent of measures to be taken in accordance with the respective higher risk of ML/TF. Section 15(4-7) of GwG lists minimum measures which are to be included in the EDD depending on the high risk factor. Both countries allow to set up stricter EDD requirements – the Cabinet in the case of Latvia (Section 22(4) of AML/CTF Law) and The Federal Ministry of Finance in case of Germany (Section 15(10) of GwG).

2.2.4 BENEFICIAL OWNERS

While both Latvian and German laws are consistent with the minimum requirements of the EU directives in regard to the determination of UBOs, nevertheless there are differences between the countries. While Latvian law in Section 1(5) of NILLTPFN provides precisely the same definition as provided in the EU directive for UBO, Section 3 of GwG goes further and addresses some details with respect to UBOs. As such, it provides that by UBO may be understood a natural person who directly or indirectly exercises control over legal persons with some exceptions. Exceptions to legal persons include foundations with legal personality, corporate entities that are not listed on an organised market as defined in section 2(5) of the Securities Trading Act[80] and that are not subject to transparency requirements with regard to voting rights consistent with Community laws or to equivalent international standards.

In addition, while Latvian definition of UBO is silent regarding the meaning of direct and indirect control, German law provides that indirect control is deemed to exist when the corresponding percentages of shares are held by one or more associations pursuant to section 20(1)[81] which are controlled by a natural person. In particular, control is deemed to exist if the natural person is able to exercise, directly or indirectly, a dominant influence[82] on the association pursuant to section 20(1).

Section 3(1) of GwG provides, that if there is no natural person identified or there are doubts as to whether the person identified is UBO and there are no facts as specified in section 43(1)[83], UBO is assumed to be the legal representative, the managing partner or partner of the contracting party. Latvian law instead provides a different approach and if after all necessary steps were taken and UBO nevertheless was not identified, according to Section 28(2) of NILLTPFN, the business relationship shall be terminated and the request of early

[79] Following assessment of the risk factors specified in annexes 1 and 2 of the Law and taking into account provisions of Section 15(3).
[80] Germany. Securities Trading Act, (September 9, 1999). Available on: https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Aufsichtsrecht/Gesetz/WpHG_en.html. Accessed May 10, 2021.
[81] Regarding necessity and the way legal persons under private law and registered partnerships obtain information on the UBOs of these associations.
[82] While in cases of dominant influence, section 290(2-4) of the Commercial Code *(Handelsgesetzbuch)* applies *mutatis mutandis.*
[83] On Reporting Obligation of Obliged Entities.

fulfilment of obligations from the customer shall be filed. These different approaches to the identification and procession of UBOs demonstrate countries' business operations – while Germany chooses to shift the burden on the legal persons, Latvia chooses to terminate any further business relationship without a shift of the burden.

Germany also takes a tougher approach in regard to legal arrangements than Latvian law, which in essence repeats the wording provided by the 4AMLD[84]. As such, Latvian and EU law provide, that by UBO is understood a natural person who owns or in whose interests a legal arrangement has been established or operates, or who directly or indirectly exercises control over it, including who is the settlor, the trustee or the protector (manager) of such legal arrangement. German law, however, in Section 3(3) of GwG, goes further and provides that firstly, a legal arrangement shall mean foundations with legal capacity and legal arrangements used to manage or distribute assets on trusts or through which third parties are instructed with such management or distribution, or comparable legal constructs. Secondly, in addition to what is provided in the EU law, UBO is also a member of the foundation's board, the group of natural persons for whose benefit the assets are to be managed or distributed if the natural person intended to become the beneficiary of the assets under management has not been designated yet, any natural person who, directly or indirectly, otherwise exercises a controlling influence on the management of the assets or on the distribution of the income. Additionally, in cases of trading on instruction, the person at whose instruction the transaction is carried out is deemed to be a UBO. Insofar as the contracting parties act as trustee, they, too, are deemed to be trading on instruction.

2.2.5 POLITICALLY EXPOSED PERSONS

With respect to PEPs, however, Latvian law goes further and essentially widens the definition of PEP. In general, German law repeats the definition suggested by the 4AMLD and in the case of defence attachés even in essence changes the definition[85], however, provides a wider definition for directors, deputy directors, members of the board or other managers with a comparable function in an international organization, in which *European intergovernmental organization is included* [emphasis added], while it is not required by the EU law. Latvian law instead provides that by PEP is understood, *inter alia*, not only a member of the boards of courts of audit and of the boards of central banks, but also members of the council of respective bodies. However, Latvian law provides a narrower approach in respect to State capital company, where only a council or board member is regarded as a PEP, while by the EU law members of the administrative, management or supervisory bodies of State-owned enterprise are required to be regarded as PEPs.

The situation is completely different when it comes to family members of the PEPs. In this regard, Latvia in addition to what is required by the EU law and what is enshrined in German law[86], provides that by family members are also understood grandparents, grandchildren, siblings, children of the spouse[87] and their spouses[88]. Both countries, however,

[84] Article 3(6) of the 4AMLD.
[85] *Supra* note 39, Defence attaché essentially means appointed military expert who is attached to a diplomatic mission, while the EU law provides, that by PEP, *inter alia*, is understood a high-ranking officer of the armed forces. While usually defence attaché position is filled by a high-ranking officer of the armed forces, it is, however, not necessarily a case and may cause troubles in interpretation when PEP from other countries to be determined.
[86] *Supra* note 40.
[87] Or a person equivalent to a spouse of PEP.
[88] Or a person equivalent to a spouse.

are silent in regard to stepfather, stepmother, and in the case of Latvia, stepsister, stepbrother, step-grandparents and step-grandchildren. Thus, a step-family relationship remains an open issue for both countries and up for interpretation for the obliged entities.

There is also a difference in understanding of a person closely related to the PEP. While the EU and German law provide, that it can be, *inter alia*, natural persons with whom the PEP has "any other close business relations", Latvian law, however, provides a different wording: all natural persons with whom the PEP has business or other close relations. Thus, while the EU requires only business relations to be taken into account, Latvian law suggests that any other close relations other than business shall be taken into account.

While the EU law provides and German law repeats, that after the PEP loses its status, a continuing risk posed by that person should be taken into account by the obliged entities and appropriate measures are to be applied until such time as that person is deemed to pose no further risk specific to PEP[89], Latvian law, nevertheless, provides an exception to this rule in Section 25(5)(1) in case if the PEP has died.

2.3 CRIMINAL LIABILITY

In general, Latvian Criminal Law (hereinafter referred to as the "LCL")[90] in its wording is rather broad and hence is able to partially cover the issues addressed by the 6AMLD. However, Latvian law faces problems in the transposition of the 6AMLD and so far presents only minimum requirements to those provisions which it has addressed so far. As such, Article 3 of the 6AMLD is not actually addressed by LCL although it is partially touched by Section 195[91], Section 314[92], Section 315[93], Section 20[94] (also in relation to Article 4, perfectly covered) and Section 272[95]- most of the requirements of Article 3 of the 6AMLD, however, are not yet covered by LCL[96]. Liability for legal[97] and natural[98] persons committing a crime within the meaning of Article 5 and Article 7 of the 6AMLD is established by LCL. However, the law at the moment does not provide listed sanctions in regard to legal persons[99] for committing ML offences as provided by Article 8 of the 6AMLD[100].At the moment, Article 6 of the 6AMLD is only partially covered in respect to offence committed within the framework of a criminal organization (Section 48(1)(2) of LCL on offence committed in a group of persons and Section 195), if offender is an obliged entity under NILLTPFN as well as if the laundered property derives from activities of organised criminal group and racketeering, illicit trafficking in narcotic drugs and psychotropic substances and corruption.

[89] Article 22 of the 4AMLD.
[90] Krimināllikums (Criminal Law), (June 17, 1998). Available on: https://likumi.lv/ta/en/en/id/88966-the-criminal-law. Accessed May 10, 2021.
[91] On Laundering of the Proceeds from Crime.
[92] On Acquisition, Storage and Disposal of Property Obtained by a Way of Crime.
[93] Failing to Inform about Crimes,
[94] On Join Participation.
[95] On Provision of False Information to a State Institution.
[96] For example, LCL within the meaning of Article (3)(3)(c) does not extend the property derived from conduct (Article 3(1-2)) that occurred on the territory of another MS or of a third country, where that conduct would constitute a criminal activity had it occurred domestically.
[97] Section 70^1 and Section 12 of LCL.
[98] Covered pursuant to wording of Section 195, Section 314, Section 315, Section 20.
[99] While there are types of coercive measures against legal persons as provided by Section 70^2, nevertheless LCL does not provide sanctions mentioned in Article 8 of the 6AMLD.
[100] It should be noted, that penalties for natural persons pursuant to Article 5 are addressed by LCL.

Article 9 is perfectly addressed by Section 42[101], Section 70[12] [102]and Section 70[13] [103]of LCL on the issues related to confiscation of property. Article 10 of the 6AMLD is partially addressed by Section 2 and Section 4 of LCL, however an amendment as to prosecute if the offence was committed even only in part on its territory is needed, as well as provisions regarding extension of jurisdiction pursuant to Article 10(2) of the 6AMLD and cooperation pursuant to Article 10(3) of the 6AMLD. In addition, while the 6AMLD or any other AML Directive do not require it, Section 195[1] provides that non-provision

of information and provision of false information regarding ownership of resources and the true beneficiary is punishable and Section 195[2] criminalizes avoidance of declaring of cash.

Germany, however, unlike Latvia, took a radical and solid step to implement the 6AMLD. In particular, the federal government has reformed the ML budget. The draft law to improve the criminal law fight against money laundering recently passed the Bundestag, which approved it on February 11, 2021[104]. As a result, Germany amended German Criminal Law (hereinafter referred to as the "StGB")[105] transposed the 6AMLD before a transposition while providing stricter laws than those required by the 6AMLD. For instance, it not only transposed all requirements of Article 3 into national law, but also increased the maximum term of imprisonment from the required four years to five years (Section 261 of StGB). While the 6AMLD does not require punishment for whoever unaware of the fact that the object is derived from an unlawful act, Section 261(5) nevertheless provides for a penalty of imprisonment for a term up to two years or a fine. While at the moment German Law does not have a criminal liability of legal entities (corporate liability), StGB in Section 14 and in Section 74e nevertheless provides for liability for natural persons. Sanctions for legal persons can be found in Section 78 of German Civil Law (BGB)[106] and in the Administrative Offenses Act[107]. Besides going beyond what is required by the 6AMLD, Germany is currently in the process of drafting a new law that would entail a corporate criminal liability for legal persons. Given Germany's tough approach to the 6AMLD, it might not be too long before the information of a new Seventh Anti-Money Laundering Directive appears.

It should be noted, that the transposition deadline for the 6AMLD was December 3, 2020, therefore countries that are in delay of transposition of the Directive into national law may suffer enforcement actions to be taken by the European Commission, however, a report on MSs' implementation of the Directive is due to be completed only in 2022.

[101] On Confiscation of Property.
[102] On Confiscation of an Object of a Criminal Offence
[103] Confiscation of the Property Connected with a Criminal Offence.
[104] Haufe.de. Geldwäscheprävention und -bekämpfung 2021: Weitere Initiativen (Preventing and combating money laundering in 2021: Further initiatives), March 17, 2021. Available on: https://www.haufe.de/compliance/recht-politik/reform-des-geldwaeschegesetzes-bringt-verschaerfte-anforderungen_230132_398444.html (in German). Accessed May 10, 2021.
[105] Germany. German Criminal Code, (November 13, 1998). Available on: https://www.gesetze-im-internet.de/englisch_stgb/. Accessed May 10, 2021.
[106] Germany. German Civil Code, (January 2, 2002). Available on: https://www.gesetze-im-internet.de/englisch_bgb/. Accessed May 10, 2021.
[107] Germany. Act on Regulatory Offences, (February 19, 1987). Available on: https://www.gesetze-im-internet.de/englisch_owig/. Accessed May 10, 2021.

3 PROFILE OF LATVIAN AND GERMAN AML/CTF SYSTEM IN REGARD TO THE FINANCIAL SECTOR

For the purpose of this work, this chapter provides an overview of the development of the AML/CTF regulatory framework in regard to the financial sector of Latvia and Germany. As such, this chapter provides a general outlook of risk profiles of countries, main AML/CTF authorities, as well as analysis of the development and current AML/CTF regulatory framework in Latvia and Germany and analysis on how the development of the AML/CTF system of both countries correlates with surrounding it circumstances and what they can reflect.

3.1 LATVIA

3.1.1 RISK PROFILE OF THE COUNTRY

Latvia is a regional financial center with a majority of its commercial banks focusing on servicing foreign customers, mainly from the Commonwealth of Independent States (hereinafter referred to as the "CIS") countries. Given its geographic location, as well as its EU membership and ability to provide services in Russian, Latvia, according to the latest mutual evaluation Moneyval report of 2018 is especially vulnerable to risks posed by clients coming from CIS countries, where economic crime such as corruption remains high[108]. Published in December 2019 follow-up report re-rated the country on ten Recommendations originally rated as "partially compliant" to "largely compliant" and one Recommendation originally rated as "largely compliant" to "compliant"[109]. Thus, nowadays Latvia is compliant on seven of the 40 FATF Recommendations and "largely compliant" on 33 of them[110]. Latvia has also become the first Moneyval member which had brought all 40 FATF recommendations to a level of at least "largely compliant"[111].

The structure of the financial sector suggests, that at the end of 2019, there were 14 banks in Latvia and five branches of foreign banks. The total amount of bank assets at the end of 2019 comprised 2,5 billion EUR, 58% of which are issued loans. At the end of 2019, there were a total of six insurance companies operating in Latvia (two life insurance companies and four non-life insurance companies) as well as eleven branches of foreign insurance companies[112].

Latvia has a history of two national risk assessments (hereinafter referred to as the "NRA"s) for the time period of 2013-2016 and 2017-2018. The latest NRA acknowledged that a significant number of Latvian legal persons and foreign legal entities are very likely involved in ML/TF schemes. However, the NRA does not consider them to be vulnerabilities

[108] Council of Europe, Moneyval. *Latvia Mutual Evaluation Report*, July 2018, pp. 6-8. Available on: https://rm.coe.int/moneyval-2018-8-5th-round-mer-latvia/16808ce61b. Accessed May 10, 2021.
[109] Re-rating concerns recommendations 2, 6, 7, 8, 10, 22, 26, 28, 32, 39, 40. Council of Europe, Moneyval. *Latvia First Enhanced Follow-up Report*, December 2018, p. 4. Available on: https://rm.coe.int/anti-money-laundering-and-counter-terrorist-financing-measures-latvia-/16809988c1. Accessed May 10, 2021.
[110] *Ibid*, p. 14.
[111] Council of Europe, Moneyval. *Committee of Experts on the Evaluation of Anti-money Laundering Measures and the Financing of Terrorism 59th Plenary Meeting Report*, January 2020, p. 15. Available on: https://rm.coe.int/09000016809cc848. Accessed May 10, 2021.
[112] Investment Development Agency of Latvia (LIAA). Financial Environment, available on: https://www.liaa.gov.lv/en/invest-latvia/business-guide/financial-environment. Accessed May 10, 2021.

in the AML/CTF system of the country. A burden of the existing vulnerabilities has been shifted to the private sector and its insufficient understanding of AML/CTF risks in the company service providers sector[113].

Latvia's own level of corruption, vulnerability to international organised crime and significant shadow economy are also key factors of the overall ML risk faced by Latvia. The NRA assesses the overall ML risk of the country as "medium high"[114] and TF risk as "low-medium"[115]. However, according to the Moneyval report in 2018, the risk of TF does not appear to be appropriately identified and assessed by Latvia. It notes that the main sources of criminal proceeds are corruption and bribery, tax offences, fraud and smuggling as confirmed by most judicial and LEAs met onsite. According to the NRA, a significant part of laundered proceeds is generated abroad, while domestic ML mainly pertains to self-laundering. ML methods employed in Latvia are complex and wide-ranging and involve a number of sectors.

International cooperation constitutes a critical component of the country's AML/CTF system. Latvia demonstrates many of the characteristics of an effective system in that area. Overall, the Latvian authorities proactively cooperate with foreign counterparts, effectively providing and seeking not only MLA, but also exchanging financial intelligence, and engaging in joint investigations and cooperation meetings with positive results. However, with the exception of the FCMC, the supervisory authorities do not seem to take an active part in international cooperation. The main challenge appears to be connected with difficulties to obtain assistance from countries of the CIS, which should be critical partners given Latvia's risk profile[116].

3.1.2 COMPETENT AUTHORITIES

Office for the Prevention of Laundering of Proceeds Derived from Criminal Activity or FIU Latvia, established by Section 50 of NILLTPFN, is the competent authority for execution of the financial restrictions to combat international terrorism and manufacturing, storage, transportation, use or distribution of weapon of mass destruction (hereinafter referred to as the "WMD"),[117] as well as institutions which exercise control over suspicious transactions and other information received[118]. Domestically, FIU Latvia distributes up-to-date information to credit institutions and other financial institutions, State Security Service (SSS) and other competent institutions regarding current criteria of identification of the possible TF and PF cases. Similarly, methodological materials for mitigation of TF and financing of WMD risks are prepared and further transferred to the obliged entities under NILLTPFN, as well as information exchange is provided concerning persons that might be linked to terrorism, its financing or PF. Institutions are also informed of important amendments to the national or international laws and regulations. Internationally, FIU cooperates with analogous foreign FIUs, as well as national law enforcement authorities.

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[113] Financial Intelligence Unit Latvia. *Latvia National Terrorist and Proliferation Financing Risk Assessment Report for the time period 2017-2018*, updated in July 2019, p. 3, para. 3. Available on: https://eng.fid.gov.lv/index.php/useful/national-risk-assessment. Accessed May 10, 2021.
[114] *Ibid.*, on a scale of high, medium-high, medium, medium-low and low.
[115] *Ibid.*, p. 3, para. 4.
[116] Moneyval, *supra* note 108, pp. 7-8.
[117] Starptautisko un Latvijas Republikas nacionālo sankciju likums (Law on International Sanctions and National Sanctions of the Republic of Latvia), Section 13(1). Available on: https://likumi.lv/ta/en/en/id/280278-law-on-international-sanctions-and-national-sanctions-of-the-republic-of-latvia. Accessed May 10, 2021.
[118] *Supra* note 50, Section 50(1).

Section 45 of NILLTPFN mentions Supervisory Authorities that determine ML and TF risk identification and assessment methodology in accordance with the activity of the supervised and controlled obliged entities under NILLTPFN. Duties and rights of the Supervisory Authorities have been laid down in Sections 46 and 47 of NILLTPFN. As such, a supervisor in the financial sector as mentioned earlier is the FCMC, which, according to Section 45(1)(1) controls credit institutions, electronic money institutions, insurance companies, insofar as they are carrying out life insurance or other insurance activities related to the accumulation of funds, private pension funds, insurance intermediaries, insofar as they are providing life insurance services or other insurance services related to the accumulation of funds, investment brokerage companies, managers of alternative investment funds, investment management companies, savings and loans associations, providers of re-insurance services and payment institutions.

While the FCMC displays the highest level of risk-understanding, other supervisors, however, demonstrate widely varying views and knowledge about ML/TF risks. In particular, issues such as understanding the nature or significance of ML/TF risks, or a lack of knowledgeable resources, prevented the supervisory authorities from fully implementing programs focused on higher-risk market segments[119].

3.1.3 DEVELOPMENT OF THE AML/CTF SYSTEM AND REGULATORY FRAMEWORK

Following the allegations made by Financial Crimes Enforcement Network (hereinafter referred to as the "FinCEN") in its report in respect to Latvia's third largest bank ABLV where it is claimed that at least 50 million EUR may have been laundered by the bank between 2015 and 2018, Latvia has suffered a lot of changes in its AML/CTF regulatory framework. Although a recent report by the Corruption Prevention and Combating Bureau (KNAB)[120] has failed to prove the involvement of ABLV Bank's management in bribery as claimed in the FinCEN report and hence the criminal proceeding was terminated, this case nevertheless served as a trigger that Latvian AML/CTF system has shortcomings that need to be addressed. In particular, the case of ABLV revealed that the bank had very high levels of non-resident deposits and an extremely large and risky non-resident customer base, which was not adequately monitored. In this regard, the bank faced a similar allegation as it was with Trasta Komercbanka, another Latvian bank that was at the heart of "Russian laundromat[121]" and which was as a result closed down in 2016. Additionally, as FinCEN claims in the report, the bank not only facilitated transactions for North-Korea-sanctioned entities, but also that it lied about doing so, breaking by that sanctions all over the world; the bank was involved in the theft of over 1 billion USD in assets from three Moldovan banks in 2014, and covers ML[122]. Although the ABLV case is not over yet and allegations are not proven yet, the very initiation of proceeding against one of the largest banks in Latvia has made a lot of damage to

[119] Moneyval, *supra* note 108, p. 7.
[120] Original name is *Korupcijas novēršanas un apkarošanas birojs* (KNAB) is the leading specialised anti-corruption authority of Latvia.
[121] In this context, a "laundromat" describes a set of uncovered methods that are used to launder money on a grand scale which are made up of complex international company networks and transaction patterns.
[122] Financial Crimes Enforcement Network. *Proposal of Special Measure Against ABLV Bank, AS as a Financial Institution of Primary Money Laundering Concern*, Federal Register, Volume 83, Issue 33, February 16, 2018. Available on: https://www.fincen.gov/sites/default/files/federal_register_notices/2018-02-16/2018-03214.pdf. Accessed May 10, 2021.

the country's image[123]. Although Latvian banks have already been alleged by FinCEN, in cases with VEF Bank and Multibanka, the scale of the problem has never been that big before.

In the mutual evaluation Moneyval report of 2018, only six recommendation were compliant with the FATF Recommendations[124], 18 were rated as largely compliant[125], and the others were rated as partially compliant. The report also rated the effectiveness of the system, where only international cooperation was rated as substantially effective. At the same time, TF preventive measures and TF/PF financial sanctions, were rated as being low in effectiveness. Other areas were rated as moderately effective.

To resolve the revealed shortcomings of Latvian system, Latvia took radical steps to follow Moneyval Recommendations. Since 2012, NILLTPFN has been amended several times (with the latest amendments enforced on June 13, 2019)[126], as well as amendments to the Law on International Sanctions and National Sanctions of the Republic of Latvia (with the latest amendments enforced on June 13, 2019)[127], to the Criminal Law (with the latest amendments related to AML/CTF enforced on July 7, 2020)[128], to the Law On Declaration of Cash at the State Border (with the latest amendments enforced on July 1, 2019)[129], to the Law on the Financial and Capital Market Commission (with the latest amendments enforced on June 29, 2019)[130] were made. As noted by the Moneyval report in July 2018:

> [u]ntil recently, the judicial system of Latvia did not appear to consider ML as a priority and to approach ML in line with its risk profile as a regional financial centre. This appears to have changed lately to a certain extent, with some large-scale ML investigations underway, involving bank employees having actively facilitated the laundering of proceeds[131].

As a result, in October 2018, Latvia adopted an action plan to implement Moneyval recommendations on strengthening the abilities to fight financial crime to achieve effective results[132]. This plan has been called a "massive refurbishment of Latvia's finance system" and

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[123] As well as led to the volunteer liquidation, see *ABLV Bank AS* v *European Central Bank*, T-281/18, ECLI:EU:T:2019:296.
[124] Moneyval, *supra* note 108, p. 14, recommendations 1, 4, 9, 21, 27, 34.
[125] *Ibid*, recommendations 2, 3, 5, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 23, 24, 25, 29, 30, 31, 33, 35, 36, 37, 38.
[126] *Grozījumi Noziedzīgi iegūtu līdzekļu legalizācijas un terorisma finansēšanas novēršanas likumā* (Amendments to the Law on the Prevention of Money Laundering and Terrorist Financing), *Latvijas Vēstnesis*, 129, June 28, 2019. Available on: https://likumi.lv/ta/id/307811-grozijumi-noziedzigi-iegutu-lidzeklu-legalizacijas-un-terorisma-finansesanas-noversanas-likuma. Accessed May 10, 2021.
[127] Grozījumi Starptautisko un Latvijas Republikas nacionālo sankciju likumā (Amendments to the Law on International and National Sanctions of the Republic of Latvia*), Latvijas Vēstnesis*, *124*, June 20, 2019. Available on: https://likumi.lv/ta/id/307657-grozijumi-starptautisko-un-latvijas-republikas-nacionalo-sankciju-likuma. Accessed May 10, 2021.
[128] *Grozījumi Krimināllikumā* (Amendments to the Criminal Law), Latvijas Vēstnesis, 119, June 22, 2020. Available on: https://likumi.lv/ta/id/315653-grozijumi-kriminallikuma. Accessed May 10, 2021.
[129] Grozījumi likumā "Par skaidras naudas deklarēšanu uz valsts robežas" (Amendments to the Law "On Declaring Cash at the State Border"), *Latvijas Vēstnesis, 129*, June 28, 2019. Available on: https://likumi.lv/ta/id/307803-grozijumi-likuma-par-skaidras-naudas-deklaresanu-uz-valsts-robezas-. Accessed May 10, 2021.
[130] Grozījumi Finanšu un kapitāla tirgus komisijas likumā (Amendments to the Law on the Financial and Capital Market Commission), *Latvijas Vēstnesis, 129*, June 28, 2019. Available on: https://likumi.lv/ta/id/307806-grozijumi-finansu-un-kapitala-tirgus-komisijas-likuma. Accessed May 10, 2021.
[131] Moneyval, *supra* note 108, p. 9.
[132] Guna Snore, "Latvia's latest technical report to MONEYVAL demonstrates measurable progress in enhancing national AML/CFT frameworks", *Cabinet of Ministers Republic of Latvia*, August 30, 2019. Available on: https://www.mk.gov.lv/en/article/latvias-latest-technical-report-moneyval-demonstrates-measurable-progress-enhancing-national-amlcft-frameworks. Accessed May 10, 2021.

a “grand cleansing operation” aimed at dramatically reducing non-resident deposits in Latvia’s financial system and renewing the system’s reputation[133].

However, despite all efforts taken by Latvia so far, some deficiencies remain in Latvia’s technical compliance framework that are yet to be addressed, for example with respect to preventive measures, the TFS regime, international cooperation, investigation, prosecution, confiscation and others, as provided by the Action Plan of AML/CTF for the period 2020-2022[134].

3.1.4 CURRENT AML/CTF SYSTEM AND REGULATORY FRAMEWORK

After Latvia made changes to its AML/CTF system, in 2020 it was announced that Latvia avoided being placed on the international ML "grey list" by FATF. In its decision, FATF recognized the progress of Latvia by saying that[135]:

> Latvia has set up a strong and robust financial crime prevention system and will not be subject to 'enhanced surveillance' or 'grey listing'.

This decision was commented by the Prime Minister of Latvia, Krisjanis Karins[136]:

> [t]he overhaul of Latvia’s financial sector supervision has been a resounding success – we have re-established the reputation of our country and created a strong and robust anti money laundering system.

A contributing factor to avoiding being placed on a grey list are not only changes made to the national AML/CTF system, but also because of the growing awareness of the ML/TF risks, as can be seen in the latest NRA which demonstrates that STRs have begun to be more often sent to the FIU. In 2018, the FIU reported that altogether it received 6,617 STRs (3,202 were eventually assessed), comparing to 7,722 STRs (2,462 were eventually assessed) in 2017, and 5,008 STRs (2,068 were eventually assessed) in 2016[137]. Notably, this data may indicate a possible existence of the use of defensive reporting by obliged entities. In 2018, financial assets of the total amount of 101,482,000 EUR were seized, which is historically the largest amount of seized financial assets. Although no data regarding unusual transactions reports (hereinafter referred to as the “UTR”s) is provided in the NRA, which was deemed by Moneyval as an indicator of general confusion between UTRs and STRs in the country[138], a new report of the FIU does provide it.

The FCMC reported that in 2018-2019 all high-risk banks have been subjected to the FCMC on-site inspections and that all banks have undergone ML risk assessment. In the time period of 2016-2019, a total amount of 17 fines worth 18,7 million EUR was issued.

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[133] Financial Secrecy Index. *Narrative Report on Latvia*, Tax Justice Network, February 18, 2020. Available on: https://fsi.taxjustice.net/PDF/Latvia.pdf. Accessed May 10, 2021.

[134] Par pasākumu plānu noziedzīgi iegūtu līdzekļu legalizācijas, terorisma un proliferācijas finansēšanas novēršanai laikposmam no 2020. līdz 2022. gadam (On an action plan for the prevention of money laundering, terrorism and proliferation financing for the period 2020-2022), *Latvijas Vēstnesis, 192*, October 5, 2020. Available on: https://likumi.lv/ta/id/317729-par-pasakumu-planu-noziedzigi-iegutu-lidzeklu-legalizacijas-terorisma-un-proliferacijas-finansesanas-noversanai-laikposmam. Accessed May 10, 2021

[135] LSM. “Latvia avoids being placed on international money-laundering "gray list", February 21, 2020. Available on: https://eng.lsm.lv/article/economy/banks/latvia-avoids-being-placed-on-international-money-laundering-gray-list.a349027/.

[136] *Ibid.*

[137] Office for Prevention of Laundering of Proceeds Derived from Criminal Activity. *Annual Report for 2018*, March 31, 2019, p. 5, Table “Reports on suspicious transactions and performed financial intelligence”. Available on: https://eng.fid.gov.lv/images/Downloads/about/reports/Report_2018_EN.pdf. Accessed May 10, 2021.

[138] Moneyval, *supra* note 108, p. 6.

However, in 2020, there were only a few cases where the FCMC had to decide on administrative proceedings or the application of sanctions[139]. A general number of non-resident's deposits in Latvian bank has dropped by 29% in 2019 comparing to 2015. As a result, in 2019 in Latvian bank only 6% of deposits were held by non-residents, comparing to 35% in 2015[140]. Such a decline indicates a general trend of not tolerating risk related to non-residents – obliged entities more often terminate the business relationship with non-residents due to their low risk appetite associated with a given risk factor. On January 7, 2021, FCMC reported that "generally banks had taken substantial steps to improve internal control systems"[141].

According to Transparency International Corruption Perception Index, Latvia is ranked 42th out of 180 countries with a score 57/100, meaning that country is moderately corrupted. Over the past nine years, Latvia's score as, well as rank, have been improving every year, comparing to its position in 2012 with being ranked as 54th with a score 49/100[142]. At the same time, Latvia is scored 68.3/100 in Worldwide Governance Indicators – Control of Corruption, where 100 indicates a perfectly clear from corruption state. Latvia's score in the Worldwide Governance Indicators has been constantly growing since 1996[143]. According to the Basel AML Index in 2021[144], Latvia is scored with 4.62[145] and is ranked 52th, meaning that country presents a medium risk[146] In the regional context of Europe and Central Asia, Latvia is ranked 31st out of 52 countries[147].

Despite positive progress, Latvia, however, remains in enhanced follow-up procedures and is obliged to report back to Moneyval on further progress to strengthen its implementation of AML/CFT measures. According to Moneyval, Latvia remained a subject of the enhanced follow-up mainly because of the number of low and moderate ratings awarded for effectiveness. It is provided, that uneven and overall inadequate appreciation, understanding and awareness of the ML/TF risks remain in place[148].

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[139] LSM. "Regulator: Latvian banks have taken 'substantial steps' to counter money laundering", January 7, 2021. Available on: https://eng.lsm.lv/article/economy/banks/regulator-latvian-banks-have-taken-substantial-steps-to-counter-money-laundering.a388065/. Accessed May 10, 2021

[140] FCMC. *Infographics: FCMC progress in the AML/CTF field*, February 2020. Available on: https://www.fktk.lv/en/news/infographics/fcmc-progress-in-the-aml-cft-field/. Accessed May 10, 2021. *See also* Joshua Kirschenbaum, "Latvian Banking: Recent Reforms, Sustainable Solutions", *Alliance for Securing Democracy*, May 24, 2018. Available on: https://securingdemocracy.gmfus.org/latvian-banking-recent-reforms-sustainable-solutions/. Accessed May 10, 2021.

[141] LSM, *supra* note 139.

[142] Transparency International. *Corruption Perception Index: Latvia*. Available on: https://www.transparency.org/en/cpi/2020/index/nzl. Accessed May 10, 2021

[143] The World Bank. *Worldwide Governance Indicators, Control of Corruption: Latvia*. Available on: https://databank.worldbank.org/source/worldwide-governance-indicators. Accessed May 10, 2021

[144] Basel Institute of Governance. *Basel AML Index Expert Edition Ranking by May 10, 2021, Latvia*.

[145] In the min-max 0-10 system, where 10 indicates the highest risk level. Overall score of the country takes into account other factors, *i.e.* ML/TF Risk is scored with 5.27, Corruption Risk is scored with 3.94, Financial Transparency & Standards is scored with 3.67, and Political and Legal Risk is scored with 4.29. For Public Transparency and Accountaibility data is not available.

[146] On a scale of high, medium-high, medium, medium-low and low.

[147] Basel Institute of Governance, *supra* note 140.

[148] *See* Andrew Bowen, and Galeotti Mark. "Latvia and Money Laundering: An Examination of Regulatory and Institutional Effectiveness in Combating Money Laundering". *Central European Journal of International & Security Studies*, Volume 8, Issue 4: pp. 78-98. Prague, 2014. *See also* Arnis Lagzdins and Biruta Sloka, "Compliance and the Recovery of Financial Services of the European Union: New Challenges for Latvia's Banking Sector", *European Integration Studies*, Issue 5, pp. 132-140, Kaunas: Kaunas University of Technology, 2011, accessed May 10, 2021, doi:10.5755/j01.eis.0.5.1088.

3.2 GERMANY

3.2.1 RISK PROFILE OF THE COUNTRY

Germany is one of the largest financial centres in Europe, thus making it attractive to organized criminals and tax evaders. The financial sector of Germany is among the largest in the world and crucial to the strong industrial base that underpins the country's prosperity. Unlike Latvia, Germany is not subject to the enhanced follow-up procedures by Moneyval. The latest mutual assessment report of Germany prepared by FATF in 2010 suggests, that because of Germany's large economy, as well as its strategic location in Europe and its strong international linkages, Germany is susceptible to ML and TF. As such, the report presents, that substantial proceeds of crime are generated in Germany, at the time of the report estimated to be 40 EUR to 60 EUR billion, inclusive of tax evasion, annually[149]. In regard to TF, terrorists have carried out terrorist acts in Germany and in other nations after being based in Germany. After Germany has made sufficient progress in addressing the deficiencies identified in its 2010 mutual evaluation report, it was decided in 2014 in the third follow-up report that Germany is removed from the regular follow-up process. Therefore, so far, the third follow-up report of Germany represents the latest version of the country's compliance with FATF Recommendations. In the present, dates of the Fourth Round of Mutual Evaluations of Germany are still not set, however, it is expected to be in 2021.

The structure of the financial sector suggests, that in 2019, there were 1,717 credit institutions active in Germany, of which 276 were private banks. In addition, Germany is an important FinTech market in Europe and the fourth largest in the world. Germany's insurance market – measured in terms of premium revenue – is the second-largest reinsurance market in the world after the USA[150].

Germany has a history of only one NRA for the time period of 2018-2019. According to its findings, the ML and TF risks in Germany are rated as "medium-high"[151]. The main reason for such ranking is the availability of options for conducting transactions anonymously, such as in cash[152]. The report underlines that cash is highly popular in Germany and the overwhelming majority of Germans regularly pay in cash. According to a Deutsche Bundesbank study on payment behaviour in Germany in 2017, cash accounts for 48% of all turnover (about 74% of all transactions[153]). In 2020, however, largely due to pandemic, a share of cash transactions dropped to 60% of all transactions[154]. However, a number remains to be high considering the risk posed by the cash transactions - cash is generally suited to ML

[149] FATF. *Germany Mutual Evaluation Report*, February 19, 2010, p. 9. Available on: https://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20Germany%20full.pdf. Accessed May 10, 2021
[150] Germany Trade & Invest (GTAI). Financial Sector, available on: https://www.gtai.de/gtai-en/invest/industries/financial-sector. Accessed May 10, 2021.
[151] On a scale of high, medium-high, medium, medium-low and low. Federal Ministry of Finance, Germany First National Risk Assessment 2018/2019, October 19, 2019, p. 25 and p. 44. Available on: https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Press_Room/Publications/Brochures/2020-02-13-first-national-risk-assessment_2018-2019.pdf?__blob=publicationFile&. Accessed May 10, 2021.
[152] *Ibid.*, p. 26.
[153] Deutsche Bundesbank. *Payment Behaviour in Germany* in 2017, February 14, 2018, p. 38. Available on: https://www.bundesbank.de/en/publications/reports/studies/payment-behaviour-in-germany-in-2017-737278. Accessed May 10, 2021.
[154] Deutsche Bundesbank. *Payment Behaviour in Germany in 2020*, January 14, 2021, p. 3. Available on: https://www.bundesbank.de/en/publications/reports/studies/payment-behaviour-in-germany-in-2020-858022. Accessed May 10, 2021.

as its anonymity makes it possible to avoid leaving a trail[155]. Special attention to other options for conducting transactions anonymously should be given as well, where certain crypto assets and prepaid credit cards may present a risk. Given a high share of cash transactions in Germany, as well as the availability of other options to conduct transactions anonymously, it is especially important for obliged entities to maintain efficient AML/CTF internal policies to identify counterparties and attempts to conceal the illegal origin of money. In this regard, the game of chance/betting sector, trade-based sector, catering, craft trades are sectors of increased control due to their cash-intensiveness[156]. In addition, German AML/CTF system remains to be vulnerable in the real estate sector, Organised Crime in the Form of Clan Crime, Serious (Tax) Criminal Acts, *e.g*. Carousel Fraud, Commercial Fraud and Identity Theft, Use of New Payment Methods, Misuse of NGOs/NPOs, Misuse of Money and Value Transfer Services[157].

Corruption plays a fairly minor role in Germany in terms of the frequency of cases, however, it also tends to entail complex investigations, in some instances involving an international dimension and relatively large monetary amounts[158]. The small number of ML investigations and convictions following corruption offences is frequently due to the use of other options for clearing up offences under German law[159]. From 2014 to 2016, between 4,300 to 6,600 corruption cases were reported annually[160]. Investigating and prosecuting tax evasion is a major concern for Germany and is vigorously pursued. This is reflected in the criminal tax cases concluded in Germany from 2014 to 2016, with between about 13,800 and 15,300 such cases finally concluded annually[161]. Value added tax (hereinafter referred to as the "VAT") evasion, in particular, tends to be an offence committed on an organised and commercial basis. It cannot be ruled out that there may be a large number of unreported cases of VAT evasion and that this number may further rise due to the good economic situation. Not all tax offences are currently listed as ML predicate offences, however, it is suggested that predicate offence must in any case be more than 'simple' tax evasion in order to come within the scope of criminal liability for ML[162]. The majority of ML predicate offences in Germany took place domestically, however, frequently also have links to multiple countries. The ML threat for Germany was assessed as high risk with regard to the following eleven regions/states: Eastern Europe (i.e. Latvia and Russia)[163], Turkey, China, Cyprus, Malta, British Virgin Islands, Cayman Islands, Bermuda, Guernsey, Jersey and Isle of Man.

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[155] Federal Ministry of Finance, *supra* note 151, p. 26.
[156] *Ibid.*, *see also* Financial Intelligence Unit Germany. *Annual Report 2019*, June 2020, p. 32. Available on: https://www.zoll.de/SharedDocs/Downloads/DE/Links-fuer-Inhaltseiten/Fachthemen/FIU/fiu_jahresbericht_2019_en.pdf?__blob=publicationFile&v=2. Accessed May 10, 2021.
[157] *Ibid.*, pp. 32-33.
[158] Federal Ministry of Finance, *supra* note 151, p. 29.
[159] In particular, sections 154 (Partial suspension in the event of several offenses) and 154a (Limitation of prosecution) of the Code of Criminal Procedure. Available on: https://www.gesetze-im-internet.de/stpo/. Accessed May 10, 2021.
[160] Federal Ministry of Finance, *supra* note 151, p. 30, Table 2: Predicate offences with medium money laundering threat.
[161] *Ibid.*
[162] *Ibid.*, p. 29.
[163] *Ibid*, pp. 31-32. It is suggested, that Russian and Russian-speaking OC groups pose a substantial and sustained ML threat to German (and European) security interests. Western Europe is thus a focus of Russian OC money laundering activities. ML risk is additionally amplified by close ties between Russian OC and intelligence structures in the region.

International cooperation is an important aspect of the German AML/CTF system due to the large amount of cross-border cases[164], however, as the report suggests, it was not always possible, despite requests for MLA, exchange between FIUs and via Interpol, to determine conclusively where (in Germany or abroad) the predicate offence took place, or where the incriminated funds originated[165].

3.2.2 COMPETENT AUTHORITIES

Germany FIU is the central office for financial transaction investigations, which analyses SARs under GwG. In particular, according to Section 28 of GwG, it is responsible for collecting and analysing information related to ML/TF and passing this information on to the competent domestic public authorities for the purpose of the investigation, prevention or prosecution of such offences. Section 50 of the GwG lists all supervisory authorities for different sectors, where the supervisory authority for obliged entities in the financial sector as mentioned earlier is BaFin. In particular, according to Section 50(1), BaFin supervises credit institutions with the exception of the Deutsche Bundesbank, financial services institutions as well as payment institutions and electronic money institutions, domestic branches and branch offices of credit institutions domiciled abroad, financial services institutions domiciled abroad and payment institutions domiciled abroad, asset management companies within the meaning of section, domestic branch offices of EU management companies and of foreign alternative investment fund, management companies , foreign alternative investment fund management companies for which Germany is the member state of reference, agents and electronic money agents, companies and persons under section 2 (1) no. 5[166] and the KfW[167] Banking Group. As it already can be seen, subjects of the financial sector are different in Latvia and Germany, which not only indicates the differences in the work of the supervising authorities, but also indicates a different approach to the financial sector and understanding of it in the country. Additionally, BaFin represents the AML work of Germany internationally, it is the most authoritative regulator in Germany in the area of AML/CTF.

Section 51 of GwG clarifies competence, rights and duties of the supervisory authorities, such as take steps to enforce compliance of obliged entities with the law, possibility to conduct inspections, review compliance of the obliged entities. Notably, the supervisory authorities may, unlike in Latvia, delegate the conduct of the inspections to other persons and institutions by contract. *Ad-hoc* exchange between agencies takes place as needed. The main state agencies to be involved alongside the supervisory authorities are police forces, the FIU and the intelligence services[168].

3.2.3 DEVELOPMENT OF THE AML/CTF SYSTEM AND REGULATORY FRAMEWORK

Although Germany was removed from a regular follow-up procedure of Moneyval, a constant improvement of the AML/CTF system was required given the risk profile of the country and existing deficiencies in the system. A report by the International Monetary Fund (IMF) on Germany published in 2016 suggests, that although Germany has introduced a significant number of reforms to enhance its AML/CTF regime since the last FATF mutual assessment

[164] *Ibid.*, p. 41.
[165] *Ibid.*, p. 25.
[166] *Supra* note 64.
[167] Reconstruction Credit Institute, original name is *Kreditanstalt für Wiederaufbau* (KfW).
[168] Federal Ministry of Finance, *supra* note 151, p. 38.

report[169], nevertheless many issues are still to be addressed and improved[170]. Since then, Germany made quite a few amendments to the AML/CTF system, however, as it can be seen in the NRA report, room for development and improvement still exists. As such, following the findings in the NRA report, a new amended version of the GwG entered into force in January 2020[171], as well as the Strategy to counter ML/TF and to come closer to the European goal of combating ML/TF more successfully was presented by the Federal Ministry of Finance of Germany on July 30, 2020, where, in particular, a need of further prioritization of AML/CTF was highlighted[172]. As such, to address deficiencies present in the real estate sector, Anti-Money Laundering Act Reporting Duty Ordinance - Real Estate was adopted and entered into force on October 1, 2020.[173]

Moreover, recent ML investigation cases in the financial sector of Germany, in particular, Wirecard AG[174], Deutsche Bank[175], Danske Bank[176] (named as the biggest ML scandal in Europe by the European Commission[177]), trigger new changes to be made not only in the GwG, but also reforms in the work of the supervisory authorities is required. As such, the action plan "Combating balance sheet fraud and strengthening control over capital and financial markets"[178], which arose in the context of the events surrounding Wirecard AG was presented by Germany during its EU Council Presidency. Additionally, the draft law for the Financial Market Integrity Act[179] was presented on December 16, 2020, which aims to amend 25 individual laws and acts was presented by Federal Government and intends to help

[169] Key legislative actions were taken including amendments to the following: the Criminal Code (Strafgesetzbuch); the Anti-Money Laundering Act (GwG) financial laws including the Banking Act (Kreditwesengesetz); and the Administrative Offenses Law. Germany also improved its oversight over DNFBPs by increasing the number of supervisory staff and with the Länder increasing their sanctions over supervised entities. International Monetary Fund. Country Report No. 16/190, Germany Financial Sector Assessment Program Anti-Money Laundering and Combating the Financing of Terrorism – Technical Note, June 2016, p. 8. Available on: https://www.imf.org/external/pubs/ft/scr/2016/cr16190.pdf. Accessed May 10, 2021.

[170] *Ibid*., p. 6.

[171] Which, in particular, contained changes related to obligation to register with the Financial Intelligence Unit, increased due diligence requirements, reporting obligations to the transparency register for limited partnerships, and others.

[172] Federal Ministry of Finance. *Strategy to counter money laundering and terrorist financing*, July 30, 2020. Available on: https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Press_Room/Publications/Brochures/2020-07-30-strategy-to-counter-money-laundering.html. Accessed May 10, 2021.

[173] Original name of the law is *Verordnung zu den nach dem Geldwäschegesetz meldepflichtigen Sachverhalten im Immobilienbereich*, also known as *GwGMeldV-Immobilien.*

[174] Jörn Poltz, "German prosecutors open Wirecard money laundering probe", *Reuters*, July 9, 2020. Available on: https://www.reuters.com/article/us-wirecard-accounts-probe-idUSKBN24A1EH. Accessed May 10, 2021

[175] Henrik Böhme, "Deutsche Bank's biggest scandals", *Deutsche Welle*, September 20, 2020. Available on: https://www.dw.com/en/deutsche-banks-biggest-scandals/a-54979535. Accessed May 10, 2021

[176] *Ibid*., *see also* German authorities raid Deutsche Bank over Danske scandal, Reuters, September 25, 2019. Available on: https://www.reuters.com/article/us-deutsche-bank-raid-idUSKBN1WA1IX. Accessed May 10, 2021.

[177] Rupert Neate and Jennifer Rankin, "Danske Bank money laundering 'is biggest scandal in Europe'", *The Guardian*, September 20, 2018. Available on: https://www.theguardian.com/business/2018/sep/20/danske-bank-money-laundering-is-biggest-scandal-in-europe-european-commission. Accessed May 10, 2021

[178] Federal Ministry of Finance. *Combating financial reporting fraud and strengthening controls over financial markets*, October 9, 2020. Available on: https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/Financial_markets/Articles/2020-10-09-combating-financial-reporting-fraud-strengthening-controls-financial-markets.html. Accessed May 10, 2021.

[179] Original name of the law is *Finanzmarktintegritätsgesetz,*

uncover fraudulent acts on the financial market more quickly, while at the same time reforming financial supervision and balance sheet control[180].

According to the Germany FIU Annual Report in 2019, suspected cases of ML/TF and jumped by 49% in 2019 compared to the previous year, with the total amount of 114,914 received STRs. The report also suggests, that since 2009, the annual total number of STRs received in Germany has multiplied by a factor of almost twelve, while the high total number of STRs started posing a great challenge in 2017[181]. Since then, the number of STRs received each year has almost doubled which makes further development of the AML/CTF system particularly important. For the year of 2019, the FIU reported that it managed to make its filter function of STRs more efficient[182], where 17,565 feedback reports were received back from the public prosecution authorities after reports were disseminated to the authorities by the FIU.[183]. Altogether, 156 penalty orders, 133 indictments and 54 convictions were issued. In regard to fines imposed as part of convictions, approximate amount was 1,750 EUR on average. When custodial sentences were imposed, they amounted to just under 12 months on average. For penalty orders, the average fine amounted to around 2,200 EUR[184].

For the reference year, BaFin initiated a total of 319 administrative fine proceedings and imposed administrative fines totalling 9,625,900 EUR[185]. It is, however, suggested, that compared to previous year[186], the total amount of administrative fines was lower because in 2019 BaFin put the focus of its prosecution practice on pursuing administrative offences at institutions rather than at agents. In 2019, BaFin initiated 110% more proceedings against institutions than in 2018. As BaFin President Felix Hufeld outlined in this regard, "[w]e have adapted our supervisory requirements in light of the crisis"[187].

3.2.4 CURRENT AML/CTF SYSTEM AND REGULATORY FRAMEWORK

It should be noted, that Germany presides the FATF for the time period of 2020-2022[188] which indicates international acknowledgment of German success in developing and improving its AML/CTF system, as well as serving as a good example for other countries in dealing with ML/TF risks[189]. While Germany is often perceived as a country of primary concern when it comes to ML/TF threats, a general understanding of the ML/TF risks in the country is high and the system is constantly developing[190], while new laundromats[191] are

[180] Federal Ministry of Justice and Consumer Protection. *Law to Strengthen Financial Market Integrity*, December 16, 2020. Available on: https://www.bmjv.de/SharedDocs/Gesetzgebungsverfahren/DE/Finanzmarktintegritaet.html (in German). Accessed May 10, 2021.
[181] Financial Intelligence Unit Germany, *supra* note 151, p. 15.
[182] *Ibid.*, p. 20.
[183] *Ibid*., p. 21.
[184] *Ibid*., p. 22.
[185] BaFin. *Annual Report 2019*, August 17, 2020, p. 40. Available on: https://www.bafin.de/EN/PublikationenDaten/Jahresbericht/jahresbericht_node_en.html. Accessed May 10, 2021.
[186] *Ibid*., p. 42.
[187] BaFin. *Annual Press Conference*, May 15, 2020. Available on: https://www.bafin.de/SharedDocs/Veroeffentlichungen/EN/Meldung/2020/meldung_2020_05_12_Pressekonferenz_en.html. Accessed May 10, 2021.
[188] FATF. *Priorities for the Financial Action Task Force (FATF) under the German Presidency, Objectives for 2020-2022*. Available on: http://www.fatf-gafi.org/media/fatf/documents/German-Presidency-Priorities.pdf. Accessed May 10, 2021.
[189] Given the fact, that President of the FATF is appointed by the FATF Plenary from among its members.
[190] Buzzer.de. Changes to the AML Act (GwG), available on: https://www.buzer.de/gesetz/12598/l.htm. Accessed May 10, 2021.

constantly researched and reported. However, as from time to time new scandals related to ML arise in the country, Germany has to constantly review and update its policy in relation to ML/TF.

According to Transparency International Corruption Perception Index, Germany is ranked as 9th out of 180 countries with a score 80/100, meaning that country is corrupted less than on average. Over the past nine years, a score of Germany, as well as rank, have been mainly stable, however, also improving comparing to its position in 2012 with being ranked as 13th with score 79/100[192]. At the same time, Germany is scored 95.2/100 in Worldwide Governance Indicators – Control of Corruption, where 100 indicates a perfectly clear from corruption state. Germany's score in the Worldwide Governance Indicators has been either stable or growing since 2007[193]. According to the Basel AML Index in 2021[194], Germany is scored with 4.41[195] and is ranked as 40th, meaning that country presents a medium-low risk[196]. In the regional context of Europe and Central Asia, Germany is ranked 26th out of 52 countries[197].

3.3 CORRELATION BETWEEN CURRENT NATIONAL AML/CTF SYSTEMS AND THEIR DEVELOPMENT WITH PROFILES OF COUNTRIES

It can be seen that both Latvia and Germany actively started improving their AML/CTF systems after new emerging risks of ML/TF started reaching countries' financial sectors. After many changes to address these risks have been undertaken by countries at different levels, at the moment it can be said that countries demonstrate high achievements in the improvement of their AML/CTF systems. In particular, most of the changes affected primarily those areas that were most vulnerable.

For example, in the case of Germany, changes affected on a large scale the real estate sector, the banking sector, as well requirements for transactions related to cash and understanding of suspicious transactions were tightened. While Germany holds very good positions in the rankings provided earlier which in general reflects very good AML/CTF system established in the country, together with other international recognition received by the country, such as presiding over the FATF, scandals related to ML are nevertheless present in the country and continue to emerge. To improve its system against ML/TF risks in the financial sector, not only a completely new version of the GwG was introduced, but also a draft bill of the Financial Market Integrity Strengthening Act which aims to amend 25 individual laws and acts was presented by Federal Government. In addition to the tough approach of the full transposition of the 6AMLD, Germany decided to go even further beyond

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[191] Financial Intelligence Unit Germany, *supra* note 156, p. 16.
[192] Transparency International. *Corruption Perception Index: Germany*. Available on: https://www.transparency.org/en/cpi/2020/index/nzl. Accessed May 10, 2021.
[193] The World Bank. *Worldwide Governance Indicators, Control of Corruption: Germany*. Available on: https://databank.worldbank.org/source/worldwide-governance-indicators. Accessed May 10, 2021.
[194] Basel Institute of Governance. *Basel AML Index Expert Edition Ranking by May 10, 2021, Germany.*
[195] In the min-max 0-10 system, where 10 indicates the highest risk level. Overall score of the country takes into account other factors, *i.e.* ML/TF Risk is scored with 5.4, Corruption Risk is scored with 1.63, Financial Transparency & Standards is scored with 3.13, Public Transparency and Accountability is scored with 4.05, Political and Legal Risk is scored with 2.2.
[196] On a scale of high, medium-high, medium, medium-low and low.
[197] Basel Institute of Governance, *supra* note 194.

what is necessary and at the moment prepares a draft of the Corporate Sanctioning Act[198] which entails a corporate criminal liability for legal persons. While there is a tendency of the improvement work and efficiency of the AML/CTF system and work of the competent authorities, according to the strategy on the further plan to combat AML/CTF, Germany decides to keep tighten the requirements related to AML/CTF in the future.

In the case of Latvia, following a threat to be put into the grey list of the FATF after the started proceedings against one of the largest banks in Latvia, ABLV Bank, Latvia introduced a number of changes that affected a significant amount of legal instruments of Latvia having a direct or indirect relation to AML/CTF system. However, even after it was revealed that Latvia eventually avoided being put into the grey list, and after a respective recognition of the country's success in strengthening the AML/CTF system was received both domestically by improved work of supervisory authorities as provided by the reports of FCMC and FIU Latvia and internationally by receiving recognition of the achievements by different international organizations reflected also in a number of rankings. However, the country has not stopped its progress and shared its plans for further strengthening of control of the AML/CTF system. Latvia has learned its lesson as it can be in the Action Plan of AML/CTF for the period 2020-2022, which, in particular, tends to address recommendations made by the Moneyval Latvia Follow-up Report on 22 January 2020 and the assessment of Latvia's effectiveness in NILLTPFN approved by the FATF Plenary in February 2020. In particular, the plan specifically sets a priority to increase the compliance of the financial sector NILLTPFN and restore the country's reputation. The plan provides for a wide range of ambitious measures which are going not only to strengthen the system but also to increase its efficiency. Latvia tends to improve the AML system not only domestically, but also at the European level. As such, Latvian Finance Minister Dana Reizniece-Ozola called for "the creation of a financial intelligence unit at the EU level as the scope of combating ML/TF goes far beyond the supervision of the financial sector[199]. However, the increasingly demanding regulatory requirements have led to the phenomenon of "de-risking", pursuant to which Latvian financial institutions terminate or limit business relationships with high-risk clients rather than managing the risks in line with an RBA.

It should be noted, that neither Germany's nor Latvia's positions ever dropped in any of the rankings provided earlier, which means that shortcomings of their AML/CTF system have been revealed only recently accompanied by the respective cases, the rank the countries have do not however precisely demonstrate the ability of the countries to address all new emerging ML/TF risks, as well as shortcomings and vulnerabilities in the systems are still present in the countries' AML/CTF systems. As a result, it suggests that the standards and requirements which would indicate a well-established system are growing every year, and for the system to remain effective, simply maintaining a position is not enough, while continual improvement of the system to be able to address emerging risks and ML schemes is essential.

[198] Original name of the law is *Verbandssanktionengesetz* (VerSanG).
[199] Alexander Weber, "Money-Laundering Scandals Prompt EU Rethink on Policing Banks," *Bloomberg*, October 2, 2018. Available on: https://www.bloomberg.com/news/articles/2018-10-02/money-laundering-scandals-prompt-eu-rethink-on-policing-banks. Accessed May 10, 2021.

CONCLUSIONS AND RECOMMENDATIONS

An answer to the first initially asked research question "How minimum requirements set in Latvian and German AML/CTF law differ?" the answer is as follows.

Based on the legal analysis provided in this research, there are in general differences between Latvian and German law in connection to the most vulnerable fields of the financial sectors of both countries. If the field is determined as possessing a risk to the country's AML/CTF system given the risk profile of the country and the composition and status of the financial sector of the country, both countries usually tend to provide a tougher approach than required under the EU law. In addition, depending on the vulnerabilities of the AML/CTF systems of countries, Latvia and Germany differently address the same issues.

As such, in general, Latvia, unlike Germany, which in essence repeats the EU law, toughens requirements for risk-decreasing factors, while at the same time Germany and Latvia have respectively the same requirements with some exceptions in regard to high-risk countries and transactions. A substantial difference in regard to general due diligence requirements of Latvia and Germany is present – with respect to the definition of the transaction, foreign currency, cash transactions, exemption from customer due diligence, record retention, factors indicating attempt of ML/TF. In regard to SDD, Latvian law in addition to risk-reducing factors lists also circumstances under which performance of SDD is allowed, while German law provides only risk reducing factors. Moreover, countries provide for a different meaning of SDD and hence there are different requirements to be met if SDD applies to the case. In regard to EDD, both countries provide for a different determination and assessment of the risk based on the differences of the risk factors and elements to be included in the EDD. While the concept of UBO in Germany is stricter and more detailed than provided by the EU and Latvian law, German law, however, unlike Latvian law, permits continuing of the business relationship in certain case if the beneficial ownership is not established but can be assumed. At the same time, however, Latvia, unlike Germany, provides a criminal liability for persons providing false information regarding UBOs. In respect to the PEPs, however, Latvia significantly widens the EU definition in relation to family members of the PEPs, by providing that siblings, grandparents, grandchildren, children of the spouse and their spouses are also regarded as family members of the PEP, while Germany, in essence, repeats the wording suggested by the EU law. Moreover, Latvian law unlike German law suggests that any other close relations other than business are considered to be close relations too. As for criminal liability, while Latvia has not actually transposed the 6AMLD yet, despite the fact that the transposition deadline is already overdue, German law, however, transposed it fully and set stricter norms than those required by the EU law. In addition, Germany also intends to adopt a legal act broadening criminal liability for legal persons, although it is not required by the EU law yet.

In regard to the second initially asked research question "What is the link between development of the AML/CTF systems of Latvia and Germany with their country profiles?", the answer is as follows.

Both countries encountered significant changes in their AML/CTF systems following revealed cases of ML in the financial sectors of countries. It led not only to an attempt to eliminate shortcomings of the countries' AML/CTF systems, but also encouraged the strengthening of respective laws of countries and to take more progressive steps and legislate before shortcoming and vulnerabilities of the AML/CTF system are abused, to prevent the

damage to countries' reputation which can ultimately affect the financial sector, market as a whole and countries' development. As such, it not only demonstrates that there is a link between development of countries' AML/CTF system with profiles of both countries, but it also suggests that a link is direct.

Nowadays, both countries demonstrate their high achievements in the improvement of their AML/CTF systems. Based on this study, it is possible to conclude that despite the different risk profiles of both countries and different approaches to problems, different degrees of concern about the risks associated with ML/TF, as well as a different state of the financial market, its composition, the degree of diligence in relation to AML/CTF, countries' indicators in various ratings and international recognition - none of this gives a guarantee that the system is in fact efficient until a major scandal(s) appear. Moreover, it should be noted, that when the scandal(s) appear, it becomes already too late for a timely response to the issues associated with the AML/CTF system, especially if they were known before, so that further development of the system is not an improvement of the system, but rather a forced measure to restore the reputation and image of the country and its system. As a result, instead of waiting for the disclosure of such scandals, Latvia and Germany have now taken a pro-active approach instead of a reactionary one, which means that now there is a continuous improvement of the AML/CTF at different levels aimed at further strengthening the system and at improving the effectiveness of the system, with respect to both preventive measures and punitive measures.

The study could be improved with more words available through a broader analysis of the national law in relation to each selected element (RBA, identification, criminalization), as well as the history of the development and revision of each individual national provision and the events preceding it could be analysed.

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