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PROCEDURAL QUESTIONS ARISING FROM THE AML POLICIES AND REGULATIONS IMPLEMENTED BY FINANCIAL INSTITUTIONS

Master's thesis
Programme: Master of Social Sciences, specialization: Law and Technology

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Tallinn 2022

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ABSTRACT

The European anti-money laundering obligations imposed on financial institutions and the banking sector by the European Commission are the result of the long-term development of the entire complicated system aimed at preventing and combating the illegal flow of funds across the European Union. One of the best-known tools implemented to carry out the duties involved is a due diligence procedure called “Customer Enhanced Due Diligence” and “Know Your Customer”. It is intended to investigate the origin of funds of a customer and understand the nature of both transactions and the business field of activity. However, it is highly problematic to apply above mentioned principles without interfering in secrecy, thus impacting equally the rights of the customer and the institutions’ reputation. Financial institutions and banks have no other choice but to administer monitoring processes. The greatest concerns extend to the Financial Supervisory Authorities, who are the entities that delegate the money-laundering preventing role to private sector organizations, forcing them not only to allocate millions of dollars to finance processes and systems unrelated to their core interest but also to take over a public function under no obligation to follow public sector legal obligations and constraints. These schemes virtually suggest that financial institutions are above the law, the customers are not equal, and that there is no guarantee to the public that there will be procedural fairness or accountability in the management of financial products, services, or information. This work will tackle this last aspect and focus on issues of competence, transparency, and accountability of the customer enhanced due diligence processes that are conducted by financial institutions to prevent money laundering and terrorism financing.

Keywords: Anti-money laundering, Transparency, Enhanced Due Diligence, Know Your Customer, Financial Supervisory Authority, financial institutions, private sector accountability, delegation of public powers, European Union

INTRODUCTION

Money laundering and terrorism financing are not the newest curses to the global economy and peace, but undoubtedly among the most damaging. According to the United Nations estimations, roughly 2% - 5% of the world's gross domestic product is being laundered every year, through different and very complex schemes[1] involving high-profile experts and 'exotic' jurisdictions.[2] While most of the terrorist attacks in Europe in the past 20 years have cost less than 10 000 USD,[3] their impact on society is not only enormous: it cannot merely be measured in numbers.

In the light of the above and the fact that money laundering and terrorism financing crimes have become a widespread concern across jurisdictions, drastic responses from the international organizations such as the United Nations,[4] European Union,[5] International Monetary Fund,[6] Financial Action Task Force,[7] and governments have followed.[8] This work is going to explicitly highlight five types of legal documents and regulations that are generally aimed at combating and preventing the illicit flow of funds, and to which not only governmental authorities but also banks tend to refer. The fact that banks (and other financial institutions) were historically widely used as

[1] United Nations: Office on Drugs and Crime. Accessible: https://www.unodc.org/unodc/en/money-laundering/overview.html (07.02.2022)

[2] Christensen, J. (2012). The hidden trillions: Secrecy, corruption, and the offshore interface. *Crime, Law, and Social Change*, 57(3), Pp. 331. Accessible: https://link.springer.com/content/pdf/10.1007/s10611-011-9347-9.pdf (17.02.2022)

[3] Global Terrorism Index 2017. Measuring and Understanding the Impact of Terrorism. (2017). *Institute for Economics & Peace*. Pp, 86 Accessible: https://reliefweb.int/sites/reliefweb.int/files/resources/Global%20Terrorism%20Index%202017%20%284%29.pdf (07.02.2022)

[4] General Assembly resolution 74/177, *Strengthening the United Nations Crime Prevention and Criminal Justice Programme, in Particular Its Technical Cooperation Capacity*, A/RES/74/177 (27 January 2020). Accessible: https://documents-dds-ny.un.org/doc/UNDOC/GEN/N19/431/54/PDF/N1943154.pdf?OpenElement (13.03.2022)

[5] Council Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU

[6] International Monetary Fund. (2021). *IMF and the Fight Against Money Laundering and the Financing of Terrorism*. Accessible: https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/16/31/Fight-Against-Money-Laundering-the-Financing-of-Terrorism (13.03.2022)

[7] Financial Action Task Force (2012 – 2022), *International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation*, FATF, Paris, France. Accessible: https://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html (13.03.2022)

[8] Financial Action Task Force. (2021). Annual Report 2020 – 2021. Pp. 60-65 Accessible: https://www.fatf-gafi.org/media/fatf/documents/brochuresannualreports/Annual-Report-2020-2021.pdf (13.03.2022)

the main gatekeepers for criminals to launder their illicit funds,[9] have put the latter in a vulnerable position and under strict supervision from the dedicated Financial Supervisory Authority. The pattern of how anti-money laundering regulations are designed allows Financial Supervisory Authorities to delegate their key functions to banks with all penalties and consequences in case of non-compliance (including fines and sanctions). The best-known and widely used tools that are used to carry out the duties applied by the banks are customer due diligence and Know Your Customer procedures.

The purpose of the customer due diligence and Know Your Customer procedures is simple - to investigate the source of funds of a specific customer (private or business), understand the field of business activity of a customer, and verify the actual beneficiary.[10] The procedures include *inter alia* interference into not only the customer's bank account and transactions history but also open a door for unlimited access to documentation of the customer via the uncontrolled amount of inquiries to the customer. The latter impacts the customer's rights and affects the institutions' reputation. What is worth mentioning is the fact that different experts, scholars, and legal researchers have already raised several fundamental concerns and contradictions between anti-money laundering and counter-terrorism financing legislation, and human rights.[11] And the overall legislative pattern is heading in the way that European anti-money laundering policies are transforming into less harmonized allowing the Member States to impose as strict rules as they want in order to be more flexible in fighting money laundering and terrorism financing and be able to adopt to always changing environment.[12] However, despite the latter, a terrifying number of financial institutions (including branches) are being accused all over the World of being involved in money laundering[13] might become a sign that the current development path is ineffective by

[9] Yeoh, P. (2020). Banks' vulnerabilities to money laundering activities. *Journal of Money Laundering Control*, Pp. 124-125. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JMLC-05-2019-0040/full/pdf?title=banks-vulnerabilities-to-money-laundering-activities (07.02.2022)

[10] Financial Action Task Force. (2013). *Anti-Money Laundering and Terrorist Financing Measures and Financial Inclusion*. FATF, Paris, France. Pp. 31 Accessible: https://www.fatf-gafi.org/media/fatf/documents/reports/AML_CFT_Measures_and_Financial_Inclusion_2013.pdf (15.03.2022)

[11] De Vido, S. (2015). Anti-Money Laundering Measures Versus European Union Fundamental Freedoms and Human Rights in the Recent Jurisprudence of the European Court of Human Rights and the European Court of Justice. German Law Journal, 16(5). Pp. 1271-1292. Accessible: https://www.cambridge.org/core/services/aop-cambridge-core/content/view/5C926A2D6D80AFF0309F145953143E2A/S207183220002112Xa.pdf/antimoney_laundering_measures_versus_european_union_fundamental_freedoms_and_human_rights_in_the_recent_jurisprudence_of_the_european_court_of_human_rights_and_the_european_court_of_justice.pdf?fbclid=IwAR2QUNgr_mJeoj5pIdGZ_Y1yrJFmo8PZM2Wm2dj4RsUpsTgIrBD_qI0W59Y (09.02.2022)

[12] *Ibid*., Pp. 1281-1285

[13] Deslandes, J., Dias, C., Magnus, M. (2019). Anti-Money Laundering – Reinforcing the Supervisory and Regulatory Framework. *European Parliament*. *European Governance Support Unit*. Accessible: https://www.europarl.europa.eu/RegData/etudes/IDAN/2018/614496/IPOL_IDA(2018)614496_EN.pdf (18.02.2022)

design, creating an environment of wide noncompliance, and negligence towards human rights protection in favour of anti-money laundering measures.

The greatest concerns extend to the Financial Intelligence Units, who are the entities that delegate the money laundering preventing role to private sector organizations, forcing them not only to allocate billions of dollars[14] to finance processes and systems unrelated to their core interest but also to take over a public function under no obligation to follow public sector legal obligations and constraints. The situation worsens by the fact that the Financial Action Task Force the granted flexibility to the banks in deciding and choosing the most effective way to address money laundering risks, so as to adjust the anti-money laundering means as they want.[15]

There is a little known about the criteria applied by financial institutions to decide on the accounts both termination and onboarding. In the light of the fact that the processes are not transparent and financial institutions do not disclose what principles they apply, the issue is not sufficiently covered by legal scholars. This research problem is basically supported by the articles from different newspapers and journals, where people are expressing their dissatisfaction with the fact that their bank accounts were terminated without proper justification and clear transparent legal grounds.[16] Consequently, as there is a clear lack of scientific coverage of the topic to support the research, this thesis will equally rely on international agreements and directives review, including the assessment of established practices among financial institutions operating in the European Union.

The first chapter of the following thesis will provide a background of the research and a brief historical overview of the money laundering phenomenon starting from the first mention of money laundering in China dated as of 2000 B.C[17] involving merchants hiding their income from the Rulers that were willing to take their income off them. Furthermore, the hiding or disguising

[14] European Banking Federation. (2020). Lifting the Spell of Dirty Money. EBF Blueprint for an Effective EU Framework to Fight Money Laundering. Pp 33. Accessible: https://www.ebf.eu/wp-content/uploads/2020/03/EBF-Blueprint-for-an-effective-EU-framework-to-fight-money-laundering-Lifting-the-Spell-of-Dirty-Money-.pdf (23.02.2022)

[15] Financial Action Task Force. (2014). *Guidance for a Risk-Based Approach. The Banking Sector*. Paris, France. Pp 8. Accessible: https://www.fatf-gafi.org/media/fatf/documents/reports/Risk-Based-Approach-Banking-Sector.pdf#page=10&zoom=100,80,117 (18.03.2022)

[16] Jones, R. (2018). NatWest Closed My Account with No Explanation. *The Guardian*. Accessible: https://www.theguardian.com/money/2018/feb/03/natwest-closed-my-account-with-no-explanation (23.02.2022)

[17] Schwalje, L.N. (1996). Lords of the Rim: The Invisible Empire of the Overseas Chinese. *Journal of International Affairs*, Vol 49 (2). Pp. 633 – 638. Accessible: https://www.jstor.org/stable/pdf/24357579.pdf?refreqid=excelsior%3A4a059d70f3fb37782113dc23e1cff5c2 (23.02.2022)

process included the movement of merchants' funds for further investment in businesses. This part continues by demonstrating how and why Al Capone was considered not only as a romantic gangster but also as a founder of the term "money laundering".[18] Important to keep in mind that money laundering crimes and activities are always analyzed in combination with terrorism financing, thus the author believes that it is worth mentioning notorious events known as 9/11, which proclaimed the era of counter-terrorism financing.[19]

The second chapter is aimed at analysing the correlation between anti-money laundering legal documents with fundamental human rights,[20] data protection regulation, and the widespread usage of Artificial Intelligence in transaction monitoring. This part will demonstrate the imperfections of the European anti-money laundering approach in comparison with existing legal documents. And give an overview of the stages of development and progress made in creating modern money laundering prevention legislation.

The third chapter explores and opens a discussion on how the European anti-money laundering directives have influenced the business from different perspectives. That part opens a discussion on what has become a cause of fines and withdrawals of the banking operation licenses, so as to provide ways to minimize the negative effects.

The last part is the core of the research as it raises concerns and opens a discussion on based on what grounds the banks act as the governmental authority without actually being authorized to behave in such a manner. Furthermore, this chapter demonstrates the imperfections of the current system of money laundering prevention from the customers' and the banks' perspectives. The analysis is predominantly based on the Estonian legislation and historical notorious money laundering scandals that occurred in the country. Enhanced due diligence and transaction monitoring systems were assessed from the competence, transparency, and accountability perspectives.

[18] Unger, B. (2013). Can Money Laundering Decrease? *Public Finance Review*, 41(5). Pp. 659 Accessible: https://journals.sagepub.com/doi/pdf/10.1177/1091142113483353 (24.02.2022)
[19] Sinha, G. (2013). AML-CTF: A Forced Marriage Post 9/11 and Its Effect on Financial Institutions. *Journal of Money Laundering Control*, vol 16 (2). Pp. 142 – 158. Accessible: 444416 142..158 (emerald.com) (24.02.2022)
[20] Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C326/47. Accessible: Accessible: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT (01.03.2022)

Methodology

The following thesis focuses on exploring the cause of the widespread delegation of powers from governmental authorities to private financial institutions in terms of money laundering prevention and countering terrorism financing. The role and responsibilities of the financial institutions in executing governmental obligations and the issues caused to its customers. The following work attempts to tackle and explore the issues of competence, lack of transparency in the processes aimed at preventing money laundering implemented by the financial institutions, and absence of accountability affecting financial institutions' customers. This thesis has examined stated research questions mainly with the support of process tracing methodological tools[21] and using the comparative analysis between directives and actual practice, thus the qualitative research method to be applied throughout the research. The latter tools will help to assess and collect the evidence of the weak design of the European anti-money laundering. In addition, partially the historical representative tools are applied in order to give an overview of the development of the term "money laundering" and in understanding the background of anti-money laundering directives.[22]

[21] Beach, D. (2017). Process-Tracing Methods in Social Sciences. Accessible: http://politics.oxfordre.com/view/10.1093/acrefore/9780190228637.001.0001/acrefore-9780190228637-e-176 (03.03.2022)

[22] Klotz, A., Prakash, D. (2008). Qualitative Methods in International Relations. A Pluralist Guide. *Palgrave Macmillan*, New York, Pp. 80-85.

1. BACKGROUND

1.1. Antecedents of money laundering and terrorism financing phenomenon

The emergence of the term "money laundering" used for defining the process of making illicit funds gained from illegal activities into possessions that has the appearance of being lawfully received, is widely connected with Al Capone's criminal legacy.[23] However, surprisingly it is not Al Capone, whom the world should thank for inventing the term but Chinese merchants. During the Han dynasty, the latter was capable of both staying invisible from bureaucrats and escaping extortion from imperial eunuchs.[24] The demand of being uncaught and untracked was explained by the fact that the merchants' attitude was to avoid any direct confrontation but to keep their conquest through economic strategies instead of military tactics or intervention. Intriguingly, earned funds later were divided into pieces and reinvested into other businesses so that no one was capable of tracking the initial origin of the funds, and even force the merchants to pay taxes or charge accordingly.[25]

Speaking of Al Capone's legacy, then during the era of the National Alcohol Prohibition in the United States (nationwide ban on production, sale, and transportation of alcoholic drinks)[26] a huge amount of money from the sale of alcohol (and other illegal activity) was passing through the Chicago mafia. In order to avoid suspicions and disguise the illegal origin of funds, they were shuffled with legal money via automatic laundromats. Laundromats were accepting cash payments only and it was impossible to trace real data on how many customers or services were used.[27] However, scholars and experts mutually agree that there is no actual connection between Al

[23] Kacaljak, M. (2015). Tackling Illegal Activities Through Tax Law – Al Capone Case Study. Danube (Brno), 6(1). Pp. 52. Accessible: https://www.sciendo.com/article/10.1515/danb-2015-0003 (08.03.2022)
[24] Schwalje, L.N. (1996), *supra nota* 17, Pp. 635
[25] *Ibid*
[26] Hall, W. (2010). What are the policy lessons of National Alcohol Prohibition in the United States, 1920-1933? Addiction (Abingdon, England), 105(7). Pp. 1165. Accessible: https://onlinelibrary.wiley.com/doi/full/10.1111/j.1360-0443.2010.02926.x (08.03.2022)
[27] Serio, J. (2004). Fueling global crime: The mechanics of money laundering. International Review of Law, Computers & Technology, 18(3). Pp. 436. Accessible: https://heinonline.org/HOL/Page?lname=&public=false&collection=journals&handle=hein.journals/irlct18&men_hide=false&men_tab=toc&kind=&page=435 (08.03.2022)

Capone and laundromats, but more of a local myth or marketing strategy as the date of Al Capone's imprisonment does not match the date of the very first introduction of a laundromat.[28]

Mafia traces or footprints in the money laundering schemes do exist but the roots are much deeper than in just simple laundromats. Fortunately, policemen and law enforcement divisions quickly realized that the effective way to catch mafia members is to trace their income gained using illegal means, instead of waiting and catching them by the hand at the crime scene. What is worth mentioning is that even today, modern law enforcement officers and investigators also predominantly rely on the same principles used back then.

Not to be mentioned the Watergate scandal, which has become a landmark case and widened the term money laundering, consequently leading to Richard Nixon's resignation.[29] The incident happened in 1972 when during the presidential campaign five people were arrested and suspected (later on convicted) of espionage and attempts of illegal installment of listening devices. The author believes that details about the case might be excluded from the consideration as the following thesis is dedicated mostly to money laundering, thus jumping straight to a conclusion is justified. It was proven that most of the money for Richard Nixon's re-election campaign was coming from anonymous sources located in different jurisdictions involving offshore transactions, etc.[30] Moreover, the widespread misuse of corporate money and suspicious payments could affect the integrity of the system of capital formation.[31]

The common misconception is that money laundering is always related to terrorism financing and *vice versa.* However, even though the latter two criminal acts might correlate with each other, and even the purpose might be the same, while these acts have significant differences. Speaking of money laundering, then the process always involves active usage of illegally gained or dirty money. While one of the attributes of terrorism financing is the fact that no illegal funds could be involved at all. For example, a series of small transactions to a criminal's banks' account aimed at bypassing banks supervision systems and disguising any suspicion. Or a person with no suspicious

[28] *Ibid.*
[29] Prasch, A. (2015). Retelling Watergate: Apologia, Political Eulogy, and Richard Nixon's "Final Campaign". The Southern Communication Journal, 80(4). Pp. 281-284. Accessible: https://www.tandfonline.com/doi/pdf/10.1080/1041794X.2015.1045622?needAccess=true (09.03.2022)
[30] Laudone, S. (2016). The Foreign Corrupt Practices Act: Unbridled Enforcement and Flawed Culpability Standards Deter Smes from Entering The Global Marketplace. The Journal of Criminal Law & Criminology, 106(2). Pp. 361 - 366. Accessible: https://web.p.ebscohost.com/ehost/pdfviewer/pdfviewer?vid=1&sid=8fe0749a-fb0a-48fc-878a-aa4399c3f951%40redis (09.03.2022)
[31] *Ibid.*, Pp. 361-362

or criminal background might be involved both by force or he/she willingly assists the criminal act (example, a nurse making a transaction or donation using money she/he received as salary to support or finance a terrorist). Methods used for terrorism financing are very different including complicated were dozens of layers and counterparties involved, up to unsophisticated described above. The above-mentioned acts are automatically considered as a terrorism financing and are punishable by pretty much every state today.[32]

The term counter terrorism financing aimed at both preventing and fighting terrorism emerged as the response to notorious events that happened in the United States on 9/11.[33] The latter event not only strengthened the control in the airport, and proclaimed an anti-terrorism era, but also introduced the concept of "money dirtying" which in fact is something completely opposite to money laundering.[34] Money dirtying is the process when legally gained money is used to finance or support by any financial means criminal act. Taking the 9/11 event as an example of how effective the terrorists attack could be with only $400 000 – $500 000 which were spent to plan and actually conduct the attacks, which led to thousands of casualties and proclaimed long-lasting anti-terrorist war.[35] Despite the effort put into fighting transnational terror organizations such as "Al Qaeda",[36] there have not been any effective preventive measures developed to counter homegrown terrorist groups.[37] Homegrown groups are posing even more danger to the society as modern terrorists are no longer demand a lot of funding[38] and with only $500 any terrorist is capable of causing millions of losses to property, and countless damage to its victims.[39]

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[32] Penal Code RT I 2001, 61, 364. § 237 Accessible: https://www.riigiteataja.ee/en/eli/ee/521082014001/consolide/current (09.03.2022)
[33] Sinha, G. (2013), *supra nota* 19. Pp. 142.
[34] Compin, F. (2018). Terrorism financing and money laundering: Two sides of the same coin? Journal of Financial Crime, 25(4). Pp. 963-964. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JFC-03-2017-0021/full/pdf?title=terrorism-financing-and-money-laundering-two-sides-of-the-same-coin (10.03.2022)
[35] Kean, T., & Hamilton, L. (2004). The 9/11 Commission report (Official government ed.). Washington, DC: National Commission on Terrorist Attacks upon the United States. Pp. 169 – 173. Accessible: https://www.govinfo.gov/content/pkg/GPO-911REPORT/pdf/GPO-911REPORT.pdf (11.03.2022)
[36] Hellmich, C. (2012). Fighting Al Qaeda in Yemen? Rethinking the Nature of the Islamist Threat and the Effectiveness of U.S. Counterterrorism Strategy. Studies in Conflict and Terrorism, 35(9). Pp. 626 - 627. Accessible: https://web.p.ebscohost.com/ehost/pdfviewer/pdfviewer?vid=1&sid=0d7d447f-296e-444f-b285-52c2fff71873%40redis (11.03.2022)
[37] Balasubramaniyan, V. (2015). Understanding the costing decisions behind terror attacks – an analytical study. Journal of Money Laundering Control, 18(4). Pp. 476 - 477. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JMLC-03-2014-0009/full/pdf?title=understanding-the-costing-decisions-behind-terror-attacks-an-analytical-study (11.03.2022)
[38] *Ibid.*, Pp 477
[39] Temple-Raston, D. (2014). How Much Does a Terrorist Attack Cost? A Lot Less than You'd Think. *Parallels*. Accessible: https://www.npr.org/sections/parallels/2014/06/25/325240653/how-much-does-a-terrorist-attack-cost-a-lot-less-than-you-think?t=1646951671290 (11.03.2022)

1.2. Research problem

Financial institutions are not only expected but also obliged by international laws to have a proper risk assessment methodology for their customers as prescribed by the Financial Action Task Force.[40] The idea behind risk assessment is crystal clear and meant to identify the risks of being used in an illegal manner and provide sufficient knowledge of financial institutions' customers' behavioural draft so as gives a clear overview of the actual business field of activity of their customers, nature of their business relationship, and possible future activities and plans. These aspects help the obliged entities in their duty of detecting and preventing deviant behaviour and if needed to report anything suspicious accordingly.

On the other hand, failure in combatting money laundering and terrorism financing harms not only the society, but it may also cause significant reputational damage to any financial institution, not to mention the risk of sanctions and fines the bank can face, and also jeopardizing the relationship with its investors, clients, and other financial institutions.[41] On the other side of the coin, persistent interference into customers' activities from the bank's side has negatively affected the overall level of trust in the latter.[42] The presence of way stricter, unclear, and non-transparent due diligence processes have become the main catalyst for the increasing popularity of digital currencies, which are notoriously known and used in money laundering schemes worldwide.[43]

The problem is exacerbated by the fact that Financial Supervision Authorities and Financial Intelligence Units more and more often delegate their responsibilities and require the financial institutions to implement stricter monitoring mechanisms to fulfill the competence of the Financial Intelligence Units. The widespread promotion and recommendation for to use of Artificial Intelligence in anti-money laundering monitoring[44] is not only financially hard to realize, but also

[40] Financial Action Task Force. (2013). National Money Laundering and Terrorist Financing Risk Assessment. Accessible: https://www.fatf-gafi.org/media/fatf/content/images/National_ML_TF_Risk_Assessment.pdf (07.02.2022)
[41] *Ibid.*, Pp. 10
[42] Accenture Strategy. (2018). The Bottom Line on Trust. Achieve Competitive Agility. Accessible: https://www.accenture.com/_acnmedia/thought-leadership-assets/pdf/accenture-competitive-agility-index.pdf (23.02.2022)
[43] Barone, R., & Masciandaro, D. (2019). Cryptocurrency or usury? Crime and alternative money laundering techniques. *European Journal of Law and Economics*, 47(2). Pp. 233-254. Accessible: https://link.springer.com/content/pdf/10.1007/s10657-019-09609-6.pdf (23.02.2022)
[44] Financial Action Task Force. (2021). *Opportunities and Challenges of New Technologies for AML/CTF*. FATF, Paris, France. Pp. 7-8. Accessible: https://www.fatf-gafi.org/media/fatf/documents/reports/Opportunities-Challenges-of-New-Technologies-for-AML-CFT.pdf (19.03.2022)

the Artificial Intelligence in monitoring is posing an additional unwanted danger to human rights compliance.[45] The stricter approach extends not only to technical development but is also applied to current and future employees joining the financial companies. When it comes to technical development then it is important to keep in mind that any solution requires billions of dollars of investments and the overall compliance costs increased by 53% worldwide for just banking institutions without any signs of slowing down.[46] The above-mentioned investments are not just a one-time event but should become a reoccurring money "hole". Another money draining hole is finding qualified employees with sufficient knowledge of anti-money laundering compliance and a basic understanding of legal compliance and data protection.

1.3. Legal framework

The World and international community have done a lot to prevent and mitigate money laundering and terrorism financing crimes. The crucial and the greatest impact on money laundering and drug trade prevention was the establishment of an intergovernmental organisation namely the Financial Action Task Force in 1989[47] and later adaptation of the latter's 40 recommendations by countries that were willing to build a common regime in terms of preventing money laundering.[48] These recommendations are designed to minimize and mitigate harm to the integrity of financial systems at all levels. Furthermore, the Financial Action Task Force is also responsible for assessing the compliance of the member states in regard to anti-money laundering and counter terrorism financing standards. What is worth mentioning is the fact that the Financial Action Task Force's developments are recognized as soft rules/laws as nations are cautious of undertaking way too

[45] Bertrand, A., Maxwell, W., & Vamparys, X. (2021). Do AI-based anti-money laundering (AML) systems violate European fundamental rights? International Data Privacy Law, 11(3), Pp. 277. Accessible: https://tutl-primo.hosted.exlibrisgroup.com/primo-explore/fulldisplay?docid=TN_cdi_crossref_primary_10_1093_idpl_ipab010&context=PC&vid=372TUTL_VU1&lang=en_US&search_scope=default_scope&adaptor=primo_central_multiple_fe&tab=default_tab&query=any,contains,Are%20AI-based%20Anti-Money%20Laundering%20Systems%20Compatible%20with%20European%20Fundamental%20Rights&offset=0 (19.03.2022)

[46] Mekpor, E., Aboagye, A., & Welbeck, J. (2018). The determinants of anti-money laundering compliance among the Financial Action Task Force (FATF) member states. *Journal of Financial Regulation and Compliance*, 26(3), Pp. 443. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JFRC-11-2017-0103/full/pdf?title=the-determinants-of-anti-money-laundering-compliance-among-the-financial-action-task-force-fatf-member-states (18.03.2022)

[47] Murrar, F., & Barakat, K. (2021). Role of FATF in spearheading AML and CFT. *Journal of Money Laundering Control*, 24(1), Pp. 77-79. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JMLC-01-2020-0010/full/pdf?title=role-of-fatf-in-spearheading-aml-and-cft (19.03.2022)

[48] Financial Action Task Force (2012 – 2022), *supra nota* 7.

excessive or extreme commitments.[49] The soft laws are known for giving wide variety and flexibility to the states allowing the latter to choose more appropriate rules and apply them in case of demand.[50] What is especially interesting is that the soft design of the Financial Action Task Force recommendations allows not only continuous updating but the active participation of financial institutions (including banks and non-state organizations) in its development.[51]

[49] Montanaro, F., & Borlini, L. (2017). The Evolution of the EU Law Against Criminal Finance: The 'Hardening' of FATF Standards within the EU. Georgetown Journal of International Law, 48(4), Pp. 1011-1012. Accessible: https://www.law.georgetown.edu/international-law-journal/wp-content/uploads/sites/21/2018/05/48-4-The-Evolution-of-the-EU-Law-Against-Criminal-Finance.pdf (19.03.2022)

[50] Brummer, C. (2010). Why soft law dominates international finance: And not trade. Journal of International Economic Law, 13(3), Pp. 628. Accessible: https://heinonline.org/HOL/Page?lname=&public=false&collection=journals&handle=hein.journals/jiel13&men_hide=false&men_tab=toc&kind=&page=623 (19.03.2022)

[51] General Assembly resolution 74/177, *supra nota* 4.

2. MONEY LAUNDERING AND HUMAN RIGHTS

Human rights are usually referred to as the God-given gifts that any human being possesses. The Second World War has become a catalyst for rethinking the value of individuals and pushed forward the development of human rights.[52] The establishment of the Universal Declaration of Human Rights has initially aimed also at preventing future wars, covering, and disclosing particular rights that are automatically applied to every human just by the fact of his/her birth. A further step in human rights development was the adoption of the European Convention on Human Rights by the Council of Europe in 1950.[53] The latter convention was aimed at protecting and promoting political freedoms and human rights in Europe. It is crucial to keep in mind that each state that ratified the convention has become a holder of the human rights values and ought to follow the document. And the last but not the least document that should be taken into account when dealing with money laundering investigations is the Treaty on the Functioning of the European Union and the General Data Protection Regulation.[54] The way the above-mentioned documents correlated with the anti-money laundering directives will be analyzed below.

2.1. Treaty on the Functioning of the European Union

The European Convention on Human Rights and the Treaty of the Functioning of the European Union are undoubtedly the two key documents that correlated with one another and formed the legal framework within Europe. Its importance and effectiveness cannot be measured in numbers. Both documents highlight the main fundamental rights and possibilities prescribed to its beneficiaries (exactly the citizens of the European Union, and the companies operating in Europe). However, the discussions on how compatible human rights and the rights granted by the Treaty on the Functioning of the European Union with the European Anti-Money Laundering Directives are actively held among legal and political scholars.

[52] United Nations, Universal Declaration of Human Rights. 10.12.1948
[53] Convention For the Protection of Human Rights and Fundamental Freedoms and Protocol, *supra nota* 24.
[54] Consolidated version of the Treaty on the Functioning of the European Union, *supra nota* 20.

The greatest concerns were related predominantly to how to align in non-discriminatory manner with articles 49 and 56 of the Treaty on the Functioning of the European Union **(**freedom of establishment, freedom to provide services)[55] with the strict European anti-money laundering measures requiring performance of Know Your Customer procedures and in most of the cases prohibiting opening the bank account for non-local companies due to the latter's weak connection to the state or with any other unclear reason. However, the overall European Court of Justice practice and decision pattern shows that when the money laundering topics are tested against pretty much any other rights, the principle of the general public interest in most of the cases wins and becomes the main reference or basis backing the decision not to open or terminate the existing relationship.[56]

2.2. The development of anti-money laundering policies

Before jumping into milestone directives against money laundering implemented in European Union, it is worth describing the money laundering process as such. The very initial stage of the money laundering process and at the same time the first stage is considered as the most dangerous for the criminals as the majority of illicit funds are being caught at the placement stage. The process involves the placement or introduction of the illegally obtained physical funds into the financial system.[57] Criminals use different schemes from pretty simple like breaking up large amounts of cash into smaller parts with later deposition on the bank account.[58] Or via the creation of invalid/falsified invoices for the services or products that were not actually bought. On the other hand, more complicated schemes involve already at least a basic knowledge and understanding of different jurisdictions and offshores' specifications. Thus, more advanced criminals apply to transfer their funds overseas in order to disguise the beneficial owner or avoid complex customer due diligence processes in favor of less strict implemented by questionable or shady banks.[59] Although, "dirty" money could be used by criminals without the actual need to place them into the

[55] Consolidated version of the Treaty on the Functioning of the European Union, *supra nota* 20.
[56] Jyske Bank Gibraltar Ltd v Administración del Estado, Application number C-212/11, ECJ, 2013.
[57] Cassella, S. (2018). Toward a new model of money laundering: Is the "placement, layering, integration" model obsolete? *Journal of Money Laundering Control*, 21(4), Pp. 496. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JMLC-09-2017-0045/full/pdf?title=toward-a-new-model-of-money-laundering-is-the-placement-layering-integration-model-obsolete (20.03.2022)
[58] Financial Action Task Force. (2018). *Professional Money Laundering*. FATF, Paris, France. Pp 36. Accessible: https://www.fatf-gafi.org/media/fatf/documents/Professional-Money-Laundering.pdf (21.03.2022)
[59] Financial Action Task Force. (2021). *Money Laundering from Environmental Crimes.* FATF, Paris, France. Pp 19. Accessible: https://www.fatf-gafi.org/media/fatf/documents/reports/Money-Laundering-from-Environmental-Crime.pdf (21.03.2022)

financial system, making the latter much harder to find by law enforcement authority and absolutely impossible to detect by the financial institutions as the money have never been placed there. The simplest example is when the dirty money is used to pay salaries to illegal immigrants or to purchase illegal goods or services (weapons, briberies, etc.).[60] Scholars consider the placement stage as something requiring the movement of the original source into some other form for further layering and disguising.[61]

The second stage is called the layering and involves the shuffle of illegally obtained funds with the legally "pure" ones. Unlike the placement stage, the layering is considered as the most complicated to perform, though the most rewarding if successful. The idea of this stage is to change the nature of illicit funds and make them hard or even impossible to be tracked.[62] Through different financial operations and transactions, the funds are layered and shuffled in order to complicate the investigation of law enforcement agencies (and complicate the investigations performed by the financial institutions) in finding the initial origin of illegal funds subject to confiscation or reporting. The role of financial institutions (especially banks) is the most critical as they stand as the first line of defense, thus criminals tend to look for more legal methods of layering in order to avoid detection systems, because of the fact that banks are obliged to report any suspicious transaction to the respective authority as prescribed by the Financial Action Task Force.[63] At that point, criminals prefer using offshore banks, gray or blacklisted jurisdictions where anti-money laundering preventive measures are not that strict in order to disguise traces of their original source or final destination.[64]

Finally, the third and the last stage is called integration. Via the integration, the illegal funds are returned to the economy making them appear not only pure but almost impossible to recognize by high-tech solutions implemented by financial institutions and even by experienced investigation

[60] Kepli, M., Y., M; Nasir, A.,M. (2016). Money Laundering: Analysis on the Placement Methods. *International Journal of Business, Economics and Law, Vol. 11, Issue 5*. Pp. 33. Accessible: http://ijbel.com/wp-content/uploads/2017/03/IJBEL-50.pdf (21.03.2022)
[61] *Ibid.*
[62] Financial Action Task Force. (2018). *Professional Money Laundering, supra nota* 58. Pp. 18
[63] Financial Action Task Force. (2017). *Guidance on Private Sector Information Sharing*. FATF, Paris, France. Pp. 12. Accessible: https://www.fatf-gafi.org/media/fatf/documents/recommendations/Private-Sector-Information-Sharing.pdf (21.03.2022)
[64] Financial Action Task Force. (2022). *Jurisdictions Under Increased Monitoring – March 2022*. Accessible: https://www.fatf-gafi.org/publications/high-risk-and-other-monitored-jurisdictions/documents/increased-monitoring-march-2022.html (22.03.2022)

experts.[65] Consequently, once all three above-mentioned stages were performed and the money laundering process went without any issues, then it is difficult or almost impossible to trace the origin of illicit funds.[66]

2.2.1. I Directive

The First Anti-Money Laundering Directive was introduced by the European Council in 1991.[67] The main idea behind the directive was to raise the awareness of money laundering and proposed to consider and deal with the money laundering crimes seriously, as the only international and harmonized approach would be the most effective way of combating the latter crimes. Furthermore, the significant influence on the content of the directive has played the Financial Action Task Force establishment with its further 40 Recommendations.[68] The Directive also introduced the scope of responsibilities that are applied to the financial institutions requiring them to implement and develop customer due diligence and Know Your Customer procedures with storing the records for up to five years after the business relations with the customer have ended.[69]

2.2.2. II Directive

Partially, the further development of the Second Anti-Money Laundering Directive[70] was influenced by the notorious 9/11 event in the United States and the urgent need to update the previous directive because of its significant gaps.[71] The crucial update that the Second Directive brought was the recognition that is it not only banks that are vulnerable to money laundering but also other types of financial institutions (including insurance companies, investment undertakings,

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[65] Teichmann, F., & Falker, M. (2020). Money laundering through consulting companies. Journal of Financial Regulation and Compliance, 28(3), Pp. 486-487. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JFRC-07-2019-0091/full/pdf?title=money-laundering-through-consulting-companies (22.03.2022)

[66] Gao, S., & Xu, D. (2009). Conceptual modeling and development of an intelligent agent-assisted decision support system for anti-money laundering. Expert Systems with Applications, 36(2), Pp. 1494. Accessible: https://reader.elsevier.com/reader/sd/pii/S0957417407005891?token=3D0B157917335B2883AFB1FFB28D35613C368859874157F1A80F477D2E6B3F76212993243FBB9B8BBDCEE63F69DCF4FA&originRegion=eu-west-1&originCreation=20220321223713 (22.03.2022)

[67] Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering (L 166, 28/06/1991 P. 0077 – 0083)

[68] Financial Action Task Force (2012 – 2022), *supra nota* 7.

[69] *Ibid.*, 67, article 4 (1)

[70] Council Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering - Commission Declaration (OJ L 344, 28.12.2001, p. 76–82)

[71] Ping, H. (2005). The new weapon for combating money laundering in the EU. Journal of Money Laundering Control, 8(2), Pp. 116-117. Accessible: https://www.emerald.com/insight/content/doi/10.1108/13685200510621163/full/pdf?title=the-new-weapon-for-combating-money-laundering-in-the-eu (24.03.2022)

and investment firms).[72] What is worth mentioning is that lawyers' secrecy is no longer protected in case the latter was directly involved in money laundering or was contributing to laundering.[73]

2.2.3. III Directive

The Third Anti-Money Laundering Directive[74] have significantly widened the anti-money laundering obligations among different sectors including real estate agents, casinos, auditors, notaries, etc.[75] In addition, having anonymous accounts or passbooks was prohibited among all Member States, forcing the financial institutions to identify and verify the owner of the account via customer due diligence measures.[76] Lastly, the risk-based approach to money laundering investigation procedures was introduced, allowing the implementation of customer due diligence with regard to the risk profile of the specific customer.

2.2.4. IV Directive

Once the newest Financial Action Task Force recommendations on combating money laundering and terrorism financing were published in 2012,[77] the European Commission has initiated the creation of the Fourth Directive.[78] Historically all Directives were aimed at widening and updating the previous documents in order to align the legal framework with the reality. However, the biggest difference between previous directives was their complexity as they required the Member States to implement a significant number of changes and upgrades. The greatest and by different estimations the costliest development was the introduction of a centralized database for storing beneficial owners' data. Member States were ought to store data in publicly available commercial registers making the information about the beneficial owners available to any counterparty that have a legitimate interest.[79] Another significant improvement was made in the risk-based approach, requiring financial institutions to have not only monitoring systems in place but also

[72] Council Directive 2001/97/EC, *supra nota*, 70. Article 1
[73] *Ibid.*
[74] Council 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 (OJ L 309, 25.11.2005, p. 15–36).
[75] *Ibid.*, article 2 (1).
[76] *Ibid.*, article 6
[77] Financial Action Task Force (2012 – 2022), *supra nota* 7.
[78] Council Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p. 73–117)
[79] *Ibid.*, article 30 (3)

documented methodology for conducting risk assessments and rules for customer due diligence implementations.

2.2.5. V Directive

The weakest point in the Fourth Directive was its unclear definition of what is cryptocurrency and providers of virtual currency were not in the scope of the directive so as they were not classified as obliged entities. While the Fifth Directive was precisely focusing on virtual currency and the obligation of its providers.[80] That much attention paid to virtual currency and prepaid card limits was directly related to the notorious terrorist attacks in Paris[81] and the United Kingdom[82]. One of the most outstanding changes was the reduction in prepaid card limits, as the latter method was used in the preparation for the Paris attack.[83] Additionally, the European Commission aimed at investigating how cryptocurrency might and could be used by criminals in the future to strengthen the upcoming directives.[84]

As the Fifth Directive was amending the previous one, thus one of the amendments was related to making beneficial owner's registers available to the public (previously, it was available only if legitimate interest was shown).[85] Additionally, all European Union member states are required to create a list of politically exposed persons within the country and implement ongoing monitoring of these individuals and regular updates in case if any changes in their risk profiles occurred.[86]

In the light of the fact that member states are allowed to implement as strict rules as they find appropriate,[87] the Estonian government has adopted one of the most complicated procedures for becoming a compliance officer who will be responsible for dealing with anti-money laundering

[80] Council Directive (EU) 2018/843, *supra nota* 5.
[81] Chrisafis, A. (2021). 'There Was Blood Everywhere': UK and Irish Survivors on 2015 Bataclan Attack. Witnesses to Atrocity in Paris Music Venue that Killed 90 Tell Court of Playing Dead and Trying to Help the Wounded. *The Guardian*. Accessible: https://www.theguardian.com/world/2021/oct/15/uk-and-irish-survivors-of-2015-bataclan-attack-tell-court-how-they-escaped-death (26.03.2022)
[82] Siddique, H. (2019). London Bridge Attacks: How Atrocity Unfolded. Attack Lasted 10 Minutes and in that Time Eight People Were Killed and 48 Seriously Injured. *The Guardian*. Accessible: https://www.theguardian.com/uk-news/2019/jun/28/london-bridge-attacks-how-atrocity-unfolded (26.03.2022)
[83] European Commission. (2016). *In the Spotlight: How the EU is Combatting Terrorist Financing*. Accessible: https://ec.europa.eu/newsroom/fisma/items/29693 (26.03.2022)
[84] *Ibid.*
[85] Council Directive (EU) 2018/843, *supra nota* 5, article 20a (5, c)
[86] *Ibid.*
[87] De Vido, S. (2015), *supra nota* 11, Pp. 1281-1285

matters (including permanent residency of the candidate, personal qualities assessment, education, experience, background, and in some cases additional examination performed).[88]

2.2.6. Latest VI Directive and proposals

In July 2021 a significant and ambitious package of legislative proposals was presented by the European Commission to not only strengthen current anti-money laundering and counter terrorism financing guidelines[89] but also to improve the cooperation and harmonization between member states, and separate financial supervision authorities.[90] The Sixth Directive and additional proposals to the latter are more complicated than any previous and also it expands the criminal responsibility of money laundering participants (including not only individuals but also legal entities are now responsible and punishable). What is especially important to highlight is that since the adoption of the Sixth Directive the criminal responsibility also falls on anyone aiding or abetting the laundering process.[91] The latter change is related to the fact that more and more European banks were accused of having insufficient money laundering preventive measures or for being directly involved in the movement of illicit funds.[92] Furthermore, it was proposed to establish the European Anti-Money Laundering Authority[93] who will be integrated with national supervisory authorities and intelligence units, granting their mutual support and cooperation on anti-money laundering and counter terrorism financing matters.

As of today, the biggest weakness with the current anti-money laundering and terrorism financing legal framework and directive is related to the fact that it takes too much time for the directive to be implemented in the national law, causing severe delays and an unharmonized approach across the European Union. Although, the adaptation of the "single European rulebook" is going to solve the issue with regular delays, as the latter rules will no longer require transfer into national law.[94]

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[88] Money Laundering and Terrorist Financing Prevention Act RT I, 17.11.2017. Article 17 (5). Accessible: https://www.riigiteataja.ee/en/eli/ee/524032022001/consolide/current (26.03.2022).
[89] Council Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law (OJ L 284, 12.11.2018, p. 22–30)
[90] Council Proposal for a Directive of The European Parliament and of The Council (2021) on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849.
[91] *Ibid.,* 89, article 4
[92] Guarascio, F. (2019). Explainer: Europe's Money Laundering Scandal. *The Reuters.* Accessible: https://www.reuters.com/article/us-europe-moneylaundering-explainer-idUSKCN1RG1XI (27.03.2022)
[93] Council Proposal for a Regulation of the European Parliament and of the Council (2021) establishing the Authority for Anti-Money Laundering and Countering the Financing of Terrorism and Amending Regulations (EU) No 1093/2010, (EU) 1094/2010, (EU) 1095/2010.
[94] *Ibid.,* 90.

Moreover, the "single European rulebook" will consist of a common detailed set of rules applicable to the Member States, so as it is planned on creating a common technical standard that will harmonize different preventive means. However, despite the great number of planned improvements, the issue of delegation of powers to the financial institutions is still present and not even taken into account. Seems that the legislator is trying and successfully ignoring this problem hoping for the best.

2.2.7. Summary

Overall, the European approach towards anti-money laundering and counter terrorism financing has significantly changed its draft and improved throughout its historical and technical development. There is a clear interconnection between anti-money laundering directives and events happening in the World and on European territories respectively. Despite a significant delay in adopting more accurate laws (for example the establishment of the "single European rulebook"[95]) the overall legislative pattern is heading towards a more harmonized, enhanced, and technically superb way. There are clear signs that Europe understood its shortcomings in combating money laundering, especially in terms of cooperation and alignment of policies between member states. However, the problems that are still actual and in need of an urgent solution are discussed further in the thesis.

2.3. Artificial Intelligence in money laundering prevention

Machine-learning algorithms and widespread usage of Artificial Intelligence have become not just a new tendency Worldwide but one of the most effective supportive tools in any sphere of life. When it comes to banking then Artificial Intelligence is used predominantly for optimization of processes and redirecting the workforce from performing monotonous activities to more useful and profitable for the banks. The latter profit increase is related not only to a dramatic increase in revenues but might occur as the result of freeing technical personnel.[96] Unfortunately, it is not only technical personnel and employees who might be affected by the implementation of Artificial

[95] *Ibid.*, 90.
[96] Boustani, N. (2021). Artificial intelligence impact on banks clients and employees in an Asian developing country. Journal of Asia Business Studies, Ahead-of-print(Ahead-of-print), Journal of Asia business studies, 2021, Vol.ahead-of-print (ahead-of-print). Pp. 276. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JABS-09-2020-0376/full/pdf?title=artificial-intelligence-impact-on-banks-clients-and-employees-in-an-asian-developing-country (22.03.2022)

Intelligence, but also regular employees even with experience or professional certificates. On the hand, the Artificial Intelligence provides many opportunities for the banking sector including customer loan credit scoring to properly identify the risk of default,[97] improvement of customer experience and communication,[98] fraud detection and compliance,[99] etc.

Despite the overall feeling that Artificial Intelligence is flawless and creates only a positive environment for every counterparty (from the bank side and up to the end customer). Scholars and technical experts are raising and expressing their concerns on the matter. The artificial Intelligence decision-making process is being criticized due to the fact that it is humans who set the algorithms depending on their assumptions and assessment of what is good and bad, influencing the Artificial Intelligence and erasing the impartial line.[100] The latter imperfections may not only cause noncompliance with regulators and law, yet the obligation to respect human rights may also be violated.

When it comes to machine learning algorithms and Artificial Intelligence usage in money laundering prevention and countering terrorism financing, then the issue is much more complex in its nature and design. From a positive perspective, algorithms are capable of much effective detection of suspicious transactions or activities on the customer's bank account, helping the compliance and money laundering investigation teams with handling the incidents. Furthermore, the obligation of having the continuous / ongoing monitoring process implemented in the core systems of the banks is prescribed by article 13(1, d) of the IV anti-money laundering directive.[101] In addition, as a part of the customer due diligence process banks also must provide sufficient

[97] Goh, R., Lee, L., Seow, H., & Gopal, K. (2020). Hybrid harmony search-artificial intelligence models in credit scoring. Entropy (Basel, Switzerland), 22(9), 989. Pp. 3-5. Accessible: https://web.s.ebscohost.com/ehost/pdfviewer/pdfviewer?vid=0&sid=2458ce22-5ef0-485b-8efd-cd224d5d3692%40redis (22.03.2022)

[98] Song, M., Xing, X., Duan, Y., Cohen, J., & Mou, J. (2022). Will artificial intelligence replace human customer service? The impact of communication quality and privacy risks on adoption intention. Journal of Retailing and Consumer Services, 66, 102900. Accessible: https://reader.elsevier.com/reader/sd/pii/S0969698921004665?token=CEFBFCE67109C13094B950F5C1D80C0EBBD1180DE378288CA3DC00351D7A5F573074FFA4B9F04FBEAEA336ECCF645437&originRegion=eu-west-1&originCreation=20220321234007 (22.03.2022)

[99] Rahman, M., Ming, T., Baigh, T., & Sarker, M. (2022). Adoption of artificial intelligence in banking services: An empirical analysis. International Journal of Emerging Markets, Ahead-of-print (Ahead-of-print), International journal of emerging markets, 2022, Vol.ahead-of-print (ahead-of-print). Accessible: https://www.emerald.com/insight/content/doi/10.1108/IJOEM-06-2020-0724/full/pdf?title=adoption-of-artificial-intelligence-in-banking-services-an-empirical-analysis (22.03.2022)

[100] Heinrichs, B. (2021). Discrimination in the age of artificial intelligence. AI & Society, 37(1), Pp. 145-147. Accessible: https://link.springer.com/content/pdf/10.1007/s00146-021-01192-2.pdf (22.03.2022)

[101] Council Directive (EU) 2015/849, *supra nota* 78.

monitoring of the transactions[102] and the latter directive allowed the banks to ask for the proof of source of funds or any necessary documents, data or information to be kept up to date.[103]

Despite all the advantages that were brought by the widespread dominance of Artificial Intelligence in preventing money laundering crimes within financial institutions, there are some unsolved contradictions and issues related to the monitoring algorithms. The biggest concerns are related to the assessment of the effectiveness and non-discriminatory approach of the algorithms applied in the monitoring systems. In accordance with the Supervisor's opinion[104] the financial institutions are not receiving any feedback from the respective Financial Intelligence Unit on reports they have submitted regarding suspicious activity on the customer's accounts. The data protection authority explains this phenomenon by the need to protect the individual's privacy, however, the fact that the financial institutions are left with no feedback makes the process of readjusting the monitoring algorithms absolutely impossible. In addition, as no feedback receive the financial institution cannot assess how effectively the system has identified potential deviant transactions. The consequences of the latter have led to a significant change in the behavior of financial institutions, which are now rather report as much as possible to avoid future possible penalties.

2.4. Data protection perspective in anti-money laundering compliance

Another gray area that raises several concerns is related to the General Data Protection Regulation[105] and its compatibility with the European Anti-Money Laundering Directives. The purpose of the General Data Protection Regulation is to transform the way companies and/or organizations handle the personal data of their customers affecting European businesses and any foreign dealing on the territory of Europe or with its citizens. In addition, the latter regulation aimed at harmonizing and clarifying data security legislation, creating a common rule for collecting, using, and storing personal data.

[102] *Ibid.*, article 12 (1, e), 15 (3)
[103] *Ibid.*, article 13 (1)
[104] European Data Protection Supervisor. (2020). Opinion 05/2020 on the European Commission's Action Plan for a Comprehensive Union Policy on Preventing Money Laundering and Terrorism Financing. Pp. 14. Accessible: https://edps.europa.eu/sites/edp/files/publication/20-07-23_edps_aml_opinion_en.pdf (30.04.2022)
[105] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the Protection of Natural Persons with Regard to the Processing of Personal Data and on the Free Movement of Such Data, and Repealing Directive 95/46/EC (General Data Protection Regulation) (OJ L 119, 4.5.2016, p. 1).

From the financial institution's perspective, the adoption of the General Data Protection Regulation has been a real challenge affecting not only its monetary investments, operations, workforce, but also significantly influencing their customer due diligence processes.[106] Furthermore, the General Data Protection Regulation brought an additional source of worry as non-compliance or violation of the latter brings a severe additional penalty of up to €20 million or 4% of global revenue to probable money-laundering related fines.[107]

The issue to be assessed further is related to the way the Fourth Anti-Money Laundering Directive[108] is designed towards the retention period of personal data and the fact that it is posing a danger to the right to privacy and data protection of the people. As the financial institutions (or any other obliged entity) are obliged to verify, identify, and assess the customer's identity, prior to establishing a business relationship, consequently the financial institution has no other choice but to collect valid identification documents of the customer.[109] Moreover, once the business relationship is established, the financial institution (in that case the bank) is required to perform continuous transaction monitoring[110] and in case of a suspicious or unusual transaction to report to the respective Financial Intelligence Unit. The described above activity has become a standard procedure for pretty much every financial institution. However, the problem occurs when the business relationship has come to an end and there is a need to get rid of the personal data as the latter is no longer proceeding and there is no legitimate interest. The Fourth Anti-Money Laundering Directive prescribed that the period of storing the copy of a customer's data is five and up to ten[111] years (including the copy of identification documents and any other used for the purpose of customer due diligence).[112] The problem with storing the data comes from the fact that the historical data of the customer's transactions and his account statement could directly lead to the disclosure of his intimate details, including but not limited to sex preferences, religious, and even criminal convictions. Historical transaction data might say a lot about its owner and unintentionally disclose even a special category of personal data.[113] Regrettably, instead of conducting a proper analysis of the issue by the highest European bodies, the problem described

[106] Xuereb, K., Grima, S., Bezzina, F., Farugia, A., Marano, P. (2019). The Impact of the General Data Protection Regulation on the Financial Services' Industry of Small European States. *International Journal of Economics and Business Administration,* Vol 6(4). Pp 253 – 255. Accessible: https://www.ijeba.com/journal/342/download (29.04.2022)
[107] *Ibid.*, 105. Article 83 (5)
[108] Council Directive (EU) 2015/849, *supra nota* 78. Article 40
[109] *Ibid.* Article 11, 13.
[110] *Ibid.* Article 13 (d)
[111] *Ibid.*, 111. Article 40 (2)
[112] *Ibid*. Article 40 (1; a, b)
[113] *Ibid.*, 108. Article 9 (1)

above so as the processing of personal data within the Anti-Money Laundering laws was recognized as the public interest, thus the consent from the data subject was no longer needed.[114]

[114] Council Directive (EU) 2018/843, *supra nota* 5. Article 43

3. INFLUENCE OF THE DIRECTIVES ON BUSINESS

3.1. Affecting the business

It is now apparent that Anti-Money Laundering Directives implemented by the European Commission are focusing their attention on regulating financial institutions as the latter is considered as the main gateway for criminals to launder illicit funds. What is worth mentioning is the fact that the majority of European banks are predominantly owned by different private shareholders or investment companies (mostly non-governmental entities and/or individuals).[115] This fact demonstrates that legal entities (exactly banks) are operating as any other company on the territory of the European Union. Without any doubt, different companies have specific requirements for the services they provide and should not only act in the best interest of their customers and employees but also to safeguard an overall secure and non-discriminatory environment within the country of its operations.

3.2. Non-compliance and its consequences

Oftentimes banks are the main subject of anti-money laundering directives and regulations, thus the following subchapter is going to concentrate on three types of consequences to which banks are exposed the most. For sure, other financial institutions and obliged entities are not excluded from facing at least the same severe consequences, however as this thesis is predominantly based on the banking sector the path of below discussion will not shift away from the initial topic. It is obvious that non-compliance with anti-money laundering regulations may and will cause the banks a fortune. Thus, banks are investing billions[116] to improve their money laundering prevention systems and train or hire qualified staff. Apart from anti-money laundering investments, the banks should maintain their main business area in order to stay on the market, be competitive, and

[115] Barry, T., Lepetit, L., & Tarazi, A. (2011). Ownership structure and risk in publicly held and privately owned banks. Journal of Banking & Finance, 35(5). Pp. 1331-1334. Accessible: https://reader.elsevier.com/reader/sd/pii/S0378426610003857?token=FF120BA75E73B72C27BFF488263B67593B1A73A8DA1A836E3D9B475B1353E46E2A3888661E4FDEF51E27B074F7FAC535&originRegion=eu-west-1&originCreation=20220330212526 (31.03.2022)

[116] European Banking Federation. (2020), *supra nota* 14. Pp 33.

maintain their reputation at the highest possible level. At the same time, all the above efforts will be in vain once the Financial Supervisory Authority or Financial Intelligence Unit suspects or in the worst-case scenario proves the bank's involvement in money laundering or non-compliance.

Below is the list of two types of categories that the banks might be facing, if only they fail to comply with the applicable anti-money laundering directive and / or regulations. It is important to disclose that the types described below are equally harmful to the financial sector and the order in which they are presented does not demonstrate their importance but is rather illustrative.

3.2.1. Regulatory fines

As of today, in accordance with different estimations, the anti-money laundering regulation non-compliance has costed $5.35bn.[117] However, regulatory fines are not only about money but also include the possibility of getting sanctions and probable revocation of banking or any similar operating license of an obligated entity (including insurance license, lawyer's license, etc.).

Speaking of financial sanctions then becoming a sanctioned party significantly reduces an ability to provide services and transactions to the company's customers (especially when it comes to international transactions). The reasons for becoming sanctioned banks are very different and depend on many factors. The latest example of financial and economic sanctions applied, because of the geopolitical decision, to the whole group of financial institutions have materialized when Russian Federation invaded Ukraine in 2022.[118] However, international sanctions additionally could be implemented on private persons especially to publicly exposed persons[119], government-controlled companies, or even to entire government of a state in question. At the same time, it is the financial institutions or obliged entities to regularly monitor epy status of their customers whether or not a specific customer is still under sanctions and forbid any activity to this customer

[117] Macknight, J. (2022). AML and Data Breach Fines Halved in 2021. *The Banker*. Accessible: https://www.thebanker.com/Editor-s-Blog/AML-and-data-breach-fines-halved-in-2021#:~:text=Of%20the%20almost%20%245.4bn,AML%20regulations%20totalled%20%245.35bn (01.04.2022)

[118] Inman, P., Rankin, J. (2022). Sanctions and Boycotts: How the West Has Responded to the Invasion of Ukraine. Governments are Imposing Sanctions Against Russia While European and US Companies Have Severed Ties. *The Guardian.* Accessible: https://www.theguardian.com/world/2022/mar/02/sanctions-boycotts-west-response-russian-invasion-ukraine (02.04.2022)

[119] U.S. Department of the Treasury. (2022). *Russia-Related Designations; Belarus Designations; Issuance of Russia-Related Directive 2 and 3; Issuance of Russia-Related and Belarus General Licenses; Publication of New and Updated Frequently Asked Questions*. Accessible: https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20220224 (15.04.2022)

depending on the sanctions imposed. Failure to monitor or limit access to the services is considered as a punishable crime leading to not only financial fines but imprisonment in case of deliberate assistance to circumvent the sanctions.[120] It is important to keep in mind that complicity in circumventing sanctions by financial institutions might lead to the process when the latter financial institution will be also affected by the secondary sanctions, which are usually more severe and strict than the initial ones.[121] Moreover, despite the concerns about the way the secondary sanctions are designed and discussions that the latter might in many cases violated public international law, especially taking into account the recent United States – United Nations Security Council issue when the United States threatened its partner with the secondary sanctions if only they will not cut its commercial ties with Iran.[122] The danger and harm it brings to the banks are way too significant, forcing the banks to do whatever it takes to avoid them.

3.2.2. Reputational damage

The reputation of a bank is an intangible asset that is usually interconnected with a public reputation of the bank in terms of its trustworthiness, competence, and quality of services, which are directly related to the perception of the stakeholders and investors.[123] The reputation may be affected as a result of any event, action or inaction, behaviour either by the bank itself, its direct employees, or those with whom the bank is associated with. Overall, the reputation might be damaged by dozens of different other factors. The failure or negligence of adapting to modern realities was and still is one of the explanations why different companies fail to grow or were shut down.[124] The company's reputation is the key factor ensuring the continuity of the company in terms of long-term profitability and credibility of the latter. Taking into consideration the modern market, the flawless or at least moderated reputation of the company allows it to stand the competition.

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[120] Coppoloa, F. (2015). Deutsche Bank's Fine for Breaking Sanctions is by no Means Its Biggest Problem. *Forbes*. Accessible: https://www.forbes.com/sites/francescoppola/2015/11/07/deutsche-banks-recent-fine-for-breaking-sanctions-is-by-no-means-its-biggest-problem/?sh=eaf45bf2bfa8 (15.04.2022)

[121] Flatley, D. (2022). What Secondary Sanctions Mean, for Russia and World. *Bloomberg*. Accessible: https://www.bloomberg.com/news/articles/2022-04-05/what-secondary-sanctions-mean-for-russia-and-world-quicktake (30.04.2022)

[122] Patrick C R Terry. (2020). Enforcing U.S. foreign policy by imposing unilateral secondary sanctions: Is might right in public international law? Washington International Law Journal, 30(1). Pp. 1-27. Accessible: https://web.s.ebscohost.com/ehost/pdfviewer/pdfviewer?vid=0&sid=40cd6e20-582b-469a-a485-77c163db6f90%40redis (30.04.2022)

[123] Zaby, S., Pohl, M. (2019). The Management of Reputational Risks in Banks: Findings from Germany and Switzerland. SAGE Open, 9(3), Pp. 1-3. Accessible: https://journals.sagepub.com/doi/pdf/10.1177/2158244019861479 (01.04.2022)

[124] Schatz, R., Newquist, S., Eccles, R. (2007). Reputation and Its Risks. *Harvard Business Review*. Accessible: https://hbr.org/2007/02/reputation-and-its-risks (01.04.2022)

Thus, it is obvious that not only high-class employees, but also senior management knows the importance of their company's reputation. Better the reputation the company has, the more new and respectful customers they attract. There is a direct correlation between the two variables. While at the same time, having loyal customers trusting the company will deliver sustainable earnings and growth. Furthermore, scholars consider that approximately 80% of the market value comes from intangible and hardly assessable assets including brand equity, intellectual capital, and goodwill, consequently the companies are extremely vulnerable to anything that could harm their reputation.[125]

Everything described above is especially applicable for money laundering charges or suspicions announced by law enforcement to the public. The reputation could be irreparably destroyed just by publicly announcing that any investigation by the prosecutor or the Financial Supervisory Authority has started. Statistically speaking, the loss of customer trust directly reflects on the shares' price[126] and the latest research shows that an approximate loss in share price equals 21%.[127] Unfortunately, there are dozens of examples when money laundering non-compliance has smashed the reputation of different banks including *Danske Bank, Pilatus Bank, Verso Bank,* and the list can go on and on.[128]

3.3. Types of common shortcomings

Consequences of noncompliance with anti-money laundering regulations are posing a serious danger to any financial institution as the latter is always exposed to facing them. The consequences differ depending on the severity of the financial institution's involvement, sums laundered via the financial institution, and overall, the attitude towards the compliance culture within the company. At the same time the financial institutions are expected to take action as an ongoing continues process, more precisely identifying and assessing the risks of money laundering they are exposed

[125] *Ibid.*
[126] Basaran-Brooks, B. (2022). Money laundering and financial stability: Does adverse publicity matter? *Journal of Financial Regulation and Compliance*, 30(2). Pp. 199-200. Accessible: https://www.emerald.com/insight/content/doi/10.1108/JFRC-09-2021-0075/full/pdf?title=money-laundering-and-financial-stability-does-adverse-publicity-matter (02.04.2022)
[127] Basquill, J. (2022). Share Price and Reputational Damage: Banks Count Cost of AML Failings. *Global Trade Review*. Accessible: https://www.gtreview.com/news/global/share-price-and-reputational-damage-banks-count-cost-of-aml-failings/ (02.04.2022)
[128] *Ibid.*, 126. Pp. 206

to on all company (including subsidiaries), product, country, and business area levels. The analysis of money laundering related fines imposed on different financial institutions in the World shows the four most common shortcomings or reasons causing the fines.

a. Insufficient compliance culture and careless attitude. The most widespread shortcoming is related to the accusation that the financial institution's internal policies are designed in the way to be maximumly profitable, ignoring any actual presence of criminal activity occurring in favour of gaining profits. Despite the overall increasing regulatory enforcement attention, higher penalties, and criminal liabilities implemented by the enormous international regulations, the issue is still present, and companies are being punished on regular basis. Furthermore, even though personal liability for aiding or abetting money laundering or any similar crimes has become a real threat, the presence of the latter has not yet significantly influenced the issue. Scientific research was performed to analyse employees' attitudes towards their feeling of how well compliance culture is organized within their company, while the results showed that significant improvement is needed in regard to the company's approach towards anti-money laundering compliance.[129] The latest and the most discussed cases are: in 2020 *Deutsche Bank* received a fine for participation in a commodities fraud scheme performed by its employees;[130] in 2021 *Swedbank AB* was punished for disclosure of classified information breaching Nasdaq rules;[131] in 2021 *Julius Baer Bank* admitted that its former employee was involved in the conspiracy of money laundering bribes to the Federation Internationale de Football Association.[132]

What unites the above-mentioned cases and dozens of similar incidents is the fact that almost in every case it is actually the company's employees who have become the cause of the severe consequences including reputational and financial fines. However, the pattern could be

[129] Vision, T. (2014). Many financial institutions lack strong culture of compliance. Waterford: Aspen Publishers, (1447). Pp. 4. https://web.s.ebscohost.com/ehost/pdfviewer/pdfviewer?vid=0&sid=7c96e8a2-3635-4526-ba53-466f63aa6769%40redis (04.04.2022)

[130] Office of Public Affairs. (2021). Deutsche Bank Agrees to Pay Over $130 Million to Resolve Foreign Corrupt Practices Act and Fraud Case. *The United States, Department of Justice.* Accessible: https://www.justice.gov/opa/pr/deutsche-bank-agrees-pay-over-130-million-resolve-foreign-corrupt-practices-act-and-fraud#:~:text=25%2C%202020%2C%20a%20Chicago%20federal,roles%20in%20the%20commodities%20scheme (04.04.2022)

[131] The Reuters. (2021). Swedbank Fined $5.5 Mln by Nasdaq Stockholm for Poor Money Laundering Controls. Accessible: https://www.reuters.com/article/europe-moneylaundering-swedbank-idUSL8N2MS28F (04.04.2022)

[132] U.S. Attorney's Office. (2021). Bank Julius Baer Admits Laundering Over $36 Million in Bribes in FIFA case. *The United States Attorney's Office,* New York. Accessible: https://www.justice.gov/usao-edny/pr/bank-julius-baer-admits-laundering-over-36-million-bribes-fifa-case (05.04.2022)

changed by communicating the importance and the role of ethics and compliance within the company. The latter should be instilled and promoted not only by regular employees but also the promotion should be led by the top management. For sure, there has been a major improvement done with the help of different scientific researchers and practitioners that aimed at improving the corporate cultures since the 2008 Financial Crisis.[133] While there is still plenty of space for improvement in tackling the issue.

b. Failing to report Suspicious Activity Reports. The suspicious activity report is a document disclosing to dedicated authorities any identified suspicious of money laundering, terrorism financing, or other offense directly or indirectly related to violation of the anti-money laundering laws.[134] The suspicious activity report is the key tool assisting governmental bodies in identifying and performing accurate and time-critical enforcement activities. By different estimations, the approximate number of suspicious activity reports filed by large financial institutions equals 640 000 reports.[135] The importance of the latter tool is impossible to underestimate, however not following the strict rules of reporting (especially when it comes to specific deadlines of reporting)[136] is not only a severe violation of anti-money laundering laws but also results in serious consequences for obliged entities.[137]

c. Inadequate risk assessment. The risk assessment or risk-based approach is a cornerstone of any financial institution in combating money laundering and preventing terrorism financing as it designates necessary measures and helps in allocating resources to areas where the most significant risks are or could occur. The idea behind the risk-based approach is to classify each customer depending on their business field of activity, geographical location, and tons of other markers. By having accurate risk classifications, the banks can apply proper customer due diligence accordingly which protects them from regulatory sanctions.[138] However, the problem

[133] Burdon, W., & Sorour, M. (2018). Institutional Theory and Evolution of 'A Legitimate' Compliance Culture: The Case of the UK Financial Service Sector. Journal of Business Ethics, 162(1). Pp. 48-50. Accessible: https://link.springer.com/content/pdf/10.1007/s10551-018-3981-4.pdf (12.04.2022)
[134] Money Laundering and Terrorist Financing Prevention Act, RT I, 17.11.2017, *supra nota* 88. Article 49
[135] Bank Policy Institute. (2018). Getting to Effectiveness – Report on U.S. Financial Institution Resources Devoted to BSA/AML and Sanctions Compliance. Pp 2. Accessible: https://bpi.com/wp-content/uploads/2018/10/BPI_AML_Sanctions_Study_vF.pdf (12.04.2022)
[136] *Ibid* 134. Article 49 (1)
[137] Nicodemus, A. (2020). Deutsche Bank Fined $15.9M for Lag in Reporting Suspicious Transactions. *Compliance Week*. Accessible: https://www.complianceweek.com/regulatory-enforcement/deutsche-bank-fined-159m-for-lag-in-reporting-suspicious-transactions/29598.article (01.04.2022)
[138] Netherlands Public Prosecution Service. (2021). ABN AMRO Pays EUR 480 Million on Account of Serious Shortcomings in Money Laundering Prevention. Accessible:

and the cause of fines among the others is still interconnected with a weak risk assessment methodology or these methodologies are designed incorrectly.

d. Anti-money laundering weak controls. Lastly, in accordance with regulators' fine drafts, the weaknesses in anti-money laundering controls are being referred to often.[139] The list could be started from failing in identification of a politically exposed person, verification of the source of funds, ignoring adverse media alarms, improper customer identification, and verification, and customer due diligence non-performance. The latter list often stands as a sign of deficiencies in the compliance areas of the financial institutions, which creates unlimited access for criminals to launder their funds.

https://www.prosecutionservice.nl/latest/news/2021/04/19/abn-amro-pays-eur-480-million-on-account-of-serious-shortcomings-in-money-laundering-prevention (01.04.2022)

[139] Malta Financial Services Authority. (2019). Supervision. Risks Identified, Weaknesses and Expected Controls. A Cross-Sectoral Analysis. *TriQ L-IMDINA.* Pp. 9 – 15. Accessible: https://www.mfsa.mt/wp-content/uploads/2019/11/20191106_MFSA-Supervision-Risks-Identified-Weaknesses-And-Expected-Controls.pdf (13.04.2022)

4. GOVERNMENTAL AUTHORITY AND THE BANKS

There is plenty of complicated and sophisticated technical solutions enshrined by the banks on every level of their daily operations, in order not only to conduct new sales but to maintain the existing ones on the highest level possible. By different estimations, the largest banks are spending billions on their technological development and maintenance annually.[140] While at the same time the second biggest line of inevitable expenses stands for salary and employees related compensations or benefits.[141] The above-mentioned facts are crucial as they are closing the concerns that the lack of technological development or shortage of workforce is affecting the banks' obligation to prevent money laundering, furthermore, the shortage of financial means does not release from company's obligations before the law enforcement agencies and regulators.

Throughout the following thesis, several times the procedure of enhanced due diligence was mentioned explaining its purpose and importance. While the following chapter is going to analyze and assess enhanced due diligence from the bank's perspective in comparison with governmental authority's obligations taking into account three main perspectives, namely competence, transparency, and accountability.

4.1. Competence

In today's business companies no longer should only worry about making profits, but they ought to know with whom they are having business with. Knowing the company's counterparty literally means that the counterparty must be identified, verified before jumping into business relations, and monitored through the ongoing business relationship via all possible supportive means to meet the Know Your Customer standards. On the one hand, the desperate need of knowing the counterparty is justified by the fact that any company (especially a bank or any other obligated entity under anti-money laundering laws) must know or at least guess the counterparty's ability to

[140] Shevlin, R. (2019). How Much Do Banks Spend on Technology? (Hint: IT Would Weight 670 Tons in $100 Bills). *Forbes.* Accessible: https://www.forbes.com/sites/ronshevlin/2019/04/01/how-much-do-banks-spend-on-technology-hint-chase-spends-more-than-all-credit-unions-combined/?sh=12e25aaf683a (16.04.2022)
[141] Franklin, J., Moise, I. (2022). Top Wall Street Banks Paid Out $142bn in Pay and Benefits Last Year. *Financial Times*. Accessible: https://www.ft.com/content/9bdef7a6-69f1-4f42-b27d-74dd34db4804 (16.04.2022)

pay out depts or fulfill other types of responsibilities especially when it comes to providing services under procurement agreement. However, the above-described demand to check its counterparty is fully at the company's discretion and only internally regulated depending on risk appetite. There is absolutely no governmental intervention or supervision when it comes to choosing the best counterparty capable of providing outsourcing services, except in the cases when there are signs of unfair competition or violation of competition provision.[142] Although, in these cases, it is the governmental body (namely Competition Authority) with sufficient powers who is obligated to conduct an investigation and file the claim to the court if needed.

On the other hand, the pattern dramatically changes when an additional variable is taken into the account, which is anti-money laundering directives and regulations.[143] From the governmental perspective, there are Financial Supervisory Authority and Financial Intelligence Unit who are obliged by the Public Information Act to "*ensure that the public and every person has the opportunity to access information intended for public use, based on the principles of a democratic and social rule of law and an open society, and to create opportunities for the public to monitor the performance of public duties*".[144] In other words, literally, every person is capable of receiving, monitoring, and assessing the activities performed by the governmental bodies with reasonable exclusions if the matter is about classified information.[145] Thus, the process of gathering information, explanations, and descriptions has never been that easy. Furthermore, in favor of citizens, there is not only the Public Information Act but Article 44 of the Estonian Constitution granting a wide variety of access rights to the public.[146]

The wide range of responsibilities and rights of governmental authorities is not questionable as they are reasonable, transparent, and more importantly, is that the latter have plenty of obligations. Although, under what law or provision the banks, basically private sector players, have received pretty much the same rights as governmental bodies when it comes to money laundering prevention, is not clear. Probably, the following thesis will be void if only banks would have the same responsibilities as governmental bodies do. However, as of today the banks only get and benefiting the full list of the same rights any governmental institutions have, but without any obligation to follow governmental authority's responsibilities. In order to avoid the speculative

[142] Competition Act RT I, 2001, 56, 332
[143] Money Laundering and Terrorist Financing Prevention Act, RT I, 17.11.2017, *supra nota* 88.
[144] Public Information Act RT I, 2000, 92, 597. Article 1
[145] *Ibid.*, Article 2 (2)
[146] The Constitution of the Republic of Estonia, RT 1992, 26, 349. Article 44

nature of the above-mentioned statements, it is crucial to analyze Estonian anti-money laundering legislation[147] and to test the statement mentioned in the previous paragraph from the legal perspective.

At first, the Financial Intelligence Unit is responsible for a great number of different activities in the field of anti-money laundering and countering terrorism financing, including but not limited to the "*supervision over the activities of obliged entities in complying with this Act, unless otherwise provided by law*".[148] Furthermore, implemented by the Financial Action Task Force's international recommendations[149] prescribed that it is the countries' authority that should ensure that the financial institutions are subject to adequate regulation and supervision, and have effectively implemented and continuously adjusting the Financial Action Task Force's existing and future Recommendations.[150] However, an extended analysis of legal documents has shown that the current level of the permissiveness of the banks is not justified, as not a single national or international legal document grants comprehensive authorization for financial institutions to behave as a governmental authority.

Secondly, enhanced due diligence is a complicated process involving not only simply personal data about a customer's transaction gathering but also an analysis of the findings, investigation of potential violations, and what is, more importantly, proper communication with the customer with all due respect, and references to legal acts in case of customer's explanations on some transactions are needed. In other words, a person working as an enhanced due diligence investigator should have a wide range of different skills and a very specific mindset. In the light of the overall shortage of qualified employees in the banking sector, the issue becomes alarming as for example only in the US in 2021 more than 35 million people quit their banking jobs in response to the COVID pandemic.[151] Furthermore, the overall situation worsens due to serious shortcomings in qualified and experienced anti-money laundering specialists and experts with sufficient legal knowledge or at least understanding.[152] The issue with the lack of competent employees is directly related to

[147] Money Laundering and Terrorist Financing Prevention Act, RT I, 17.11.2017, *supra nota* 88.
[148] *Ibid.,* Article 54 (4)
[149] Financial Action Task Force (2012 – 2022), *supra nota* 7.
[150] *Ibid*., Pp 23
[151] Reich, G. (2021). How the Banking Industry Will Survive 'The Great Resignation'. *The Financial Brand.* Accessible: https://thefinancialbrand.com/126386/banking-great-resignation-pandemic-employee-hiring-culture-pay/ (20.04.2022)
[152] Grieve, C. (2021). 'Shortage of People': CBA Defends Labour Hire to Fight Financial Crime. *The Sydney Morning Herald.* Accessible: https://www.smh.com.au/business/banking-and-finance/shortage-of-people-cba-defends-labour-hire-to-fight-financial-crime-20210628-p584u7.html (19.04.2022)

stricter anti-money laundering controls and the fear of potential criminal liability and charges in case of unintentional or especially intentional violation of anti-money laundering regulations.

The compilation of these two factors and the initial aim of the banks to gain profits and stay as compliant as possible (avoid unnecessary attention) create a situation when even if banks understand that the way they are operating, and the way laws are designed contradict one another no objections or at least proposals on improving the current system are forwarded to the Financial Intelligence Unit. Lastly, the lack of competent employees does no good when it comes to good practice and providing the highest level of services, especially in regard to private data protection and customer enhanced due diligence. Thus, the banks have no other choice (or not willing to complicate their activities) to administer the existing procedures and requirements.

4.2. Transparency

Another grey area of specifically customer enhanced due diligence is the fact that the whole process is not transparent and clear for the end customer whose bank account is under investigation. During preparation for writing the following thesis, a huge amount of scientific literature, public documents, and guidelines (including policies of several banks operating on the territory of the European Union) were thoroughly analysed to understand how the process of enhanced due diligence is designed in order to test its adequacy and overall have a clear understanding of the process.

The concerns regarding the fact that the customer enhanced due diligence process is not clear have become one of the major topics of discussion in Estonia in the period 2018 - 2020. At that time several Estonian respectful newspapers have published a series of articles related to the closure of Danske Bank's money laundering investigation[153] and simultaneously as a response to the latter scandals, the rest of Estonian major commercial banks have changed their approach to stricter without any notice or preconditions. Consequently, the stricter approach has triggered not only widespread bank accounts closure and dissatisfaction among Estonian residents[154], but also a

[153] ERR. (2020). USA Closes Danske Estonia Money Laundering Investigation. Accessible: https://news.err.ee/1214059/usa-closes-danske-estonia-money-laundering-investigation (21.04.2022)
[154] Pärli, M. (2020). Inimesed Hädas: Pangad Sulgevad Nende Kontosid, Otsust põhjendamata. [People in Trouble: Banks are Closing Their Accounts, Decision Unjustified]. *ERR*. Accessible: https://www.err.ee/1062597/inimesed-hadas-pangad-sulgevad-nende-kontosid-otsust-pohjendamata (21.04.2022)

discussion in responsible governmental institutions.[155] The main issue highlighted was the fact that customers' bank accounts were closed without proper justifications and put people into the position where they are left behind with no bank account, and even going to the court to challenge the bank's decision has become a challenge as these people are not able to pay state duty for the application (not to mention inability to receive a salary, pay bills, etc.). The position of the banks is that customer's business relationship is terminated in case of business model, ownership structure, or business activity is unclear to the latter. Additionally, when the bank suspects that the customer performs transactions with a suspicious counterparty or there are signs that the beneficial owner is a strawman.[156]

However, how can one trust and rely on the bank's unbiased assessment given the circumstances that the way the process of enhanced due diligence is established is not disclosed to the public and is kept probably as a company's secret. The core issue is that no one except the Financial Intelligence Unit and Financial Supervision Authority is authorized to analyze and get to know the process descriptions to which the banks are referring when dealing with enhanced due diligence. Leading to the issue when a customer has no chance to test how adequately the enhanced due diligence is designed and whether his/her rights were violated or there were signs of discriminatory attitude. One may oppose that the Financial Supervisory Authority or even internal bank's audit are regularly monitoring bank's approach towards anti-money laundering, which they definitely might be performing as prescribed by the law.[157] However, a person whose account is under investigation has no access to the process and cannot oppose conclusions made by the bank's specialist, and what is only left is to obediently wait for the final verdict and hope for the best.

What makes the process of obedient patience even more disgraceful is the fact that banks are not ought to notify the customer about the fact that the latter customer is under investigation or his/her data is being processed. Consequently, it makes it impossible to trace the process and test the person(s) responsible for due diligence (how qualified they are, do they have sufficient knowledge or credentials, etc.). In the light of the fact that there is a shortage of qualified labor force, how can one trust that the credentials of the particular employee responsible for making a decision comply with the role he/she takes? The compilation of all the factors makes the process of the customer

[155] Õiguskantsler. (2020). *Märgukiri Põhimakseteenuste Tagamise Kohta*. [Chancellor of Justice. *Memorandum on the Provision of Basic Payment Services*]. Accessible: https://www.oiguskantsler.ee/sites/default/files/field_document2/M%C3%A4rgukiri%20p%C3%B5himakseteenuste%20tagamise%20kohta.pdf (21.04.2022)
[156] *Ibid.*, 154.
[157] Money Laundering and Terrorist Financing Prevention Act, RT I, 17.11.2017, *supra nota* 88. Article 54 (4)

enhanced due diligence untransparent and untraceable for the end customer, raising serious concern about whether performed actions were in compliance with the law and there was no malicious intent or discrimination.

4.3. Accountability

The last aspect to be assessed is the accountability of the enhanced customer due diligence procedures implemented by the banks and what rights and remedies a victim of these processes has. The greatest concern related to accountability is the fact that there is no due process or competence that the public knows about. For example, the banks are required to implement a monitoring system allowing the latter to detect any deviant transactions and activities.[158] However, neither Anti-Money Laundering Directives nor the Financial Action Task Force gives their official guidelines on how the monitoring must be performed, letting the banks independently decide what systems to implement and what transactions to consider deviant or suspicious. Need to agree and admit, that the Financial Intelligence Unit supervises these systems and assesses them from the anti-money laundering perspective. But not only a regular customer has no access or understanding of these processes making it impossible for the latter to file a complaint as he would do with governmental authorities acting in the same manner, but also the banks do not receive any feedback from the respective authorities.[159]

Furthermore, the banks are allowed to offboard or terminate a business relationship[160] with the customer based on the results of their internally performed enhanced due diligence and on the grounds that they believe to have enough evidence of their customer's deviant behaviour and signs of money laundering, in other words, the banks are acting as a judge proclaiming the ex-customer guilty. Such behaviour violates one of the fundamental human rights which is the presumption of innocence, as the person is called guilty by the private financial entity that has no rights and authorization for such decisions and statements. Otherwise, what is the purpose of the judicial and executive powers, if pretty much any bank can unilaterally investigate and make a verdict covering behind the wall of international directives and abusing its gaps.

[158] Milaj, J., & Kaiser, C. (2017). Retention of data in the new Anti-money Laundering Directive - 'need to know' versus 'nice to know'. *International Data Privacy Law*, 7(2). Pp. 118 - 120. Accessible: https://academic.oup.com/idpl/article/11/3/276/6214488 (30.04.2022)
[159] European Data Protection Supervisor. (2020), *supra nota* 104
[160] Money Laundering and Terrorist Financing Prevention Act, RT I, 17.11.2017, *supra nota* 88. Article 43(3)

CONCLUSION

The purpose of this thesis was to analyse the concerns and the consequences of the fact that governmental authorities are widely delegating their powers to private financial institutions when it comes to money laundering prevention and countering terrorism financing. The biggest issue in this delegation is the fact that private sector organizations are not bound to follow the public sector legal obligations, creating an environment for unlimited violations of their customers' rights. The issue occurred mainly due to the unusual design of the European anti-money laundering and terrorism financing prevention laws requiring a private sector player to act as a police officer, jailer, and judge with unwritten permission from the Financial Intelligence Unit. Such a delegation might be caused by the fact that the European legislators realize that the law enforcement agencies are not prepared to perform all the investigations without involving third parties. Seems that an adequate response from law enforcement would require millions of investments in preparing the personnel, educating them, and establishing an investigating department. Thus, the European legislators have readjusted the Directives and allowed the banks and financial institutions to be sort of eyes, and an arm holding a judicial gavel.

Despite the importance of preventing money laundering and terrorism financing crimes, the dominance of the rule of law enshrined in the Treaty on the Functioning of the European Union and rigorous compliance with the latter Treaty was always the main goal of the European Union among following the General Data Protection Regulation. The proposal and possible solution to avoid violations are to transform and rearrange Anti-Money Laundering Directives into Self-Regulations for the banks alone, as it is the Financial Intelligence Units who should be the only responsible for conducting the investigations on behalf of the government, consequently, it is them to be accountable and questioned in case of any rights violation. The involvement of the banks into the communication with the suspect should be minimal, and the banks should maintain their daily operations. The idea is to remove the responsibility of conducting customer due diligence from the banks to the governmental authorities, who not only should have enough trained experts and legal professionals, but also should be capable of providing explanatory notes to the customers regarding any query they make in accordance with the established practice of any public entity.

This change will not only restore the reputation of the banks but will allow the latter to reinvest the money into providing better services and be able to compete on the market. The implementation of self-regulation guidelines for different corporates and business sectors is a common approach and is used widely.

Once the above mentioned is set, then the upcoming establishment of Anti Money Laundering Authority prescribed by the Anti-Money Laundering Directive could take the role of intermediary between financial institutions and the Financial Intelligence Units. In accordance with the proposed strategy, the Anti-Money Laundering Authority will supervise and assess self-regulations firstly among the banks inside a specific country. The next step could be the harmonization of self-regulation guidelines among other Member States' financial institutions. In accordance with the described plan, the Anti-Money Laundering Authority will not only fulfill its initial purpose, which is to create harmonized rules and increase the cooperation between different levels of institutions. While at the same time financial institutions could present their opinion and share their thoughts on how to implement the Financial Intelligence Unit into the process of customer due diligence, know you customer procedure, and transaction monitoring with respect to human rights, Treaty on the Functioning of the European Union, and best practices of money laundering prevention all at once.

Aspects that require additional research and were not covered in this thesis are still present and open to debate. The usage of Artificial Intelligence algorithms could be assessed from the technical perspective showing the specific variable used in their order once they are published or disclosed by any financial institutions. Furthermore, it is interesting to analyze the issues other jurisdictions (like the United States, high-risk third countries, or offshores) have in terms of money laundering legislation.

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