RIGA GRADUATE SCHOOL OF LAW

ANTI-MONEY LAUNDERING: CIVIL LIABILITY OF BANKS VIS-A-VIS THEIR CUSTOMERS

MASTER'S 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.

(Signed) …….

RIGA, 2018

Summary

In this master's thesis the nearly unexamined topic of the civil liability of banks *vis-à-vis* their customers for improper application of anti-money laundering measures in the Latvian perspective is explored. The findings and conclusions of this thesis will be relevant in Latvia from both the point of view of theoretical analysis and practical applicability.

In the course of the research the concept of money laundering and the important role of banks in combating the money laundering is reviewed. In doing so the different types of the banks' anti-money laundering obligations are regarded. The thesis follows with the research of the banks' civil liability if they have failed to properly enforce the anti-money laundering measures and by doing so have caused losses to their customers. Forth, the principle of exemption of the banks' liability and its borders are researched in the light of the principle of good faith. In the last chapter of the thesis the distribution of burden of proof in the customers' claims against the banks is analysed distinguishing between different categories of the customers of banks.

It is concluded in the thesis that if the banks fail to acquire sufficient evidence to substantiate their suspicion regarding the customers' involvement in money laundering they risk being held liable for improper application of the law towards their customers. It is further concluded that although the Law on the Prevention of Money Laundering and Terrorism Financing only lists specific circumstances that allow the aggrieved customers to claim compensation for losses it does not limit any other potential claims not explicitly covered by that regulation. It is argued that application of the restrictive anti-money laundering measures must be reasonably assessed by the banks. Enforcement of these measures must not be arbitrary, and they must be justified by sufficient evidence and rooted in a diligent application of the regulation. It is also concluded that the burden of proof lies with the banks to show that they have properly applied the restrictive anti-money laundering measures. Lastly, a conclusion is made that the credibility of evidence for proving the good faith and suspicions of the bank varies depending on the status of the counter party in the transaction with the bank.

List of Abbreviations

AML - anti-money laundering

AML/CTF Law - Law on the Prevention of Money Laundering and Terrorism Financing

EU - European Union

FATF - Financial Action Task Force

FCMC -The Financial and Capital Market Commission

FIU – Financial Intelligence Unit

ML - Money laundering

TF – Terrorism financing

TFEU - Treaty on the Functioning of the European Union

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1. INTRODUCTION

The profits generated by organised crime are enormous. Based on a study by the United Nations Office on Drugs and and Crime, profits were estimated to be between 2% to 5%[1] (that is, $800 billion to $2 trillion) of global GDP.

Money laundering (hereafter – "ML") is the process of disguising the unlawful source of criminally derived proceeds to make them appear legal. It is the lifeline and the driving force of the organised criminal industry. ML can have negative effects, economically, socially and politically, both in the short term and long run. There have been various attempts on a national, supranational and international level to combat ML by adopting anti-money laundering (hereafter – "AML") legislation and introducing new AML measures.

The banking system plays a crucial role helping prevent preventing ML. ML would be largely impossible without the network of banks and other financial institutions that facilitate it. As a consequence, the financial and related sectors have always been positioned at the forefront of the drive to combat ML. Because of the money launderers' need to dispose of cash, deposit-taking institutions are particularly vulnerable to risks of ML. Both international and national AML regulations impose various strict obligations on the banks, including customer due diligence, verification of clients' beneficial owners, reporting of suspicious and unusual transactions, and refraining from execution of transactions. The law also allows banks to terminate legal relationships and close clients' accounts with persons and entities considered representing a high ML risk.

The issue of ML in Latvian banks has come to the fore in recent years. A number of Latvian banks have faced fines amounting to millions imposed by the supervisor for failing to properly implement AML measures. In the spring of 2018, liquidation of the third largest Latvian bank ABLV was initiated following the decision of the US Financial Crimes Enforcement Network (FinCEN) to prohibit the opening or maintaining of a correspondent accounts in the United States for or on behalf of ABLV Bank. FinCEN made this recommendation based on its finding that "ABLV is a foreign bank of primary money laundering concern"[2].

Increasing AML obligations and potential fines have inevitably led to stricter imposition of the AML measures on the banks' customers. This would have been completely acceptable had AML laws and regulations been properly applied by the banks. However, an issue arises if the banks if the banks start applying the restrictive AML measures *vis-à-vis* their customers formally and imprudently, thereby harming both the customers suspected of ML and customers free of unlawful activity. In this context, the potential civil liability of the banks towards the customers against whom the restrictive measures have been improperly imposed becomes relevant.

[1] See United Nations Office on Drugs and Crime, "Money-Laundering and Globalization", Available on: https://www.unodc.org/unodc/en/money-laundering/globalization.html, Accessed 17 April 2018.

[2] FinCEN press release. Available online - https://www.fincen.gov/news/news-releases/fincen-names-ablv-bank-latvia-institution-primary-money-laundering-concern-and. Accessed 3 May 2018.

Although the problematic issue of legal remedies of customers for the banks' improper application of the AML/CTF regulation was touched upon about a decade ago by the Constitution Court of Latvia[3], the topic is still nearly unexamined by the Latvian legal authors. A few authors have indicated some deficiencies of selected aspects of the legislation, but without a further research of the matter[4].

The AML regulation prescribes that financial institutions generally be exempted from civil legal liability when applying AML regulations *vis-à-vis* their customers, i.e. customers do not have legal remedies against banks that have enforced AML regulations in good faith. It is widely accepted that this exemption has a highly broad scope ensuring that they are not discouraged to apply the AML obligations due to potential claims of their customers. If banks have in good faith refrained from executing customers' payment orders (frozen the customers' accounts) and reported this to the authorities, then the losses to the customers are compensated from the state budget. However, this regulation is vague and ambiguous and remains silent on the issue of whether the banks' customers have remedies for other losses caused to them due to improper application of the AML regulation.

In this master's thesis, firstly, the concept of ML and the role and obligations of the banks will be assessed. Secondly, to what extent banks are liable to their customer for improperly applying restrictive AML measures. Thirdly, the principle of exemption of civil liability will be researched. The focus will be on analysing the limits of this exemption in Latvia and what potential remedies the clients have. And fourthly, the evidence required by banks for the exemption to apply.

The author is not aware of civil disputes in Latvian courts concerning customer claims against the banks for improper application of AML measures. However, courts in other countries have reviewed similar disputes. This court practice will be reviewed in the thesis also providing an assessment if and to what extent those finding would be relevant in the disputes before the Latvian court.

The hypothesis of the thesis is that banks may have civil liability *vis-à-vis* their customers if the banks fail to properly apply the restrictive AML measures and the potential remedies of customers go beyond the framework set by the Law on the Prevention of Money Laundering and Terrorism Financing[5] (hereafter – the „AML/CTF Law"). The research question of the thesis is to determine whether restrictive AML measures applied by the banks towards their customers are arbitrary[6] or whether they

[3] Judgment of 28 May, 2009, case No.2008-47-01, Constitutional Court of Latvia, section 15.9. Available online: http://www.satv.tiesa.gov.lv/wp-content/uploads/2016/02/2008-47-01_Spriedums.pdf. Accessed 31 March 2018

[4] E.g., see See. Agneta Rumpa „Banku loma noziedzīgu līdzekļu legalizācijas un terorisma finansēšanas novēršanā" (The Reole of Banks in Anti-money Laundering and Counter Terrorism Financing), *Jurista Vārds*, 27.09.2016., Nr. 39 (942), pp. 12-18., Aldis Alliks, „Naudas "atmazgāšanas" novēršana bankās – starp tiesiskuma un populisma dzirnām", *Jurista Vārds*, 17 May, 2016, No. 20 (923), pp.13.-15.

[5] Noziedzīgi iegūtu līdzekļu legalizācijas un terorisma finansēšanas novēršanas likums (Law on the Prevention of Money Laundering and Terrorism Financing): Latvijas Republikas likums, Latvijas Vēstnesis, 2008, 28.augusts, nr.116.

[6] For the purspose of this thesis the arbitrary conduct corresponds to the definition of an arbitrary judicial decision provided in the Black's Law Dictionary: a conduct "founded on prejudice or preference rather

need to be based on objective evidence for the exemption of liability to apply. The question of whether the level of necessary evidence may vary from different types bank customers will also be reviewed.

A comment needs to be made here regarding the counter-terrorism financing (hereafter – "CTF") measures aimed at combating the illicit funding of terrorism. The CTF regulation is universally regarded alongside the AML regulation[7]. However, for the matter of simplicity the focus of this thesis shall be on ML. Still, considering that banks obligations within the framework of application of the restrictive measures towards their customers are almost identical for both types of illegal activity, the findings and conclusions of the thesis apply both in respect of AML and CTF measures.

It also needs to be pointed out that the liability of the banks is explored in the thesis as they have the highest impact of all the subjects of the AML/CTF Law. They are also significantly more often apply the restrictive AML measures against their customers and therefore are also more exposed to causing losses to their customers and hence exposing themselves to a potential liability. However, most of the findings of this thesis may also in certain circumstances be applicable to subjects of the AML regulation.

than on reason or fact". Black's Law Dictionary, Ninth Edition, Garner, Bryan A., and Henry Campbell Black. *Black's Law Dictionary.* 9th ed. St. Paul, MN: West, 2009, p.119.

[7] Money laundering presupposes an illegitimate *source* of funds whilst the financing of terrorism entails the illegitimate *use* of funds, both adopt techniques in using financial institutions to 'layer' (i.e. disguise the origin and destination of) money"

2. MONEY LAUNDERING AND THE ROLE OF BANKS

In this Chapter of the thesis, the notion of the ML shall be explored reviewing its negative effects. The central role of the banks in the combating ML are, assessed along with the primary obligations of the banks in the AML field. In the light of the thesis, the most relevant issues are those AML obligations of the banks that may cause losses to their customers that they might seek compensations for.

2.1 The Definition and effects of money laundering

Although there are slightly different definitions of ML used, generally it is defined as a deliberate concealment or disguise of the illicit origin of money transactions, securities transactions or other income, which proceed from criminal activities.[8] ML is the process of disguising the unlawful source of criminally derived proceeds to make them appear legal. The origin of the term is unclear: some point to the literal meaning of the expression whilst other point to the use of the laundromats of organised crime in the United States during the Prohibition Era to integrate the proceeds of their crimes into the legitimate economy[9]. In this thesis the term of "money laundering" will be used over the less popular term "legalization of the proceeds of crime" - though they both mean the same thing.

The need to use the proceeds of crime generates the need to launder money thus freeing the assets from their illegal origin. Illegal producers and traders are forced to launder their illicit assets, i.e. to inject them into legal economic and financial market, at the same time concealing their true origin[10]. There are three main reasons to launder money: a) Firstly, ML is the lifeline and the driving force behind organised crime.[11] b) Secondly, it would be unwise to receive money directly from the illegal activities and directly invest it as law enforcement could easily trace the origin of those funds. And c) thirdly, the proceeds of crime can be targeted by confiscation or seizure[12].

The process of ML is typically analysed in the three following stages:

a) *Placement.* The first is the "placement" stage when the proceeds of the crime are "placed" into the financial system, e.g., being deposited into the banking or retail economy[13];

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[8] Cornelia Gerster, Germaine Klein, Henning Schoppmann, David Schwander and Christoph Wengler, *European Banking and Financial Services Law* (Hague: Kluwer Law International, 2004), p.179.

[9] Eva Lomnicka , „Money Laundering and the Financing of Terrorism", in *Ellinger's Modern Banking Law. Fifth edition*, ed. E.P. Ellinger, Eva Lomnicka and C.V.M. Hare (New York: Oxford University Press, 2011), p.92.

[10] Клаус Коттке, *Грязные" деньги - что это такое? Справочник по налоговому законодательству в области "грязных" денег. Изданиэ 7*-е ("Dirty" money – what is it? Guidebook on tax law in the area of "dirty" money) (Москва: Дело и Сервис, 1998), с. 15.

[11] *Ibid.*

[12] Harry Dixon, „Maintaining Individual Liability in AML and Cybersecurity at New York's Financial Institutions", *Penn State Journal of Law and International Affairs*, Vol. 5, Issue 1 (April 2017), p.85.

[13] Eva Lomnicka, „Money Laundering and the Financing of Terrorism", in *Ellinger's Modern Banking Law. Fifth edition*, ed. E.P. Ellinger, Eva Lomnicka and C.V.M. Hare (New York: Oxford University Press, 2011), p.92.

b) *Layering.* The second is the "layering" stage in which there is the first attempt at concealment by disguising the source of the ownership of the funds[14].At this stage the proceeds are moved, usually through series of wire transactions or other transactions designed to place a further distance between the funds and their criminal origins, thus obscuring any audit trail[15]. Cross border transactions – using offshore centres with laws protecting the secrecy of financial transactions – are a common feature of the layering process[16].

c) *Integration*. The third stage is "integration", when the criminal resumes control of the proceeds, free from any link to their criminal source.[17] Establishing companies to invest in real estate, shares, or other assets may do this[18]. The most common way of ML is to hide it through apparently legitimate commercial transactions[19]. Thus, the proceeds of crime return to a legal market by way of investment[20].

The costs of ML are so significant that the legislators of the European Union (hereafter – "EU") have stated, "massive flows of dirty money can damage the stability and reputation of the financial sector and threaten the single market"[21]. However, the direct effect of ML is sometimes questioned. ML usually does not have direct victims; it can even be considered a "victimless crime"[22].

ML can have various negative effects - economic, social and political. The economic effects, for instance, concern unfair competition between honest and dishonest businesses, distortion of prices, negative effects on investments, and the marginalisation of legitimate and transparent businesses. In the short-term ML distorts prices, rates of consumption, savings and investment, increases import/export volatility, the demand for money and interest and exchange rates; and it alters the availability of credit. Therefore, in the short run, ML therefore negatively impacts the operation of a legitimate economy[23]".

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[14] William C. Gilmore, *Dirty Money: The Evolution of Money Laundering Countermeasures. Second edition* (Strasbourg: Council of Europe Publishing, 1999), p. 29.

[15] Charles Proctor, The Law and Practice of International Banking, (Oxford: Oxform University press, 2010), p.144.

[16] Eva Lomnicka, „Money Laundering and the Financing of Terrorism", in *Ellinger's Modern Banking Law*. *Fifth edition*, ed. E.P. Ellinger, Eva Lomnicka and C.V.M. Hare (New York: Oxford University Press, 2011), p.92.

[17] *Ibid*.

[18] Charles Proctor, *The Law and Practice of International Banking* (Oxford: Oxform University press, 2010), p.144.

[19] Prince Michael von und zu Liechtenstein, „Money Laundering and small states: the practical experience of Liechstenstein", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p. 145.

[20] Клаус Коттке, *"Грязные" деньги - что это такое? Справочник по налоговому законодательству в области "грязных" денег. Изданиэ 7-е* (Москва: Дело и Сервиц, 1998), с. 15.

[21] Recital 1 of the Preamble of the Directive of the European Parliament and of the Council No.2005/60/EC of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

[22] Brigitte Unger, „Introduction", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde (Cheltenham: Edward Elgar Publishing Limited, 2013), p.5.

[23] Killian J. McCarthy, „Why do some states tolerate money laundering. On the competition of illegal money", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p.130.

On the other hand, in the long-term ML endangers the survival of the host countries' financial sector – not only because of the risks it poses in terms of stability and liquidity, but also in terms of reputation and profitability. This, in turn, threatens the continuance of foreign direct investment flows in the country and denies it an instrument of growth[24]. Depriving potential launderers of access to financial markets helps those markets maintain a reputation for integrity which enhances their stability and hence attractiveness.

The social effects of ML concern increase of corruption and bribery. Laundering needs helpers and facilitators, stimulating an increasing number of people to be drawn into criminality. Political effects include undermining democratic systems[25]. ML also plays the role of multiplier for crime, corruption, bribery and terrorism, which at its worst can undermine both the democratic institutions and the foreign policy objectives of its people[26]. In the long run ML can be seen to pose an existential threat to the fundaments of a country. Thus, the author agrees with the opinion that dealing with ML and confiscation of criminal assets is not only a key indicator of success in terms of protecting national economies, but it "should also be seen in terms of enforcement of the rule of law"[27].

In the majority of developed countries judicial authorities find it very hard both to detect ML transactions and to convict the guilty persons.[28] The key problem in measuring ML lies with its non-observational character, as is the case for some other economic variables such as the underground economy and home production.[29]

In respect of the financial sector ML can cause the failure of banks and financial institutions. For instance, if a large sum of money is transferred to a bank and then, shortly thereafter, that money is then transferred to another bank-- liquidity may be a problem to the bank's financial assets. The bank can go bankrupt if a large number of people begin withdrawing their deposits upon learning that large amounts of money have been moved from that bank by money launderers[30]. Furthermore, ML also cripples the reputation of the financial institutions.

Even though international pressure is strong on countries to combat ML, there are significant incentives for the government of an open economy to tolerate it. As the ML

[I] *Ibid.*.

[25] Brigitte Unger, „Introduction", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p.4.

[26] Killian J. McCarthy, „Why do some states tolerate money laundering. On the competition of illegal money", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p.130.

[27] *Cf.* Ladislav Hamran, „Confiscation of Proceeds from Crime: a Challenge from Criminal Justice", in *Democracy and Rule of Law in the European Union*, ed. Flora A.N.J. Goudappel, Ernst M.H. Hirsch Ballin, (Hague: T.M.C. Asser Press, 2016), p.174.

[28] Michelle Bagella, Francesco Busato and Amedo Argentiero, „Using Dynamic Macroeconomics For Estimating Money Laundering: a Simulation for the EU, Italy and the United States", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p.7.

[29] *Ibid.*,p.8.

[30] Waseem Ahmad Qureshi, "An Overview of Money Laundering in Pakistan and Worldwide: Causes, Methods, and Socioeconomic Effects", *2 U. Bologna L. Rev.*, 300 (2017) pp. 316-317, (pp.300-345).

industry offers money launderers high profits at low cost, the temptations are high for those in-the-know in the developed world to engage in ML[31]. In a closed economy, the state is forced to "internalise" the total costs of crime. As a result, the state suffers the negative consequences of crime. Accordingly, crime prevention is a political priority. And financial transparency – as a tool for tackling crime – is set at a higher level. However, in an open economy the illegal business of creating criminal profits can be done "in one part of the world, while the "odour-less" profits that it creates can be transferred to invest somewhere else"[32].

Governments in the developed world might be tempted to permit lowering the standards of AML to attract criminal investment flows from other countries where the criminal offense providing the proceeds of the crime took place. While developed countries tackle crime in their own jurisdictions, they have few levers to combat crime – and in the process reduce the profitability – in other jurisdictions[33]. Thus, a necessity for a strong and clear international AML regulation and guidance preventing the offenders from reaping the fruits of the crime is highlighted.[34] Economic globalisation requires ever developing supranational legal rules, as national regulation is often unable to respond with sufficient celerity to new stimuli represented by the globalisation process[35].

With respect to the financial sector, the possibility of earning significant profits is powerful and can serve as a strong motivation for financial institutions to knowingly violate the law. The relationship with money launderers is "so lucrative that some financial institutions who know they are violating the law and continue to do so"[36]. At the same time, banks are at the forefront in combating ML and are tasked with not allowing their illicit funds to enter the financial system. In the following sub-chapter, the role of the banks and the financial sector will be reviewed in light of AML regulations.

2.2 Role of the banks and financial institutions

All economies are substantially dependent on the integrity of their financial sector. ML activities may endanger the integrity of a financial centre and thus the economy as a

[31] Killian J. McCarthy, „Why do some states tolerate money laundering. On the competition of illegal money", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p.130.
[32] [1]*Ibid.*, p.134.
[33] Killian J. McCarthy, „Why do some states tolerate money laundering. On the competition of illegal money", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p.137.
[34] Elena Madalina Busuioc, „Defining Money Laundering", in *The Scale and Impacts of Money Laundering*, Brigitte Unger (with a contribution of Elena Madalina Busuioc), (Cheltenham: Edward Elgar, 2007), p.15.,
[35] Alexander J. Bělohlávek, „Regulation of Financial Markets and Money Laundering: Contemporary Trends in European and International Cooperation", *Czech yearbook of international law* : Vol. IV (2013). New York: Juris Publishing, 2013. p. 96.
[36] Joel Slawotsky, "Are financial institutions liable for financial crime under the alien tort statute", *University of Pennsylvania Journal of Business Law*, n. 15(4), 2013, p. 975.

whole[37]. The soundness, integrity and stability of credit and financial institutions and confidence in the financial system could be seriously jeopardised by the efforts of criminals and their associates either to disguise the origin of criminal proceeds or to channel illicit money[38].

As money launderers need to rid themselves of their illicit funds and cash, deposit-taking institutions are particularly vulnerable to being manipulated. Hence, many of the efforts to combat ML are concentrated on the procedure adopted by deposit-takers[39]. However, in Latvia the free flow of assets seems to be an even more topical issue. Without the network of banks and other financial institutions to facilitate all the three stages of ML and to provide respectability to the proceeds when they eventually reappear, ML would be largely impossible[40]. In the context of the internal market, financial flows are integrated and cross-border by nature, and money can flow swiftly, if not instantly, from one EU Member State to another[41], allowing criminals to move funds across countries while avoiding detection by authorities thus abusing the internal market of EU[42].

Financial and related sectors have always been positioned at the forefront and the outpost in combating ML. Therefore, it is now generally accepted that banks should be active participants in the fight against ML. For legal, reputational, and many other reasons, banks are now vigilant so as to prevent the use of their services and facilities as a means of laundering or transferring the proceeds of crime[43].

The banking industry recognizes that the existing threat of ML and terrorist financing is real and thus requires the coordinated efforts of all parties. Accordingly, the industry continues to support any initiatives in place to improve the efficiency of the existing AML regime and recognizes that the regime needs to be occasionally reviewed and adapted to new trends and methods (typologies), technological developments and, in particular, new threats.[44] The costs associated with the due diligence of implementation, monitoring, and reporting under the AML laws will likely reduce the profits of strong

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[37] Ewald Nowotny, „The role of small states for financial market integrity: Austria", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p. 148.

[38] Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, preamble recital 2, OJ L 309, 25.11.2005. Available on: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32005L0060. Accessed September 23, 2017.

[39] William C. Gilmore, Dirty Money: The Evolution of Money Laundering Countermeasures. Second edition, (Strasbourg : Council of Europe Publishing, 1999), p. 31.

[40] Eva Lomnicka , „Money Laundering and the Financing of Terrorism", in *Ellinger's Modern Banking Law*. *Fifth edition*, ed. E.P. Ellinger, Eva Lomnicka and C.V.M. Hare (New York : Oxford University Press, 2011), p.92.the Basel Committee's Report on Customer Due Diligence (2001).

[41] Report from the Commission to the European Parliament and the Council on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border activities, p. 2, Available on: http://ec.europa.eu/newsroom/document.cfm?doc_id=45319, Accessed 17 April 2018.

[42] *Ibid.*

[43] Charles Proctor, *The Law and Practice of International Banking*, (Oxford: Oxform University press, 2010), p.143.

[44] Indranil Ganguli, "The Third Directive: Some Reflections on Europe's New AML/CFT Regime", *Banking & Financial Services Policy Report*, Volume 29 , Number 5 May 2010, p.12.

financial institutions and may even drive smaller financial institutions out of business. ML is not a static activity. Those serious about winning this fight must continually adjust to an ever-changing environment[45].

The potential bank profits in dealing with non-residents increases the risks of being involved in ML. Banks serving Latvian non-resident are particularly exposed. In the Latvian National ML/Terrorism Financing Risk Assessment Report, the high-risk appetite for transactions involving foreign customers has exposed Latvian to increased ML/TF risks. The risk in the sector of foreign customer serving banks has been named as the number one factor in the vulnerability of the financial sector[46].[47]

To mitigate the risk appetite in unmanageable proportions and combat ML in general, the banks are tasked with specific obligations, examined in the next sub-Chapter.

2.3 Primary AML duties of the banks

Both the international and national legislation provide for specific obligations of the banks in provision of their services to a certain extent prevent situations that their customers would engage in ML/TF activities. Some authors have even named the banking sector a "private police" in performance of the AML obligations[48].

At the international level, the main AML guidance body is the Financial Action Task Force (hereafter – "FATF")[49]. The competence of the FATF is specifically directed towards the fight against ML and terrorism financing in a global environment.[50] In 1990 the FATF adopted "the 40 Recommendations" on combating ML which set standards that governments are expected to meet, with a special emphasis on the critical role that the financial sector has to play.[51] In May, 2002, FATF issued a Consultation paper, *Review of the FATF Forty Recommendations*, seeking to comment on proposed changes in the Forty Regulations. The measures would generally put more obligations to adopt Know Your Customer policies and enhance suspicious transaction reporting. It also discusses the application of the standards to a broad range of financial institutions.[52]

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[45] Michael J. Anderson and Tracey A. Anderson, "Anti-money laundering: history and current developments", *Journal of International Banking Law and Regulation*, 30(10) (2015), p.531.

[46] Latvian National money laundering/terrorism financing risk assessment report, Riga, 27 April 2017, p.7, Avaialble at: http://www.kd.gov.lv/images/Downloads/useful/ML_TF_ENG_FINAL.pdf, Accessed 12 April 2018

[47] The other important factors include a) Insufficient independence of the AML/CTF system due to serious deficiencies in the organizational structure c) insufficient competence of the banks' personell and deficiencies in the field of security of the personal liability; d) improper IT systems in the management of ML/TF risks.

[48] E.g. see Lloyd Himaambo, "Role of Banks as Private Police in the Anti-Money Laundering Crusade", *9 Bocconi Legal Papers* (2017):pp.157 – 186.

[49] Douglas W. Arner, *Financial Stability, Economic Growth, and the Rule of Law* (New York: Cambridge University Press, 2007), p. 190

[50] Charles Proctor, *The Law and Practice of International Banking*, (Oxford: Oxform University press, 2010), p.145.

[51] Eva Lomnicka, „Money Laundering and the Financing of Terrorism", in *Ellinger's Modern Banking Law. Fifth edition*, ed. E.P. Ellinger, Eva Lomnicka and C.V.M. Hare (New York: Oxford University Press, 2011), p.94

[52] Hal S. Scott and Philip A. Wellons, *International Finance. Transactions, Policy, and Regulation. Ninth edition* (New York: Foundation Press, 2002), p.1392.

The FATF identified a series of measures that financial institutions must take on the basis of national legislation to prevent ML. These measures, known as "preventive measures", have been designed by the FATF to protect financial institutions from abuse and help them to adopt adequate controls and procedures[53].

Reinforcement of the risk-based approach is the general and underlying principle of all AML systems. Contrary to the rule based approach the risk-based approach requires that existing risks are well understood and that relevant measures are calibrated accordingly.[54] This means that financial institutions are expected to understand, identify, and assess their risks, take appropriate actions to mitigate them, and allocate resources efficiently by focusing on top risk areas.[55] The current regime is predicated on the measurement and management of risk, by means of risk assessments, and the subsequent shaping of the required customer due diligence measures.[56]

The AML rules have also been harmonized on the EU level in four so called "AML Directives" with the fifth being in development. Since the first attempts to harmonize the AML regulation in the EU money laundering countermeasures have developed substantially, and always in parallel with international developments, in particular initiatives of the FATF[57].

The increasing sophistication of the ML schemes and the inability of the prosecution to set aside sufficient resources to investigate into such constructions caused legislators to take a step to burden financial institutions with investigative duties[58]. Although the EU does not have a criminal law competence, its powers under the provisions on the co-operation in police and criminal justice affairs nonetheless allow for effective action.[59]

On the Latvian national level, the banks (credit institutions) are subjects of the AML/CTF Law pursuant to Article 3 (1) (1) of the Law. The AML/CTF Law, in which

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[53] Financial Action Task Force Guidance "Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion. With a Supplement on Customer Due Diligence", November 2017, p.35, Available online: http://www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf. Accessed 9 April 2018.

[54] Paolo Constanzo, „The Risk-based Approach to Anti-money Laundering and Counter-terrorist Financing in International and EU standards: what it is, what it entails", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p. 349.

[55] Financial Action Task Force Guidance "Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion. With a Supplement on Customer Due Diligence", November 2017, p.35, Available online: http://www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf. Accessed 9 April 2018

[56] Liz Campbell, "Dirty cash (money talks): 4AMLD and the Money Laundering Regulations", *Crim. L.R.* 2018, 2, p.106.

[57] Valsamis Mitslilegas and Bill Gilmore, „The EU legislative Framework Against Money Laundering and Terrorist Finance: A Critical Analysis in the Light of Evolving Global Standards", *International & Comparative Law Quarterly*, January 2007, Vol. 29, part1, p 120.

[58] E.g. see Jonida Milaj and Carolin Kaiser, „Retention of data in the new Anti-money Laundering Directive—'need to know' versus 'nice to know'", *International Data Privacy Law*, Volume 7, Issue 2, 1 May 2017, available on: Oxford Academic. Accessed November 11, 2017.

[59] Volker Röben, Ewald Nowotny, „The Regulation of Financial Services in the European Union", in *The Regulation of International Financial Markets. Perspectives for Reform*, ed. Ed. Rainer Grote and Thilo Marauhn, (Cambridge: Cambridge University Press, 2006), p. 139.

both the requirements under the FATF recommendations and the EU AML directives are transposed, prescribes certain AML obligations of the banks.

The primary obligations of the banks under the AML regulation are briefly reviewed below. Although they are all important in relation to the banks' potential liability *vis-a-vis* their customers, the most relevant are the restrictive AML measures imposed by banks on their customers and which may cause them losses – the refraining from transactions (freezing of the customers' assets and not making the transfer) and the termination of the legal relationship with the customers.

2.3.1 Termination of the customer relationship

Article 28 (2) of the AML/CTF Law provides that if the subject of the Law has not received true information and documents in the amount necessary for the compliance with the customer due diligence enabling it to perform a compliance check, the banks shall end the business relationship with the customer and request the early fulfilment of obligations from the customer. The banks must exclude those customers who intend to use the financial system to launder money, as well as those customers whose ML risk cannot be mitigated appropriately[60]. This will especially happen where the fees that can be raised when they are retained as clients do not justify the risk mitigation measures in relation to such clients[61].

This so called "de-risking" may take many forms. Three elements are particularly common: first, the closure of (or refusal to open) bank accounts for certain individuals and firms, and other restrictions on access to financial services; second, the withdrawal or restriction of banking services from money transfer organizations and other remittances facilities; and third, the severing of correspondent banking relationships, which can entail the loss of access to international payments clearing system[62]. The loss of correspondent banking relationships is potentially highly destructive as it entails possible systemic effects within the affected economy and could lead to a less efficient international payments system[63].

Higher ML risk leads to higher exposition of the operators in these sectors to de-risking - termination of the relationship by the banks. The following sectors have been indicated as significantly and highly significantly exposed to ML/TF risks on the EU level in the supra-national risk assessment of the risks of ML and TF[64]:

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[60] Louis De Koker; Supriya Singh; Jonathan Capal, "Closure of Bank Accounts of Remittance Service Providers: Global Challenges and Community Perspectives in Australia*", 36 U. Queensland L.J.* 119 (2017), p. 126.

[61] Louis de Koker, "Aligning anti-money laundering, combating of financing of terror and financial inclusion: questions to consider when FATF standards are clarified", (2011) 8 Journal of Financial Crime p.368.

[62] James A. Haley, "De-Risking of Correspondent Banking Relationships: Threats, Challenges and Opportunities", Canada Institute, Woodrow Wilson International Centre for Scholars, p.1, Available on: http://www.forensic-caribbean.com/wp-content/uploads/2017/10/a.-De-Risking-of-Correspondent-Banking-Relationships.pdf. Accessed 17 April 2018.

[63] *Ibid*. Accessed 17 April 2018

[64] Report from the Commission to the European Parliament and the Council on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border

- Electronic money operators[65]
- Money value transfer services (i.e. money remittances)[66]
- Safe custody services[67]
- Crowdfunding platforms and virtual currencies
- Land-based betting and poker
- Online gambling[68]
- Designated non-financial businesses and professions[69]
- Non-profit organisations[70]
- Real estate sector[71]
- Sectors offering similar facilities to cash (gold, diamonds) or high-value, easily tradable "lifestyle" goods, (e.g. cultural artefacts, cars, jewellery, watches)[72].

Recently the value of foreign customer deposits in Latvia significantly decreased by almost one-third EUR 3.3 bln.293[73]. Thus, there is a tendency to lower the banks' amount of highly risky customers and this tendency is expected to continue. The named operators in these more risky sectors and non-residents are consequently more likely to try claiming legal remedies against the banks for improper termination (refusal) of legal relationship.

2.3.2 Refraining from executing the transaction

Pursuant to Article 32 (1) of the AML/CTF Law the banks have the obligation to refrain from executing a transaction if it is related with or if there are substantiated suspicions related to ML. As stated by the Constitutional Court of Latvia, refraining from executing such transactions is a temporary measure that ensures that funds of which there are reasonable suspicions that they have illicit origin do not come into possession

activities, pp.4-8, Available on: http://ec.europa.eu/newsroom/document.cfm?doc_id=45319, Accessed 17 April 2018

[65] Due to their anonymity features under 3AMLD.

[66] Due to uneven monitoring capacities among obliged entities

[67] due to limitations in monitoring capacities for obliged entities – and the existence of non-regulated storage facilities (e.g. free zones).

[68] Due to the huge volumes of transactions/financial flows and non-face-to-face element.

[69] Especially for trust and company services providers, tax advisors, auditors, external accountants, notaries and other independent legal professionals.

[70] Due to the diverging NPO landscape and differences in legal frameworks and national practices.

[71] Due to the variety of professionals involved in real estate transactions (real estate agents, credit institutions, notaries and lawyers).

[72] Due to weak controls.

[73] Latvian National money laundering/terrorism financing risk assessment report, Riga, 27 April 2017, Avaialble at: http://www.kd.gov.lv/images/Downloads/useful/ML_TF_ENG_FINAL.pdf, Accessed 12 April 2018.

of such persons that could use them for illegal purposes and that these funds are not laundered while the authorities assess the situation[74].

When refraining from executing a transaction, the banks must not carry out any actions with the funds involved in the transaction until such time when an order of the Office for the Prevention of the Laundering of the Proceeds Derived from Criminal Activity (Financial Intelligence Unit) (hereafter – the "FIU") is received to terminate refraining from executing a transaction[75]. Essentially, during that time, the customers cannot exercise their ownership over the funds. Furthermore, following the order of the FIU regarding freezing of funds, the banks must ensure freezing of funds without delay until the date indicted in the order or until the time when the order of the FIU to terminate freezing of funds is received. After the enforcement of the freezing order, the banks are obligated to notify the customer in writing regarding the order of the FIU send a copy of the order of the FIU to the customer where the procedures for the disputing thereof are explained[76].

Some Latvian authors have argued that the length period for freezing the assets in the instances when the banks' suspicions are unfounded (most of cases) is a „disproportionate limitation of the rights to property"[77]. The author considers that in the light of the important legitimate aim of preventing the ML, if an effective system for legal remedies for private individuals is in place the length of limitation is proportional.

As has been confirmed by Latvian court practice, banks upon adoption of a decision to refrain from pursuing the transaction in the customers' accounts do not perform a public function. In these situations, the banks follow their obligations imposed under public law. However, it does not mean that public administrative tasks would be bestowed on them[78]. Thus, relationship between the banks and their clients remains a private legal relationship and any potential infringement of such relationship must be regarded within the framework of civil law.

2.3.3 Customer due diligence

To ensure that financial institutions can detect potential ML schemes, there are several legal requirements, which culminate in the customer due diligence procedure, often referred to as Know Your Customer (or more precisely: Counterpart).[79] Although 95-

[74] Judgment of 28 May, 2009, case No.2008-47-01, Constitutional Court of Latvia, section 13. Available online: http://www.satv.tiesa.gov.lv/wp-content/uploads/2016/02/2008-47-01_Spriedums.pdf. Accessed 31 March 2018

[75] Article 32 (3) of the AML/CTF Law.

[76] Article 32.[1] (3), (4) of the the AML/CTF Law.

[77] See. Agneta Rumpa „Banku loma noziedzīgu līdzekļu legalizācijas un terorisma finansēšanas novēršanā" (The Reole of Banks in Anti-money Laundering and Counter Terrorism Financing), *Jurista Vārds*, 27.09.2016., Nr. 39 (942), pp. 12-18.

[78] Judgment of 4 March 2008, case No.SKA-140/2008, Administrative Department of the Senate of the Supreme Court of Latvia. Available online: http://at.gov.lv/downloadlawfile/4843. Accessed 31 March 2018.

[79] Janos Böszörmenyi and Erich Schweighofer, „A review of tools to comply with the Fourth EU anti-money laundering directive", *International Review of Law, Computers & Technology*., Vol. 29 Issue 1 (2015), p.67.

99% of the banks' customers not related to ML/TF the banks must be able to identify the seemingly negligible 1-5% who represent such risk[80].

Customer due diligence processes must be designed to help banks understand who their customers are by requiring them to gather information on what they do and why they require banking services[81]. The 4th AML directive emphasises the so-called risk-based approach. This means that customers can be treated differently, depending on their risk categorisation[82].

Already at the start of a possible customer relationship, a financial institution must take measures to identify and verify the customers' identity and to understand the customers' circumstances and business[83]. Banks must know their customers and their businesses to decide whether their customers are engaged in suspicious or illegal activities.[84]

Customer due diligence consists of two phases. The first phase starts before entering into a business relationship[85]. Credit institutions are obliged to require proof of identity of their customers when entering into business relationship (e.g. opening of accounts).[86]

A common technique for criminals is to create shell companies, trusts or complicated corporate structures to hide their identities. In such cases, while the funds involved may be clearly identified, the beneficial owner remains unknown[87]. Therefore, to comply with customer due diligence standards, the bank must perform adequate checks, not just of the customer, but also of the persons standing behind the customer, meaning that they have to verify the identity of any beneficial owner.[88]

The Supervisory institution of the Latvian banks, the Financial and Capital Market Commission (hereafter – the „FCMC") has provided in its regulation that in the client risk assessment the Latvian banks must assess at least the following client-risk

[80] Goce Trajkovski and Blagoja Nanevski, "Customer Due Diligence – Focal Point Of The Anti-Money Laundering Process*". Journal of Sustainable Development (1857–8519)*. Jun 2015, Vol. 5, Issue 12, p.40.
[81] Financial Action Task Force, Guidance for a Risk Based Approach. The Banking Sector, October 2014, p.19, Available on: http://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf, Accessed 10 April 2018.
[8282]Janos Böszörmenyi and Erich Schweighofer, „A review of tools to comply with the Fourth EU anti-money laundering directive", *International Review of Law, Computers & Technology*., Vol. 29 Issue 1 (2015), p.67.
[83] Ewald Nowotny, „The role of small states for financial market integrity: Austria", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p. 153.
[84] Hal S. Scott, *International Finance: Law and Regulation. Second eddition* (London: Weet & Maxwell, 2008), p.790.
[85] Janos Böszörmenyi and Erich Schweighofer, „A review of tools to comply with the Fourth EU anti-money laundering directive", *International Review of Law, Computers & Technology*., Vol. 29 Issue 1 (2015), p. 67.
[86] Cornelia Gerster, Germaine Klein, Henning Schoppmann, David Schwander and Christoph Wengler, *European Banking and Financial Services Law* (Hague: Kluwer Law International, 2004), p.179.
[87] Report from the Commission to the European Parliament and the Council on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border activities, p.9, Available on: http://ec.europa.eu/newsroom/document.cfm?doc_id=45319, Accessed 17 April 2018.
[88] Ewald Nowotny, „The role of small states for financial market integrity: Austria", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p. 154.

segments: a) the client risk; b) country and geographic risk of the customer; c) the services and the product risk; and d) services and product channel risk[89]. The Regulation of the FCMC provides for the minimum standards in relation to customer due diligence and transaction monitoring. The detailed measures must be provided in the internal procedures of the banks. It is important that the regulation provides for a burden of proof to ensure that the banks are able to prove that the due diligence measures taken by the bank correspond to the risk related to the relationship with the client.[90]

2.3.4 Suspicious activity reporting

The reporting of suspicious transactions and activities is another critical aspect of the country's ability to utilize financial information to combat ML, terrorism financing and other financial crimes[91]. To be able to determine that suspicious or unusual transactions are in fact occurring, banks need to use sophisticated software to monitor transactions and business partners. They also need to have access to watch lists to identify higher risk counterparts[92].

If has been acknowledged by Latvian courts that delayed reporting of suspicious transactions to the FIU provides for an increased ML risk. By failure to receive the information on the suspicious transaction in a timely manner, the FIU cannot perform its obligations in the field of ML prevention, *inter alia* provision of the information to the police, prosecution or courts[93]. The suspicious transaction reporting is closely linked with the refraining from the executing transactions as both these measures almost always are taken in parallel.

2.3.5 Other measures

Risk analysis – both of banks' activities and of individual customers' activities – is another cornerstone of every system to prevent ML at banks. One objective of risk analysis is to identify customer relationships that represent an elevated risk for an institution and that consequently must be treated as high-risk. The provisions of the risk-based AML/CTF approach obligate credit institutions to classify all customers

[89]Section 9, Klientu padziļinātās izpētes normatīvie noteikumi kredītiestādēm un licencētām maksājumu un elektroniskās naudas iestādēm (Normative Regulation Regarding Enhanced Customer Due Diligence for credit insittutions and electronic payment institutions": Normative regulation No.3 of the Financial and Capital Market Commission, Latvijas Vēstnesis, 2018, 15.janvāris, nr. 10 (6096).

[90] Section 3, Klientu padziļinātās izpētes normatīvie noteikumi kredītiestādēm un licencētām maksājumu un elektroniskās naudas iestādēm (Normative Regulation Regarding Enhanced Customer Due Diligence for credit insittutions and electronic payment institutions": Normative regulation No.3 of the Financial and Capital Market Commission, Latvijas Vēstnesis, 2018, 15.janvāris, nr. 10 (6096)

[91] Financial Action Task Force Guidance "Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion. With a Supplement on Customer Due Diligence", November 2017, p.66, Available online: http://www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf. Accessed 9 April 2018

[92] Janos Böszörmenyi and Erich Schweighofer, „A review of tools to comply with the Fourth EU anti-money laundering directive", *International Review of Law, Computers & Technology*., Vol. 29 Issue 1 (2015), p. 67.

[93] Judgment of 9 October 2013, case No.A420565912, Administrative Distric Court. Available online: https://www.tiesas.lv/nolemumi/pdf/116398.pdf. Accessed 31 March, 2018.

according to the specific risk they represent.[94]These risk assessment processes, though certainly not arbitrary, are not particularly standardised or categorised. There is no calculation of risk factors based on an equation such as *probability x severity x detectability*, as is the case in risk assessment in other sectors[95].

The customers' risk rating is an important tool to trigger further diligence requirements, because it determines the level of necessary due diligence. Also, the risk rating determines the degree to which new customers need to be scrutinised and to which review, and documentation obligations arise[96].

The structural and process organization of credit institutions is another key component of the system to prevent ML. Here, not just the quality and amount of infrastructure of the units charged with the prevention of ML are important; but the design of the processes is also significant. The organisation of the credit institution must be such that all information about customers can be ascertained and measures can be taken to prevent transactions linked to ML. [97]

Pursuant to Article 20 of the AML/CTF Law after establishment of a business relationship or when executing occasional transactions the banks must continuously monitor the activities and transactions of the customers in order to ascertain that the transactions are not considered unusual or suspicious. Upon carrying out monitoring of customers' transaction the banks have to pay special attention to transactions uncharacteristic to the specific customers – either in size or complexity, as well as to transactions that have no apparent economic purpose or are concluded with persons from high-risk third countries.

Thus, banks must use their internal data and IT systems not just for regular reviews of customers' primary data, but also to perform the ongoing monitoring of transactions. Transaction monitoring represents a key component of the procedure to prevent ML at a credit institution[98]. Controls are applied through top-down internal control relationship between a parent company and its branches and subsidiaries, wherever established.[99]

Chapter 1 established that ML could have various negative effects - economic, social and political, in both the short and long term. The banks are tasked with the obligation of being a "watchdog" of the financial system having specific obligations in the AML

[94] Ewald Nowotny, „The role of small states for financial market integrity: Austria", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p. 152.
[95] Liz Campbell, "Dirty cash (money talks): 4AMLD and the Money Laundering Regulations 2017", *Crim. L.R.* 2018, 2, p.110.
[96] Janos Böszörmenyi and Erich Schweighofer, „A review of tools to comply with the Fourth EU anti-money laundering directive", *International Review of Law, Computers & Technology*., Vol. 29 Issue 1 (2015), p. 68.
[97] Ewald Nowotny, „The role of small states for financial market integrity: Austria", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p. 152.
[98] Ewald Nowotny, „The role of small states for financial market integrity: Austria", in *Research Handbook on Money Laundering*, ed. Brigette Unger and Daan van der Linde, (Cheltenham: Edward Elgar Publishing Limited, 2013), p.154.
[99] Alberto Santa Maria, *European Economic Law, European Economic Law, 3rd eddition*, (The Netherlands: Wolters Kluwer Law & Business: 2014), p.394.

field. In the next Chapter, the extent to which banks have a civil liability towards their customers if the banks apply these AML measures improperly and consequently cause losses to the customers will be explored.

3. CIVIL LIABILITY OF BANKS

In this Chapter the civil liability of banks *vis-à-vis* their customers for failure to properly apply the restrictive AML measures that cause them losses will be reviewed. In the first subchapter the background of such civil liability will be regarded reviewing. In the following subchapter it will be discussed whether the liability grounds provided in the AML/CTF Law are exhaustive or there are additional grounds and occasions when the banks can have the liability and lastly the types of civil liability shall be observed.

3.1 The background for civil liability

Customers' rights are encroached upon when the bank applies the restrictive measures under the AML regulation. The fulfilment of the banks' AML/CTF obligations that have been described by some authors as „investigation without criminal proceedings"[100] may lead to encroachment of individuals' legal rights and interests.

These measures primarily encroach upon the rights to property of the customers, although other customers' rights might also be relevant, including the right of defence, the protection of individuals' procedural rights, and guarantees that would be available e.g. in the criminal proceedings[101], but are not available to customers when the restrictive AML measures are applied. For instance, the right to exercise ownership of the funds is encroached upon if the bank refrains from executing the transaction – the customers cannot make use of their funds - make further transactions, settle invoices for received goods and services, distribute dividends etc. If a bank wrongly refuses to make a payment to its customer, the customers' claim will most often be for damages to compensate for any losses incurred by the customer because of the bank's failure to pay[102]. Furthermore, if the bank decides to terminate the relationship with the customer, the effect is similar as the customer no longer having access to the financial market and is unable to make use of the money transfers. The question of whether banks can be held liable for such an encroachment or can be exempted from such liability will be explored in this part of the thesis.

There are various legal definitions of civil liability. The theoretical aspects of the definition of the notion of civil liability as such are outside the scope of this thesis. The author considers that for the purposes of the thesis the definition suggested by Prof. Kalvis Torgāns thoroughly reflects the potential civil liability of the banks towards their customers for the improper application of AML/CTF regulation. Civil liability is thus defined in the following way:

> "an obligation that arises as the result of an illicit conduct, supplements or replaces another violated obligation or emerges anew due to a deficit and that manifests as the obligation to prevent or mitigate the negative effects of the

[100] Aldis Alliks, „Naudas "atmazgāšanas" novēršana bankās – starp tiesiskuma un populisma dzirnām", *Jurista Vārds*, 17 May, 2016, No. 20 (923).
[101] *Ibid*.
[102] Lloyd Himaambo, "Role of Banks as Private Police in the Anti-Money Laundering Crusade*", 9 Bocconi Legal Papers* (2017), p.182.

illicit conduct by way of a financial compensation, contractual penalty or another satisfaction to the creditor[103]".

The obligations of the banks regarding their customers within the field of AML are founded on public law, however upon enforcement of these AML regulation the relationship between the banks and their customers does not turn into a public relationship between the bank as a public authority and the customer as a private entity[104]. Therefore, the author considers that the legal remedies of the customers and potential customer *vis-a-vis* the banks must be regarded within the framework of private (civil) law.

Article 8 of the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism provides that each signatory state shall adopt such legislative and other measures as may be necessary to ensure that interested parties affected by the AML measures have effective legal remedies to preserve their rights[105]. An interested party includes any party whose rights have been are affected[106]. As explained by the Explanatory Report to this Convention, the claims of the affected parties should in principle be honoured in cases where the innocence or *bona fides* of the party concerned is likely or beyond reasonable doubt. If no final confiscation order has been made against him or her, the accused may also qualify as an interested party[107]. The legal provisions of the national law, as required by this Article of the Convention, must therefore guarantee "effective" legal remedies for interested third parties. However, Article 8 of the Convention does not bestow upon private citizens any right beyond those normally permitted by the domestic law of the Party[108].

Chapter XIV of the AML/CTF Law explicitly deals with the compensation of losses caused by the subjects of the Law, including the banks, by unjustified and unlawful application of the AML/CTF obligations, distinguishing between the two types of wrongdoings. The author considers that the compensation mechanism under Chapter XIV of the AML/CTF Law is ambiguous and has various deficiencies from the perspective of substance and form that renders the regulation hardly applicable.

The procedure laid down in Chapter XIV of the AML/CTF Law provides that the private person is compensated for the losses incurred due to inability to access its assets held by the subject of the AML/CTF Law if it later is established that the freezing was

[103] Kalvis Torgāns, *Saistību tiesības. I daļa. Mācību grāmata*. (Contract Law. Part I. A Textbook) (Rīga: Tiesu namu aģentūra, 2006), 205.lpp.
[104] See Judgment of 4 March 2008, case No.SKA-140/2008, Administrative Department of the Senate of the Supreme Court of Latvia, section 6. Available online: http://at.gov.lv/downloadlawfile/4843. Accessed 31 March 2018
[105] Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, Warsaw, 16.V.2005, available online: https://m.likumi.lv/doc.php?id=203016, Accessed 1 April 2018.
[106] Kris Hinterseer, *Criminal Finance:The Political Economy of Money Laundering in a Comparative Legal Context Law* (Hague: Kluwer Law International, 2002), p.148.
[107] Explanatory Report to the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, Council of Europe Treaty Series - No. 198, p.15 Available on: https://rm.coe.int/16800d3813, Accessed 5 April, 2018.
[108] *Ibid*, p.16.

been unfounded. The losses are primarily reimbursed by the state that may later have a recourse claim against the subject of the AML/CTF Law. Such procedure is explained by the legislator with the rationale that, as the legislator has obliged the subject of the AML/CTF Law to mandatorily execute certain AML obligations the subject of the law is exempted from liability. The liability therefore is covered by the state itself[109].

The author considers that the approach that the state primarily compensates the losses to the customers and then has a right to bring recourse claims against the banks is debatable. On the one hand, it is easier for the customers to claim compensation from the state than guessing whom the real infringer of their rights is (the state authorities or the banks). On the other hand, if the banks having the two-level review system for have infringed the rights of the customers, the banks' civil liability (initially by the Prosecutor General's office and then the courts in the civil claim) indicates shortcomings of procedural efficiency. This would be particularly relevant if the customers' rights would have been violated by the banks, by not only the conduct explicitly provided in the AML/CTF Law giving right to compensation, but also other infringements of the AML regulation. This issue might be subject to further research in the field of the bank's liability towards customers for improper application of the AML measures.

Pursuant to Article 68 (1) of the AML/CTF Law the compensation of losses shall take place if the banks have refrained from the execution of the transactions and frozen the assets of their customers and, consequently, the following decisions have been adopted:

- An order of the FIU to terminate the refraining from executing transactions;
- A notice of the FIU issued to the subject of the AML/CTF Law on the fact that the FIU has not detected any basis to issue the freezing order;
- An order of the FIU issued to the subject of the AML/CTF Law by which it is notified that further temporary freezing of funds is to be terminated because the FIU has not detected any basis to issue the freezing order;
- An order of the FIU to revoke the freezing order;
- A decision of the Prosecutor-General or specially authorised prosecutor by which the freezing order of the FIU is repealed.

However, the AML/CTF Law remains silent as to whether the aggrieved persons may claim compensation for losses in other instances of the improper application of AML obligations not explicitly covered by Article 68 (1) of the AML/CTF Law. One might argue that, as the list of legal grounds for compensation of losses provided in Article 68 (1) of the AML/CTF Law is exhaustive, the legislator has intentionally limited the instances, which give grounds to claims of the customers. On the other hand, other instances of wrongful enforcement of restrictive AML measures (e.g., unjustified termination of legal relationship) are also causing losses to the customers. It can be

[109] Annotation of the Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing of 7 June 2012. Available online: http://titania.saeima.lv/LIVS11/SaeimaLIVS11.nsf/0/25151E42DA0D5B9BC2257998004D1BCE?OpenDocument. Accessed 31 March 2018

argued that such exclusion does not comply with the general principle of compensation for losses.

The question of whether the liability provided in the AML/CTF Law covers all possible civil liability of banks that can arise due to improper application of the AML/CTF obligations will now be explored.

3.2 Non-exhaustive application of the AML/CTF Law

The concept of the compensation of losses due to improper application of the AML regulation by the subjects of the AML/CTF Law was introduced into law in the amendments of 7 June 2012[110]. Prior to these amendments, the AML/CTF Law was completely silent on the matter whether the customers are entitled to bring claims either against the subjects of the AML/CTF Law or the investigative authorities. These amendments were adopted as a follow up to prevent the deficiencies indicated in the judgment of 28 May 2009 of the Constitutional Court of Latvia in Case No.2008-47-01[111].

In this case the Constitutional Court concluded that although the legislator had established a procedure that a private person (subject of the Law) within the frame civil transactions has AML/CTF obligations that encroach on the basic rights of the customer the legislator "has not provided for effective measures that would allow challenging unlawful decisions of such subject of the AML/CTF Law"[112]. The Constitutional Court also stated that the legislator had also not provided for a mechanism that the State in a reasonable process and amount would compensate for the losses that incurred to the person, due to the fact that the bank has deterred from the transaction it later turned out that the decision was not well founded[113].

Importantly, the Constitutional Court also noted that although the AML/CTF Law is silent on the compensation mechanism, it cannot be excluded that the customer of the bank based on the directly applicable Article 92 of Satversme[114], constitution of Latvia, brought a claim in the court of regular jurisdiction pursuant to civil procedure against the bank for compensation of losses "if the conduct of the credit institution is not based on the [AML/CTF] law or it exceeds the [scope of the] law or the order of the FIU"[115].

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[110] Grozījumi Noziedzīgi iegūtu līdzekļu legalizācijas un terorisma finansēšanas novēršanas likumā (Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing): Latvijas Republikas likums, Latvijas Vēstnesis, 2012, 27.jūnijs, nr. 100 (4703).

[111] Annotation of the Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing of 7 June 2012. Available online: http://titania.saeima.lv/LIVS11/SaeimaLIVS11.nsf/0/25151E42DA0D5B9BC2257998004D1BCE?OpenDocument. Accessed 31 March 2018.

[112] Judgment of 28 May, 2009, case No.2008-47-01, Constitutional Court of Latvia, section 15.9. Available online: http://www.satv.tiesa.gov.lv/wp-content/uploads/2016/02/2008-47-01_Spriedums.pdf. Accessed 31 March 2018.

[113] *Ibid.*, sections 14.5, 15.9.

[114] Latvijas Republikas Satversme: Latvijas (Satversme of the Republic of Latvia): Latvijas Republikas likums, Latvijas Vēstnesis, 1993, 1.jūlijs, nr.43.

[115] Judgment of 28 May, 2009, case No.2008-47-01, Constitutional Court of Latvia, section 17. Available online: http://www.satv.tiesa.gov.lv/wp-content/uploads/2016/02/2008-47-01_Spriedums.pdf. Accessed 31 March 2018.

Thus, in this judgment the Constitutional Court already hinted that the aggrieved persons might have claims against the banks for improper application of AML obligations.

Second sentence of Article 92 of Satversme provides that „[e]veryone, where his or her rights are violated without basis, has a right to commensurate compensation"[116]. This provision enshrines a general constitutional principle that either the injured party or the society in whole, which is represented by the state and its legislative and judicial enforcement power, cannot ignore a violation of one's rights[117]. Similarly, Article 1635 (1) of the Civil Law[118] provides that every infringement of rights, that is, every wrongful act *per se*, as a result of which harm has been caused (also moral damage), must give the person who suffered the harm therefrom the right to claim satisfaction from the infringer, insofar as he or she may be held at fault for such act.

Another general constitutional principle is that every limitation of basic rights must be interpreted narrowly. The author considers that the same rule also applies to interpretation of Article 68 (1) of the AML/CTF Law. Namely, this Article only lists circumstances that allow the aggrieved person to claim compensation for losses under the specific procedure provided in Chapter XIV of the AML/CTF Law – to request the state to compensate the losses. It does not limit any other potential claims of the aggrieved persons not covered by Article 68 (1) of the AML/CTF Law. Under the Civil Procedure Law the aggrieved persons can bring such claims directly against the wrongdoer (e.g. the bank) that improperly applied the AML obligations.

The author considers that this conclusion must be explicitly provided in the AML/CTF Law to prevent misconception in future. Interpretation through provisions of the Constitution to allow the aggrieved persons to bring claims against the banks is excessively burdensome for private persons. Therefore, the author suggests amending the Article 68 by adding a following paragraph (3):

> "If the losses are caused to the person by such conduct of the subject of the law in application of the Law that is not covered by the first paragraph of this Article, for protection of its legitimate interests the aggrieved person may bring a claim against the subject of the Law pursuant to the procedure provided in the Civil Procedure Law. The court must observe the exemption of liability, including the civil liability, of the subject of the Law provided in the Law[119].[120]

[116] Latvijas Republikas Satversme: Latvijas (Satversme of the Republic of Latvia): Latvijas Republikas likums, Latvijas Vēstnesis, 1993, 1.jūlijs, nr.43.
[117] Kalvis Torgāns, *Saistību tiesības. I daļa. Mācību grāmata*. (Contract Law. Part I. A Textbook) (Rīga: Tiesu namu aģentūra, 2006) 202.lpp.
[118] Civillikums (Civil Law): Latvijas Republikas likums, *Valdības Vēstnesis*, 1937, 20.februāris, Nr.41.
[119] Translation in Latvian: *„Ja zaudējumi personai nodarīti ar tādu likuma subjekta rīcību šī likuma piemērošanā, kas nav uzskaitīta šā panta pirmajā daļā, aizskartā persona savu likumīgo tiesību aizsardzībai var celt prasību pret likuma subjektu Civilprocesa likumā norādītajā kārtībā. Tiesai jāņem vērā šājā likumā noteiktais likuma subjekta atbrīvojums no juridiskās, tajā skaitā civiltiesiskās atbildības*".
[120] Corresponding changes would also have to be made to Article 64 (1) linking the unjustified conduct to paragraph 1 of Article 68 of the AML/CTF Law, not the whole Article 68.

3.3 General types of civil liability

Civil liability can typically manifest itself in damages compensation for losses, compensation for non-pecuniary harm (including the moral harm) and contractual penalty. The other types of civil liability for unlawful activity include request to stop the wrongdoing, payment on interest, and cancellation of the contract[121]. However, the primary objective of civil liability is to prevent the negative consequences of the illicit activity to the injured party,[122] and as far as possible reinstate the situation before the offense took place. Thus, the compensation for losses (damages) is the primary remedy in case of an unlawful conduct.

Article 6 of the AML/CTF Law defines the losses as "a materially assessable deprivation, which is caused to a person because of unjustified or unlawful conduct by the FIU or the subject of the Law". This definition directly corresponds to the general definition of losses provided in Article 1770 of the Civil Law. The following three prerequisites must be met before the obligation to reimburse for losses is triggered: 1) unlawful activity of the offender; 2) losses in a certain amount; 3) causal link between the offense and the losses incurred[123].

The Civil Law generally provides for the principle of full (complete) compensation of losses[124]. At the same time Article 1776 (2) states that the infringer may request a reduction of the compensation amount which a victim could have prevented through the exercise of due care, except in a case of malicious infringement of their rights. Furthermore, pursuant to Article 1779.[1] of the Civil Law the infringer must only compensate the losses in such amount, which could have been reasonably foreseen upon entering into a transaction as, expected consequences of non-performance, unless such non-performance occurred through malicious intention or gross negligence. These provisions provide the banks with an option to limit their liability for losses by submitting evidence regarding the customers' opportunities to limit the losses and regarding their own fault.

Pursuant to Article 1716 of the Civil Law the contractual penalty is defined as a penalty which a person undertakes to bear regarding his or her obligation in such case as he or she does not perform the obligation, does not perform it satisfactorily or does not perform it within due time (time period). Application of the contractual penalty becomes a manifestation of a liability and serves for the purpose of both faster and easier (from the matter of proof perspective) compensation for losses or punishment to

[121] Kalvis Torgāns, "Eiropas līgumu tiesību principi un Latvijas Civiltiesības" (Principles of European Contract Law and Latvian Civil Law), in Kalvis Torgāns. *Current topics on Civil, Commercial Law and Civil Procedure. Selected articles 1999-2009* (Rīga: tiesu namu aģentūra, 2009), 218.lpp.
[122] Kalvis Torgāns, *Saistību tiesības. I daļa. Mācību grāmata*. (Contract Law. Part I. A Textbook) (Rīga: Tiesu namu aģentūra, 2006), 207.lpp.
[123] *Ibid.*, 246.lpp
[124] Kalvis Torgāns, "Eiropas līgumu tiesību principi un Latvijas Civiltiesības" (Principles of European Contract Law and Latvian Civil Law), in Kalvis Torgāns. *Current topics on Civil, Commercial Law and Civil Procedure. Selected articles 1999-2009* (Rīga: tiesu namu aģentūra, 2009), 218.lpp.

the infringer[125]. From the perspective of the banks' liability for the improper application of the AML regulation, the contractual penalty becomes relevant if it is provided in the contract between the banks and the customer, e.g. for unlawful termination of the contract or delay of making the ordered transaction. In practice, the banks rarely agree on significant contractual penalties with their retail customers. However, this remedy may become much more relevant for "tailor-made" contracts with larger customers.

3.4 Liability under the AML/CTF Law

As described above, Chapter XIV of the AML/CTF Law now explicitly deals with the compensation of losses caused by the subjects of the Law, including the banks, by unjustified and unlawful application of the AML obligations in circumstances provided in Article 68 (1). The Law covers liability for unjustified and unlawful application of the Law, by making a clear distinction between the two concepts. This distinction follows the rationale that the aggrieved person must be compensated, regardless of the fact whether the subject of the Law acted strictly within the framework of the AML/CTF Law (due to unjustified or unlawful application)[126].

Article 64 (1) states that an action by the subject of the AML/CTF Law is unjustified, if upon receiving the decision the subject acted in good faith in compliance with the provisions of AML/CTF Law, however later one of the legal basis for compensation of losses determined in Article 68 (1) of the AML/CTF Law has arisen.

Article 65 (1) of the AML/CTF Law prescribes that a conduct of the subject of the Law is unlawful, if it does not comply with the provisions of the AML/CTF Law. It is important to note that the wording of Article 65 (1) does not link the right for the compensation for unlawful activity with the subjects' good faith or circumstances prescribed in Article 68 (1) of the AML/CTF Law. Therefore, one may argue that the compensation procedure under Chapter XIV of the Law applies to all unlawful activities of the subjects of the Law. However, Article 68 (1) itself states that it lists "the legal basis" for compensation of losses, thus establishing the legal framework of application of Chapter XIV. It can be concluded that Article 68 (1) refers to both unjustified and unlawful application of the AML/CTF obligations by the subjects of the Law. Thus, the compensation mechanism for unlawful application of the o AML/CTF Law under Chapter XIV only occurs in the circumstances provided under Article 68 (1).

The author considers that to prevent uncertainty in its application, the AML/CTF Law Article 65 (1) needs to be amended specifically stating this link likewise Article 64 (1). Thus, this provision of the law should be stated in the following wording:

[125] Kalvis Torgāns, *Saistību tiesības. I daļa. Mācību grāmata*. (Contract Law. Part I. A Textbook) (Rīga: Tiesu namu aģentūra, 2006) 207.lpp.

[126] Annotation of the Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing of 7 June 2012. Available online: http://titania.saeima.lv/LIVS11/SaeimaLIVS11.nsf/0/25151E42DA0D5B9BC2257998004D1BCE?OpenDocument. Accessed 31 March 2018

> "The action of the subject of the Law shall be unlawful, if it does not comply with the provisions of this Law and one of the legal basis for the compensation of losses determined in Article 68 (1) of this Law has arisen"[127].

Article 67 (1) of the AML/CTF Law prescribes that the right to compensation for losses takes place if there is a direct causal link between the unjustified or unlawful actions of the subject of the Law or the FIU and loss caused to a person. The causal link is an objective link between the actions of the subject of the Law or the FIU and its consequences following in terms of time that causes loss, namely, the wrongful conduct is the main factor, which has inevitably caused such consequences. This provision repeats the general notion of civil law that prescribes that a prerequisite for compensation of losses is the causal link between the wrongdoer's conduct and the losses incurred [128].

However, the following provision of the AML/CTF Law is more ambiguous. Article 67 (2) states that:

> "[T]he causal link for compensation of losses does not exist, if the same loss would have arisen also if circumstances giving legal basis to compensation of losses had not taken place".

In other words, this provision states that if there are also other circumstances causing the losses apart from the circumstances listed in Article 68 (1) of the AML/CTF Law then there is no causal link between the subjects' (e.g. banks') conduct and the losses incurred and thus the losses do not have to be compensated. Considering the general conclusion made in the previous Chapter that losses inflicted by an inappropriate application of the AML/CTF obligations other than those listed in Article 68 (1) have to be compensated in the regular procedure according the Civil Procedure Law, the Article 67 (2) AML/CTF Law must be interpreted as only describing the limits for application of Article 68 (1) AML/CTF Law. It does not limit other potential claims against the banks.

The aggrieved person can primarily claim the losses from the State in circumstances specifically provided in Article 68 (1) of the AML/CTF Law, not from the banks. The rationale of such arrangement is that as the State has imposes a mandatory obligation on the banks, e.g. reporting suspicious transactions or refraining from the transactions, while at the same time exempting the subjects from liability for actions in good faith, the State has committed itself to be liable for the actions of the subject[129].

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[127] Translation in Latvian: „*Likuma subjekta rīcība ir nelikumīga, ja tā neatbilst šā likuma noteikumiem un ir radies viens no šā likuma 68.panta pirmajā daļā noteiktajiem zaudējumu atlīdzināšanas tiesiskajiem pamatiem*".

[128] See e.g. Kalvis Torgāns, *Saistību tiesības. I daļa. Mācību grāmata*. (Contract Law. Part I. A Textbook) (Rīga: Tiesu namu aģentūra, 2006), 246.lpp

[129] Annotation of the Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing of 7 June 2012. Available online: http://titania.saeima.lv/LIVS11/SaeimaLIVS11.nsf/0/25151E42DA0D5B9BC2257998004D1BCE?OpenDocument. Accessed 31 March 2018

Article 70 (1) of the AML/CTF Law provides that the following direct losses shall be compensated to a person: a) losses due to refraining from executing transactions or unearned income as a result of suspension of the relevant actions; b) losses caused as a result of non-fulfilment of obligations or delay; c) other direct losses, which are determined in the Civil Law and which a person may prove. The AML/CTF Law provides that in determining the proper amount of compensation for loss, the legal and factual justification and motives of the action by the subject of the AML/CTF Law, as well as the conduct of the customer, must be considered.

Article 71 (3) of the AML/CTF Law limits the compensation depending on the amount of the losses. The losses are compensated in full amount if they do not exceed 150,000.00 EUR. If the losses are between 150,000.00 EUR and 1,425,000.00 EUR the sums exceeding 150,000.00 EUR are compensated by 75%, and the sums exceeding 1,425,000.00 EUR are compensated by 50%. The AML/CTF Law limits the liability of the subjects of the law and the state itself to encourage them to perform their AML obligations and not be discouraged by the potential claims for damages against them. However, such limitation of compensation and failure of full restitution is questionable from the perspective of the rights of the aggrieved person, even more so considering that second sentence of Satversme, i.e., a legal norm of a higher power provides for a basic right to receive an "adequate" compensation. The question regarding the limitation of recoverable losses is constitutional may be the subject of further research as it relates to the liability of the improper application of the restrictive AML measures.

According to Article 76 (1) of the AML/CTF Law, if the State has compensated the losses to the customer of the subject of the AML/CTF Law due to its unlawful conduct the State has a recourse claim against the specific subject of the AML/CTF Law.

The author has compared the regulation of the AML/CTF Law with that of the Estonian Money Laundering and Terrorist Financing Prevention Act[130] (hereafter – "Estonia AML Act") passed on 26 October 2017 with respect of the banks' potential liability towards their customers. Notably, the Estonian AML Act does not contain provisions regarding the persons' right to bring claims against the subjects of the Law for improper application of the AML measures. Likewise, the AML/CTF Law, Paragraph 52 of the Estonian AML Act contains a general clause for the discharge of the subjects' liability for damages caused to a person or customer if the AML measures have been applied in good faith. However, it remains silent on the legal consequences if this obligation, if it has been breached by them. In this regard, the the regulation of the AML/CTF Law is superior as it, albeit being subject to potential improvements, at least, specifically indicates that the aggrieved customers have remedies for infringement of their rights by improper application of the restrictive AML measures.

Unnecessary distinction between "unjustified" and "unlawful" conduct

As an additional matter the author considers that the distinction between the "unjustified" and "unlawful" activities of the subjects of the AML/CTF Law is

[130] Estonia. Rahapesu ja terrorismi rahastamise tõkestamise seadus (Money Laundering and Terrorist Financing Prevention Act of the Republic of Estonia), *RT I*, 17.11.2017, 2, Available on: https://www.riigiteataja.ee/en/eli/517112017003/consolide, Accessed 15 May 2018.

unnecessary. The intention of the legislator for inclusion of Chapter XIV of the AML/CTF Law was aimed at the reimbursement of losses for private individuals due to the freezing of their funds, if it is later established by the authorities that the freezing was not required[131].

If the bank acted in good faith in refraining from the transaction (freezing the funds), the state reimburses for the damage and the bank is exempted from liability. If the subject of the Law did not act in good faith, the state reimburses the damage and brings a recourse claim against the subject of the Law. Thus, in essence, the matter does not depend on the subjects' hypothetic compliance with the AML/CTF regulation, but on the determination of whether the subject acted in good or bad faith.

Therefore, the distinction between the subjects' "unjustified" and "unlawful" conduct in respect of freezing the assets of the customers is artificial and unnecessarily confusing. The two notions in Latvian "*nepamatota rīcība*" and "*nelikumīga rīcība*" are close synonyms that both refer to an infringement of a certain regulation, thus rendering the application of Chapter XIV AML/CTF Law even more confusing.

The author accordingly suggests reworking the regulation under Chapter XIV AML/CTF Law without the distinction of the two notions and subjecting the potential recourse claim on the faith, in which the subject of the Law refrained from executing the transaction.

In this Chapter the notion of the banks' civil liability for improper application of the restrictive AML measures was explored. It was established that the customers of the banks could claim damages for improper freezing of the customers' assets under the procedure provided in the AML/CTF Law. However, it was further concluded that the AML/CTF Law does not exclude any other potential claims of the aggrieved customers who may bring such claims directly against the the banks that improperly applied the AML obligations under the Civil Procedure Law. It was established that the primary remedy of the customers is claiming damages from the banks, but in specific circumstances also other remedies like contractual penalties, may be available.

In the following Chapter the notion of the banks' exemption of liability will be explored, also testing its limits in the light of the principle of good faith.

[131] See Annotation of the Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing of 7 June 2012. Available online: http://titania.saeima.lv/LIVS11/SaeimaLIVS11.nsf/0/25151E42DA0D5B9BC2257998004D1BCE?OpenDocument. Accessed 31 March 2018.

4. EXEMPTION OF THE CIVIL LIABILITY AND ITS LIMITS

In was established in the previous Chapter that the banks could be held liable for failing to properly apply the restrictive AML measures towards their customer. However, this potential liability must be regarded in light of the general exemption of liability provided both in the international and national AML regulation. The exemption generally applies if the subject of the AML regulation has applied the AML measures in good faith.

In this chapter, the principle of exemption of civil liability will be researched. It will further be assessed whether or not, and on what conditions, this exemption is inapplicable, in the light of the principle of good faith. More specifically, how the exemption can be pierced if the banks have terminated the legal relationship with their customers or refrained from executing the bank transfer based on the AML regulation will be reviewed. In this regard, the court practice of other countries that have already faced the claims of the customers against the banks, will be explored.

4.1 Exemption of the civil liability

Recommendation 21 of FATF Recommendations[132] provides that the states must ensure that financial institutions, their directors, officers and employees are protected by law from criminal and civil liability for breach of any restriction on disclosure of information imposed by contract or by any legislative, regulatory or administrative provision, if they report their suspicions in good faith to the FIU, even if they did not know precisely what the underlying criminal activity was, and regardless of whether illegal activity actually occurred. Besides this provision regarding the exemption of liability for the breach of any restriction on disclosure of information, there is no reference in the FATF recommendation regarding either liability of the banks *vis-a-vis* their customers, or exemption of such liability.

Pursuant to Article 26 of Directive No.2005/60/EC[133] disclosure by the bank concerned shall not constitute a breach of any restriction on disclosure imposed on the bank and shall not involve the institution or person or its directors or employees in liability of any kind. In other words, reporting suspicious activity to the competent authority will not amount to a violation of privacy requirements under civil or criminal laws[134]. This provision has an all-important role to play in the prevention of international crime and it suggests full recognition of the overriding importance of the core rules laid down for the

[132] Financial Action Task Force, (2012-2018), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, FATF, Paris, France, p.17, Available on: www.fatf-gafi.org/recommendations.htm, Accessed 10 April 2018.

[133] Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, preamble recital 2, OJ L 309, 25.11.2005. Available on: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32005L0060. Accessed September 23, 2017.

[134] Alberto Santa Maria, *European Economic Law, European Economic Law, 3rd eddition*, (The Netherlands: Wolters Kluwer Law & Business:2014), p.411.

collective protection of international public interests versus the rules protecting individual persons' interests[135].

The legislator explains the exemption of the named liability with the fact that the legislator has obliged the subject of the AML/CTF Law to mandatorily execute certain AML/CTF obligations[136]. Article 40 (1) of the AML/CTF Law provides for the general notion of the liability exemption of the banks and their management stating that if the subject of the Law complies with the requirements of this Law, the action of its management (the members of management and supervisory board) and employees thereof may not be qualified for a violation of the norms regulating the professional activity or the requirements of the supervisory and control authorities. Although, the exemption of the liability of the management and employees was specifically introduced under the AML/CTF Law by the recent amendments of the AML/CTF Law that came into force on 9 November 2017[137], the author considers that the potential liability of the management had to assessed on the same terms as that of the subjects of the AML/CTF Law also before the amendments.

Other paragraphs of Article 40 of the AML/CTF Law in detail provide for more specific exemptions. Thus, Article 40 (2) of the AML/CTF Law provides that if the subject of the Law has reported in good faith to the FIU in compliance with the requirements of the AML/CTF Law, the reporting to the FIU shall not be deemed to be a disclosure of confidential information and, therefore, the subject of the Law shall not be subject to legal nor civil liability. The liability is exempted, irrespective of whether the fact of ML or an attempt to carry out such conduct or another associated criminal offence is proved or not proved during the pre-trial criminal proceedings or on trial, as well as irrespective of the provisions of the contract between the customer and the subject of the AML/CTF Law.

Article 40 (3) of the AML/CTF Law deals with exemption of liability for refraining from execution and termination of legal relationship with the clients. It states that

> „[i]f the subject of the [AML/CTF]Law in good faith has refrained from executing the transaction [..], has ended business relationships or has requested early fulfilment of obligations [..], the subject of the [AML/CTF]Law, its management (the members of management and supervisory board) and employees shall not be subject to legal or civil liability due to such refraining or delay of the transaction, ending business relationships, or requesting the early fulfilment of obligations".

Pursuant to Article 40 (5) of the AML/CTF Law, if the FIU has issued an order regarding freezing of funds, then, irrespectively of the outcome of the freezing of funds,

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[135] Alberto Santa Maria, *European Economic Law, European Economic Law, 3rd eddition*, (The Netherlands: Wolters Kluwer Law & Business:2014), p.413.

[136] Annotation of the Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing of 7 June 2012. Available online: http://titania.saeima.lv/LIVS11/SaeimaLIVS11.nsf/0/25151E42DA0D5B9BC2257998004D1BCE?OpenDocument. Accessed 31 March 2018

[137] Grozījumi Noziedzīgi iegūtu līdzekļu legalizācijas un terorisma finansēšanas novēršanas likumā (Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing): Latvijas Republikas likums, Latvijas Vēstnesis, 2017, 8.novembris, nr. 222 (6049).

the subject of the AML/CTF Law shall not be subject to legal liability, including the civil liability.

According to to Article 43 (3) of the AML/CTF Law a credit institution or financial institution shall not be subject to civil liability for the termination of the business relationship with a customer or for requesting the early fulfilment of the customer's obligations if the requirements of the law have been complied with.

4.2 Limits of the exemption of liability

The banks' liability *vis-a-vis* their customers can only be triggered if the banks have failed to appropriately apply the AML regulation due to some shortcomings committed by the banks. However, if the grounds for adoption of the restrictive measures are objective and are well based, e.g. under legal provisions or the customers' presence in a foreign sanction list, the potential liability is largely excluded.

For instance, on 28 April 2018 the Latvian government adopted amendments[138] to the AML/CTF Law thee Latvian legislator adopted regulation restricting banks from having a legal relationship with shell companies if these companies meet the two criterions provided in Article 1 15^{1}) of the AML/CTF Law. If the banks terminate the legal relationship with such companies, there will be no requirement of a subjective assessment of the banks regarding their customers as the law directly prohibits the prohibition of such legal relationship.

As stated in the previous Chapter, the exemption of the civil liability of the banks applies only as far as the bank has acted in good faith. Therefore, to assess the scope of the exemption it is necessary to determine what the principle of good faith entails and what obligations (if any) it imposes on the banks in the application of the AML restrictive measures.

Article 1 of the Civil Law provides that rights shall be exercised, and duties performed in good faith. "Good faith" is a general legal clause – a legal concept of a general nature provided in the legal provisions that must be filled with a specific content to allow application of the legal norm for resolution of a specific real-life circumstances. General clauses are used in drafting legal norms as the understanding of the general clauses may in time be flexibly adjusted to the society's ever-changing assessment of the legal, social, and every day phenomena[139].

The legal term of "good faith" and the similar term of "fairness" are very ample and broad. The existing theory of private law and practice admit that the criterion of good faith is an auxiliary criterion, if the law or the contract does not provide a clear solution

[138] Grozījumi Noziedzīgi iegūtu līdzekļu legalizācijas un terorisma finansēšanas novēršanas likumā (Amendments to the Law on the Prevention of Money Laundering and Terrorism Financing): Latvijas Republikas likums, Latvijas Vēstnesis, 2018, 8.maijs, nr. 89 (6175).

[139] Kaspars Balodis, *Labas ticības princips mūsdienu Latvijas civiltiesībās* (Principle of Good Faith in the Latvian Modern Civil Law), Latvijas Vēstnesis, 3.decembris, 2002 /Nr. 24 (257). Available on the database of www.juristavards.lv, Accessed 30 April 2018.

to the problem[140]. "Good faith" is an objective, not subjective criterion. It means that Article 1 of the Civil Law refers to practice that can be objectively requested for ensuring fairness in civil circulation and this measure does not depend solely on the assessment of the exerciser of the right[141]. When it turns out that literal application of the legal provision would lead to an evidently unfair result, the courts must find a fair resolution for the situation by applying the special legal provision[142] - the AML/CTF restrictive measure in the context of this thesis.

The obligation to exercise the persons' rights in a manner that considers other persons' legitimate interest and established trust is derived from the principle of good faith. This, firstly means that the person must exercise their rights and fulfil obligations not formally, but from the perspective of the said right's (obligation's) intention and aim[143]. It is appropriate to speak about exercising rights in an unrighteous way in situations when, although acting within the framework of subjective rights set by the law or the contract (i.e. within the framework that formally conforms with the content of the right in question), the exercise of these subjective rights manifests as a conduct inconsistent with good faith[144]. In a broader sense, the aim of the principle of good faith is to facilitate mutual loyalty, trust, and fairness in the legal environment. Thus, the law requires both loyal behaviour of the persons, while at the same time prohibits disloyal conduct towards other participants of the civil relationships[145]. The basis of the principle of good faith is the rationale that in exercise of the rights and fulfilment of obligations every person must act within the framework of ethical boundaries, a breach of which does not enjoy legal protection[146].

Considering the afore mentioned, the author considers that applying the restrictive AML measures towards their customers in good faith requires not only that the banks are prohibited from displaying malicious intent to harm their customers, but also that the application of the measures must be reasonably assessed based on objective evidence. Enforcement of the AML regulation by the banks must not be arbitrary and it must be justified by sufficient evidence. For the purpose of this thesis, the arbitrary conduct

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[140] Kalvis Torgāns, "Freedom of Private Contracts and Influence of Public Power Thereon", in Kalvis Torgāns. *Current topics on Civil, Commercial Law and Civil Procedure. Selected articles 1999-2009*, Rīga: tiesu namu aģentūra, 2009, pp.99-100.

[141] Evija Slicāne, "Labas ticības princips un tā piemērošana Latvijas civiltiesībās" (Principle of Good Faith and its application if the Latvian Civil Law), *Jurista Vārds*, 6.februāris, 2007, Nr. 6 (459). Available online in the database www.juristavards.lv, Accessed 30 April, 2018.

[142] Kaspars Balodis, "Labas ticības princips mūsdienu Latvijas civiltiesībās" (Principle of Good Faith in the Latvian Modern Civil Law), *Latvijas Vēstnesis*, 3.decembris, 2002 /Nr. 24 (257). Available on the database of www.juristavards.lv - http://www.juristavards.lv/doc/68945-blabas-ticibas-princips-musdienu-latvijas-civiltiesibasb/, Accessed 30 April 2018.

[143] Evija Slicāne, "Labas ticības princips un tā piemērošana Latvijas civiltiesībās" (Principle of Good Faith and its application if the Latvian Civil Law), *Jurista Vārds*, 6.februāris, 2007, Nr. 6 (459). Available online in the database www.juristavards.lv, Accessed 30 April, 2018.

[144] [I]*Ibid.*.

[145] Kaspars Balodis, "Labas ticības princips mūsdienu Latvijas civiltiesībās" (Principle of Good Faith in the Latvian Modern Civil Law), *Latvijas Vēstnesis*, 3.decembris, 2002 /Nr. 24 (257). Available on the database of www.juristavards.lv - http://www.juristavards.lv/doc/68945-blabas-ticibas-princips-musdienu-latvijas-civiltiesibasb/, Accessed 30 April 2018.

[146] Kaspars Balodis. *Ievads civiltiesībās* (Introduction to Civil Law) (Rīga: Zvaigzne ABC, 2007), 141.lpp.

corresponds to the definition of an arbitrary judicial decision provided in the Black's Law Dictionary: a conduct "founded on prejudice or preference rather than on reason or fact"[147].

Thus, the author agrees with the conclusions of the Constitutional Court of Latvia regarding the refraining from executing the transactions that:

> "the sole doubts of the subject of the [AML/CTF] law do not represent sufficient grounds to deter from the transaction, as the doubts have to be "well grounded, i.e., there must be specific factual circumstances that indicate the connection of the customer to ML or TF[148]".

Hence, pursuant to the principle of good faith, when a bank applies the restrictive AML measures, it is obliged to gather sufficient evidence and information about the customer in question, otherwise risking being held liable for improper application of the law *vis-à-vis* its customer. The customer can rely on the fact that the bank will perform its obligations, including the AML obligations, in good faith with proper diligence. As has been promptly stated by professor K. Torgāns that under the formula "in private law everything that is not prohibited, is allowed" "it is wrong to study if the law directly prohibits a certain action. It is important to verify whether the provisions of Article 1 and 1415 of the Civil Law have not been violated"[149]. Exercise of the right in certain situations may become contrary to the principle of good faith if, upon exercise of the right, the subject contravenes their previous conduct (*venire contra factum proprium*) [150], especially if the factual circumstances have not changed (e.g. a stricter AML regulation has not been adopted or the factors defining the customer's AML risk exposure have not changed).

Subjective exercise of the right under the good faith principle is not allowed if the person does not have a legitimate interest that would justify exercise of the right or if the interests of the opposing party are to be considered as more important[151]. Risk management and compliance with the AML regulation evidently qualify as the bank's legitimate interest. However, the bank's decision cannot be intentionally harmful to the customer (e.g. a competitor) or completely arbitrary, e.g. for reporting all transactions of their customers to the FIU or de-risking (de-banking) whole classes of customers (if there are no grounds whatsoever for such risks) to escape hypothetical administrative liability for failure to enforce the AML rules. Such conduct does not comply with the

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[147] Black's Law Dictionary, Ninth Edition, Garner, Bryan A., and Henry Campbell Black. *Black's Law Dictionary*. 9th ed. St. Paul, MN: West, 2009, p.119

[148] Judgment of 28 May, 2009, case No.2008-47-01, Constitutional Court of Latvia, para 15.7. Available online: http://www.satv.tiesa.gov.lv/wp-content/uploads/2016/02/2008-47-01_Spriedums.pdf. Accessed 31 March 2018

[149] Kalvis Torgāns, "Freedom of Private Contracts and Influence of Public Power Thereon", in Kalvis Torgāns. *Current topics on Civil, Commercial Law and Civil Procedure. Selected articles 1999-2009*, Rīga: tiesu namu aģentūra, 2009, pp.99-100.

[150] Kaspars Balodis, "Labas ticības princips mūsdienu Latvijas civiltiesībās" (Principle of Good Faith in the Latvian Modern Civil Law), *Latvijas Vēstnesis*, 3.decembris, 2002 /Nr. 24 (257). Available on the database of www.juristavards.lv - http://www.juristavards.lv/doc/68945-blabas-ticibas-princips-musdienu-latvijas-civiltiesibasb/, Accessed 30 April 2018.

[151] *Ibid.*

principle of good faith and would expose the bank to a potential liability towards their customers.

Lastly, it is important to note that the AML/CTF Law exempts banks from liability if they acted in "good faith", not their being in "good awareness". Although both the terms look almost identical in Latvian ("*Laba ticība*"and „*labticība*") they refer to different notions. "Good awareness" is not a legally ethical principle as is the "good faith". "Good awareness" is a subjective intellectual element – the confidence of the person regarding existence or non-existence of some facts"[152]. Thus, it can be concluded that AML/CTF Law and other AML sources do not directly link the exemption of the civil liability to the banks' knowledge or suspicions of their customers' potential involvement in ML, but the overall application of the AML regulation in a prudent and diligent manner (in good faith). Certainly, if the banks know or must have known about such customers' involvement in ML, the banks are obliged to impose the restrictive AML measures and there would be no grounds for civil liability. However, the author considers that the application of the good faith principle transcends such awareness and obliges the bank to gather sufficient evidence and information on which a reasonable suspicion is based before applying the restrictive measures.

4.3 The termination or refusal of the legal relationship

In civil relationships the parties are free to decide on whether to sign a contract, with whom and what content should be included therein[153]. The law recognises the freedom of banks to choose with whom they wish to do business, and the law, often reinforced by the underlying contract with the customer, enables them to terminate that relationship when they choose to do so, provided that they give reasonable notice[154].

Furthermore, the high costs of performing the AML measures and risks of potential sanctions among other factors may lead the banks to a process called de-risking. This notion refers to the phenomenon of banks terminating or restricting business relationships with clients or categories of clients "to avoid, rather than manage, risk in line with the FATF's risk-based approach" [155] to minimise compliance cost and effort[156]. De-risking can in fact be described as a form of risk avoidance[157].

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[152] Kaspars Balodis, *Labas ticības princips mūsdienu Latvijas civiltiesībās* (Principle of Good Faith in the Latvian Modern Civil Law), Latvijas Vēstnesis, 3.decembris, 2002 /Nr. 24 (257). Available on the database of www.juristavards.lv - http://www.juristavards.lv/doc/68945-blabas-ticibas-princips-musdienu-latvijas-civiltiesibasb/, Accessed 30 April 2018.

[153] Kalvis Torgāns, *Freedom of Private Contracts and Influence of Public Power Thereon*, in Kalvis Torgāns. Current topics on Civil, Commercial Law and Civil Procedure. Selected articles 1999-2009, Rīga: tiesu namu aģentūra, 2009, p.89.

[154] Louis De Koker; Supriya Singh; Jonathan Capal, *Closure of Bank Accounts of Remittance Service Providers: Global Challenges and Community Perspectives in Australia*, 36 U. Queensland L.J. 119 (2017), p.135.

[155] Financial Action Task Force publication, "FATF clarifies risk-based approach: case-by-case, not wholesale de-risking, publication", Available online: http://www.fatf-gafi.org/publications/fatfgeneral/documents/rba-and-de-risking.html, Accessed 6 April 2018

[156] Liz Campbell, "Dirty cash (money talks): 4AMLD and the Money Laundering Regulations 2017", *Crim. L.R.* 2 (2018), p.113.

[157] *Ibid*, p.114

The right to terminate the legal transaction with the customer is explicitly provided in the FATF recommendations. Pursuant Recommendation 11, if the bank is unable to comply with the applicable requirements of customer due diligence, it should be required not to open the account, commence business relations, or perform the transaction; in short, it should be required to terminate the business relationship[158]. However, the FATF Recommendations only require financial institutions to terminate customer relationships on a case-by-case basis where the ML risks cannot be mitigated. The FATF itself has stated that the wholesale cutting loose of entire classes of customers without considering, seriously and comprehensively, their level of risk or risk mitigation measures for individual customers within a particular sector "is not in line with the FATF standards"[159]. Applying an overly cautious, non-risk-based approach to AML safeguards when providing financial services (both at the on-boarding stage or in the context of ongoing relationships) can have the unintended consequence of excluding legitimate consumers and businesses from the regulated financial system[160]. A key FATF concern is that the termination of relationships can potentially force people and entities into less regulated or unregulated channels that are not supportive of AML measures[161].

The issue of de-risking or financial exclusion is a concern that should be kept in mind when addressing AML policy. Customers must not be rejected by regulated financial providers and compelled to use underground banking or underground transfer services[162]. The EU adopted the Payment Accounts Directive in 2014, which provides EU consumers with the right to open a payment account that allows them to perform essential operations, such as receiving their salaries and making payments. The right is certainly not absolute. In specific circumstances, banks may refuse to open or terminate an account, for example where there is a breach of ML by the customer, or where the customer abuses the account, for instance, by committing fraud against the bank. Increased due diligence costs are not a sufficient reason to close that account[163].

Exercising the right in good faith means acting in a manner that considers the other persons' legitimate interest and established trust. It has been suggested in the legal

[158] Financial Action Task Force, (2012-2018), International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation, FATF, Paris, France, p.14, Available on: www.fatf-gafi.org/recommendations.htm, Accessed 10 April 2018.

[159] Financial Action Task Force publication, "FATF clarifies risk-based approach: case-by-case, not wholesale de-risking, publication", Available online: http://www.fatf-gafi.org/publications/fatfgeneral/documents/rba-and-de-risking.html, Accessed 6 April 2018.

[160] Financial Action Task Force Guidance "Anti-Money Laundering and Terrorist Financing Measures and
Financial Inclusion. With a Supplement on Customer Due Diligence", November 2017, p.2, Available online: http://www.fatf-gafi.org/media/fatf/content/images/Updated-2017-FATF-2013-Guidance.pdf. Accessed 9 April 2018.

[161] Louis De Koker; Supriya Singh; Jonathan Capal, "Closure of Bank Accounts of Remittance Service Providers: Global Challenges and Community Perspectives in Australia", *36 U. Queensland L.J.* 119 (2017), p.128

[162] Report from the Commission to the European Parliament and the Council on the assessment of the risks of money laundering and terrorist financing affecting the internal market and relating to cross-border activities, p. 8, Available on: http://ec.europa.eu/newsroom/document.cfm?doc_id=45319, Accessed 17 April 2018

[163] Paragraph 47 of the Preamble.

Latvian legal doctrine that, even if the contract between the parties provides for one party's right to freely and unilaterally withdraw from the contract, "unilateral termination of the contract may be declared as inconsistent with the good faith principle, if the party that withdraws from the contract does not have a sufficient reason for such conduct"[164]. The author concludes that the banks are not entitled to arbitrarily terminate the contractual relationship with the customers by simply invoking the unilateral termination clause or formally referring to Article 43 (3) of the AML/CTF Law to exempt them of liability.

Avoiding risks by refusing and terminating risky relationships when they are not commercially justified is a reasonable option for a compliance officer[165]. However, in the event of a dispute, the banks have to be able to provide objective justification for the closure of their customers' accounts, similarly to what was established by the High Court of Justice of the United Kingdom in the Dahabshiil[166] case examined below. The decision to terminate certain relationships must be justified by "objective necessity", i.e. such termination should be indispensable and proportionate to the goal pursued by the bank. Generally, liability will not occur if a refusal of relationship is based on a genuine need to reduce the ML risk exposure or in situations where the correct information on the beneficial owner of the banks is not revealed compelling the banks to terminate the relationship.

Article 1415 of the Civil Law *inter alia* provides that an impermissible or indecent action, the purpose of which is contrary to good faith (moral principles), may not be the subject-matter of a lawful transaction; such a transaction is void. If a bank unilaterally terminates a contract with the customer based on the provision provided in the contract allowing a free termination, such unilateral termination legally is also a transaction. If the sole purpose of the termination is to harm the opposing party, it can theoretically be argued that such withdrawal may be declared void. However, in such situations a very high threshold for proof would be required to prove that the aim of the transaction was indeed damaging to the opposing party. In practice, it would be nigh impossible. Therefore, the primary remedy for the customer would still be claiming damages for the improper application of the obligations by the bank, which itself is a very complicated matter, as discussed in this thesis.

According to the publicly available information, Latvian courts have not yet reviewed cases where the banks' customers bring a claim against the banks for unlawful termination of the customer relationship that would be based on improper application of the AML regulation. However, considering the increasingly vigorous imposition of the AML regulation on Latvian banks by legislators and the FCMC, and the ongoing

[164] Evija Slicāne, *Labas ticības princips un tā piemērošana Latvijas civiltiesībās* (Principle of Good Faith and its application if the Latvian Civil Law), Jurista Vārds, 6.februāris, 2007, Nr. 6 (459). Available online in the database www.juristavards.lv, Accessed 30 April, 2018.

[165] Louis De Koker; Supriya Singh; Jonathan Capal, "Closure of Bank Accounts of Remittance Service Providers: Global Challenges and Community Perspectives in Australia", *36 U. Queensland L.J.* 119 (2017), p.149.

[166] Judgment of 5 November 2013 of Chancery Division of the High Court of Justice, Dahabshiil Transfer Services Ltd. v Barclays Bank Plc [2013] EWHC 3379 (Ch) (United Kingdom), Available on: http://www.bailii.org/ew/cases/EWHC/Ch/2013/3379.html, Accessed 9 April 2018

reduction of banks customers (especially non-residents), the likeliness of such cases is continuously increasing. While Latvian court practice is still silent on the issue, the courts of other countries have recently already started facing such claims. The author will examine some of those cases in which the argumentation may be useful to the Latvian practitioners if (more likely – when) the Latvian courts face similar disputes.

4.3.1 Dahabshiil transfer services ltd. v Barclays bank plc (United Kingdom)

The following is an example of a (partially) successful challenging of the closure of the accounts due to the ML/TF risk relevance in the England and Wales High Court (UK) in the case Dahabshiil Transfer Services Ltd. v Barclays Bank Plc [167] where an application on the imposition of interim measures was reviewed by the court. The basic issue in the case was whether the defendant, Barclays Bank, should wait until trial or until a further order be restrained from terminating the supply of banking services to the claimants, or if they should be ordered to continue to supply them with such services[168]. Each of the claimants carried out an international money transfer and remittance business and banked with Barclays. Barclays gave the applicants notice of its intention to withdraw banking services from their businesses. The reasons for termination were related to be excessive ML/TF risks of the applicants and the risk-based approach followed by the Bank.

There was no dispute that Barclays was contractually entitled to terminate its provision of banking services to each of the claimants. Instead, the claimants contend that by giving them notice of its intention to withdraw banking services from their businesses, Barclays acted unlawfully, because Barclays was alleged in a dominant position in the market for the provision of banking services to money remittance businesses. According to the applicants, by ceasing to provide banking services without objective justification, Barclays would be abusing its dominant position contrary to Article 102 of the Treaty on the Functioning of the European Union[169] and the Chapter II prohibition in the UK's Competition Act 1998[170].

The Chancery Division granted the interim injunctions stating that there was a "far greater danger of irremediable prejudice to the claimants in refusing the grant of injunctions until trial than there would be in granting the injunctions"[171]. It was ruled that a dominant undertaking could commit an abuse where, without justification, it cut off supplies of goods and services to an existing customer. However, it is important that in the proceedings on the application of interim measures, Barclays' defence and justification for the termination due to ML/TF risk was not fully examined. That would

[167] *Ibid.,* Accessed 9 April 2018.
[168] Ibid, paragraph 1.
[169] Treaty on the Functioning of the European Union (Consolidated version 2012), *OJ C* 326, 26.10.2012. Available on: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT. Accessed September 20, 2017
[170] Ibid, paragraph 2.
[171] Ibid, paragraph 76.

have been done at trial, but the parties settled the case[172]. Still, this is a very important decision showing that banks holding a dominant position in the market may be subjected to justifying termination of their customer's accounts even if the closure is argued against by the ML/TF risk cutting. The author considers that if the Latvians reviewed the dispute, the customers could have also invoked the breach of good faith principle in the proceedings.

4.3.2 Bredenkamp v Standard Bank (South Africa)

The South African Supreme Court of Appeal has reviewed another significant case regarding termination of the legal relationship with the bank's customer due to AML/CTF risks [173]. In this case Mr Bredenkamp and entities owned or controlled by him applied for an interdict restraining against Standard Bank, a large South African bank, from terminating their accounts. Mr Bredenkamp and the related legal entities were listed in the US Department of Treasury's Office of Foreign Asset Control (OFAC) list as part of the imposition of US sanctions on Zimbabwe and due to Mr Bredenkamp's ties to President Mugabe[174]. Mr Bredenkamp was allegedly also involved in grey-market arms trading, oil distribution and diamond extraction[175].

The Bank had stated that, disregarding whether the allegations were correct or not, a continuing relationship with Bredenkamp would give rise to "legal, reputational, and business risk" and therefore they decided to close the accounts[176]. The Bank also sought to justify its right to terminate its relationship in the contractual terms as the express term of its contracts allowed it to close the accounts with reasonable notice. Lack of the bank's good faith (*bona fides*) was not alleged nor was it argued that the Bank was not *bona fide* in closing the accounts[177].

The Supreme Court of South Africa held that:

> "all contractual provisions have to be "reasonable" and [..] their enforcement must also be reasonable. [..] However, it is difficult to see how someone can insist on opening a banking account with a particular bank and, if there is an account, to insist that the relationship should endure against the will, *bona fide* formed, of the bank.[178]".

The Court emphasized that the Bank's cancellation was not premised on the truth of the allegations underlying the listing; it was based on the fact of the listing and the possible reputational and commercial consequences of the listing for the Bank. Thus, the Court

[172] Louis De Koker; Supriya Singh; Jonathan Capal, Closure of Bank Accounts of Remittance Service Providers: Global Challenges and Community Perspectives in Australia, 36 U. Queensland L.J. 119 (2017), p. 138.
[173] Judgment of 27 May 2010, Case No.599/09, Supreme Court of Appeal of South Africa, Bredenkamp v Standard Bank (599/09) [2010] ZASCA 75 (27 May 2010), Available online: http://www.saflii.org/za/cases/ZASCA/2010/75.html. Accessed 9 April 2018.
[174] Bredenkamp v Standard Bank (599/09) [2010] ZASCA 75 (27 May 2010), Available online: http://www.saflii.org/za/cases/ZASCA/2010/75.html. Accessed 9 April 2018.
[175] Ibid, paragraph 15.
[176] Ibid, paragraph 17-18.
[177] Ibid, paragraph 31.
[178] Ibid, paragraph 26, 57

did not request for a certain level of threshold to verify the suspicions of the Bank. The OFAC listing *per se* served the purpose. Furthermore, following the rationale that if the agreement provided for an option to cancel the contract without any cause, all the more so the bank was entitled to do so given the ML/TF suspicions.

The author agrees with the reasoning of the Supreme Court of South Africa that being listed on a sanctions list of another country's (e.g. the OFAC list of the US) may present grounds for lawful termination of the banks' legal relationship with their customers without exposure to civil liability. However, the bank still needs to put some effort in verifying the grounds for such listing and whether the listing is not e.g. evidently a measure of political reprisal.

4.4 Refraining from the executing a transaction

Pursuant to Article 32 (1) the banks must refrain from executing a transaction if the transaction is related with or there are substantiated suspicions that it is related ML, or there are substantiated suspicions that the funds are directly or indirectly obtained as a result of a criminal offence. Essentially, it means that the bank, on its own initiative, freezes the funds in the account of its customer until the FIU has adopted its decision on whether to issue a freezing order or to stop the refraining from executing the transaction. As described in the previous chapters, the AML/CTF Law provides for mechanism that, if after the freezing of the assets, it is established that there were initially no grounds for freezing, the state compensates for the losses to the customer. If the banks that have refrained from the transactions have acted unlawfully, i.e. not in compliance with the regulation of the AML/CTF Law, the banks then can be held liable via recourse claim brought by the Prosecutor General's Office.

Pursuant to Article 6 of the Regulation No.674 of the Cabinet of Ministers on reporting of unusual and suspicious transactions, banks have to include the reasoning for their suspicions on the link of the assets to ML and also indicate the typology of the potential criminal offense in question[179]. As stated in the annotation of this Regulation the aim of this requirement is to encourage the subjects of the AML/CTF Law as the original sources of information to perform the initial analysis and to pass high quality information to the FIU that can further be effectively used[180]. Thus, this requirement of the Regulation shows that the banks must not act arbitrary, and have to be able to provide at least some objective information or evidence on which their suspicions are based. The same rationale applies to refraining from the execution of transactions as these both obligations of the bank are strongly interconnected.

[179] Noteikumi par neparasta darījuma pazīmju sarakstu un kārtību, kādā sniedzami ziņojumi par neparastiem vai aizdomīgiem darījumiem (Regulation on the List of Signs of Unusual Transactions and the Procedure in Which the Reports on Unusual and Suspicious Transactions Must be Made), Ministru kabineta noteikumi Nr. 674, Latvijas Vēstnesis, 2017, 23.novembris, Nr. 232 (6059).

[180] Annotation of the Regulation of the Cabinet of Ministers on the List of Signs of Unusual Transactions and the Procedure in Which the Reports on Unusual and Suspicious Transactions Must be Made. Available online: http://tap.mk.gov.lv/doc/2017_11/FMAnot_060917_NDPSK.2342.docx, Accessed 12 May 2018.

The Constitutional Court of Latvia has stated that regarding the refraining from executing the transactions the sole doubts do not represent sufficient grounds to deter from the transaction, as the doubts have to be "well grounded, i.e., there must be specific factual circumstances that indicate the connection of the customer to ML or TF[181]". This statement leads the author to conclude that if the banks have arbitrarily and without insufficient (reasonable) evidence and assessment refrained from executing the transactions, such conduct can be described as a conduct that is incompliant with the provisions of the AML regulation and can therefore be subject to civil liability. The law does not prescribe for the threshold of profoundness for such information and evidence, although the author considers that it has to be reasonably well grounded, so that an average expert in the AML field would objectively arrive at the same conclusion on the suspiciousness of the transaction[182].

Pursuant to Article 40 (5) of the AML/CTF Law, if the FIU has issued an order regarding freezing of funds, then, irrespectively of the outcome of the freezing of funds, the subject of the AML/CTF Law shall not be subject to civil liability. Although a grammatical interpretation of the clause would lead to a conclusion that if the FIU issues the freezing order the banks are fully exempted from liability. However, the author considers that this provision of the AML/CTF Law and the respective exemption also must be regarded through the prism of application of the principle of good faith. If the FIU adopts the freezing order on the basis of misleading or distorted information and documents received by the bank that although suggest suspicion of ML but have not been anyhow verified by the bank in limited occasions the exemption of liability can still be pierced. The same principle applies to the potential liability of the banks if they refrain from the transaction but the FIU order to stop from the refraining.

In the process of this research, the author could not find any existing Latvian court practice regarding the customers' claims against the banks for improper refraining from execution of the transactions by freezing their funds or about the State's claim against the banks through a recourse claim under the AML/CTF Law regulation. However, likewise in the situation with unlawful closure of the customers' accounts the courts will likely in future review this issue as the application of the AML regulation keeps intensifying within the banking sector. Again, the experience of foreign courts would be of useful assistance.

A similar issue to this thesis topic has been reviewed by the Court of the United Kingdom in Shah v. HSBC Private Bank Ltd. Case[183]. Mr Shah, the customer of HSBC had instructed the bank to execute four transactions for approximately $38 million between September 2006 and February 2007 but the bank did not immediately execute the transactions because it suspected that they related to ML[184]. The bank made a

[181] Judgment of 28 May, 2009, case No.2008-47-01, Constitutional Court of Latvia, para 15.7. Available online: http://www.satv.tiesa.gov.lv/wp-content/uploads/2016/02/2008-47-01_Spriedums.pdf. Accessed 31 March 2018

[182] See Article 68 (2) of the AML/CTF Law.

[183] Shah v. HSBC Private Bank (UK) Ltd [2010]. Shah v. HSBC Private Bank (UK) Limited [2012] EWHC 1283.

[184] *Ibid.*

suspicious activity report to the Serious Organised Crime Agency and sought consent to proceed with the transactions, but the bank's suspicions were later found to be false. Shah brought a claim for damages caused by the bank's delay in executing the transactions. HSBC's defence to Mr Shah's claim was that it could not process the transactions because it suspected that they constituted ML. The Court of Appeal held that the burden is upon the reporting institution (the bank) to prove suspicion and that the bank may be required to do so at trial when sued by the relevant customer for failure to carry out a transaction while awaiting consent. This also entails that financial institutions will potentially be required to disclose how, when and from whom these suspicions originated[185]. The case does not alter the fact that the test for suspicion is low and therefore provided that the institution properly records its reasons for making the suspicious activity report, it is unlikely to incur liability[186].

4.5 Liability to customers *vs.* liability for breach of AML regulation

The AML/CTF duties have put banks in a precarious position whereby they are required to obey the law by, among other obligations, reporting suspicious activities, the failure of which they may lead to their being prosecuted[187]. In Latvia FCMC has authority and mandate to carry out AML/CTF supervision of financial institutions. A wide range of administrative penalties, including but not limited to, monetary penalties and suspension/withdrawal of licence, and is available to FCMC in the case of non-compliance with AML/CTF requirements. FCMC exercises its powers to impose the administrative penalties meeting the requirements of the 4th EU AML Directive[188].

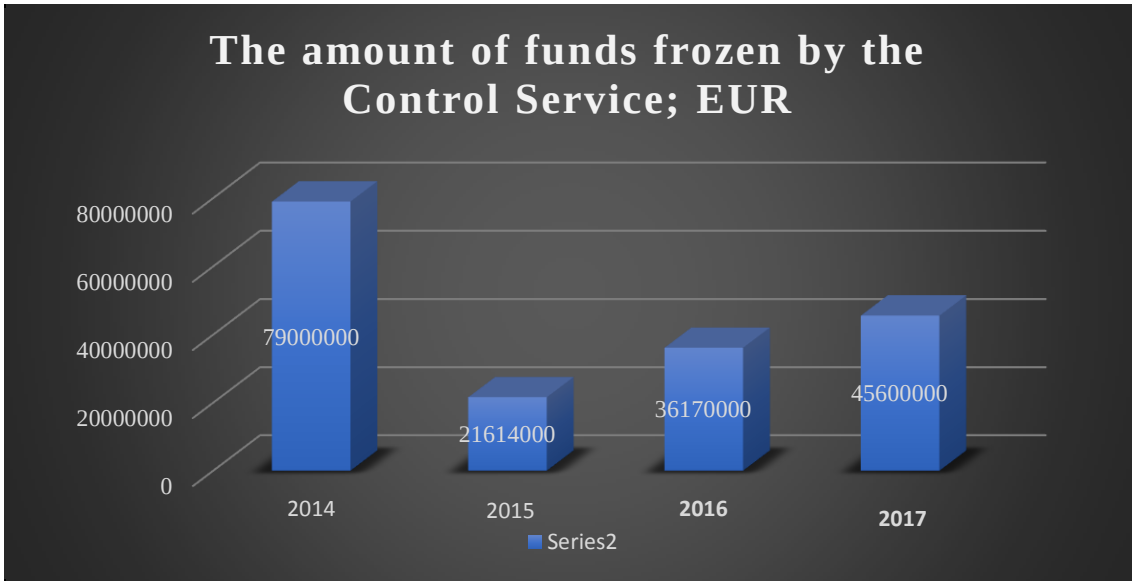
On the other hands banks risk civil litigation and claims for damages e.g., due to breach of contract/mandate if they fail to honour the instructions of their clients in relation to money in the account or terminate customer relationship with the client[189]. This potential dual liability of the banks raises an evident question –could facing a potential liability against their customers hinder the banks from enforcing the AML/CTF regulation? To assess this issue, a simplified comparison between the risk exposure of administrative fines for breach of AML regulation and customers' claims for the statutory interest for delayed execution of transactions will now be performed.

The research period for this purpose shall be 2014-2017. The author notes the financial assessment would be more accurate if the reference period would be longer (6 years – 10 years)

[185] Lloyd Himaambo, "Role of Banks as Private Police in the Anti-Money Laundering Crusade", *9 Bocconi Legal Papers* (2017), p.184.
[186] Peter Burrell, Rita Mitchell, David Savell, A Troubling Bank Balance — Competing Duties for Banks When Making Suspicious Activity Reports, The Banking Law Journal, VOLUME 129, NUMBER 6, JUNE 2012, p. 546 (pp.542-547).
[187] Lloyd Himaambo, "Role of Banks as Private Police in the Anti-Money Laundering Crusade", *9 Bocconi Legal Papers* (2017), p. 182.
[188] Latvian National money laundering/terrorism financing risk assessment report, Riga, 27 April 2017, p.52, 55, Avaialble at: http://www.kd.gov.lv/images/Downloads/useful/ML_TF_ENG_FINAL.pdf, Accessed 12 April 2018.
[189] Lloyd Himaambo, "Role of Banks as Private Police in the Anti-Money Laundering Crusade", *9 Bocconi Legal Papers* (2017), p. 182.

as it may take more than four years for the courts to declare the funds reported by the FIU to be proceeds of crime. However, it was not possible to review a longer period in this thesis as the earliest publicly available data is from 2014. For the future research a longer review period would be advisable.

The amount of funds frozen by the FIU during the period of 2014-2017[190] is indicated in the following table:



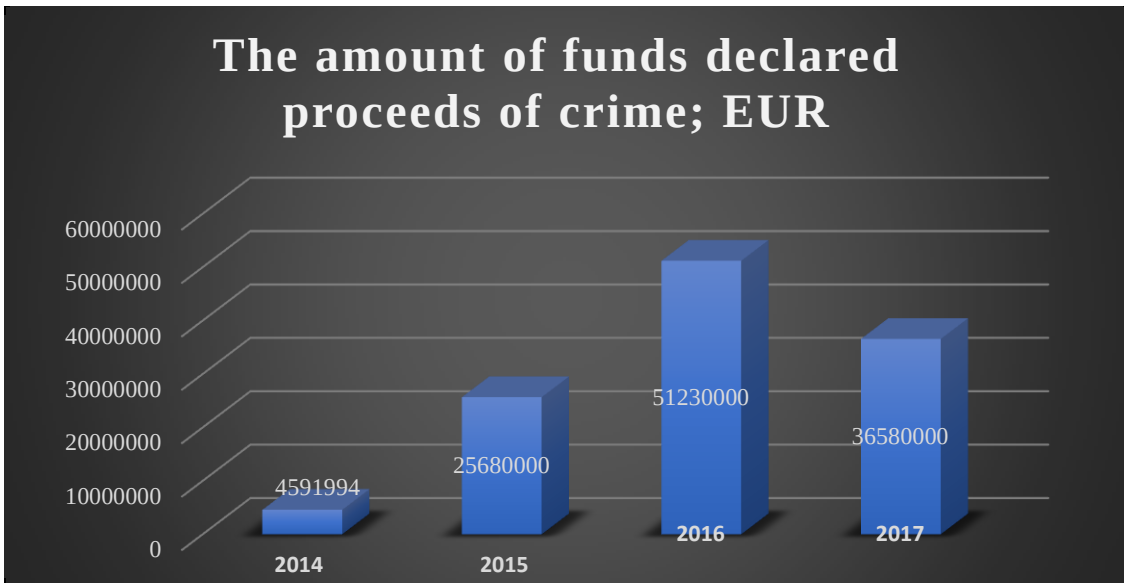
Source: Office for Prevention of Laundering of Proceeds Derived from Criminal Activity[191]

The average amount of the funds frozen pursuant to the orders of the FIU during the period of 2014-2017 is 45,596,000.00 EUR.

During the same period, the Latvian court adopted decisions on declaring funds to be proceeds of crime following information received from the FIU in the following amount:

190

191 Report of 2017 of the Office for Prevention of Laundering of Proceeds Derived from Criminal Activity, available online: http://kd.gov.lv/images/Downloads/about/reports/KD%202014g_atskaite1.pdf, http://kd.gov.lv/images/Downloads/about/reports/KD_2017_g_atskaite.pdf, Accessed 19 May 2018.



Source: Office for Prevention of Laundering of Proceeds Derived from Criminal Activity[192]

The average amount of the funds found to be the proceeds of crime, pursuant to the information received by the FIU during the period of 2014-2017, is 29,520,498.50 EUR.

Thus, on average the FIU issues freezing orders for the amount that exceeds the sums the funds declared by the court to be proceeds from crime by 16,075,501.50 EUR per year. It can be established that these are the average sums that are improperly frozen by the FIU annual. Approximately 70% of all the suspicious and unusual transaction reports to the FIU are reported by banks[193]. Thus, it can be assumed that annually about 11,252,851.10 EUR of the improperly frozen funds are related to the reports of the banks[194]. If the improper freezing of all these funds by the FIU would be the direct consequence of the banks' improper application of the AML reporting measures, the banks could theoretically be held liable for the losses related to their freezing (the maximum amount attributable to banks).

If the clients are unable to use the funds in their accounts, they may claim the statutory interest from the amount of the frozen assets for a delay of performance of the payment obligations. Pursuant to Article 1765 (1) of the Civil Law the annual statutory interest rate is 6%.

Generally, the maximum period of the freezing of funds for which liability may be attributable to the banks due to their misleading suspicious/unusual transaction report

[192] Reports of 2014 and 2017 of the Office for Prevention of Laundering of Proceeds Derived from Criminal Activity, available online: http://kd.gov.lv/images/Downloads/about/reports/KD%202014g_atskaite1.pdf, http://kd.gov.lv/images/Downloads/about/reports/KD_2017_g_atskaite.pdf, Accessed 19 May 2018.

[193] Data from the Latvian National money laundering/terrorism financing risk assessment report, Riga, 27 April 2017, pp 130-142, Avaialble at: http://www.kd.gov.lv/images/Downloads/useful/ML_TF_ENG_FINAL.pdf, Accessed 12 April 2018.

[194] It is important to note that this approximation is based on the assumption that the improper freezing of the funds does not significantly differ from the categories of the reporting subjects. There is no data publicly available regarding proportion of the banks' reports leading to improper freezing of funds issued by the FIU.

related to ML is 85 days. This period is comprised of the temporary freezing order of the FIU following the suspicious/unusual transaction report related and the order to freeze the funds for 45 days under Article 32.[2] (2) 1) b) (the decision must be adopted within 40 days after the banks have submitted the suspicious/unusual transaction report related).

The maximum risk exposure potential claims for the statutory interest for delayed payments if a freezing order has been issued by the FIU due to misleading suspicious/unusual transaction report related to ML is calculated in the following way:

$$R = (A * Rst)/Y) * D,$$

Where:

R – the annual risk exposure

A – amount of improperly frozen assets

Rst – Statutory interest rate

Y- days in the respective year

D – Maximum of days for attributability of liability

Thus, the maximum exposure to potential claims for the statutory interest for delayed payments if a freezing order has been issued by the FIU due to misleading suspicious/unusual transaction report related to ML is on average 157,231.62 EUR annually[195].

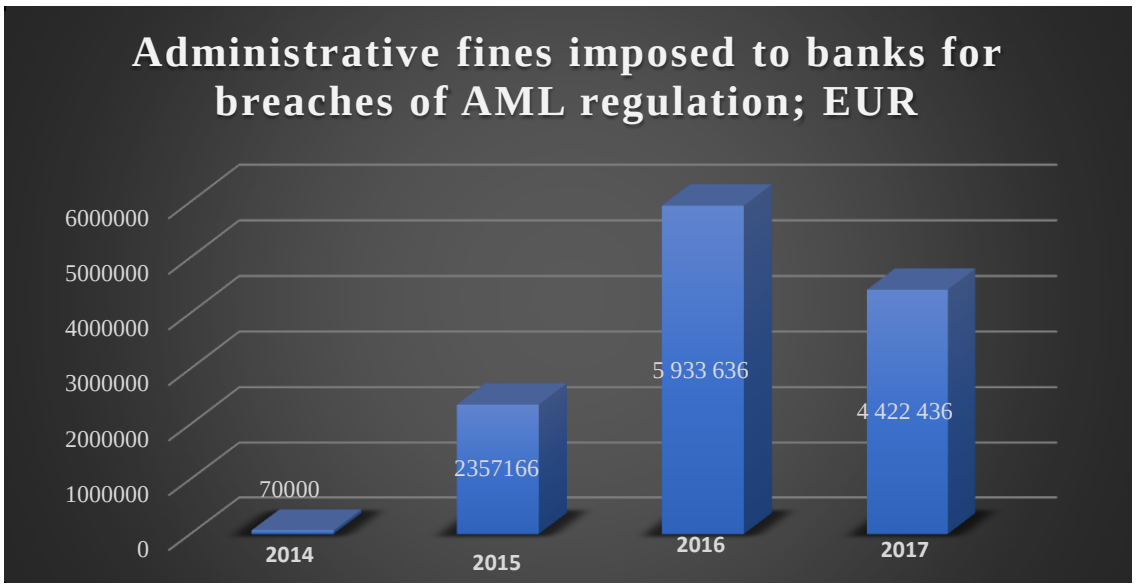
This risk exposure estimation does not include other potential claims for damages that are related to the freezing of the customers' funds like contractual penalties that are imposed on the customers' for failure to honour their payment obligations with their business partners. However, it is nearly impossible to make those calculations due to the unavailability of data. Further, The estimate does not include the claims for statutory interest for the funds that the banks freeze pursuant to their own initiative but in respect of which the FIU does not adopt the freezing order. Hence, the risk exposure for claims for statutory interest in practice may be even higher. On the other hand, these other potential claims for statutory interest would likely be for significantly lower amounts, as the maximum period of exposure for such conduct is only 8 business days until the FIU adopts the decision to stop refraining from executing the transaction pursuant to Article 32.[2] (1) of the AML/CTF Law[196].

The estimated risk exposure will now be compared to the administrative fines imposed on the banks for failure to properly apply the AML obligations[197]. In the period 2014-2017, the FCMC imposed administrative fines to the banks and their management for failure to properly apply the AML obligations in the following amounts:

[195] 11,252,851.10 *0.06.

[196] it is not possible to make even an approximate calculation for thhis exposure as there is no publicly available information regarding the sums that the banks freeze when refraining from executing the transation but the FIU issues the order to stop the refraining.

[197] Only the administrative fines are regarded in the calculation. Other types of administrative liability incluede e.g. warning or suspension of the banks' licence.



Source: The Financial and Capital Market Commission[198]

The average annual amount of the fines during the reference period was 3,195,809.50 EUR. The amount of fines has also increased substantially after 2014. In the future, the administrative fines for breaches of AML regulation can be even materially higher as pursuant to the 26 October 2017 amendments to the AML/CTF law introducing the requirements of the 4th EU AML directive the maximum amount of fines is 10% of the consolidated annual turnover of the bank.

The difference between the estimated risk exposure for the customers' claims for statutory payment and the fines imposed to the banks is more than 20 times. Thus, it can be concluded that in terms of potential negative financial consequences, the banks are exposed to a materially higher risk of being held administratively liable than being sued by the customers for collection of the statutory interest payments.

The author considers that this difference properly reflects the aims of aims of the AML regulation and strikes an appropriate balance between the obligation of the banks to apply the AML regulation and the risk of being sued by the customers for doing so improperly. When applying the AML regulation, the banks primarily have to be concerned with compliance requirements that include reporting the suspicious activities of their customers to the FIU. The aim of the whole AML system would be severely jeopardized if, due to the potential claims of their customers the banks would be afraid to refrain from executing the customers' transactions if the banks have suspicions regarding the potential ML. At the same time, the application of the restrictive AML measures that have significant negative effect on the customers must be applied in a prudent manner based of well-assessed decisions. To ensure such application the banks have to remain aware of the risks of potential claims of the clients.

Litigation against the banks' customers for improper AML/CTF application could be costly to the banks due to legal fees and reputation. However, these aspects will not

[198] Data available online: http://www.fktk.lv/lv/tirgus-dalibnieki/kreditiestades/2014-10-22-fktk-piemerotas-sankcijas.html, Accessed 19 May 2018.

significantly affect the above-mentioned conclusions and calculations. The legal costs of the banks can potentially be recovered by the opposing party in the civil dispute[199] and the reputational risks of the banks would be affected both in the litigation against the customer and failure to comply with the AML/CTL obligations, the latter arguably damaging the reputation of the bank much more significantly.

In this Chapter, it has been established that although there is a general exemption of civil liability for application of AML measures provided in the AML regulation, the banks are still not entitled to apply the restrictive measures arbitrarily. When the banks apply the restrictive AML measures, they are obliged, pursuant to the principle of good faith, to gather sufficient evidence and information to form a reasonable suspicion, otherwise they risk not being covered by the exemption of liability and being held liable for the improper application of the law *vis-à-vis* its customer.

In the following Chapter, the central procedural aspect regarding the customers' potential claims will be explored - the distribution of burden of proof between the parties.

[199] Article 44 (2) of the Civil Procedure Law.

5. ANALYSIS OF THE BURDEN OF PROOF

As was noted in the previous Chapter of the thesis in the UK case Shah v. HSBC Private Bank Ltd. Case[200] the UK courts have concluded that a bank has a burden of proof to prove suspicion of ML when sued by the relevant customer. If the matter of the banks' potential liability was reviewed by the Latvian courts the issue of the burden of proof of the banks' suspicion likewise in the Shah v. HSBC Private Bank Ltd. case would be one of the central ones.

Therefore, in this Chapter the distribution of the burden of proof between the parties in the civil disputes regarding liability of banks for improper application of restrictive AML measures will be examined. The question of whether and to what extent the banks have a burden of proof to prove their suspicions will also be discussed. And finally, it will be examined whether the burden of proof varies from the category of the customer of the banks - a regular customer, a subject of the AML/CTF Law, or the competitor of the bank.

5.1 General rules for burden of proof

As has been shown in Chapter 4 of the thesis, the banks are generally exempted from liability if they reasonably suspect that the customer might be involved in ML and in good faith apply some restrictive measures. However, it has also been shown that the exemption is not absolute and can be challenged by third parties.

Article 93 of the Civil Procedure Law states that each party must prove the facts upon which they base their claims or objections. Plaintiffs must prove that their claims are well founded. Respondents must prove that their objections are well founded. Evidence must be submitted by the parties and by other participants in the case. In civil claims for damages against the banks for inappropriate application of the AML/CTF regulation typically the (potential) customers will be the plaintiffs and the banks will be the respondents.

The distribution of the burden of proof between the litigants is based on the principle *ei incumbit probatio qui dicit, non qui negat* (The burden of the proof lies upon him who affirms not he who denies). Thus, the *onus probandi* (burden of proof) initially lies with the plaintiff that brings a claim to court. Until the plaintiff has proven their claim the respondent does not have to prove anything and can deny the claim without any evidence[201].

Pursuant to basic legal doctrine of the Latvian civil procedure law established by Prof. Vladimirs Bukovskis in claims for damages, the burden of proof is distributed in the following way. The plaintiff must prove 1) the infringement of rights that has caused losses has indeed taken place; 2) the amount of losses inflicted by the infringement of

[200] Shah v. HSBC Private Bank (UK) Ltd [2010]. Shah v. HSBC Private Bank (UK) Limited [2012] EWHC 1283.

[201] Aivars Līcis, *Prasības tiesvedība un pierādījumi. Prof. K.Torgāna zinātniskajā redakcijā. Mācību līdzeklis tiesību zinātņu studentiem* (The claim litigations and evidence) (Rīga: Tiesu namu aģentūra, 2003), 72.lpp.

rights (passive basis of the claim)[202]. If the claimant argues that the respondent acted with malicious intent, the claimant must prove this allegation. If the claimant has successfully proven the said facts the respondent must prove that fault for the infringement of rights is not attributable to respondent. If the claimant has proven that the respondent has acted with malicious intent, the respondent can prevent the negative consequences by proving that the claimant has acted with a malicious intent as well[203]. It can be derived from the legal provisions that depending on the circumstances not only specific facts, but also rights and certain circumstances – defects of will, intent etc. must be proven[204]. These arguments and evidence can be, for instance, the lack of any questions from the bank regarding the origin of the customers' assets or ignoring the information provided by the customer in the customer due diligence process.

Neither the Civil Procedure Law, nor the AML/CTF Law expressly provide for provisions regarding the level of proof (evidence) that certain categories of the banks' customers would have to reach to show that the bank may have breached the good faith. The law is also silent regarding the level of evidence for the bank to prove to the contrary. However, the central criteria in evaluation of evidence is the assessment of its credibility, "which is to be understood as determination of the compliance of the evidence with the objective reality and factual circumstances"[205]. The court's confidence in the credibility of the evidence must be sufficient, i.e. this confidence cannot be based on the possibility of the truthfulness of the evidence, disregarding the doubts[206]. The norms of the Civil Procedure law do not bind the court with formalistic criteria for the evaluation of evidence, but obliges it to motivate its conduct in assessing the evidence in the judgment[207].

Thus, in a claim for damages against the banks, the customer would have to prove that there are legal grounds for reimbursement of losses, namely: 1) unlawful activity of the bank – inappropriate application of the AML regulation; 2) the customer has incurred losses in a certain amount; 3) there is causal link between the conduct of the bank and the losses incurred[208]. If one of the litigants refers to a breach of the good faith and the other party denies it the accuser must prove the allegation[209]. To prove the unlawful activity, the customer also must provide arguments based on at least some objective evidence regarding the bad faith of the bank in application of the bank to prevent the exemptions of the bank's liability.

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[202] The modern legal doctrine also requests proving of causual link for establishment of civil liability.

[203] Vladimirs Bukovskis, *Civīlprocesa mācības grāmata* (Text Book on Civil Procedure) (Rīgā: Autora izdevums, 1933), 775.lpp.

[204] Aivars Līcis, *Prasības tiesvedība un pierādījumi. Prof. K.Torgāna zinātniskajā redakcijā. Mācību līdzeklis tiesību zinātņu studentiem* (The claim litigations and evidence. Educational tool for student of law) (Rīga: Tiesu namu aģentūra, 2003), 76.lpp.

[205] *Ibid*, 78.lpp.

[206] *Ibid.*, 79.lpp.

[207] Jānis Rozenbergs, Kalvis Torgāns, *Trešā sadaļa. Pierādījumi.* in *Civilprocesa likuma komentāri. I daļa (1.-28.nodaļa)* (The Commentary of the Civil Procedure Law. Part I (Sections 1-28)), Autoru kolektīvs. Prof. K.Torgāna zinātniskajā redakcijā. – Rīga: Tiesu namu aģentūra, 2011, 272.lpp.

[208] Kalvis Torgāns, *Saistību tiesības. I daļa. Mācību grāmata*. (Contract Law. Part I. A Textbook) (Rīga: Tiesu namu aģentūra, 2006) 246.lpp

[209] Kaspars Balodis, *Labas ticības princips mūsdienu Latvijas civiltiesībās* (Principle of Good Faith in the Latvian Modern Civil Law), Latvijas Vēstnesis, 3.decembris, 2002 /Nr. 24 (257)

The author considers that the customers do not have to prove the "negative fact" that they have no connection to ML and there could have been no well-grounded suspicion for the bank to have it. Only the bank can prove that they had a well-grounded suspicion about the client's involvement in ML. However, the author agrees that this approach is somewhat inconsistent with the principle of *ei incumbit probatio qui dicit, non qui negat* and it can be argued that the bank may abstain from filing any evidence regarding its suspicions until the claimant has submitted enough evidence indicating a case for the lack of good faith in the bank's conduct.

The burden of proof (rebuttal) shifts to the respondent only when the claimant has proven its claim. The claimant cannot rely on a rationale – "I cannot prove grounds of my claim, therefore the respondent must prove its objections" [210]. In the context of civil liability, the person that wants to be exempted from the obligation to pay damages must prove that the infringement of the rights has taken place without its fault[211].

If the customer has proven the requirements for establishing the civil liability the *onus probandi* would shift to the bank. The bank can provide evidence that the prerequisites for civil liability have not been met. It can also re-invoke its exemption of liability if it provides evidence that it acted in good faith in applying the AML measures, i.e. there were reasonable grounds and sufficient evidence for suspicion that the customer may have been engaged in ML.

On the other hand, it is correct that at the moment of the application of the restrictive AML regulation, the banks do not have all the information resources that are available e.g., to the FIU. The aim of the AML regulation, as discussed in the first Chapter of this thesis, would be severely jeopardized if it would be required for the banks to undergo universal investigation and gathering massive evidence before, e.g. refraining from the execution of the transaction and reporting the transaction to the FIU. The position of the author is that the banks must have sufficient evidence for suspicion before applying the measures in accordance with the good faith principle. The threshold for such "sufficiency" is low, however, it may not be non-existent. It may also vary between some categories of customers, as will be argued in the next chapters.

Suspicion is defined as a possibility that is more than fanciful concerning the relevant facts[212]. A vague feeling of unease is insufficient. The onus is on financial institutions to prove the held suspicion. They will, potentially, be required to show the basis of their suspicion[213]. Proving the suspicion in court can be costly to the bank in terms of legal fees and reputation[214]. Given the burden of proof, the reporting process needs to be designed carefully. The reporting process must prevent situations, where one individual

[210] Aivars Līcis, *Prasības tiesvedība un pierādījumi. Prof. K.Torgāna zinātniskajā redakcijā*. Mācību līdzeklis tiesību zinātņu studentiem (The claim litigations and evidence) (Rīga: Tiesu namu aģentūra, 2003), 72.lpp.

[211] Agris Bitāns, *Civiltiesiskā atbildība un tās veidi* (Civil liability and its types) (Rīga:AGB, 1997), 79.lpp.

[212] Anna Simonova, Identity Protection or Not for Employees Reporting Money Laundering - The UK Case, 8 Macquarie J. Bus. L. 300 (2011), p.300 (pp.300-303).

[213] *Ibid.*, p.302-303 .

[214] Lloyd Himaambo, Role of Banks as Private Police in the Anti-Money Laundering Crusade, 9 Bocconi Legal Papers (2017), p.183 (pp.157 – 186).

employee acts out of bad faith, and ensure the wider spread of employees involved in the reporting process. In large financial institutions, it is easier to accomplish due to a large staff turnover. Meanwhile, this task becomes more challenging in smaller financial institutions[215].

In this regard the burden of proof of the banks would be similar to that which the banks have in their relationships with the FCMC pursuant to Regulation Regarding Enhanced Customer Due Diligence[216] for credit institutions and electronic payment institutions, namely, to show that AML measures taken by the bank have been taken properly and correspond to the risk related to the relationship with the client.

5.2 Different categories of customers

The author considers that the credibility of evidence for proving the or bad faith and suspicions of the bank in application of the AML obligations varies depending on the status of the counter party in the transaction with the bank. Such an approach does not infringe the principle of equality provided in the first sentence of Article 91 of Satversme. The Constitutional Court of Latvia has established the objective of the principle of equality is to ensure that such requirement of the rule of law is observed if the law is applied without any privileges[217].

At the same time the principle of equality allows and even requires different treatment of persons that are in different circumstances, as well as allows different treatment of persons in the same circumstances, if there are objective and reasonable grounds for this[218]. The different categories of the banks' customers involve different ML risks and the moral hazard of the banks to worsen their condition. Hence, the different types of customers are not in the same circumstances and differences in burden of proof for good faith does not trigger infringement of the principle of equality.

5.2.1 Regular customers

For the purposes of this thesis, both natural persons and private entities fall within this category of the banks' customers, unless they are characterized by other criteria described in the following sub-sections.

Typically, the banks are not inherently interested in applying the specifically stricter AML measures towards the regular customers if they do not represent additional ML risk (geographic risk, product risk, politically exposed persons etc.). Having more customers is in the banks' commercial interest from a financial perspective. Natural

[215] Anna Simonova, Identity Protection or Not for Employees Reporting Money Laundering - The UK Case, 8 Macquarie J. Bus. L. 300 (2011), p.302-303 (pp.300-303).
[216] Section 3, Klientu padziļinātās izpētes normatīvie noteikumi kredītiestādēm un licencētām maksājumu un elektroniskās naudas iestādēm (Normative Regulation Regarding Enhanced Customer Due Diligence for credit insittutions and electronic payment institutions": Normative regulation No.3 of the Financial and Capital Market Commission, Latvijas Vēstnesis, 2018, 15.janvāris, nr. 10 (6096)
[217] Judgment of 2 March, 2016, case No.2015-11-03, Constitutional Court of Latvia, section 17. Available online: http://www.satv.tiesa.gov.lv/wp-content/uploads/2015/04/2015-11-03_Spriedums-1.pdf. Accessed 29 April 2018.
[218] *Ibid*.

persons are generally consumers in the relationship with the banks, unless they enter into the relationship within the scope of their commercial or professional activity[219]. The banks must ensure that they do not breach the prohibition of the unfair commercial practice provided in the Unfair Commercial Practices Prohibition Law[220]. Commercial practice is unfair if it *inter alia* does not conform to professional diligence and has a substantial negative effect or may have a substantial negative effect on the economic actions of such average consumer or an average representative of such group of consumers in relation to goods or services, to whom the commercial practice is addressed or whom it concerns[221].

The author considers that the assessment of the banks' good faith criteria in the civil proceedings against their regular customers can be regarded through the prism of the expected "professional diligence". It can be expected from any professionally diligent financial market participant that their decisions, especially in application of restrictive measures, are well grounded and based on objectively assessed evidence. Therefore, the banks' decision to apply the restrictive AML measures *vis-a-vis* their customers must not arbitrary and must be rooted in a diligent application of the risk-based approach. As argued above, it is the banks' customers that must provide at least some reasoning for raising the suspicion that the banks have failed in its duties of diligence. If the customers suspect that the bank has failed to act with sufficient diligence, the customers are entitled to request the bank to submit evidence to the court based on which the decision to apply the restrictive measure was based.

Therefore, in terms of assessing whether the bank failed to act in good faith in applying the AML measures, the level for burden of proof is the higher for the regular customers in comparison with other categories of customers described below. It means that it would be harder for them to prove the lack of good faith in the banks' conduct and *vice versa*, it would be easier for banks to prove their good faith and reasonable suspicion regarding the regular customers.

5.2.2 Subjects of AML regulation

The subjects of the AML regulation are listed in Article 3 (1) of the AML/CTF Law. In the AML setting, subjects of the AML laws are gatekeepers-turned-police, required to detect, monitor and report suspicions of ML, but are viewed also as possible facilitators or enablers that can be deterred or punished through criminalisation[222]. The legislator has tasked these professions and institutions with AML obligations as they operate in areas and deal with customers that might represent a significant ML risk. On the other hand, the subjects of the AML are more aware of the general ML risks as they are obliged to comply with the AML regulation and introduce risk-mitigating measures in

[219] Patērētāju tiesību aizsardzības likums (Consumer Rights Protection Law): Latvijas Republikas likums, Latvijas Vēstnesis, 1999, 1.aprīlis, Nr.1564/1565.
[220] Negodīgas komercprakses aizlieguma likums (Unfair Commercial Practices Prohibition Law), Latvijas Republikas likums, Latvijas Vēstnesis, 2007, 12.decembris, 199 (3775).
[221] Article 4 (2) 1) of the Unfair Commercial Practices Prohibition Law.
[222] Liz Campbell, "Dirty cash (money talks): 4AMLD and the Money Laundering Regulations 2017", *Crim. L.R.* 2 (2018), p.108.

their business. Thus, the author considers that the status of the subjects of the AML/CTF Law *per se* does not significantly affect the level for burden of proof of the banks' good faith or the lack of it. In the claims against the banks for improper application of the AML measures, the level of the burden of proof is similar to that of the regular customers of the banks.

In one of its judgments that concerned the AML/CTF Law, the Constitutional Court concluded that companies that are engaged in currency exchange business and credit institutions that provide the currency exchange as one of the financial services upon provision of these services, are to be considered as being in equal and comparable conditions with the banks according to specific criteria[223]. Based on this initial conclusion the Constitutional Court went on to make a conclusion that imposition of additional AML/CTF measures on the currency exchange companies by the Central Bank that are not applicable to banks and violates the principle of equality and is therefore unconstitutional. Even though this judgment was based on an inappropriate delegation of legislative powers from the legislator to the Bank of Latvia, it can be concluded that in certain situation the different subjects of AML/CTF Law can be considered as being in comparable situations that require equal treatment. Accordingly, in the potential claims against the banks, the level of the burden of proof of the subjects of the AML regulation would be similar, unless they also qualify under the category of the banks' competitors reviewed below.

5.2.3 Competitors of banks

Banks are subject to competition laws and regulation, in particular the prohibition on anticompetitive agreements and abuse of market power. Article 18 of the Latvian Competition law prohibits unfair competition, which is defined in the following way:

> "[a]ctions, as the result of which laws and regulations or fair commercial practices are infringed, and which have created or could create a hindrance, restriction or distortion of competition, shall be deemed to be unfair competition".

Therefore, banks must be mindful of competition law requirements when applying the AML measures e.g. by deciding to terminate existing client relationships or decline new relationships. When applying the AML rules banks must ascertain that their AML policies and decisions to report a suspicious transaction, or deal or not to deal with certain customers, withdraw from particular type of business, and criteria used in assessing risks are determined individually and without coordination, and/or information exchange with other competitors.

De-risking can be the result of various drivers, such as concerns about profitability, prudential requirements, anxiety after the global financial crisis, and reputational risk. It

[223] Judgment of 2 March, 2016, case No.2015-11-03, Constitutional Court of Latvia, section 17. Available online: http://www.satv.tiesa.gov.lv/wp-content/uploads/2015/04/2015-11-03_Spriedums-1.pdf. Accessed 29 April 2018.

is a misconception to characterise de-risking exclusively as an AML issue[224]. Limitation of competition by e.g. closing the accounts of the banks' competitors (e.g. non – banking lenders) can be a driver of the bank to apply the restrictive measures. The same rationale also applies to other restrictive measures that can cause losses to the competitors, like freezing their accounts opened with the bank.

Application of the restrictive AML measures against the competitors involves an inherently increased moral hazard and risk of acting in bad faith to hurt the competitor. Thus, the level of burden of proof for proving the good faith in application of the AML restrictive measures is the highest in comparison to other categories of customers of the bank. When assessing if the bank lacked good faith in applying the AML measures, the level for burden of proof is lower for the competitors and *vice versa*, it would be harder for banks to prove their good faith and suspicion regarding their competitors relative to other categories of customers.

If a bank has such high market power that it can be considered as having dominant position in the relevant market, it is especially exposed to potential liability for improper application of the AML restrictive measures e.g. termination of the legal relationship with its competitors. Article 102 (1) TFEU[225] prohibits any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it in so far as it may affect trade between Member States. Article 102 (2) TFEU *inter alia* specifies that the following abuse of being in a dominant position is prohibited: limiting production, markets or technical development to the prejudice of consumers; applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage. It is important to note that in determination of whether the bank holds a dominant position, the assessment of the relevant product market is important, not just the Latvian banking market in general. The narrower definition of the product market, the easier it is to conclude that an undertaking is dominant under Article 102[226].

While the dominance does not itself imply any reproach, the undertaking nonetheless has a "special responsibility", irrespective of the cause of that position. Therefore, the undertaking in a dominant position may be deprived of the right to adopt a course of conduct which is not itself abusive, and which would be objectionable if taken by a non-dominant undertaking[227]. The Court of Justice of the European Union had already held in the *United Brands* case that the dominant firm cannot refuse to meet the orders of a longstanding customer who abides be regular commercial practice[228]. Refusal by the

[224] Financial Action Task Force, "FATF clarifies risk-based approach: case-by-case, not wholesale de-risking, publication, Available online: http://www.fatf-gafi.org/publications/fatfgeneral/documents/rba-and-de-risking.html, Accessed 6 April 2018

[225] Treaty on the Functioning of the European Union (Consolidated version 2012), *OJ C* 326, 26.10.2012. Available on: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT. Accessed September 20, 2017

[226] Paul Craig, Gráinne de Búrca, *EU LAW. Text, Cases and Materials. Fifth Edition* (Oxford: Oxfor University Press, 2011, p.1012.

[227] Paul Craig, Gráinne de Búrca, *EU LAW. Text, Cases and Materials. Fifth Edition* (Oxford: Oxfor University Press, 2011, p.1025.

[228] Judgment in United Brands, ECLI:EU:C:1978:22.

dominant firm to supply existing customers will therefore be abusive unless there is some objective justification[229].

It is not under a discussion that application of AML/CTF measures is an objective justification to e.g. reject access to the banks' services (on the contrary, it would be the obligation of the bank under the AML/CTF Law if the risk would become unmanageable). However, considering the risks of abusing the market power the banks must make extra offer to record the decision-making process and review and store sufficient evidence for the application of the said measures.

Therefore, the level of proof of good faith for banks being in a dominant position or at least having significant market power is even higher than that of the banks not exercising such market power.

In this chapter, the distribution of the burden of proof between the parties in the civil disputes and between the banks and their customers was researched. It was established that in the event of a court dispute, in addition to providing the damages, the customers also have to provide arguments based on at least some objective evidence regarding the bad faith of the bank in the application of the bank to prevent the exemption of the bank's liability. When the burden of proof shifts to the banks, they have to be able to provide objective and reasonable justification for application of the restrictive AML measures.

It was also asserted in this chapter that the level for the burden of proof of the "reasonability" of the banks' suspicion may vary from the category of the customer. When assessing if the bank lacked good faith in applying the AML measures, the level for the burden of proof is lower for the competitors of the banks in comparison with other categories of customers.

[229] Paul Craig, Gráinne de Búrca, *EU LAW. Text, Cases and Materials. Fifth Edition* (Oxford: Oxfor University Press, 2011, p.1029.

6. CONCLUSION

The hypothesis of the thesis was that the banks could have civil liability *vis-à-vis* their customers if the banks have failed to properly apply the restrictive AML measures and the potential remedies of customers go beyond the framework set by the AML/CTF Law. The hypothesis of the thesis was confirmed during the research.

It was concluded that if the banks fail to acquire sufficient evidence to substantiate their suspicion regarding the customers' involvement in ML, they risk being held liable for improper application of the law *vis-à-vis* their customers. The primary type of the civil liability is the claim for damages, but in specific circumstances other remedies like contractual penalties also might become available to the customers.

It was concluded that the AML/CTF Law only lists circumstances that allow the aggrieved customer to claim compensation for losses under the specific procedure provided in the AML/CTF Law. However, it does not limit any other potential claims of the aggrieved persons not explicitly covered by the AML/CTF Law. The customers of banks can bring such claims under the Civil Procedure Law directly against the banks that improperly applied the AML obligations. The author considers that this conclusion must be explicitly provided in the AML/CTF Law to prevent misconception in future. In this regard in the thesis the author suggests introducing specific amendments to the AML/CTF Law proposed in Chapter 3.2 of the thesis.

It is argued in the thesis that the distinction in the AML/CTF Law between the banks' "unjustified" and "unlawful" in application of the AML measures, in respect of the potential liability, is artificial and unnecessarily confusing. The primary criterion for triggering the banks' liability is the assessment if the bank applied the restrictive measures if good faith. Hence, the author suggests reworking the regulation under Chapter XIV AML/CTF Law, without the distinction of the two notions and subjecting the potential recourse claim on the faith in which the subject of the Law acted in application of the restrictive measures.

The research question of the thesis was to determine whether restrictive AML measures applied by the banks towards their customers can be arbitrary or they need to be based on objective evidence and for the exemption of liability to apply. It was concluded that application of the restrictive AML measures must be reasonably assessed. Enforcement of the AML regulation by the banks must not be arbitrary and it must be justified by sufficient evidence and rooted in a diligent application of the risk-based approach and the principle of good faith. Unfounded doubts of the banks of the customers' involvement in ML do not represent sufficient grounds to apply the restrictive measures, as the doubts have to be well grounded, i.e., there must be specific factual circumstances that indicate the connection of the customer to ML.

Thus, the banks are not entitled to arbitrarily terminate the contractual relationship with the customers by simply invoking the unilateral termination clause in the contract based on a hypothetical ML risk. Neither are they allowed to arbitrarily and without reasonable evidence deny a transaction to and from the customers' accounts.

On the other hand, the aim of the AML regulation would be jeopardized if it would be required for the banks to undergo universal investigation and gathering massive evidence before applying the restrictive measures. As regulation does not prescribe for the threshold of profoundness for evidence, it was concluded that the evidence has to be reasonably well grounded, so that an average expert in the AML field would objectively arrive at the same conclusion on the suspiciousness of the transaction. The threshold for such "sufficiency" is low, but it may not be non-existent.

In respect of the distribution of the burden of proof in the customers' civil claims against the banks, the customers do not have to prove the "negative fact" that they have no connection to ML and there could have been no grounded suspicion of the bank regarding it. Only the bank can prove that they had a well-grounded suspicion about the client's involvement in ML, therefore the burden of proof would be on the bank to prove this suspicion.

Furthermore, the credibility of evidence for proving the good or bad faith and suspicions of the bank in application of the AML obligations varies depending on the status of the counter party in the transaction with the bank. When assessing if the bank acted in good faith in applying the AML measures the level for burden of proof of the banks is the higher regarding for their competitors in comparison with other categories of customers. This is especially relevant if the bank has a dominant position in the relevant market. Considering the risks of abusing the market power the banks must make extra offer to record the decision-making process and review and store sufficient evidence for the application of the restrictive measures.

Although the Latvian courts are yet to face claims of the customers against the banks for improper application of AML regulation, customers of banks in other countries have already tried bringing such claims in their national courts. The outcome has generally not been splendid from the customers' perspective, however, in some instances their arguments have met at least partial recognition of the court. The scarce case law of other countries suggests that the banks may have the obligation to prove their suspicions if sued by their customers. These findings of the courts of other countries may also be useful in potential disputes before the Latvian courts.

The Latvian banks recently have faced ever-increasing AML obligation, which has led to more rigorous application of the AML measures. The banks are presently undergoing massive cutting of their customers, especially non-residents. Loosening the grip on refraining of execution of the customers' transactions is also not to be expected in a foreseeable future. Thus, the author considers that it is just a matter of time until the customers will in practice start bringing claims against the banks when they feel that their interests have been encroached upon without merit.

The findings and conclusions of this thesis will be relevant in Latvia from both the point of view of theoretical analysis and practical applicability. The author hopes that in regard of the academic perspective the thesis might serve as a starting point for an academic discussion of the nearly void topic of the liability of banks for improper application of the AML regulation towards their customers. From the practical

perspective the practitioners might use the conclusions of the thesis in the upcoming disputes between the banks and the customers.

The conclusions of the thesis suggest that the principle of the banks' exemption for improper application of the AML obligations *vis-à-vis* their customers is not as universal as the grammatical interpretation of the international AML regulation and the wording of the AML/CTF Law may suggest. The author is aware that this narrower interpretation of the exemption of liability may facing fierce opposition and dissenting opinions arguing that the narrow interpretation of the exemption of liability may jeopardize achieving the general aims of the AML system as the banks may be afraid of imposing the restrictive measures in fear of being sued by the customers. However, the simplified financial analysis provided in Chapter 4.5 suggests that in terms of potential negative financial consequences, the banks are exposed to a materially higher risk of being held administratively liable for failure to impose the restrictive measures than being sued by the customers.

By this thesis the author by no means undermines the importance and necessity for a strict application of the AML measures by the Latvian banks, which is a cornerstone for a modern, effective and reputable financial system. However, at the same time the application of these measures that have significant negative effect on the customers must be applied in a prudent manner based of well-assessed decisions. The thesis suggests that if it becomes evident that the banks have failed to act in this manner the customers might consider pursuing the difficult but not impossible task to hold the banks liable.

Regarding the potential fields for further research, it may be relevant to explore whether the current compensation mechanism under the AML/CTF Law that the state primarily compensates the losses to the customers, and then has a right to bring recourse claims against the banks, is the optimal one and meets the requirements of procedural efficiency. Furthermore, it would also be significant to research whether the maximum liability limits provided in the AML/CTF Law comply with the constitutional right of the aggrieved person to receive an adequate compensation for the inflicted harm. Such research on the compensation mechanism and the constitutionality of the limitation of liability, in light of conclusions of this thesis, would be a challenging topic worth exploring in a PhD thesis.

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