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Recommendations for the Establishment of the Internal Control System for Anti-Money Laundering and Countering Terrorism and Proliferation Financing and Sanctions Risk Management, and for Customer Due Diligence

CONTENTS

Introduction

1. The Financial and Capital Market Commission (hereinafter - the Commission) has developed the recommendations for credit institutions, payment and electronic money institutions, private pension funds, investment firms, investment management companies, alternative investment fund managers, insurance companies, insofar as they provide life insurance or other insurance services related to the accumulation of funds, insurance intermediaries, insofar as they provide life insurance or other insurance services related to the accumulation of funds, reinsurance companies and to the branches of all of these subjects of Member States and third countries in the Republic of Latvia, as well as credit unions (hereinafter all jointly and each separately referred to as an institution) for the establishment of the internal control system (hereinafter - the ICS) for anti-money laundering and countering terrorism and proliferation financing (hereinafter - the AML/CTPF) and the sanctions risk management, and for customer due diligence (hereinafter - the Handbook). Explanations provided for in the Handbook are applicable to each institution, insofar as they are consistent with the nature of the activity of the institution, provided services and products thereof, as well as considering the risk inherent to the activity of the institution.

2. According to the requirements of the Commission's Normative Regulation No. 135 of 21 August 2019 "Regulations on the Establishment of Customer Due Diligence, Enhanced Customer Due Diligence and Risk Scoring System" (hereinafter - the Customer Due Diligence Regulations), the Commission hereby issues the Handbook, in order to:

2.1. explain the implementation of the risk-based approach, in line with the requirements of the Customer Due Diligence Regulations;

2.2. explain the requirements laid down in the Customer Due Diligence Regulations for the purposes of establishment of the customer risk scoring system;

2.3. explain the measures laid down in laws and regulations to be taken within the scope of the customer due diligence (standard, simplified and enhanced);

2.4. provide recommendations, based on the best practice in the field of anti-money laundering and countering terrorism and proliferation financing.

3. The contents of the Handbook have been set up in accordance with the core AML/CTPF principles in the following chapters and the corresponding sub-chapters, namely:

3.1. the first chapter "Risk Assessment" explains the need for performing and the core principles of the money laundering and terrorism and proliferation financing (hereinafter - the MLTPF) risk and the sanctions risk to enable the institution to establish an appropriate ICS;

3.2. the second chapter "Internal Control System" entails the most significant key requirements for the ICS, explaining the objective of each separate ICS element and the activities required for the implementation of the objective in the sub-chapters;

3.3. the third chapter "Customer Due Diligence" explains the types of customer due diligence - standard, simplified and enhanced - to be applied in accordance with the customer risk. The sub-chapters of this chapter contain explanations and examples on the scope and depth of the due diligence measures depending on the risk, as well as additionally provide the explanations on separate customer due diligence measures, the application whereof requires uniform understanding of the core principles;

3.4. the fourth chapter "Reporting and Provision of Information to Authorities" entail the questions and answers with respect to the MLTPF risk exposure reports to be submitted to the Commission, as well as the most relevant aspects with respect to the duty of the institution to report to the Financial Intelligence Unit and the State Security Service.

It is also planned to prepare other chapters, as well as to enhance the Handbook, on a regular basis, in line with the identified problem issues and the necessary explanations.

4. The purpose of the Handbook is to strengthen the implementation of the risk-based approach, in implementing the requirements in the AML/CTPF field and managing the MLTPF risk. The risk-based approach means that the institution identifies and understands the MLTPF risk (hereinafter also referred to as the risk) and applies the risk management measures pursuant to the risk the institution is exposed to, for the purposes of effective mitigation of the risk. The AML/CTPF measures are to be set in accordance with the risk assessment - for the risk inherent to the activities of the institution (the institution, when developing its operational strategy (customer policy), shall specify the customers it attracts and serves, the services and products it offers, the channels it applies for distribution of the services and products) and for the individual inherent risk of the customer (assessing all risk affecting circumstances - customer risk, country and geographical risk, the risk of services and products used by the customer, service and product delivery channels risk). The lower the customer risk, the smaller the scope and depth of the due diligence; in turn, the higher the customer risk - the larger the scope of the due diligence and the deeper it is. This principle with corresponding examples is explained in the relevant chapters of the Handbook. In addition, it is necessary for the institution to develop an effective system enabling one to detect (verify) whether the previously obtained customer due diligence data is true and relevant (for example, obtaining and verification of data from the databases of trade (enterprise) registers, verification of data in publicly available sources), as well as an effective transaction screening system enabling one to ascertain the relevance and authenticity of initially obtained information about economic or personal activities, scope of transactions, source of funds and wealth). Nevertheless, considering the fact that each institution has different offered products and services, as well as the customer base and the risk inherent thereto, measures applied by one institution may differ from the measures applied by another institution. Examples and explanations provided in the Handbook will be enhanced and supplemented, in line with the problems detected in practice.

5. The Handbook provides for a number of examples, in order to explain the requirements of the legal framework and the expected conduct of the institution. Using examples as explanatory information, they cannot be applied to all cases alike without due assessment, because the situations may differ. Real actual circumstances, even though they might seemingly be similar to the circumstances referred to in the examples, may differ, exactly when assessing the details of actual circumstances, which might result in a situation, where it is necessary to subject the institution to measures different from or additional to those referred to in the example. The conduct of the institution is also determined by the assessment of its MLTPF risk and risk policy, while the examples specified in the Handbook are not based upon particular risk assessment and policy.

1. Risk Assessment

1.1. Money laundering and terrorism and proliferation financing risk assessment

6. For the institution to be able to establish the AML/CTPF ICS consistent with its risk, inter alia, to comply with the risk-based approach and to take customer due diligence measures corresponding to the risk, first of all, it is necessary to carry out the assessment of the MLTPF risk of the institution, in order to clarify, assess and understand the risk the institution is exposed to. In the MLTPF risk assessment, the institution shall assess the money laundering, terrorism financing and proliferation financing risks in accordance with the specificity inherent to the services and circle of customer of the institution, geography of distribution of services and products thereof (for example, considering the jurisdictions, where the branch representative offices of the institution are located, etc.) and service and product delivery channels (for example, whether the agent, intermediary services are used, whether the services and products are offered online). Based on the outcomes of the MLTPF risk assessment, the institution shall assess and determine its risk appetite[1].

7. Considering the purpose of the MLTPF risk assessment, it is necessary to update the MLTPF risk assessment, prescribing the frequency of updates according to the inherent risks, but at least once every three years, as well as in cases when the institution introduces significant changes, for example, in the range of services and products, delivery channels thereof. It is necessary for the credit institutions, based on the risk inherent to their activities, to carry out the updating of the MLTPF risk assessment at least once every 18 months.

8. It shall be necessary for the institution to assess whether the risk the institution is exposed to has changed - whether any new circumstances affecting the risk are identified -, and to carry out the updating of the MLTPF risk assessment, by assessing whether the existing MLTPF risk management and mitigation measures are consistent with the risk. The MLTPF risk assessment also enables the institution to set priorities in MLTPF risk management and to effectively perform the planning and allocation of resources necessary thereto (for example, the necessary information technologies (hereinafter - IT) systems, employees and their qualification). It is necessary for the institution to ensure appropriate and adequate resources for managing and mitigating the risk inherent thereto.

9. In accordance with the requirements of the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing (hereinafter - the Law) when performing the risk assessment the institution shall take into account:

9.1. the risks identified by the European Commission in the European Union MLTPF risk assessment[2];

9.2. the risks identified in the national MLTPF risk assessment report, as well as in the risk assessment conducted by the supervisory authority;

9.3. other risks inherent to the institution;

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[1] Risk level the institution accepts and is able to manage.

[2] For instance, the assessment of 2019 is available at: https://ec.europa.eu/info/sites/info/files/supranational_risk_assessment_of_the_money_laundering_and_terrorist_financing_risks_affecting_the_union.pdf

9.4. risk factors referred to in the joint guidelines the European Banking Authority of 4 January 2018 Joint Guidelines under Articles 17 and 18(4) of Directive (EU) 2015/849 on simplified and enhanced customer due diligence and the factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with individual business relationships and occasional transactions[3] (hereinafter – the EBA Guidelines).

Example
Based on the risk assessment, the institution prescribes that low-risk customers would, in a secure manner, be identified non-face-to-face. Depending on the type of non-face-to-face identification, an increased risk may be inherent to the non-face-to-face identification, and it should be taken into account in the risk assessment. However, the evaluation thereof will not always automatically provide that all customers identified non-face-to-face are high-risk customers. It is necessary to consider the customer category for which such type of identification is permitted (for example, residents of the Republic of Latvia), what (how secure) the permissible non-face-to-face identification type is, which services the institution ensures via non-face-to-face identification. It is necessary for the institution to reflect its evaluation and arguments justifying its opinion in the risk assessment.

10. When determining the MLTPF risk the institution is exposed to, it is necessary to assess:

10.1. the inherent risk – the risk the institution is exposed to, without taking the risk management and mitigation measures;

10.2. the effectiveness of the MLTPF risk management measures;

10.3. the volume of the residual risk (by assessing the inherent risk and the effectiveness of the control measures).

Thus, in order to determine the MLTPF risk characteristic (inherent) to the institution, the following formula is applied:

Inherent risk – effectiveness of the MLTPF risk management measures = residual risk.

11. When determining the inherent risk characteristic to the institution, the institution shall assess at least the following categories:

11.1. customer risk (for example, credit turnover of customers considered to be politically exposed persons (hereinafter also referred to as the PEP)[4]; credit turnover of the customers, whose type of economic or personal activity is to be considered as high-risk, etc.);

11.2. country and geographical risk (for example, credit turnover of the customers, whose country of residence or registration is a higher risk country; payments received by the customers from higher risk countries, etc.);

[3] https://esas-joint-committee.europa.eu/Publications/Guidelines/Guidelines%20on%20Risk%20Factors_LV_04-01-2018.pdf.

[4] The turnover of incoming payments of the customer; in cases when the activities of, and the services provided by the institution, do not include the performance of payments, the credit turnover shall be understood to mean the amount of the customer's transactions.

11.3. risk of products and services used by the customers (for example, the turnover of customers using private banker's services; the turnover of customers using trust or fiduciary transaction services, etc.);

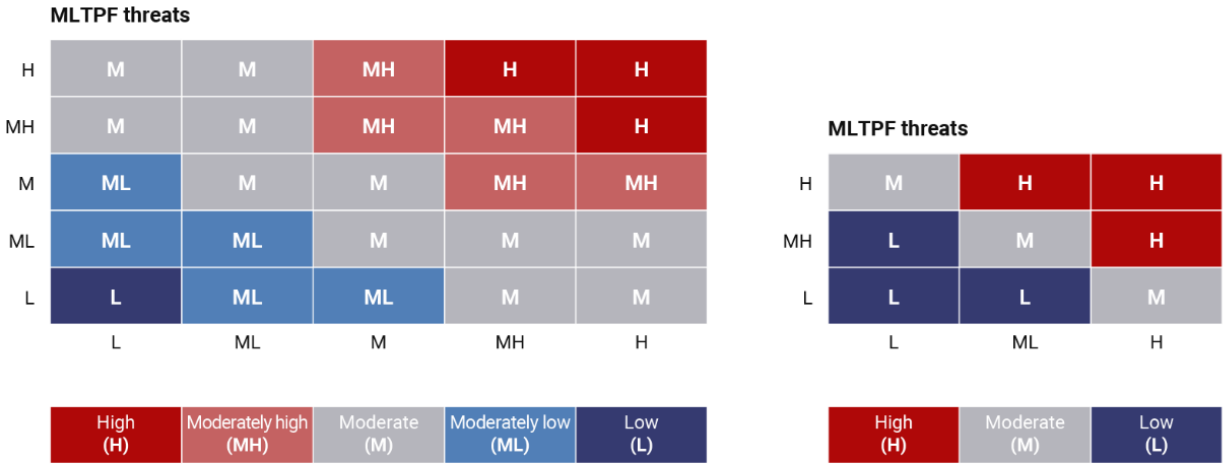
11.4. product and service delivery channels risk (for example, credit turnover of the customers identified non-face-to-face; credit turnover of the customers identified by an agent; credit turnover of customers - e-merchants; credit turnover of customers - financial institutions registered outside the European Union, etc.)

12. Other indicators may also be determined, in addition to those referred to in Clause 11. In each category the institution shall assess the risk increasing factors, in accordance with the rating whereof it shall set the inherent risk of the category. Having obtained the rating for each category, the institution shall prescribe an algorithm for the determination of overall inherent risk.

13. When determining **the effectiveness of the MLTPF risk management measures** of the institution, the institution shall assess the measures applied by it in the MLTPF risk management, in order to prevent the MLTPF and to ensure that the risk factors are identified (for example, IT systems, which are applied, requirements of policies and procedures, updating thereof, quality assurance mechanisms, management awareness and involvement, timeliness of introduction of audit recommendations, etc.). The institution shall assign the rating to each measure (for example, conforming, not conforming, significant improvement, insignificant improvement). Having obtained the rating of each individual measure, the institution shall determine the overall effectiveness of the measures.

14. **Residual risk** shall be clarified after the inherent risk has been assessed and the applied MLTPF risk management measures and the effectiveness thereof have been taken into account. It is important to note that, when calculating the residual risk according to the formula referred to in Clause 10, the largest weight shall be assigned to the inherent risk, because, irrespective of how effective the ICS operation is, it cannot reduce the current or inherent risk to zero.

15. When carrying out the MLTPF risk assessment, it is possible to apply the risk assessment matrices of different level of detail, for example:



16. The type of risk assessment matrix applied by the institution depends on the activity of the institution, the size, and the customer base thereof. For example, institutions with a smaller customer base or a limited range of the offered products and services are more often using the risk assessment matrix providing for a low, moderate and high risk. In turn, in cases, when the activities and size of the institution allows and the customer base is comprised of the customers of various profiles, and, correspondingly, a more nuanced risk breakdown would be applied for effective assessment thereof, the institution may use the risk assessment matrix providing for a more detailed risk breakdown.

1.2. Sanctions risk assessment

17. Sanctions risk assessment, similar to the MLTPF risk assessment, is necessary to enable the institution, in line with the type of its activities, to clarify, assess, understand and manage the sanctions risk inherent to its activities. One of the main tasks of the sanctions risk assessment is to identify the risks associated with possible circumvention of the sanctions regulation, where the sanctions screening is not sufficient to ensure effective observance of the sanctions regulation. At the same time, it is important to note that the sanctions screening is to be ensured irrespective of the risk rating, transaction amount and customer risk (except for intra-institutional transactions, *inter alia*, payments within the scope of a single institution, provided that a regular (at least daily) screening of the customer database is ensured.

18. Even though the MLTPF and the sanctions risk are different risks (for example, in terms of the MLTPF, a country located in the border area of the country subject to sanctions would not be have an increased inherent risk (it would not, for instance, be considered to be the country with high corruption risk or high risk of criminal offences), while, in terms of the sanctions risk, the same country, due to its location, would have an increased geographical risk related to the sanctions risk), the assessment thereof may, nevertheless, be performed concurrently, and the assessment of both of these risks may be combined in a single document.

19. When conducting the sanctions risk assessment, the institutions shall take into account the risk affecting circumstances (risk factors) both with respect to its customers and with respect to the risk inherent to its activities, services and the regions of provision thereof.

20. The sanctions risk the institution is exposed to shall be determined, based on the mechanism similar to the one applied in analysing the MLTPF risk, namely, by assessing:

20.1. the inherent risk the institution is exposed to - the sanctions risk the institution is exposed to without taking the sanctions risk management and mitigation measures;

20.2. the effectiveness of the sanctions risk management measures;

20.3. the volume of the residual risk (by assessing the inherent risk and the effectiveness of the control measures).

Thus, in order to determine the sanctions risk characteristic (inherent) to the institution, the following formula is applied:

Inherent risk – effectiveness of the sanctions risk management measures = residual risk.

21. When determining the inherent sanctions risk characteristic to the activities of the institution, the institution shall determine the risk increasing factors inherent to its customer base and the activities of the institution itself, determining the inherent risk according to the rating thereof.

22. When determining **the effectiveness of the sanctions risk management and control measures**, the institution shall assess the measures applied by it in the risk management, in order to observe the sanctions requirements and to ensure that the sanctions risk increasing factors are identified (for example, systems and requirements for the screening of customers and their transactions, *inter alia,* payments). The institution shall assess (rate) each measure (for example, conforming, not conforming, significant improvement, insignificant improvement). Having obtained the rating of each individual measure, the institution shall determine the overall effectiveness of the measures. For example, it would not be permissible that the internal control measures are assessed (rated) as effective, solely on the basis of the circumstances that there have been no cases detected with respect to violation or circumvention of sanctions.

23. **Residual risk** shall be clarified after the inherent risk has been assessed and the applied sanctions risk management measures and the effectiveness thereof have been taken into account and rated. The institution shall rate the value of the residual risk, applying the risk value rating gradations.

Like in the MLTPF risk assessment, in the sanctions risk assessment it is also possible to apply various risk assessment matrices, depending on the activities, size, services offered by and the customer base of the institution (please see the principles of selection of the matrix in Sub-chapter 1.1).

24. The institution shall develop the plan of measures for ensuring the continuity of compliance of the ICS, entailing the sanctions risk and the MLTPF risk management and mitigation measures.

25. The institution shall develop and document the sanctions risk assessment methodology. When developing the sanctions risk management and the AML/CTPF methodology, the institution may use the risk assessment guidelines developed by the international organisations, for example, *Wolfsberg* Group guidelines (available at: https://www.wolfsberg-principles.com/sites/default/files/wb/pdfs/faqs/17.%20Wolfsberg-Risk-Assessment-FAQs-2015.pdf).

2. Internal Control System

26. After the institution has developed the MLTPF risk and sanctions risk assessments, it shall, in line with the conclusions of the assessment of these risks, establish, maintain and develop the AML/CTPF and the sanctions risk management ICS suitable to its economic activity.

2.1. Independence and effectiveness of the internal control system

27. The ICS must be effective and independent, also paying attention to ensuring that the ICS ensures the fulfilment of the requirements of laws and regulations in a consistent and uniform manner with respect to all customers, *inter alia*, customers directly or indirectly associated with the stockholders of the institution, as well as the senior management of the institution. For example, when resolving upon the issues of the customers whose (ultimate) beneficial owner (hereinafter - the BO) is a person associated with the institution, the decisions taken would have to be the same as the ones that would be taken with respect to the customers not associated with the stockholders or senior management (Executive, Supervisory Board) of the institution.

28. The institution shall ensure independent decision-taking, *inter alia*, the member of the Executive Board in charge of the monitoring of the AML/CTPF, when taking a decision, shall ensure the prevention of conflicts of interest, and shall not take decisions with respect to the issue which involves or might involve the conflicts of interest. The member of the Executive Board (or the representative authorised by the senior management) in charge of the monitoring of the AML/CTPF, when taking part in the work of the Executive Board and resolving upon the issues under the competence of the institution, shall primarily act from the perspective of the AML/CTPF field.

2.2. Three lines of defense

29. The credit institution shall implement the effective management of the MLTPF risk and the sanctions risk via three lines of defense. When establishing the ICS and developing the internal regulatory enactments, the credit institution and the investment firm shall prescribe the distribution of duties, powers, and responsibilities among the lines of defense.

30. The observance of the principle of three lines of defense is also ensured by other institutions if it is consistent with the scale and substance of the economic activity thereof.

31. The first line of defense is comprised of the employees of the institution involved in the creation and selling of the services and products or the customer, service and product operational support. Within the scope of the first line of defense, the structural unit may be created (or separate

employees appointed), which shall perform the functions related to the MLTPF risk and sanctions risk management (for example, transaction monitoring, payment screening).

32. The duty of the first line of defense is to manage the MLTPF risk and the sanctions risk insofar as it is possible as a result of the customer service and product operational support (for example, the institution may prescribe in the policies and procedures that it shall be the duty of the first line of defense to identify certain indications of suspicious transactions that can be detected, when performing customer service on site, additionally setting the duty to report the identified facts to anther structural unit or employee organisationally located in the second line of defense; the institution may set a duty for the customer service specialist, when the customer arrives at the institution in person, to ascertain that the information required for the customer due diligence is updated, etc.). Institutions with a large circle of customers may also define a duty for the first line of defense to carry out the customer due diligence or separate activities necessary for the performance thereof.

33. The second line of defense shall ensure the MLTPF risk and sanctions risk control function, inter alia, the second line of defense shall supervise the first line of defense. In addition, in line with the size and structure of the institution, the second line of defense may also perform the MLTPF risk and the sanctions risk management implementation measures, ensuring, for instance, the transaction screening (for example, the institution shall define separate indications of suspicious transactions, the identification whereof is under the responsibility of the first line of defense, while the second line of defense shall be responsible for performance of a comprehensive transaction screening process, being ensured via special transaction screening system and analysis of the outcomes of supervisory scenarios). The duty of this line of defense is to conduct further enhanced, independent and comprehensive MLTPF risk and sanctions risk identification, measurement, evaluation, analysis and supervision, to regularly report to the management of the institution (both the Executive an the Supervisory Board) the outcomes of the assessment and to conduct the MLTPF risk and sanctions risk administration within the scope of its function.

34. The third line of defense is an internal audit,the duty whereof is to independently supervise the conduct of the first and the second lines of defense in managing the MLTPF risk and the sanctions risk.

35. The institution in the policies and procedures shall prescribe the duties and actions to be performed by the employees, in order to ensure the fulfilment of the requirements of laws and regulations, defining the functions under the responsibility of each of the three lines of defense. The institution must allocate sufficient resources, to enable them to ensure effective fulfilment of the MLTPF risk and sanctions risk management function in accordance with the defined functions.

2.3. Customer risk scoring system

2.3.1. Customer risk scoring system and the purpose thereof

36. The customer risk scoring system is the constituent part of the ICS, the purpose whereof is to assess the inherent customer risk and to take the due diligence measures corresponding thereto. The customer risk scoring system reflects the MLTPF risk of the customer in numerical expression, applying the risk-based approach.

37. Customer risk scoring system shall serve as a tool for introducing the risk-based approach, when determining the customer due diligence measures and the scope thereof, pursuant to the inherent risk of the customer - both when commencing a business relationship (for example, the customer is subject to standard, simplified or enhanced customer due diligence), and during the business relationship (for example, prescribing the frequency of information updates, setting transaction screening measures consistent with the risk, etc.). This means that the customer with a lower MLTPF risk is to be subjected to a smaller amount of, and less enhanced customer due diligence measures; in turn, in cases, when the inherent customer risk is higher, the larger amount of, and more enhanced customer due diligence measures are to be applied.

38. Correct customer risk scoring system is important for the risk score calculated for the customer to be consistent with the customer risk, thus also ensuring appropriate customer due diligence and supervision measures.

Example		
Under seemingly similar circumstance, the risk is determined on a case to case basis:		
Description of the customer and the activities thereof	Customer A - Limited Liability Company (hereinafter - LLC) registered in Latvia, whose BO is the resident of Latvia, type of economic activity is car sales - cars are being bought in the European Union Member States and sold in Latvia, correspondingly, the cash flow is planned to these countries, as well as the cash transactions in the amount of up to EUR 5, 000	Customer B - LLC registered in Latvia, whose BO is a resident of a higher-risk country, type of economic activity is car sales in Latvia - cars are being bought in Latvia and sold in the countries of a high corruption risk region, correspondingly, the cash flow is planned form these countries and the cash transactions in the amount of up to EUR 50, 000
Customer assessment of the customer risk scoring system	Lower than Customer B	Higher than Customer A

Risk increasing factors	Cash transactions	The BO and counterparties (cooperation partners) are a non-European Union and non-Organisation for Economic Cooperation Development Member State, cash transactions
Factors affecting the differences in the score of the customer risk scoring system	Country of residence of the BO, region of the economic operation of the customer, planned cash transactions	

39. The requirements for the establishment of the customer risk scoring system are laid down in the Customer Due Diligence Regulations, prescribing the risk increasing and decreasing factor, *inter alia*, the ones referred to in the EBA Guidelines.

40. The institution shall review the customer risk score whenever the current customer due diligence is carried out (the inherent (initial) customer risk rating is reviewed, by assessing the customer activities, executed transactions and the risk factors inherent thereto, if any emerge).

2.3.2. Core principles of the establishment of the customer risk scoring system

41. Customer Due Diligence Regulations prescribe the key requirements for the establishment of the customer risk scoring system; nevertheless each institution, considering its activities and the risks inherent thereto, may prescribe additional requirements, for example, include additional risk factors, in line with the specificity of its activities and risks inherent to cooperation with the customer[5].

42. Customer risk scoring system shall encompass:

42.1. risks and risk increasing factors prescribed by laws and regulations - the Law and the Customer Due Diligence Regulations;

42.2. risks characteristic (inherent) to the institution itself or the service and products provided by it (for example, customers of the institution are associated with the stockholders), specific risks inherent to the services (for example, ensuring payment acceptance services to the providers of online dating services or foreign online gambling services).

43. The institution may also take into account the risk decreasing factors referred to in the Customer Due Diligence or the Law, if the application thereof is consistent with the activities of the institution. If the institution takes into account the risk decreasing factors, then it shall be necessary to substantiate how and to what extent the relevant customer risk decreasing factor decreases the customer risk. It is not permissible that the sum of risk decreasing factors automatically (mathematically) **fully** decrease the score calculated by the customer risk scoring

[5] The institution shall prescribe such requirements, if there are risks inherent to its activities or risk increasing factors, not included in the Customer Due Diligence Regulations or the Law.

system (namely, the risk decreasing factors may reduce the customer risk, but the situation where the risk of the customer with an increased (higher) risk is reduced **in full** by the risk decreasing factors is not permissible).

44. The Customer Due Diligence Regulations provide for the development of methodology for the establishment of the customer risk scoring system, ensuring that the customer risk scoring system appropriately and effectively, in numerical expression, reflects the overall risk inherent to each customer.

45. The purpose of the methodology of the customer risk scoring system is to perform the evaluation of the activities and the customer base of the institution, in order to:

45.1. assess, which of the risk increasing factors refer to the institution and are applicable, considering the activities and the customer base of the institution.

Customer risk scoring system shall include the risk factors laid down in Annex 1 to the Customer Due Diligence Regulations (hereafter - Annex 1) if they refer to the institution and are applicable. The risk factors laid down in Annex 2 to the Customer Due Diligence Regulations (hereafter - Annex 2) shall not be automatically included in the scoring system. Upon the occurrence of the risk factor laid down in Annex 2, the institution shall conduct customer due diligence to an extent consistent with the relevant factor and, correspondingly, after the due diligence shall resolve upon the necessary changes to be introduced in the risk score (see more details on the due diligence in sub-chapter 3.4.3);

45.2. identify the significance of risk factors and the score to be assigned to each risk factor, and to ensure that it is able to detect the cases indicative of an increased risk, and, correspondingly, to ensure the management thereof.

Example
The institution has prescribed that it is not offering trade financing products Therewith, the methodology may prescribe that the factors related to the provision of trade financing service (risk factors referred to in Clauses 98-107 of Annex 2) shall not be assigned any score, at the same time ensuring that where the range of the offered services is changed, the methodology shall be reviewed and updated.

46. Based on the methodology, the institution shall set up the customer risk scoring system, prescribing the risk factors to be included therein.

2.3.3. Risk factors and assigning the score to risk factors

47. The Customer Due Diligence Regulations prescribe the risk increasing factors, upon the occurrence whereof the institution shall perform the enhanced customer due diligence and in accordance with the requirements of Customer Due Diligence Regulations shall apply:

47.1. all enhanced due diligence measures (upon the occurrence of the risk factors specified in Annex 1);

47.2. one or more enhanced due diligence measures to such an extent as to assess the reason of the occurrence of the respective risk factor and the impact thereof on the MLTPF risk of the customer (upon the occurrence of the risk factors specified in Annex 2).

Enhanced due diligence to be performed in accordance with Annex 1 and 2 is explained in more detail in sub-chapter 3.4.

48. The institution may determine additional risk factors inherent to its activities and customer base[6].

49. The Customer Due Diligence Regulations also entail the risk decreasing factors, in the event of the occurrence whereof the institution shall assess them and may take them into account, by reducing the sum of the risk factor score assigned to the customer (Annex 3 to the Customer Due Diligence Regulations (hereinafter - Annex 3).

50. If the risk factor specified in Annex 1 refers to the institution (is applicable, in line with its activities, provided services, customer base), then the institution shall assign the respective score to the risk factor reflecting the impact of the risk factor on the overall inherent risk of the customer.

Example
The customer, in line with the incorporation documents kept in the customer file, is entitled to issue bearer shares The bearer shares shall be considered to be risk increasing circumstances, because the transfer of the title takes place by transferring the shares. The institution must assign such number of points to the referred to risk increasing factor that would enable identifying and taking it into account, when determining the customer risk.

51. Risk increasing factors specified in Annex 2 are created as indications that may be indicative of an increased risk; nevertheless, the conclusion as to whether they increase the risk in the relevant case may be made, by performing the respective due diligence (Assessing the relevant indication). If the risk factor specified in Annex 2 refers to the institution and in essence increases the customer risk, which is assessed on an individual basis (to assess, whether, for example, the excess of the monthly, three-months' or annual transaction thresholds increases the risk in essence, it is necessary to assess whether the excess of the thresholds is justified. For example, the customer sells medicinal masks and gloves. The volume of sales before the pandemic for instance was three times less before the pandemic started, during which the demand for the product of the customer grew significantly, thus exceeding the previously prescribed thresholds and, therewith, it can be correspondingly explained), the institution shall assign a certain number of points to the risk factor and shall include it in the customer risk scoring system.

[6] The institution shall prescribe such requirements, if there are risks inherent to its activities or risk increasing factors, not included in the Customer Due Diligence Regulations or the Law.

Example

Note to Annex 2
Information or a request regarding the customer or the transactions thereof in connection with money laundering, terrorism financing or criminal offences is received from the correspondent credit institutions or other credit institutions or financial institutions where the institution has an account.

The institution may assign points to this factor automatically or depending on the outcomes of the customer due diligence, setting the term from the date of receipt of the request, during which the relevant indication is being taken into account, when performing the customer risk scoring (for example, to ensure the option to insert in the system the date of request from the correspondent bank and to provide for the setting of the customer risk scoring system so that the system still takes this date into account for a specified period of time). The institution shall determine the duration, for how long should the indication be taken into account, considering the customer risk. Upon the expiry of the prescribed term, the institution shall reassess the customer risk. Where there is a request from a correspondent bank received during this term and, having assessed the customer transactions, it is to be concluded that the transactions are indicative of the increase of the MLTPF risk, the institution shall renew the date and continue to include these factors into the customer risk scoring. If the increase of the MLTPF risk is not detected, the institution shall not take this risk factor into account in the customer risk scoring.

52. Not all the risk factors specified in Annex 2 automatically increase the risk and are to be included in the customer risk scoring system. The fact that the risk factor, in terms of essence, increases the risk may be detected within the scope of the customer due diligence, i.e., after customer due diligence is performed and information is assessed. Respectively, if during customer due diligence, it is detected that the risk factor impacts the customer risk, the institution shall review and update the customer risk after the performance of due diligence.

53. Annex 3 prescribes the risk decreasing factors referring to the customer risk and service and product risk. The institution shall assign points to the risk factors specified in Annex 3 reflecting the impact of the risk factor on the overall inherent risk of the customer. If the institution has prescribed that it takes into account the risk decreasing factors specified in Annex 3, then, upon the occurrence of the risk decreasing factor specified in Annex 3 it may reduce the overall risk of the customer according to the significance (impact) of the factors specified in Annex 3. Points to be assigned may reduce the overall risk of the customer, but they cannot be such that, in terms of points (score), they exceed the score calculated by the system, by summing up the points assigned to the risk increasing factors (for example, if the system may assign the total score of 10 points to the risk factors corresponding to the customer risk, then the total score of risk decreasing factors may not achieve or exceed this score of 10 points), creating the situation that the risk of the customer is too low or the customer has no risk at all, because the score of the risk decreasing factors is being mathematically subtracted from the score of the risk increasing factors.

54. Any of the risk factor scoring algorithms referred to in the Annexes must be formed so as to enable the institution to identify the inherent customer risks and to ensure that the risks are taken into account and their relevance to (impact on) the overall customer risk is determined, and such

customer due diligence measures are taken, which, in terms of scope and detail, are consistent with the risk. The assessment conducted by the institution, conclusions and justification thereof must be duly documented.

2.3.4. Exceptions (idiosyncrasies) in the establishment of the customer risk scoring system

55. If the institution, when developing the customer risk scoring system, detects any circumstances preventing full implementation of the prescribed requirements, in light of the idiosyncrasies of the setup of the IT system in the institution, or it cannot ensure the system automation to a full extent (if the institution according to the requirements of laws and regulations has a duty to ensure the automation of the customer risk scoring system), it is necessary to address the Commission, in order to assess the relevant situation and solutions. Differences in the customer risk scoring system, *inter alia*, the level of automation thereof, must be coordinated with the Commission. When addressing the Commission, it is necessary for the institution to specify the reasons underlying the impossibility of full implementation of certain requirements, so as to enable the Commission to assess the substantiation thereof. In addition, it is necessary for the institution to prepare its proposals with respect to a possible solution. Information must be prepared to an extent sufficient for comprehensive assessment of the situation.

2.4. Governance

2.4.1. Employees in charge of the AML/CTPF

56. In accordance with the Law the institution shall appoint one or several employees (persons in charge of the fulfilment of the requirements of the AML/CTPF Law), incl., from the senior management[7], entitled to take decisions and directly in charge of the observance of the requirements of the Law.

57. Credit institutions, licensed payment institutions and licensed electronic money institutions, as well as investment firms shall appoint the employee in charge of the fulfilment of the AML/CTPF requirements both in the senior management, ensuring the monitoring of the fulfilment of the AML/CTPF requirements, and in the internal control structural unit, performing practical fulfilment of the referred to requirements. It is recommended that this requirement is also observed by other institutions not mentioned herein above, if they have an increased inherent MLTPF risk, in order to ensure appropriate governance.

2.4.2. Qualification and conformity assessment of the responsible employees

58. The institution, in the MLTPF risk management document, shall prescribe the criteria for the adequacy of resources and the requirements for the adequacy of competence and qualification of the responsible officials.

[7] Senior management is the Executive Board (board of directors) of the institution, if any is established, or a member of the Executive Board, official or employee specially appointed by the Executive Board, who has sufficient knowledge of the exposure of the institution to the MLTPF risks and holding a position of sufficiently high level to take decisions concerning exposure of the institution to the abovementioned risks.

59. The institution, in line with the size thereof, profile of activities and risk inherent to its activities, may set higher professional suitability criteria for the person in charge of the fulfilment of the AML/CTPF requirements, for example, the existence of international professional certificates in the AML/CTPF field or equivalent certificates.

60. To achieve the purpose of the law, protect the reputation of the institution, prevent the involvement of the institution into illegal activities, identify and prevent other risks significant for the institution, safeguard the secret of the customer transaction and occasional transaction, a person (who may be the employee of the institution or an attracted third party) or a structural unit specially appointed by the institution shall ensure an appropriate procedure for assessing the suitability of a person for the position of the member of senior management or the employee in charge of the observance of the requirements of the Law, *inter alia*, shall verify the authenticity of information provided by a person concerned (for example, self-assessment questionnaire).

61. In accordance with the requirements of the Commission's Normative Regulation No. 186 of 27 November 2019 "Regulations on the Assessment of the Suitability of the Executive and Supervisory Board Members and Key Function Holders" (hereinafter – Regulation No. 186) a person in charge of the fulfilment of the AML/CTPF requirements shall be considered to be a key function holder, and credit institutions and investment firms registered in Latvia must conduct the assessment of both the members of the Executive Board performing the AML/CTPF monitoring and the persons in charge of the fulfilment of the AML/CTPF requirements in accordance with Normative Regulation No. 186, in line with the prescribed frequency of the assessment and the requirements for suitability of the officials. In accordance with Regulation No. 186 the employee responsible for sanctions risk management is not included in the list of key function holders; nevertheless the enumeration provided in Clause 2.2 of Regulation No. 186 is not exhaustive. Therewith, the institution shall be entitled, having assessed the size, scale and complexity of the institution, to prescribe that the person in charge of the sanctions risk management is also to be included on the list of key function holders[8].

62. For the credit institutions, payment institutions and electronic money institutions it is necessary to inform the Commission about both the member of the Executive Board monitoring the AML/CTPF field and the person in charge of the fulfilment of the AML/CTPF requirements, by submitting the relevant documents, *inter alia*, assessments of the officials, before the candidate for the position starts fulfilling his/her official duties or is being re-elected to the same position.

63. The Law prescribes that the institution, within a period of 30 days after obtaining the status of the subject of the Law or the changes in the composition of the employees in charge of the observance of the requirements of the Law, shall inform the Commission to this effect. Credit institutions with an increased risk inherent to their activities are invited to provide information to

[8] The institution may additionally refer to the Joint Guidelines of the European Banking Authority and the European Securities and Markets Authority "Guidelines on the assessment of the suitability of members of the management body and key function holder" (EBA/GL/2017/12), available at: https://eba.europa.eu/sites/default/documents/files/documents/10180/1972984/43592777-a543-4a42-8d39-530dd4401832/Joint%20ESMA%20and%20EBA%20Guidelines%20on%20the%20assessment%20of%20suitability%20of%20members%20of%20the%20management%20body%20and%20key%20function%20holders%20%28EBA-GL-2017-12%29.pdf?retry=1

the Commission before the introduction of changes in the composition of the employees in charge of the fulfilment of the AML/CTPF requirements to enable the Commission, in line with the risk assessment-based approach in the performance of supervision, to ascertain the prudent and well-reasoned activity of the institution (thereby it is possible to timely discuss the suitability of a person concerned and his/her vision of the issues under his/her responsibility). Credit institutions with an increased risk inherent to their activities are also invited to immediately notify the Commission of the planned termination of employment relationship with a person in charge of the observance of the requirements of the Law.

64. Considering that the Law prescribes a duty of the institution to develop a procedure specifying the distribution of powers and responsibilities of the employee (incl., from the senior management) in charge of the observance of the requirements of the Law in the field of the AML/CTPF, and the procedure for ensuring the supervision of activities of the employee (incl., from the senior management) in charge of the observance of the requirements of the Law, it is important to prescribe the subordination of the relevant responsible employees and to ensure the independence of the responsible employees in taking decisions, as well as to prescribe the reporting duty and the reporting line in detail. Determination of detailed subordination, operational supervision and reporting duty is especially important for the group companies, *inter alia*, credit institutions, where such functions are determined at the level of the entire group.

2.4.3. Separation of the risk control and compliance control functions

65. Commission's Normative Regulations of 1 November 2012 "Normative Regulations on Establishment of the Internal Control System" (hereinafter – Regulation No. 233), setting requirements for the credit institutions and investment firms for the establishment of the internal control system[9], prescribe the separation of the risk control function and the compliance control function, not only within the organisational structure of the credit institution, but also specifically at the level of the Executive Board. In accordance with Clause 12.[5] of Regulation No. 233 the institution shall ensure the independence of persons performing internal control functions from the business functions, *inter alia*, it is ensured that the chairperson of the executive board is not concurrently in charge of the performance or monitoring of the duties of a person in charge of the fulfilment of the risk control function, compliance control function and the AML/CTPF requirements.

66. It shall not be permissible to combine under a single position, the functions of the head of the risk control function (risk director) and the functions of the head of the compliance control function. Derogations shall be permissible for the credit institutions less significant, in terms of the size or nature of the activities thereof, or only for such credit institutions which have not been identified as other systemically important institutions (hereinafter - O-SIIs), and only in the case if, by combining both of the referred to internal control functions, the credit institutions implement the requirements of Chapter IX of Regulation No. 233 to an extent ensuring the prevention of an existing or potential conflict of interest situations in accordance with Clause 64 of Regulation No. 233. A credit institution not identified as O-SII must, in any case, assess the application of

[9] It is recommended that the requirements of these Regulations would be, as far as possible, also considered by other institutions, with the increased MLTPF risk inherent in their activities.

derogation under the requirements of Clause 64 of Regulation No. 233, taking into account the size and nature of activities of the institution, *inter alia*, the level of business risks.

67. When assessing possible versions of combining the positions, when one and the same person holds several significant positions in the credit institution, in addition to one of the positions of the head of internal control function, ensuring the observance of the requirements of Clause 62.1 and 62.2 of Regulation No. 233, it shall not be permissible that the relevant person not only fulfils the duties related to the controlled field of activity, but also, concurrently, fulfils the following functions:

67.1. chairperson of the Executive Board;

67.2. member of the Executive Board monitoring the AML/CTPF field and appointed in the credit institution, by way of ensuring the fulfilment of the requirements laid down in Section 10, Paragraph 2 of the Law;

67.3. employee in charge of the AML/CTPF, appointed, by way of ensuring the fulfilment of the requirements laid down in Section 10, Paragraph 1 of the Law.

68. Derogations from that which is specified in Clause 67 shall only be permissible when the head of the compliance control function concurrently performs the functions of the position of the member of the Executive Board monitoring the AML/CTPF, if the holder of the position in addition to the field of the compliance control function and the AML/CTPF field is not in charge of the fulfilment of other significant duties in the credit institution.

69. Taking into account the essential role of the Chairperson of the Executive Board in taking business decisions, when implementing the requirements of Clause 62.1 of Regulation No. 233, the risk director, the person in charge of the compliance function and the Board Member in charge of the AML/CTPF may not concurrently perform the functions of the Chairperson of the Executive Board. In addition, by way of ensuring the requirements of Clause 62.2 of Regulation No. 233, the risk director, the person in charge of the compliance function and the Board Member in charge of the AML/CTPF cannot be directly functionally subordinated to the Chairperson of the Executive Board.

70. In accordance with Section 221, Paragraph 1 of the Commercial Law, an executive board (a board of directors) is the executive institution of the company, which manages and represents the company. Therewith, even though the Board Member in charge of the AML/CTPF monitors the field of the AML/CTPF in the institution, the Executive Board is generally responsible for the activities of the institution, incl., for the observance of the AML/CTPF requirements and appropriate MLTPF risk management.

71. In accordance with the requirements of the Commission's Normative Regulation No. 13 of 21 January 2019 "Regulations on Sanctions Risk Management" the institution, when establishing the ICS for sanctions risk management, must determine the procedure for the appointment of the employee responsible for sanctions risk management, including his/her mandate in the implementation of sanction risk prevention and mitigation measures. Depending on the size of the institution, operational profile and risk volume thereof, the institution may resolve upon joining the official duties of the employee responsible for the AML/CTPF and the employee responsible for sanctions risk management, prescribing the duties and responsibilities in each of

these fields. Nevertheless, the application of such an approach would not be advisable for a credit institution, namely, in the opinion of the Commission, based on the size of the credit institutions and the risks inherent thereto, it would be advisable that the employee responsible for the AML/CTPF and the employee responsible for sanctions risk management is not one and the same person. Credit institutions are advised to appoint a separate responsible employee in each field, prescribing the duties, responsibility and subordination and ensuring the possibility for the responsible employees, if necessary, to report directly to the senior management of the credit institution. Correspondingly, different professional suitability criteria may also be set for the responsible employees of each field.

2.4.4. Committees for taking decisions on the increased risk customers

72. For the purposes of mitigation of the MLTPF risks and taking decisions, the institution may establish various committees, which shall take decisions on the commencement of the business relationship with the increased risk customers, termination of the business relationship, performance of separate transactions, etc. When organising decision-taking in such committees, it would be necessary to level out the composition of the AML/CTPF specialists and the members representing other fields, in order to ensure well-considered and appropriate decisions. Considering that such committees review the issues related to the AML/CTPF, it is necessary for the institution to create such a decision-taking system, which ensures that the arguments of the specialists representing the AML/CTPF field are heard and assessed and the taking of a decision cannot take place without due assessment and justification, by adopting the decision merely by voting. The institution may prescribe various voting methods; however it would not be permissible for the adoption of the decision to take place, without assessing the considerations expressed by the members of the committee representing the AML/CTPF field, irrespective of the number of votes. It is essential that the decisions taken at the meetings of such committees are documented, thus enabling the fully-fledged fulfilment of the adopted decisions and the due follow-up of the fulfilment thereof.

73. Decisions taken by the committees adopting the decisions on the commencement of the business relationship with increased risk customers shall not be automatically considered as equivalent to the decisions taken by the senior management, for example, with respect to the commencement of the business relationship with PEPs, where according to the requirements of the Law it is necessary to receive the consent of the senior management. Whether or not the decision of such committees on, for example, continuation of the business relationship with a PEP, can be equated to the consent of the senior management, depends on the composition of the committee, assessing whether the employees of the AML/CTPF field are represented therein, which position is held by them (with respect to the senior management, essential criteria is that the person has sufficient knowledge about the exposure of the institution to the MLTPF risks and the position of a sufficiently high level, in order to take decisions referring to the exposure of the institution to such risks), the procedure of voting and who has the casting vote in taking the decision.

2.5. Training

74. It is necessary to provide internal and external training in the field of AML/CTPF and sanctions for the employees of the institution, *inter alia*, **employees** of the branches of the

institution **or representatives performing the functions related to the AML/CTPF and sanctions risk management**.

75. The institution shall prescribe the categories of employees, whom the training in the field of the AML/CTPF and sanctions shall be provided to. When ensuring the training in the field of the AML/CTPF and sanctions for the relevant employee categories, it is necessary to take into account the knowledge and qualification required for the official duties, responsibility and level of authorisation of the employees (for example, the employee performing enhanced customer due diligence should have the qualification suitable for such a duty, the employee performing customer service should have the appropriate knowledge and qualification in the field of the AML/CTPF and sanctions insofar as necessary to be able to adequately conduct customer due diligence in accordance with the procedures (to notice the indications of suspicious transactions, ask additional questions, etc.). As the scope of issues topical for the training may differ, the institution may expand the scope of issues to be included in the training plan, considering the MLTPF risk inherent to the economic activity of the institution.

76. For separate employee categories it is necessary to ensure not only internal, but also external training. Commission's Normative Regulation No. 214 of 20 December 2016 " Regulations regarding the Provision of Staff Resources and Staff Training for Money Laundering and Terrorist Financing Risk Management", setting the requirements for the provision of staff resources and staff training for the MLTPF risk management, prescribe that the credit institution shall ensure that regular external training, at least once a year, with the involvement of foreign experts is provided to the Member of the Executive Board responsible for the AML/CTPF, the person responsible for the fulfilment of the MLTPF requirements and staff of the internal audit structural unit whose official duties include the performance of the audit in the AML/CTPF field, promoting the understanding of the issues of the AML/CTPF field and the current trends in the application of the international AML/CTPF compliance standards. Even though the requirements of these Regulations are binding on the credit institution and their branches, the observance of the core principles is advisable for al institutions, for the purposes of ensuring that the institution conducts the measures necessary for the provision of staff resources and staff qualifications, as well as the training and replacement thereof according to the MLTPF risk inherent in the economic activity thereof, in order to manage the MLTPF and sanctions risk.

77. When planning the training, the institution should be guided by the risk assessment and must assess what kind of external training is necessary for the employees, inter alia, the Member of the Executive Board responsible for the AML/CTP, the employee responsible for sanctions risk management, the employee responsible for the AML/CTPF, the employee of the internal audit structural unit, in order to ensure that the training is meaningful, feasible for the relevant employees and provides for new knowledge.

78. When planning the staff qualification requirements, the institution, based on the risk inherent thereto, may set qualification requirements, for example, for the employee responsible for the AML/CTPF and the employee responsible for sanctions risk management to obtain international certificates in the relevant field, and to define the presence of such certificates as desirable for the Member of the Executive Board monitoring the AML/CTPF field.

2.6. Internal audit

79. Internal audit service shall form a part of the entire ICS and it is necessary to also include in the inspection plan thereof, the issues related to the observance of the requirements of the Law in the institution. If the referred to structural unit, within the scope of its inspections, detects that the institution does not pay sufficient attention to the observance of the requirements of laws and regulations in the AML/CTPF field, it should immediately report it to the management of the institution, because exactly the interest of the senior management in the effective observance of the requirements is essential, in order to reduce the possibility that the institution can be involved in money laundering.

80. Considering the fact that in Regulation No. 233 the MLTPF and sanctions risk as the constituent part of the operational risk is defined as one of the material risks of the institution, the internal audit structural unit of the institution must regularly verify and assess the compliance of the operation of the institution with its MLTPF risk and sanctions risk management strategy and the policies and procedures for the implementation thereof, and must report the outcomes of inspections to the Supervisory Board.

81. Irrespective of the fact that an independent audit of the institution has been performed, the internal audit must also regularly perform the assessment of the effectiveness of the ICS. The purpose of internal audit is not to repeat the external audit, but rather to ensure more enhanced evaluation in the identified risk areas, as well as to ensure the follow-up of the fulfilment of the developed plan of measures.

2.7. Independent audit

This sub-chapter refers to credit institutions, licensed payment and electronic money institutions and branches of the Member State and third-country credit institutions and licensed payment and electronic money institutions in the Republic of Latvia, in line with the Commission's Normative Regulation No. 125 of 8 August 2019 "Normative Regulations on the Performance of Independent Assessment of the Internal Control System for Anti-Money Laundering and Countering Terrorism and Proliferation Financing", laying down the requirements for performance of the independent assessment of the AML/CTPF ICS. It is recommended that the aspects described in this sub-chapter would be, as far as possible, also considered by other institutions, with the increased MLTPF risk inherent in their activities.

82. When performing an independent conformity assessment of the operation of the ICS of the institution, in order to form a comprehensive opinion on the conformity of the ICS, it would be necessary to apply a holistic approach - to assess both the requirements of policies and procedures (whether or not they encompass all the necessary MLTPF risk management requirements, for example, customer due diligence, incl., identification requirements, duty to report to the responsible authorities, and whether or not they conform to the risk assessment of the institution and its customers), and the effective practical implementation of policies and procedures, *inter alia*, to perform sample testing of customer files, for example, preferring to select customers causing increased risk for the credit institutions and licensed payment and electronic money institutions for

the sample. The number of customer files to be verified would have to be determined in proportion to and commensurate with the total number of customers of the institution (i.e., the number of customer files to be verified would have to be determined to such an extent that enables one to make justified conclusions regarding the operation of the ICS of the institution). Merely sample testing of customer files may not be sufficient to make comprehensive conclusions as to the conformity of operation of the ICS of the institution.

83. When forming the opinion on the conformity of the ICS, it would be necessary to provide for an evaluation of the relevance of the detected deficiencies and flaws, as well as the provided recommendations, assessing their impact on risk management.

84. In accordance with the normative regulations of the Commission setting requirements for the sanctions risk management, credit institutions, licensed payment and electronic money institutions, as well as their branches in the Member States and third countries shall, at least once every 18 months,[10] ensure an independent assessment of the effectiveness of operation of the ICS for sanctions risk management, by attracting a professional external assessor. One professional external assessor may be attracted for the performance of the assessment of conformity of the AML/CTPF ICS and the effectiveness of operation of the ICS for sanctions risk management, ensuring a separate report on each of the ICS assessments[11].

85. The independent assessor may only commence the audit after the receipt of the approval of the Commission. In turn, the reference point of the audit period is considered the last date when the report on audit results is submitted to the institution.

86. It would be necessary for the institution, following the external assessment of the effectiveness of operation of the ICS of the sanctions risk management, within a reasonable period of time, not exceeding three months from the date when the final audit report has been submitted to the institution, to develop a plan of measures for the prevention of the identified deficiencies and shortcomings and a plan for the introduction of recommendations, to be approved by the Executive Board of the institution. Within one month from the approval of the plan by the Executive Board, the institution shall submit the plan to, and coordinate it with the Commission. The institution shall inform the Commission about the fulfilment of the plan at least once per quarter.

3. Customer Due Diligence

3.1. General issues of customer due diligence

87. Customer due diligence is the risk-assessment based set of measures, within the scope whereof the customer is being identified and measures are taken for the purposes of clarifying the BO of

[10] If the Commission has conducted the inspection of the institution during this period of time, the institution may address the Commission with a request to change the specified period of 18 months or the scope of independent inspection.

[11] The conformity assessment of the AML/CTPF ICS may be performed in parts (for example, to separately assess the effectiveness thereof and to separately assess the IT provision thereof). If the assessment is performed in parts, the outcomes may be included in a separate report, but if the assessment is performed regarding all the elements of the AML/CTPF ICS, the outcome shall be included in a single report.

the customer and the purpose and essence of the business relationship, as well as the transaction screening and updating of information obtained during the customer due diligence, and source data of customer due diligence is performed according to the risk, however at least once every five years.
Institutions shall ensure permanent transaction monitoring corresponding to their activities, which does not replace customer due diligence (for example, transaction monitoring does not demonstrate the change in the ownership structure, the change of the BO, etc.), but forms one of the essential measures of customer due diligence, ensuring the timely detection of potentially suspicious transactions or transactions not typical for the customer. In cases where the customer has a low MLTPF risk (standard customer due diligence is conducted) and the turnover thereof consists of everyday household transactions, for example, only work salary or pension, and/or the volume of transaction is limited (for example, low maximum possible limit of turnover is defined for the customer) and the institution understands the expenses, and where no conditions for enhanced due diligence occur with respect to the customer, no risk increasing factors are being detected, affecting the customer risk profile, no indications of potentially suspicious transactions or activity untypical for the customer are detected within the scope of transaction monitoring, ensuring, at least once every five years, the updating of the key information necessary for customer due diligence, applied in the MLTPF risk scoring of the customer, it might not be necessary to take any additional due diligence measures, during which the customer needs to fill out the customer due diligence questionnaire, observing the risk-based approach.

88. The purpose of customer due diligence is to clarify and know the activities of the customer with respect to the services provided by the institution, for the institution not to be involved in the MLTPF. Within the scope of customer due diligence, the institution shall determine the customer risk and shall assess transactions performed by the customer through the services of the institution, for example, the customer, who has just started business relationship with the institution, transfers a significant sum into the account of the customer (the significance of the sum is determined by the institution, taking into account the outcomes of customer due diligence). In such case, based on the risk assessment, the institution shall obtain information confirming the origin (source) of funds (if information about the transaction has not been already obtained during the initial due diligence).

89. According to Section 29, Paragraph 1 of the Law the institution has the right to recognise and accept the results of customer due diligence with respect to identification of the customer, the BO of the customer and the purpose and intended nature of the business relationship and occasional transaction, that the credit institutions and financial institutions have conducted in Member States and third countries, if the conditions prescribed by Section 29, Paragraph 1 of the Law have been complied with. Thus, the institution does not automatically accept that another credit institution or financial institution has performed the above mentioned customer due diligence measures, but rather ascertains as to the conformity of the performed due diligence and obtains the results of customer due diligence performed by it. Namely, if the institution exercises these rights, then it shall ensure that the credit institution or financial institution, whose customer identification and due diligence is recognised by the credit institution, transfers the relevant data immediately. Recognition of the results of the customer identification and customer due diligence may be used as a source of information for customer identification and due diligence, if the institution agrees on the transfer of information (the form of the agreement is determined by the parties thereto). The institution shall also be responsible for the fulfilment of the requirements of the Law in the case

when it exercises the rights provided for by the Law to recognise and accept the results of customer due diligence.

90. The types of customer due diligence are as follows: standard, simplified and enhanced customer due diligence. Standard due diligence differs from enhanced customer due diligence so that in the case of standard due diligence no risk increasing circumstances are present and it is not necessary to verify information at all or it is necessary to verify it to a minimum extent, as well as the level of detail of information to be obtained and necessary for customer due diligence.

Example

Situation No. 1
The customer - natural person has specified in the questionnaire that he/she is a paid employee in the local government of the Republic of Latvia, with the average monthly income comprising EUR 1, 000. The customer is willing to open an account with the institution, in order to receive the work salary and to receive mortgage loan. No risk increasing factors have been detected.

Conduct of the institution: when assessing information provided by such customer about the occupation of the customer and the need for the account, considering the absence of risk increasing factors, the institution may apply standard due diligence, during which it is sufficient to resolve upon the commencement of a business relationship, based on information provided by the customer, without verifying it (for example, it is not necessary to obtain additional information that the customer actually works in the local government).

Situation No. 2
The customer - legal person registered in a high-risk country, specifies in the questionnaire that it is willing to open the current account with the institution for the performance of investments. The economic activity thereof is the performance of investments and the key cooperation partners are enterprises registered in other higher risk jurisdictions.

Risk increasing factors - country of registration of the customer, country of registration of the partners of the customer, economic activity is not related to the Republic of Latvia.

Conduct of the institution: in such case it would be necessary for the institution to verify information provided by the customer, for example, by clarifying more detailed information regarding the planned investments, and to additionally ascertain the origin of funds.

91. In cases of standard due diligence, the degree of detail of information to be obtained is lower, as compared to information to be obtained during enhanced due diligence. For example, when obtaining information on the customer's economic or personal activity, in cases of standard due diligence it is sufficient to clarify the customer's field of activity, region (for legal persons) or customer's occupation, employer, profession (for natural persons). When obtaining information about the key business partners, it is sufficient to clarify the payees and the payers, as well as the

nature of the transactions to be performed (for example, for covering utility payments), if it is not possible to specify particular cooperation partners.

3.1.1. Scope and type of information necessary for customer due diligence

3.1.1.1. Scope

92. The customer due diligence measures shall be applicable, based on the risk assessment, and the institution in the policies and procedures shall set the types and the scope of the customer due diligence measures it applies to the customers of the relevant risk. Therewith, information to be obtained about the customer with a lower inherent risk will be of a smaller scope to the one to be obtained about the customer with a higher risk. For example, with respect to the customers, whose economic activity is not related to the Republic of Latvia or who operate in the transport sector and the economic activity thereof entails the countries of high risk, or with respect to customers having a multi-tier ownership structure, which may initially indicative of a higher risk, it will be necessary to obtain more information than about a customer, who is, for example, a manufacturing company of the Republic of Latvia.

93. For the purposes of the performance of customer due diligence, the institution shall obtain information or documents, which substantially helps to understand the economic activity and the specificity of transactions of the customer. The institution shall ensure that it is able to justify how the obtained information or documents explains the information necessary for customer due diligence.

3.1.1.2. Manner

94. Similar to the scope of information, the manner in which the institution obtains information necessary for customer due diligence may differ, as well. Based on the risk assessment, it may be a customer questionnaire, encompassing various questions for the purposes of obtaining information, which is justified and sufficient for the determination of the customer risk, as well as information from public and reliable sources, for example, commercial databases[12]. It is not necessary to request information from the customer in all cases. The use of the publicly available, reliable and independent source must be prescribed in the policies and procedures of the institution, specifying in more detail which sources the institution considers to be reliable. When determining whether or not the source is reliable and independent, aspects such as resources from which the source obtains information, frequency of information updates, person maintaining (operating) information source, etc. may be assessed. For example, information about the enterprises registered in the Republic of Latvia, *inter alia*, during the identification process, may be obtained from the Enterprise Register, incl., commercial databases maintaining the information of the Enterprise Register; in turn, information about foreign residents may be obtained from the enterprise register database of the relevant country, for example:

[12] The use of commercial databases constitutes a significant tool for obtaining and verifying the customer due diligence information.

European Union Member State, Iceland, Liechtenstein, Norway	https://e-justice.europa.eu/content_find_a_company-489-en.do?clang=en
The UK	https://beta.companieshouse.gov.uk/
Ireland	http://www.cro.ie/ena/online-services-company-search.aspx
Cyprus	https://efiling.drcor.mcit.gov.cy/DrcorPublic/SearchForm.aspx?sc=0
Luxembourg	https://www.rcsl.lu/mjrcs/displayConsult Documents.do?removeList=true&isFromIndex=true&time=1231934766691
Switzerland	http://www.zefix.ch/zfx-cgi/hrform.cgi/hraPage?alle_eintr=on&pers_sort=original&pers_num=0&language=4&col_width=366&amt=007);
The Czech Republic	https://or.justice.cz/ias/ui/rejstrik
The Russian Federation	https://egrul.nalog.ru/#
Ukraine	https://usr.minjust.gov.ua/ua/freesearch
Estonia	https://www.inforegister.ee
Lithuania	https://rekvizitai.vz.lt/en/

95. The institution, when requesting and obtaining any supporting information or documents from the customer during the customer due diligence, shall ascertain that this information or documents are related to the particular purposes of the customer due diligence (for example, justify the particular transaction, provide insight as to the education and experience of the customer, justify the origin of funds, etc.). The scope of information and documents obtained during customer due diligence must be justified and commensurate to the inherent risk of the customer or the transactions performed by them. The institution shall also document how the information and documents obtained by the institution justify the information necessary for customer due diligence (for example, the circumstances that the origin of funds has been clarified or that the determined BO is the BO of the customer).

Example

The customer-legal person has received the loan from the legal person's BO, concurrently also being the representative of the customer. The economic activity of the customer is clear to the institution and up to now there were no risk increasing factors detected with respect to the transaction. The institution is willing to clarify the essence of the transaction and the origin of funds; therefore it requests an explanation from the customer about the essence of the transaction and the statement of account of the natural person (the representative and the BO of the customer), from which the loan was received, for the period of the last year.

When detecting a transaction untypical for the customer, the institution shall, first of all, assess all the available information - the volume of the performed transaction and what volumes are

characteristic for the sector where the customer operates, the allocation of funds, the amount of wealth of the BO, the duration of the entrepreneurial activity of the customer, etc.

By assessing the available information, the institution shall determine what kind of information is to be requested as the document supporting the origin of funds.

For example, when requesting the statement of account, it would be necessary to determine a reasonable period for which the statement of account is to be provided for, and to assess whether there are any other possible documents or information sources, justifying the origin of funds, for example, explanation of the customer regarding the occupation of the representative and the BO, which can be ascertained through publicly available sources, for example, in the explanation it is specified that the BO of the customer owns the enterprise, whereon there is a publicly available information enabling one to ascertain the activities of the enterprise and the scope thereof.

96. From the information and documents obtained during customer due diligence it must be possible to obtain confidence that the institution knows the risks of the customer and takes appropriate measures for managing these risks. It is essential that information about the customer is collected and monitored purposefully in accordance with the risks, and not by merely gathering all possible information about the customer. It shall be necessary for the institution to document the justification that the information and documents at the disposal thereof justify the economic and legal purpose of the activities of the customer.

97. In assessing the customers operating in various sectors, institutions may also take into account the *Guidelines for the Subjects of the Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing Monitored by the State Revenue Service* prepared by the State Revenue Service, Chapter 7 whereof provides for a detailed explanation on the possibilities and typologies of money laundering in various sectors of operation. The Guidelines of the State Revenue Service are available at – https://www.vid.gov.lv/lv/vadlinijas.

3.1.2. High-risk third country and higher risk jurisdiction

98. With respect to the countries, laws and regulations apply both the term "high-risk third country" and the term "higher risk jurisdiction"[13]. In accordance with Section 1, Clause 12.[1] of the Law high-risk third countries are countries or territories where in the opinion of an international organisation or an organisation setting the standards in the field of AML/CTPF, there is no efficient system for the AML/CTPF in place, including countries or territories which have been determined by the European Commission as having strategic deficiencies in the regimes for the AML/CTPF, posing significant threats to the financial system of the European Union. From this definition it derives that not only the list of the high-risk third countries defined by the European Commission must be observed, but also other lists of international organisations setting the standards in the field of the AML/CTPF or the countries having no efficient AML/CTPF system, for example FATF high risk and other monitored jurisdictions (the list is available here: http://www.fatf-gafi.org/countries/#high-risk). In turn, the jurisdictions specified in Clause 2 b) - f), Paragraph 3, Section 11.[1] of the Law would have to be regarded as higher risk jurisdictions.

[13] Clause 2 a), Paragraph 3, Section 11.[1] of the Law.

99. In the Customer Due Diligence Regulations, the term "high risk third country" is used in Clause 15 of Annex No. 1. In turn, the term "higher risk jurisdiction" is used in Clause 27 and Clause 89 of Annex No. 2

3.1.3. Determination of relation to a high-risk third country and a higher risk jurisdiction

100. When determining whether the customer (both natural and legal person) is related to a high-risk third country or a higher risk jurisdiction, the institution shall take into account and assess the criteria referred to in Clause 22 of the EBA Guidelines:

100.1. jurisdiction in which the customer, the BO of the customer or the key cooperation partners of the customer are located;

100.2. jurisdiction in which the main economic activity of the customer, the BO of the customer or business activity of the key cooperation partners of the customer is carried out;

100.3. jurisdiction in which the customer, the BO of the customer or the key cooperation partners of the customer have essential personal or business activity links.

101. **When determining the relation of a natural person** to a high-risk third country or a higher risk jurisdiction, the institution shall assess at least the following elements - country of issuance of the personal identification document, country of residence of a person (if such information is available), residential address thereof.

Countries of the referred to elements may differ, for example, the country of issuance of a personal identification document and the country of domicile is the European Union Member State, but the country of residence is a higher risk country. In such cases the institution needs to assess risks, in terms of their essence, namely, to assess information obtained during the customer due diligence - whether it is indicative of the fact that the customer risk is affected (increased) by the country not regarded as the country of residence of the customer (i.e., the country where taxes are paid), and this relation to that country increases the overall risk of the customer.

Where the relation of any of the elements to a high risk third country or a higher risk jurisdiction is detected, it is necessary to assess whether such link is to be regarded as indicative that the customer is related to a high risk third country or a higher risk jurisdiction, and correspondingly indicative of the higher risk of the customer.

Example

Situation No. 1

Natural person, whose:

1) country of issuance of the personal identification document - European Union Member State;

2) nationality – European Union [14] Member State;

3) country of residence (i.e., country of tax payments) - European Union Member State;

4) based on publicly available information, a person has close personal links with the political elite of the country where high corruption risk is present (widely available information in public sources about the long-term friendship of a person with the head of the state that has facilitated the commencement and carrying out of the economic activity of a person in the country where a high corruption risk is present).

Assessment:

Even though the relevant natural person has a personal identification document issued by the European Union Member and his/her domicile is in the European Union Member State, when determining whether or not the customer is related to a higher risk jurisdiction, it is necessary for the institution to also assess and take into account the available information about the private links of a person with the country where high corruption risk is present, which can still create a higher MLTPF risk in transactions with the relevant person, incl., with respect to the origin of funds used for the performance of the transaction.

If the relation to the higher risk country is detected, the institution, provided that the particular actual circumstances correspond to the conditions of indications referred to in the Annexes to the Customer Due Diligence Regulations (for example, association with the higher risk and the turnover of the customer), shall conduct enhanced customer due diligence.

Situation No. 2

Natural person, whose:

1) country of issuance of the personal identification document - country where high corruption risk is present;

2) country of residence (i.e., country of tax payments) - European Union Member State;

3) country of actual domicile - European Union Member State.

Within the scope of enhanced due diligence, the institution concludes that the transactions of the customer are clear, no risk increasing factors were detected, no circumstances were detected that would be indicative of such links of the customer with the country where high corruption risk is present that would affect the customer risk.

Assessment:

Even though the relevant person has a personal identification document issued by the country where high corruption risk is present, taking into account information obtained during enhanced customer due diligence and assessing whether or not the customer is related to a higher risk jurisdiction, there are no grounds to consider that the customer is

[14] Example contains the European Union Member, but the same principle would also be applicable to the European Economic Area Member State or the OECD Member State.

related to a higher risk jurisdiction that might pose an increased MLTPF risk for the transactions with the relevant person.

3.1.4. Determination of relation to the Republic of Latvia

The Regulations contain several risk factors[15], referring to the cases when the customer, its activities, are not related to the Republic of Latvia. This Chapter explains how to determine the relation to the Republic of Latvia.

3.1.4.1. Determination of relation for the customer-natural person

102. In determining, whether or not the customer - natural person is related to the Republic of Latvia, the institution may apply criteria specified in the law On Taxes and Duties - the declared place of residence of the customer is in the Republic of Latvia, the customer is a Latvian citizen who is employed in a foreign country by the government of the Republic of Latvia, or the customer stays in the Republic of Latvia for 183 days or longer during any 12 month period.

103. The customer having a residence permit issued by the Office for Citizenship and Migration Affairs (for example, residence permit not exceeding six months), shall not be automatically considered as a resident of the Republic of Latvia. The customer may be considered to be a resident of the Republic of Latvia, if he/she has a residence permit issued in the Republic of Latvia and he/she has status in the Republic of Latvia (for example, resides, is employed in the Republic of Latvia, pays taxes to the State). When assessing whether the customer stays in the Republic of Latvia, the institution may take the following considerations into account:

103.1. whether a temporary residence permit or a permanent residence permit is issued to the customer;

103.2. whether the customer has a residential tenancy agreement and whether utility payments are paid for the relevant residence;

103.3. whether the customer owns real estate and whether utility payments are paid for it;

103.4. whether there is a statement from the employer of the customer registered in the Republic of Latvia, confirming that the customer is the employee of the relevant employer, whether there has been an employment contract concluded during the last three months between the customer and the employer registered in the Republic of Latvia;

103.5. whether there is a statement from the State Revenue Service regarding the tax payment performed by the employer of the customer;

103.6. whether there is a statement from the State Revenue Service regarding registration with the register of taxpayers and the actual status of tax payments;

103.7. whether there is a statement confirming that the customer studies in the educational institution of the Republic of Latvia;

103.8. whether there is a contract concluded with the educational institution of the Republic of Latvia, where the customer studies;

[15] Clause 5 of Annex No. 1, Clauses 53-55 of Annex No. 2.

103.9. whether the customer has a declared residential address in the Republic of Latvia and it is confirmed by successful verification in the portal *Latvija.lv* (verification of whether the person is declared at the specified address).

3.1.4.2. Determination of relation for the customer-legal person

104. In determining whether or not the customer - legal person is related to the Republic of Latvia, the institution may apply the following criteria[16]:

104.1. the customer-legal person is the enterprise registered in the Republic of Latvia and actually operating in the Republic of Latvia (financial statements are being filed to the State Revenue Service), thus creating economic value in the Republic of Latvia, and at least one of the BOs or authorised persons (official) of the customer-legal person is a resident of the Republic of Latvia, in line with the criteria laid down in the Law On Taxes and Duties;

104.2. the customer-legal person is registered in the country other than the low-tax or tax-free country of territory or a high risk third country, and is an enterprise actually operating in the Republic of Latvia, having a provable economic activity in the Republic of Latvia and creating clearly measurable and recordable economic value, and at least one of the BOs of the customer-legal person is a resident of the Republic of Latvia, in line with the criteria laid down in the law On Taxes and Duties.

105. Considering the fact that one of the criteria for determining the relation to the Republic of Latvia is the circumstance that the legal person is an actually operating enterprise, cresting economic value in the Republic of Latvia, it is necessary for the institution to ascertain the presence of this criterion. To ascertain that the customer-legal person is an enterprise actually operating in the Republic of Latvia, creating economic value and having a provable economic activity in the Republic of Latvia, the institution shall collect information or documents to obtain confidence that the legal person is conducting an actual economic activity, whether or not it is economically justified and the legal person has links to the Republic of Latvia, by applying one or several of the following measures:

105.1. information or documents sufficiently explaining the business operational model of the legal person;

105.2. annual financial report, audited by an external auditor, being independent from the legal person, from which sufficient understanding may be obtained regarding transactions performed by a legal person, and to establish whether the profit corresponds with the commercial activity and turnover of the legal person;

105.3. information or documents confirming the actual movement of products and services within the framework of the commercial activity implemented by the legal person. If the activity of a legal person, considering the purpose of foundation thereof, is not related to the movement of products and services, information and documents should be obtained, confirming and describing the compliance of the activity of the legal person with the purpose of foundation thereof (for example, only holding of an asset in accordance with the business activity model);

105.4. information or documents about the key cooperation partners of the legal person, confirming the actual commercial activity of cooperation partners;

[16] The institution may also prescribe additional criteria.

105.5. information or documents confirming that the legal person performs tax payments (tax declaration), if the regulatory enactments determine the obligation to pay taxes in the particular situation;

105.6. documents confirming that the legal person has attracted other persons on the basis of a contract (such as employees, outsourcing providers), who actually organise and perform the duties that refer to the commercial activity of the legal person, making sure of the compliance of duties with the commercial activity and turnover of the legal person.

106. The circumstance where, within the group of related clients, there is a link to the Republic of Latvia identified and documented for one of the participants thereof, shall not be considered to constitute the grounds for determination that all clients belonging to the group have a link to the Republic of Latvia.

3.1.5. Receipt of the management consent for cooperation with the customer related to a high risk third country

107. By implementing the requirement laid down in Section 25.[1] of the Law regarding the commencement or continuation of a business relationship, or performance of an occasional transaction with the customer related to a high risk third country, it is sufficient to receive consent from the senior management only once - before the establishment of a business relationship or performance of occasional transaction, or when taking a decision to continue a business relationship with the customer form a high risk third country, where the relation of the customer to a high risk third country was detected during the cooperation. If consent from the senior management has already been obtained once, it is not necessary to receive it following the performance of each regular enhanced due diligence.

108. The Law prescribes that for the commencement or continuation of a business relationship, or performance of an occasional transaction with the customer related to **a high risk third country**, consent from the senior management of the institution shall be necessary. In turn, the senior management is the Executive Board (board of directors) of the institution, if any is established, or a member of the Executive Board, official or employee specially appointed by the Executive Board, who has sufficient knowledge of the exposure of the institution to the MLTPF risks and holding a position of a sufficiently high level to take decisions concerning exposure of the institution to the abovementioned risks. Therewith, the receipt of consent from the senior management does not mean that it shall be necessary to receive the confirmation from the Executive Board in all cases, namely, consent may be given by a person, who has sufficient knowledge of the exposure of the institution to the MLTPF risks and holding a position of sufficiently high level to take decisions concerning its exposure to the abovementioned risks, i.e. the member of the Executive Board monitoring the AML/CTPF. The purpose of the consent (acceptance) of the senior management of the institution is to ensure that the highest possible senior management level is informed about the business relationship with the higher risk customers and the institution does not commence cooperation with such person, if there is no appropriate ICS in place.

109. When commencing or continuing a business relationship or performing an occasional transaction with the customer from **a higher risk jurisdiction**, it shall not be necessary to receive

consent from the senior management. The institution, having assessed the risk, may set such requirement, however it is not mandatory in accordance with the Law.

Example The customer is from a country with a high corruption risk and studies in the Republic of Latvia. The customer is willing to open an account in the payment institution. In accordance with Section 25.[1] of the Law the country with high corruption risk is not a high risk third country. Thus, in such case it shall not be necessary to receive consent of the senior management, in order to commence a business relationship with the customer (provided that no other circumstances exist, upon the occurrence whereof in accordance with the requirements of the Law or the internal requirements prescribed by the institution consent of the senior management is necessary).

3.1.6. Sources that can be used in determining country risk

110. Publicly available sources that can be used in determining country risk (the list serves as example only and is not exhaustive)

Low-tax or tax-free countries	https://likumi.lv/doc.php?id=294935
FATF country assessment	http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/public-statement-october-2018.html
	http://www.fatf-gafi.org/publications/high-riskandnon-cooperativejurisdictions/documents/fatf-compliance-october-2018.html
EU Commission list of high-risk third countries	https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.L_.2016.254.01.0001.01.ENG
	https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018R0105
	https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32018R0212 https://ec.europa.eu/taxation_customs/tax-common-eu-list_en#heading_4
KnowYourCountry rating	https://www.knowyourcountry.com/country-ratings-table
USA Patriot Act 311 Special Measures (FinCen)	https://www.fincen.gov/resources/statutes-and-regulations/311-special-measures
Major illicit drug producing or transit	https://www.whitehouse.gov/presidential-actions/presidential-memorandum-secretary-state-12/

Strength of auditing and reporting standards	https://tcdata360.worldbank.org/indicators/h1a88ca92?country=BRA&indicator=694&viz=line_chart&years=2007,2017
Corruption perception index	https://www.transparency.org/cpi2019?/news/feature/cpi-2019
Control of corruption	http://info.worldbank.org/governance/wgi/#home
Political risk/Risk of political violence	https://www.credendo.com/country-risk
Actual UN peacekeeping operations	https://peacekeeping.un.org/en/list-of-past-peacekeeping-operations
Regulatory quality	http://info.worldbank.org/governance/wgi/#home
Global Terrorism Index	https://ec.europa.eu/knowledge4policy/dataset/ds00160_en
Europol's information on terrorism-related risks	https://www.europol.europa.eu/activities-services/main-reports/terrorism-situation-and-trend-report-2019-te-sat

3.1.7. Assessment of the publicly available information

111. Within the framework of customer due diligence (inter alia, enhanced customer due diligence) the institution, based on risk assessment, shall also assess the publicly available information about the customer, the BO, the representative, the cooperation partner. It is important to assess materials containing not only positive, but also negative information (for example, it is not acceptable that the information available about the customer showing their prosperity, the enterprises owned by them working with profit, are taken into consideration and included in the customer's assessment, but information where a possible relation of the customer with fraud is indicated, is not mentioned and is not assessed).

112. When documenting the search and assessment of publicly available information, the institution shall be able to prove what parameters were used to search for the information (customer's name or name and surname, the name of the customer's BO and the name and surname of the representative), on what websites the information was searched, what kind of information was detected, which employee searched and assessed the information, documenting the conclusions with respect to the results of the assessment.

Example
The institution has carried out two enhanced due diligence sessions with respect to the customer for different periods. Within the scope of the first due diligence, the institution specifies that there is no negative public information found about the customer. In turn, within the scope of the second due diligence, the institution has detected negative information about the customer (published after the performance of the first due diligence); however it does not take it into

account, because it considers that such information does not refer to the due diligence period, namely, it refers to the previously assessed transactions.

It is necessary for the institution, upon the detection of negative information about the customer, to take it into account and to assess whether and in what way it affects the customer risk and further cooperation with the customer.

113. Search of publicly available information can be performed, for example, in *Google* or *Google Advanced Search* (https://www.google.com/advanced_search). In cases when the customer is related to the countries of the Commonwealth of Independent States, it is feasible to perform the search, for instance, in *yandex.ru* and in Russian.

Example

For natural persons

In Latvian

- "vārds uzvārds" VAI "uzvārds vārds" noziegums VAI atmazgāšana VAI terorisms VAI sankcijas VAI aizliegums VAI sods VAI nodokļi VAI krāpšana VAI apsūdzība VAI arests VAI pārkāpums VAI narkotikas VAI korupcija VAI kukuļdošana VAI skandāls

In English:

- "NAME SURNAME" OR "SURNAME NAME" crime OR launder OR terror OR sanction OR circumvent OR embargo OR penalt OR tax OR fraud OR charge OR arrest OR violate OR drug OR corrupt OR bribe OR scandal OR breach

In Russian:

- "ИМЯ ФАМИЛИЯ" OR "ФАМИЛИЯ ИМЯ" преступлен OR отмыв OR террор OR санкции OR обман OR запрет OR штраф OR обложить OR мошеннич OR обвинен OR арест OR наруш OR нарко OR коррупц OR взятка OR обман OR скандал

If the person has a father's name, for an additional search it is feasible to specify it along with the forename and surname.

For legal persons

In Latvian

- "uzņēmuma nosaukums (bez juridiskās formas saīsinājuma) noziegums VAI atmazgāšana VAI terorisms VAI sankcijas VAI aizliegums VAI sods VAI nodokļi VAI krāpšana VAI apsūdzība VAI arests VAI pārkāpums VAI narkotikas VAI korupcija VAI kukuļdošana VAI skandāls

In English:

- "Company name (excluding legal type)" crime OR launder OR terror OR sanction OR circumvent OR embargo OR penalt OR tax OR fraud OR charge OR arrest OR violate OR drug OR corrupt OR bribe OR scandal OR breach

In Russian:

- "НАИМЕНОВАНИЕ КОМПАНИИ" преступлен OR отмыв OR террор OR санкции OR обман OR запрет OR штраф OR обложить OR мошеннич OR обвинен OR арест OR наруш OR нарко OR коррупц OR взятка OR обман OR скандал

114. In cases when the firm name of the enterprise is widely used and with a commonly known meaning, it is feasible to also include the abbreviation of the legal form in the search.

3.1.8. Due diligence of the customer administered by the administrator of insolvency proceedings

This sub-chapter refers to credit institutions.

115. Taking into account the consequences and the impact of insolvency proceedings on the rights of a person to administer their property, attention must also be paid to the due diligence of a customer whose activities are administered by the administrator of insolvency proceedings.

116. In accordance with the Insolvency Law monetary funds received by the administrator of insolvency proceedings, when administering the property of the debtor, shall be deposited in the in the debtor's account in the credit institution. Therewith, the administrator of insolvency proceedings has a statutory task to use the financial services of the credit institution.

117. When carrying out the due diligence of a customer administered by the administrator of insolvency proceedings, attention must be paid to the following circumstances:

117.1. in accordance with the Law, within the scope of the customer due diligence, the nature and purpose of transactions must be clarified. Business relationship involving administrator of insolvency proceedings have a different purpose and nature than those of everyday business activities of legal persons. Thus, this circumstance must be taken into account when conducting customer due diligence and resolving upon the impact of the results of the assessment and customer due diligence before the insolvency proceedings on the business relationship with the customer under insolvency proceedings;

Example
If before the insolvency proceedings there was a person in the administration of the customer-legal person, with respect to whom information is available affecting the flawless reputation of the relevant person, the institution would have to assess the influence of the relevant person on the customer-legal person and its transactions during the insolvency proceedings. Therewith, the institution would take into account the circumstance that the customer-legal person, during the insolvency proceedings thereof, is no longer conducting the entrepreneurial activity characteristic thereto and the previous functions and rights of the administration thereof are transferred to the administrator of insolvency proceedings.

117.2. as to the issue regarding the BO of the customer administered by the administrator of insolvency proceedings, the institution shall exercise the rights provided for by the Law, correspondingly justifying and documenting the actions taken to determine the BO of the customer. The person holding the position in the senior management body of the legal person may be considered to be the BO of the relevant legal person, if all the possible clarification means have been used and it is not possible to clarify any natural person - the BO, as well as the doubts that the legal person or the legal arrangement has a different BO are excluded. In accordance with the Insolvency Law, the administrator of insolvency proceedings has all the rights, duties and responsibilities of administrative bodies provided for in laws and regulations, the articles of association of the debtor or in contracts. Considering the above mentioned, in cases where the credit institution is not able to determine the BO of the debtor and to obtain information about the BO as prescribed by the Law, the administrator of insolvency proceedings of the customer may be considered to be the BO of the customer.

118. In addition, it should also be taken into account that the administrators of insolvency proceedings are subjects of the Law and they have the task to carry out the activities inherent thereto and the MLTPF risk assessment of their customer, as well as to establish the ICS of the

AML/CTPF. Within the scope of the above mentioned, when conducting the assessment of the customer administered by the administrator of insolvency proceedings, the institution, in line with the risk-based approach, shall take into account and assess the measures taken by the administrator him/herself for the observance of the AML/CTPF requirements.

3.1.9. Shell arrangements

119. In accordance with Clause 15.[1], Section 1 of the Law the shell arrangement is a legal person characterised by one or several of the following indications:

119.1. has no affiliation of a legal person to an actual economic activity or the operation of a legal person forms minor economic value or no economic value at all, and the subject of the Law has no documentary information at its disposal that would prove the contrary;

119.2. laws and regulations of the country where the legal person is registered do not provide for an obligation to prepare and submit financial statements for its activities to the supervisory institutions of the relevant state, including the annual financial statements;

119.3. the legal person has no place (premises) for the performance of economic activity in the country where the relevant legal person is registered.

Example

Situation No. 1

An enterprise registered in a country, the laws and regulations whereof do not provide for an obligation to submit financial statements, has declared that it is engaged in trade of goods (household appliances), but the enterprise has no warehouse, nor can it submit any documents supporting the movement of goods (consignment notes (CMR), bills of lading, etc.), selling prices of goods specified in the contracts are identical to the prices of procurement of goods, there are no transactions in the account of the institution evidencing tax payment, etc.

Situation No. 2

In accordance with information provided by the customer in 2017 the country with high corruption and sanctions risk is specified as the actual place of conducting economic activity, the customer employs five persons. In 2019, the customer informed the institution that the actual place of conducting economic activity has been changed, and submitted the lease agreement concluded in 2018, specifying that the actual place of conducting economic activity of the customer is in a country considered to be a low-tax country. The customer questionnaire completed by the customer in 2019 specifies that five persons are employed - director, secretary, chief financial officer, chief commercial officer and accountant. Upon the receipt of the referred to information form the customer, the status of a shell arrangement granted to the customer is cancelled.

Within the scope of enhanced due diligence, in order to ascertain whether the customer is attempting to avoid being classified as a shell arrangement, it is necessary for the institution to assess at least the following considerations:

- whether the five employees specified by the customer have the necessary permits to work in the country specified as the place of conducting economic activity;

- whether the number of employees is adequate for ensuring the economic activity of the customer (for example, whether the referred to five employees are able to ensure trade in oil and oil products);
- considering the fact that, following the change of the actual address, the activity of the customer has not changed and it is related (affiliated) to the country considered to be a low-tax country, and the actual activity is still being conducted in the country with high corruption and sanctions risk, it is necessary to assess the functions for the performance whereof the customer is leasing the premises in the country considered to be a low-tax country, if, in fact, the entire economic activity is being conducted in another country (for example, by assessing the submitted lease agreement and analysing whether it contains any indications demonstrating a merely formal contract).

120. Credit institutions, payment institutions, electronic money institutions, investment brokerage companies, and, in relation to the management of individual portfolios of customers and the distribution of certificates of open investment funds, also investment management companies are prohibited from commencing and maintaining a business relationship and conducting occasional transactions with the shell arrangement, if it concurrently conforms to the indications specified in Sub-clauses "a" and "b" of the definition of a shell arrangement (Section 1, Clause 15.[1] of the Law).

121. To determine whether the legal person conforms to the indication contained Sub-clause "a", Clause 15.[1], Section 1 of the Law (Clause 119.1), the institutions referred to in Clause 120, based on the risk assessment, shall take one or several measures referred to in Clause 36 of the Customer Due Diligence Regulations[17]:

121.1. information and documents sufficiently explaining the business model of the legal person;

121.2. the annual financial report of the legal person, audited by an independent external auditor, from which sufficient understanding may be obtained regarding transactions performed by the legal person, and to establish whether the profit corresponds with the commercial activity and turnover of the legal person;

121.3. information and documents confirming the actual movement of products and services within the framework of the commercial activity implemented by the legal person. If the activity of a legal person, considering the purpose of foundation thereof, is not related to the movement of products and services, information and documents should be obtained, confirming and describing the compliance of the activity of the legal person with the purpose of foundation thereof (for example, only holding of an asset in accordance with the business model);

121.4. information and documents about key cooperation partners of the legal person, confirming the actual commercial activity of cooperation partners;

121.5. information and documents confirming that the legal person performs tax payments (tax declaration), if the regulatory enactments determine the obligation to pay taxes in the particular situation;

[17] The Commission has developed Clause 36 of the Customer Due Diligence Regulations in accordance with Paragraph 2, Section 21.[1] of the Law, and Clause 36 is applicable with respect to the indication "a" of the definition of the shell arrangement.

121.6. information and documents confirming that the legal person has attracted other persons on the basis of a contract (such as employees, outsourcing providers), who actually organise and perform the duties that refer to the commercial activity of the legal person, making sure of the compliance of duties with the commercial activity and turnover of the legal person.

122. The Customer Due Diligence Regulations prescribe the minimum measures to be taken by the institution, in order to verify whether the customer-shell-arrangement is affiliated to an actual economic activity, whether the operation of a legal person forms minor economic value or no economic value at all, and there is no documentary information at the disposal of the institution that would prove the contrary.

123. The conformity to the indication of the shell arrangement specified in Sub-clause "a", Clause 15.[1], Section 1 of the Law (Clause 119.1) shall be assessed individually, on a case by case basis.

Example
Where a holding company, which owns the shares of other companies (subsidiary undertakings) and whose main task and the purpose of economic activity is to carry out the management of the respective investments and assets, it must be assessed whether the subsidiary undertakings owned by the holding company conduct an actual economic activity, whether the group structure is transparent and is not indicative of an attempt to conceal the BO.

124. In cases where the customer, who is registered in the Republic of Latvia, does not conduct actual economic activity or the operation thereof forms a minor economic value or no economic value at all, and there is no documentary information at the disposal of the institution that would prove the contrary (for example, there are suspicions that an enterprise is being used for tax evasion schemes, the institution shall terminate the business relationship with the relevant customer, reporting the suspicious transaction to the Financial Intelligence Unit.

125. The institution shall determine the scope, nature and assessment principles of information and documents to be obtained, both depending on the MLTPF risk (such as legal form, structure of owners), country and geographical risk, the used services and products risk, services and products delivery channels risk, and depending on the type of economic activity of the legal person area of activity, the duration of activity and legal status, namely, considering various categories of legal persons.

126. As regards the indication of the shell arrangement under Sub-clause "c", Clause 15.[1], Section 1 of the Law, the Commission in its inspections has detected that the place of conducting economic activity of the legal person may also not coincide with the country of registration thereof, and the legal person should not be automatically considered to be the shell arrangement merely because of that. Taking into account the specific nature of activity of a legal person, the possibilities of remote work are being used increasingly more often (for example, companies performing translation services, providing IT services to the enterprises of other countries); therefore, it should be additionally assessed, whether the nature of economic activity of the legal person justifies the circumstance that the legal person has no place (premises) for the performance of economic activity

in the country where the relevant legal person is registered[18]. In turn, the purpose of the indication of the shell arrangement under Sub-clause "c", Clause 15.[1], Section 1 of the Law is to classify as a shell arrangement, those legal persons, which operate as letterbox companies without any clearly understandable economic activity.

3.2. Customer identification

3.2.1. Face-to-face identification

127. Face-to-face identification shall be considered to be an identification procedure carried out by the employee or authorised person of the institution (for example, an agent, with whom the institution has concluded the agreement on customer identification in the interests of the institution, or a representative, who, within the provision of payment services, acts on behalf of the payment institution or is entitled to distribute or redeem electronic money on behalf of the electronic money institution), with the customer being present in person (physically) during the identification.

128. Face-to-face identification shall also be considered to be identification, during which the sworn notary of Latvia has in person identified the principal and the attorney and the attorney arrives in person (one site) to the credit institution for the establishment of a business relationship, based on the power of attorney issued by the principal. With respect to the identification of the principal performed by the notaries of other countries, the institution shall assess the country risk, ascertain the regulation of the particular country with respect to the authorisation and functions of the notary, verify and assess whether the notary has identified the principal and the attorney and how, as well as whether the identification corresponds to the requirements of laws and regulations of the Republic of Latvia. A notarised and certified copy of a personal identification document per se without a notary's certification that the notary has performed the verification of the identity (identification) of the holder of the personal identification document is not sufficient to identify the customer.

129. The institution shall prepare the copies of the documents underlying the performance of face-to-face customer identification.

3.2.1.1. Identification of natural persons

130. When identifying the natural person, the institution shall compare the visual similarity of the customer with the photo image contained in the presented personal identification document and shall ascertain that the document does not contain the features of a forged document. In the case of doubts and if the institution is not able to ascertain that the customer presenting the personal identification document is the person depicted in the photo image of the document, or if the institution is not able to ascertain that the document does not contain the features of a forged document, it shall not commence cooperation with the relevant customer and, in line with the requirements of the Law, in the case of suspicions regarding the MLTPF, shall report to the Financial Intelligence Unit.

[18] For the purposes of solving the current situation, the Commission has filed proposals for introducing amendments to the Law, by supplementing indication "c" of Clause 15.[1], Section 1 of the Law.

131. A natural person resident shall be identified by verifying their identity on the basis of the customer's identity document, which includes information on the customer's name, surname and personal identification number. Information about the samples of identity documents issued by the Republic of Latvia is available in Cabinet of Ministers Regulation No. 134 of 21 February 2012. "Regulations Regarding Personal Identification Documents".

132. When commencing a business relationship with an underaged person (minor) represented by his/her parents (or other persons, on the basis of a valid representation document), in line with that which is stated in the laws and regulations about the representation of natural person, it would be necessary for the institution to obtain a copy of the personal identification document of the parent of the minor (or another person, if he/she is represented by another person, on the basis of a valid representation document) and a copy of the birth certificate of a minor or a copy of the entry in the passport of the parent. In cases when the minor, in accordance with the laws and regulations, has a personal identification document, the institution may prescribe that in order to commence a business relationship, the minor must have a personal identification document (passport or personal identity certificate).

133. During the identification process of the customer - foreign resident, a document recognised as valid for entering the Republic of Latvia may be used, which includes the customer's name, surname, date of birth, person's photograph, the number of the identity document and the date of issue, the country and institution that issued the document. Travel documents of foreigners shall be recognised as valid for entering the Republic of Latvia according to the requirements of Cabinet of Ministers Regulation No. 215 of 29 April 2003 "Procedures for the Recognition of Travel Documents of Foreigners".

134. In cases where a person has the right to enter and stay in the Republic of Latvia with an identity document valid for travelling and a valid visa or residence permit issued by the Republic of Latvia, the institution shall not only make a copy of the identity document, but also of the visa or residence permit, as it confirms the customer's rights to enter the country.

135. There may be cases when an identity card of a third country citizen is a residence permit issued by the Republic of Latvia (a temporary residence permit or a permanent residence permit) that is issued in accordance with the regulatory legislation governing the movement of persons. Thus, in cases when the customer has received a residence permit in Latvia in the form of an identity card, their identification may be conducted based on the residence permit.

3.2.1.2. Identification of legal persons

136. A legal person, in accordance with the requirements prescribed by the Law, shall be identified by obtaining the document confirming the firm name, legal form and incorporation or legal registration of the legal person, obtaining details about its registered address and the place of actual performance of economic activity (if the actual address differs from the registered address), as well as by obtaining the incorporation document of the legal person and identifying the persons entitled to represent the legal person in the institution.

137. As specified by the Law the institution is entitled to obtain documents certifying the establishment or legal registration of the customer's legal person from a publicly available reliable and independent source, and such use of the sources shall be determined in the policies and procedures of the credit institution. Information about the enterprises registered in the Republic of Latvia may be obtained from the Enterprise Register, incl., commercial databases maintaining the information of the Enterprise Register; in turn, information about foreign residents may be obtained from the enterprise register database of the relevant country.

138. When commencing a business relationship or performing an occasional transaction, in cases where a customer is a legal person registered abroad and has been operating for a longer time (at least one year), in addition it is also necessary to obtain documents proving the relevance of the data obtained as a result of customer identification and which are made no earlier than a year before the commencement of the business relationship (for example, by requiring the customer to submit a certificate from a register, should it be impossible to obtain it from the relevant database of the enterprise register of the country of registration of the customer, issued no earlier than a year ago, about its status or other type of a certificate containing information on the status of the customer (active or dissolved company) and the structure thereof (for example, Incumbency Certificate, Certificate of Good Standing)).

139. In the case if the director of the customer, which is a legal person, is a legal person, the institution shall pay attention to the status of this legal person and assess it as well (active or dissolved company). In order to ascertain this, the institution shall require the customer to provide a document certifying the signatory powers of the representative of the legal person, which is the director of the customer, and a document certifying the status of the company, which is the director of the company, that is not more than one year old (for example, Incumbency Certificate, Certificate of Good Standing, certificate from the register).

3.2.1.3. Identification of legal arrangements

140. Legal arrangement, in line with the requirements laid down in the Law, shall be identified, by requesting the documents attesting to the status of the legal arrangement, the purpose of creation thereof, and its firm name, obtaining details about the registered address and the place of actual performance of economic activity thereof (if the actual address differs from the registered address), as well as by clarifying the structure and mechanism of governance of the legal arrangement, including the BO or the person in whose interests the legal arrangement has been created or operates, and the authorised persons of the legal arrangement or other persons holding an equivalent position.

141. Based on the risk assessment (for example, a higher geographical risk is inherent to the customer with respect to the country of registration), regarding the customer registered abroad and having nominal stockholders - legal persons[19], the institution shall obtain the documents issued no earlier than a year ago and attesting to the active status of a nominal stockholder, (for example, Incumbency Certificate, Certificate of Good Standing, certificate from the register).

[19] The customers, for the registration whereof the services of the legal incorporation enterprises are used, create an increased risk with respect to the possible formal specification of the BO.

3.2.1.4. Verification of the personal identification document in the register

142. In accordance with the Law, upon verifying the identity of a natural person according to the personal identification document of the customer, the institution shall ascertain that the personal identification document is not invalid, by means of available public registers of the relevant country (for example, the Invalid Document Register). One of the purposes of the requirement to carry out the verification of the personal identification document in the Invalid Document Register is to ascertain that a person specified in the submitted document is alive and that the services provided by the institution are not continued to be used by a third person. Within the scope of such verification, the institution shall verify the number of the personal identification document submitted by the customer, shall ascertain that the document has not been stolen, lost, perished, withdrawn and that it is not used by a third person etc. As regards a customer who has an a personal identification document issued abroad, the institution may use the databases of the relevant country, if any (for example, in Russia – http://services.fms.gov.ru/info-service.htm?sid=2000, in Ukraine – https://nd.dmsu.gov.ua/), but it is advisable to at least verify the number of the machine readable zone of the issued document (for example, by using commercial databases). When verifying the genuineness of the personal identification document, the institution may use publicly available information (for example, http://www.consilium.europa.eu/prado/en/search-by-document-country.html) or commercial databases offering information about the types of personal identification documents in different countries. At the same time, when identifying the customer, the institution, in addition to the verification of the personal identification document in the register, must pay attention to the legal effect of identification documents - to ascertain that the personal identification document is valid, the term of validity thereof has not expired, it is not damaged and does not contain the features of a forged document.

3.2.1.5. Updating personal identification document data

143. The requirement to update the data of personal identification documents shall apply to all customers of the institution; however the frequency of updates and the type and scope of information to be obtained shall be determined, based on the MLTPF risk assessment.

144. If it corresponds to the risk assessment performed by the institution, one of the ways of updating the personal data and information may also be the obtaining of the copy of the personal identification document of the customer in scanned form, by means of the internet bank, electronic signature, courier mail or receiving the updated personal data in any other manner corresponding to the risk assessment of the institution. Updating of personal data of the customer is not the initial customer identification, therefore it is not subject to the same requirements as set for the identification.

145. Regarding natural persons - residents of the Republic of Latvia, one of the ways of obtaining the updated information is by the institution itself obtaining the information about the existence and validity of a new valid personal identification document of the customer from the public register maintained by the Ministry of the Interior of the Republic of Latvia. At the same time, it is necessary to ensure that there is documentary evidence at the disposal of the institution

as to how the relevant information was obtained (for example, by preserving a printout or other information attesting to how the relevant information was obtained and when).

146. One of the possibilities for how to achieve the updating of the personal identification document is to set restrictions for the receipt of the services to the customers who need to update the data of the personal identification documents, for example, by restricting transactions in the internet bank, limiting the range of services and conclusion of new service agreements. Nevertheless, such restrictions must be justified by the risk assessment and the application of restrictions must be commensurate to the risk inherent to the customer; for example, the customer has a high inherent MLTPF risk and the customer performs regular transfers to the higher risk countries via the internet bank.

It is neither necessary, nor justified to set the restrictions for the receipt of the services automatically to all customers.

147. Before taking any of the measures for updating the data of the personal identification document, it shall be necessary for the institution to assess the risks caused by the customer - geographical risk pertaining to the customer, economic or personal activity of the customer, services and products to be used and the delivery channels thereof, as well as the performed transactions, by ascertaining whether there are any risk increasing factors present requiring the performance of repeated customer identification on site.

3.2.2. Non-face-to-face (remote) customer identification

148. Non-face-to-face (remote) customer identification must be carried out in accordance with Cabinet of Ministers Regulation No. 392 of 3 July 2018 *Procedures by which the Subject of the Law on the Prevention of Money Laundering and Terrorism Financing Performs the Remote Identification of a Customer* (hereinafter - Cabinet Regulation No. 392) or Section 23 of the Law. If the non-face-to-face (remote) identification is performed in accordance with Section 23 of the Law, it is necessary to apply enhanced customer due diligence (Paragraph 2, Section 22 of the Law).

149. Identification of a legal person may substantially be broken down in two stages, both of which can be performed non-face-to-face (remotely).

149.1. ascertaining the legal and actual capacity of the legal person, as well as other material details, by obtaining the information prescribed by the Law;

149.2. identification of natural persons being the persons entitled to represent the legal person or authorised by the legal person.

> The key requirement for the commencement of non-face-to-face (remote) identification shall be **the risk assessment**, in order to ensure that the measures taken to identify the customer non-face-to-face (remotely) are commensurate to the MLTPF risk. To implement this requirement, it shall be necessary to develop internal regulatory enactments (**policy, procedure**), as well as to provide for the appropriate ICS and the staff training.

150. It is also possible to carry out the dentification of a legal person, by ascertaining the legal and actual capacity of the legal person, as well as other essential details, obtaining information prescribed by the Law, remotely (non-face-to-face), provided there is a possibility to ascertain that the obtained documents are appropriate and do not contain any forgery. Therewith, both the Law and number of other laws and regulations shall be applicable, based on the particular situation, jurisdiction, where the legal person is registered, as well as the risk assessment, for example, on the type of conditions for a legal effect of the documents, regulation of maintaining commercial registers, requirements set for electronic documents, certification of documents and legalisation of documents, etc.

151. In accordance with Paragraph 2, Section 13 of the Law the identification of a legal person - obtaining data and documents referred to in Paragraph 1, Section 13 of the Law - may take place by obtaining the relevant data and information from a publicly available, reliable and independent source.

152. When identifying the persons entitled to represent the legal person, Section 12 of the Law with respect to the identification of natural persons shall apply.

153. Non-face-to-face (remote) identification shall not be permissible, if:

153.1. the BO of the legal person is a family member of the PEP or a person closely related to the PEP and uses a service, the monthly credit turnover of which exceeds EUR 3, 000;

153.2. the customer is a shell arrangement;

153.3. the customer is using private banker services.

154. Based on the risk level, when performing remote identification of the customer, the types of identification specified in Cabinet Regulation No. 392 shall be used:

154.1. secure electronic signature which provides qualified electronic identification with enhanced security that corresponds to the level determined in accordance with laws and regulations or Regulation (EU) No. 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market and repealing Directive 1999/93/EC (hereinafter - eIDAS Regulation). Considering the fact that Cabinet Regulation No. 392 requires ensuring qualified electronic identification with enhanced security that corresponds to the level determined in eIDAS Regulation, and direct applicability of the eIDAS Regulation, identification in accordance with this solution shall not be interpreted narrowly merely by a secure electronic signature. It shall be permissible to also use other electronic identification means, if in accordance with eIDAS Regulation such means ensure qualified electronic identification with enhanced security;

154.2. video identification, in line with mandatory requirements prescribed in Clause 10 of Cabinet Regulation No. 392;

154.3. acquisition of data accrediting the identity of a natural person from a credit institution or payment institution by using an identification payment or another method which enables the receipt of the data referred to in Clause 13.2 of Cabinet Regulation No. 392 from a credit institution or payment institution. Laws and regulations do not limit and do not prescribe the amount of the sum, in which the identification payment shall be made, namely, it may as well constitute EUR 0.01. At the same time, as this type of identification, according to Cabinet Regulation No. 392, is already directed towards the remote identification of the customer in low risk cases and

processes related to performance of standardised payments, this type, based on the risk assessment, should basically be used in addition to any other type of remote identification;

154.4. comparison of the photograph in a personal identification document and electronic self-portrait photograph.

155. The manner of conclusion of an agreement with a new customer, within the remote identification procedures for each credit institution or payment institution must be defined based on the identified risk - by secure electronic signature or another qualified electronic solution with enhanced security, by signing the agreement on site, incl., via courier, or using distance means without a signature (for example video identification by making a record in the application).

156. The choice of the type of remote identification shall be limited to a secure electronic signature, another qualified electronic identification solution with enhanced security that corresponds to the eIDAS Regulation, or video identification in accordance with the requirements laid down in Clause 10 of Cabinet Regulation No. 392, if:

156.1. the customer or the BO is related to the higher risk jurisdiction;

156.2. the sum of transactions of the customer, previously identified by means of identification payment or comparing the photograph in a personal identification document and electronic self-portrait photograph, and subject to enhanced due diligence due to reasons not related to the facts of remote identification, exceeds EUR 3, 000 per month.

157. In cases not mentioned in Clause 156, for the purposes of remote identification in accordance with the performed risk assessment it shall also be possible to use the identification payment or another method which enables the receipt of the data referred to in Clause 13.2 of Cabinet Regulation No. 392 from a credit institution or payment institution, as well as the comparison of the photograph in a personal identification document and electronic self-portrait photograph.

158. Where the person entitled to represent the legal person or the authorised person thereof has already been identified as the customer-natural person in accordance with the requirements, within the scope of remote identification of a legal person, the relevant person shall be subject to the application of the same requirements as those applied to the natural person already identified by a credit institution or a payment institution. Considering the risk assessment, in such cases it must be assessed whether the manner in which the customer-natural person was identified, (for example, the identification payment applicable to only to low risk cases and processes related to performance of standardised payments was used) corresponds to the risk level of a legal person.

159. When taking a decision to commence remote identification of the customer, it must be noted that in accordance with Section 101.[2] of the Credit Institution Law, if a credit institution has planned to commence the provision of new financial services not provided until now or to significantly modify the procedures for the provision of one of the financial services, it shall, no later than 30 days in advance, submit a substantiated submission to the Commission. The relevant risk management policy and a description of procedures shall be appended to the submission.

160. Other institutions shall also be obliged to report the changes in internal regulatory enactments and risk management thereof (Section 26 of the Law on Payment Services and

Electronic Money, Section 10 of the Law on Alternative Investment Funds and Their Managers, Section 108.[1] of the Financial Instruments Market Law, Section 13 of the Law On Investment Management Companies, Section 10. of the Private Pension Funds Law, Section 53 of the Insurance and Reinsurance Law, Section 24.[1] of the Law On Savings and Loan Associations (Law on Credit Unions)).

161. The Commission shall assess the conformity of the planned service to the requirements of laws and regulations and the management of risks inherent to the service, *inter alia*, shall assess the risk assessment conducted by the credit institution, planned circle of customers and services offered thereto, further risk management measures, as well as the planned staff training. When carrying out the referred to assessment, the Commission shall monitor toensure that when offering the identification service, the credit institution ensures the gradual and commensurate availability of the service for its customers.

162. The Commission shall review the submission within a period of 30 days. Should it be necessary to obtain additional information, the Commission shall provide a motivated explanation about the necessary supplements.

163. When commencing the remote identification of customers, the Financial Action Task Force (FATF) Guidelines "Digital Identity" may be useful; the Guidelines are available at: https://www.fatf-gafi.org/publications/fatfrecommendations/documents/consultation-digital-id-guidance.html.

3.3. Simplified customer due diligence

164. In accordance with Section 26 of the Law the institution may carry out simplified customer due diligence:

164.1. if a low MLTPF risk is present which is not in contradiction with the risk assessment, including the national MLTPF risk assessment report, and measures have been taken to determine, assess and understand the MLTPF risks inherent to its own activities and the customer, and the customer is a merchant with the stock thereof being listed on a regulated market in one or several Member States, as well as if the customer is the Republic of Latvia, a derived public person, direct administration or indirect administration institution, or a capital company controlled by the State or a local government characterised by a low MLTPF risk (Paragraph 21, Section 26 of the Law);

164.2. if a low MLTPF risk is present and the services provided by the institution conform to all the indications referred to in Sub-clauses of Paragraph 3, Section 26 of the Law, namely:

164.2.1. the transaction has a written contractual base;

164.2.2. the transaction is executed, using a bank account which is opened by a credit institution registered in a Member State;

164.2.3. the transaction does not arouse suspicions, or no information is available that attests to MLTPF, or an attempt to carry out such actions;

164.2.4. the total amount of the transaction is not more than EUR 15, 000 or is in a foreign currency which in accordance with the exchange rate to be used in accounting in the beginning of the day of the transaction is not more than EUR 15, 000;

164.2.5. the income from the transaction cannot be used for the benefit of third parties, except for in the case of death, disability, obligation to provide subsistence or in similar events;

164.2.6. if at the time of the transaction the conversion of funds into financial instruments or insurance or any other claims is impossible, or if such conversion of funds is possible and the following conditions are conformed with:

164.2.6.1. the income from the transaction is only realisable in the long term - not earlier that after five years from the day of entering into the transaction;

164.2.6.2. the subject-matter of the transaction cannot be used as collateral;

164.2.6.3. during the term of validity of the transaction no early payments are made, the assignment of the claim rights and early termination of the transaction are not used;

Example

The institution, when providing payment initiation or account information services, must apply the customer due diligence measures on the basis of the risk assessment approach, and the inherent MLTPF risk of the services is to be assessed as limited, considering the fact that the payment initiation service provider, even though it is engaged in the payment chain, is not itself holding the funds of the user of payment services, with whom it, based on the selected cooperation model, creates an occasional business relationship or a business relationship, and the account information service provider is not involved in the payment chain and does not hold the funds of the customer.

The above-mentioned means that in the majority of cases the MLTPF risk would have to be assessed as low, namely, the simplified due diligence measures shall be applicable, provided that the conditions of Paragraph 3, Section 26 of the Law are met. At the same time, the institution, when providing the payment initiation or account information services, must have an effective transaction supervision (screening) system in place, enabling one to detect whether the transaction causes suspicions regarding the MLTPF, by applying standard or enhance due diligence measures to the customer in cases of an increased (higher) risk.

164.3. An insurance merchant, insofar as it is carrying out life insurance or other insurance activities related to the accumulation of funds, and an insurance intermediary, insofar as it is carrying out life insurance or other insurance activities related to the accumulation of funds, is entitled to conduct simplified customer due diligence, if a low MLTPF risk and the circumstances specified in Paragraph 4, Section 26 of the Law are present, namely:

164.3.1.with respect to persons whose life insurance contracts provide for the annual insurance premium of not more than EUR 1,000 or is in a foreign currency which according to the exchange rate to be used in accounting at the beginning of the day of executing the transaction is not more than EUR 1, 000, or if the single premium does not exceed EUR 2, 500 or is in a foreign currency which according to the exchange rate to be used in accounting at the beginning of the day of executing the transaction is not more than EUR 2, 500;

164.3.2. with respect to persons concluding lifelong pension insurance contracts and such contracts do not provide for the possibility of early disbursement, and it cannot be used as collateral;

164.4. a private pension fund is entitled to conduct simplified customer due diligence in relation to contributions to pension plans if the customer cannot use the abovementioned

contributions as collateral and cannot assign them, and in relation to such contributions to pension plans which are made by way of deduction from wages.

165. The institution shall not be entitled to perform simplified due diligence in the case when the MLTPF risk increasing circumstances referred to in Paragraphs 8 and 9 of Section 26 of the Law are present, namely, simplified customer due diligence shall not be applied in the cases referred to in Section 26 of the Law, if, on the basis of the risk assessment, the institution detects, or there is information at its disposal regarding MLTPF, or an attempt to carry out such actions, or an increased risk of such actions, including if the risk increasing factors referred to in Paragraph 3, Section 11.[1] of the Law are present, as well as with respect to the customers who perform economic activity in high-risk third countries.

166. According to the provisions of Section 26 of the Law, in the case of simplified due diligence, the institution shall be entitled to take customer due diligence measures referred to in Section 11.[1] of the Law, inter alia, the measures for determining the BO of the customer, within the scope corresponding to the MLTPF risk inherent to the nature of the business relationship or occasional transaction. The Law does not release the institution from the duty to perform customer due diligence, inter alia, to clarify the BO of the customer, but allows the performance of simplified due diligence - obtain information necessary or customer due diligence within the scope corresponding to the risk, for example, if the business relationship with the city council (local government) is commenced, in light of the functions thereof, it shall not be necessary to obtain information about the purpose of opening the account, key cooperation partners, planned volumes of transactions, etc. The scope of information to be obtained during the customer due diligence will be smaller than in cases of standard customer due diligence, when it is necessary to clarify information about the volumes of transactions planned by the customer, key cooperation partners, etc. elements stipulated by the Law. The manner of obtaining information may also differ, and the institution shall obtain information necessary for simplified customer due diligence in accordance with the risk (please see Sub-chapter 3.1.1.2 for more information).

167. Taking into account the above mentioned with respect to the companies with stock being listed on a regulated market, and the customers being the Republic of Latvia, a derived public person, direct administration or indirect administration institution, or a capital company controlled by the State or a local government (characterised by a low MLTPF risk), it shall be necessary for the institution to take the BO clarification measures to an extent corresponding to the MLTPF risk. Considering that the direct administration institutions have a presumed BO, the institution may obtain information about the senior management of the direct administration institution, for example, on the website of the relevant institution.

168. In accordance with Paragraph 10, Section 26 of the Law it shall be the duty of the institution, upon applying simplified customer due diligence, to obtain and document information attesting to compliance of the customer with the conditions for applying simplified due diligence specified in Section 26 of the Law, as well as, after establishment of a business relationship, to carry out the supervision thereof, based on the risk.

169. Taking into account the requirements of Paragraph 2, Section 26 of the Law, when determining the MLTPF risk inherent to the cooperation with the customer, and assessing, whether

in the particular case there are grounds to apply simplified customer due diligence, it shall be necessary for the institution to assess whether the information available about the capital company is sufficient to obtain confidence that it is a capital company controlled by the State or a local government with low inherent MLTPF risk.

3.4. Enhanced customer due diligence

3.4.1. Enhanced due diligence requirements

170. The institution shall perform the enhanced customer due diligence in the following cases:

170.1. in cases prescribed by the Law;

170.2. in accordance with the requirements of the Customer Due Diligence Regulations, namely:

170.2.1. upon the occurrence of the risk factors referred to in Annex No. 1, irrespective of the results of the customer risk scoring (score);

170.2.2. upon the occurrence of the risk factors referred to in Annex No. 2;

170.3. in accordance with the results of the customer risk scoring (score), upon achieving the threshold level specified by the customer risk scoring system of the institution, when enhanced customer due diligence is to be performed.

171. It is not always possible to automatically detect the occurrence of all risk factors specified in the Customer Due Diligence Regulations, merely by means of technological solutions. There are certain risk factors, the occurrence whereof shall be detected manually, within the scope of the customer due diligence of transaction screening.

3.4.2. Enhanced due diligence in accordance with Annex No. 1 to the Customer Due Diligence Regulations

172. Risk factors contained in Annex No. 1 are risk factors upon the occurrence whereof in accordance with the requirements of the Customer Due Diligence Regulations enhanced customer due diligence is applicable, meaning that the institution shall take all enhanced due diligence measures for the entire period of the business relationship.

173. Even though, upon the occurrence of the risk factor under Annex No. 1, it is necessary to take all enhanced due diligence measures, as a result of enhanced due diligence it is necessary to obtain information to an extent corresponding to the risk of the customer. Therewith, the enhanced due diligence measures (information to be obtained, documents supporting it) must be taken to an extent corresponding to the risk of the customer (for example, scope of information and documents obtained about the customer-student from the high risk third country, by assessing the nature and volume of the transaction, may differ from the scope of information and documents obtained about the customer coming from a high risk third country and using the services of a private banker).

174. The Customer Due Diligence Regulations and the breakdown of risk factors in Annex No. 1 and Annex No. 2 were set up, taking into consideration all the necessary scope of due diligence. Upon the occurrence of the risk factor under Annex No. 1, it shall be necessary to take all enhanced due diligence measures to an extent corresponding to the risk and regular enhanced customer due diligence is provided for. In turn, upon the occurrence of the risk factor under Annex

No. 2, such enhanced due diligence measure shall be taken, which enables one to assess whether the transaction or activity of the customer is to be considered as suspicious or increasing the MLTPF risk, and the further enhanced due diligence shall be determined based on the due diligence results.

Example

During the business relationship, the customer incurs an indication: *the customer, the BO of the customer or a key cooperation partner is related to a high risk third country*.

The institution shall take all enhanced due diligence measures:
- examine if the customer's transactions carried out, services and products used correspond to the customer's declared economic activity;
- obtain additional information in order to verify that the BO indicated by the customer or ascertained by the institution is the BO of the relevant customer;
- verify the origin of the funds of the customer;
- analyse the economic or personal activity of the customer, incl., in cases when the customer is a company registered in a low-tax territory. The institution shall obtain and document evidence about the customer's relation to a company carrying out actual economic activities and its relation with the BO of the customer.

The range of the volume of information and the type of documents obtained by the institution (for example, contracts, invoices, documents attesting to the movement of goods or documents proving the provision of services, etc.), when applying each and every of the enhanced due diligence measures, depends on the information and documents already at disposal of the institutor – it is not necessary to repeatedly obtain or request the documents attesting to the transactions with the key cooperation partners of the customer, if such documents are already at disposal of the institution[20].

For example, it shall be necessary to understand the supply contract with the term of validity of several years and submitted already a year ago, and to assess whether the performed transactions still correspond to the provisions of the contract, and to correspondingly document it.

When implementing the requirement with respect to, for instance, knowing the economic activity of the customer, it shall not be necessary to automatically request that the customer updates the customer questionnaire (besides, merely updating the questionnaire or the verification of data of the questionnaire does not mean that the institution ascertains the economic activity of the customer, it shall be necessary for the institution to assess all risk factors inherent to the customer or the activity thereof as a whole and whether there are sufficient documents and information at disposal of the institution characterising the activity of the customer), where the customer specified the same type of economic activity as before.

[20] Based on the risk, the institution may also obtain information about the key cooperation partners from public sources, for example, if the activity of the customer corresponds to the declared one and there is public information available about the key cooperation partners (for example, the customer is a farm, ensuring the supply of dairy products to the milk processing production enterprises).

The purpose of the requirement to know the economic activity of the customer is for the institution to assess whether it still knows the economic activity of the customer and whether it has sufficient information regarding the conformity of the previously clarified information to the existing circumstances. Nevertheless, there might also be situations, when, in implementing this requirement, it is justified and commensurate to request that the customer updates information about the economic activity and to also obtain additional documents, because the transactions do not correspond to the information at disposal of the institution or the institution has doubts as to the conformity of the performed transactions - for example, the transactions are performed with the cooperation partners operating in a sector different from the sector of the customer, and these sectors are not substantially related and the mutual transactions do not seem logical; the institution detects that, probably, the region of economic activity of the customer may have changed, because the model of transactions has changed.

Even in cases when all enhanced due diligence measures are applied, they shall be applicable, based on the risk and actual circumstances.

175. In the event if the customer corresponds to any of the risk factors referred to in Annex No. 1, but has not performed any transactions during the reporting period or the transactions have been insignificant (the institution shall corresponding record it in the due diligence) and if there are no other circumstances present requiring further due diligence measures, the institution shall not conduct further due diligence measures. This means that it shall not be necessary for the institution, by documenting the circumstance that the customer has not performed any transactions or that the performed transactions have been insignificant (based on the rating set by the institution, which the institution shall justify), to apply enhanced due diligence measures to the customer corresponding to any of the risk factors referred to in Annex No. 1.

Example

Indication: *the customer is a natural person who is to be recognised as a PEP, or a family member of a PEP, or a person closely related to a PEP, except for if a PEP is a resident of the Republic of Latvia whose average monthly credit turnover does not exceed EUR 3, 000.*

It shall be necessary for the institution to consider both whether the customer is to be recognised as a PEP and the average credit turnover/volume of transactions. Where the customer is a PEP and once a year contributes EUR 3, 000 into the third-pillar pension capital, it shall not mean that the relevant customer would automatically, by this indication alone, be subject to enhanced due diligence every six months, if the standard contributions per month comprise, for example, EUR 50. Nevertheless, at the same time, the institution must ensure effective transaction supervision (screening), so that, upon receipt of the funds of a larger amount, differing from the average monthly contribution of the customer, which the institution has assessed and recognised as commensurate, it would be able to detect such instances and would perform the necessary due diligence actions with respect to such contribution (for example, whether any of the factors under Annex No. 2 as regards considerable excess of the limit set by the institution occur).

3.4.3. Enhanced due diligence in accordance with Annex No. 2 to the Customer Due Diligence Regulations

176. Upon the occurrence of the risk factor under Annex No. 2, the institution shall conduct the enhanced customer due diligence, by taking **some of the enhanced due diligence measures**, which are substantially required, in order to ascertain the economic and lawful purposes of the transactions, i.e., performs the customer due diligence to an extent required to clarify whether the occurrence of the risk factor creates suspicions about the MLTPF or causes an increase of the MLTPF risk. Besides, in such cases it shall also be necessary to consider and assess the information, which is already at the disposal of the institution.

Example

The indication occurs: t*ransaction is concluded or outsourced on behalf of the customer by an accountant, attorney or a service provider for the establishment and functioning of a legal arrangement acting on behalf of the customer (not applicable to the opening of a temporary account as long as the company does not have the status of a legal person, as well as for transactions regarding the increase of share capital).*

This factor means that the institution, when detecting that the transaction in the interests of the customer is concluded or performed by an outsourced accountant, attorney or a service provider for the establishment and functioning of a legal arrangement acting on behalf of the customer, shall perform customer due diligence to such an extent that enables one to clarify whether it creates suspicions about the MLTPF or increase of the MLTPF risk.

When setting the applicable enhanced due diligence measures, the institution shall take into account the information about the customer at its disposal - for example, an enterprise registered in the Republic of Latvia with three employees, engaged in sewing (tailoring) service, has authorised an outsourced accountant for the performance of transactions, because it does not employ an in-house accountant; largescale production enterprise authorises the attorney for the performance of transactions, in order to conclude a secure agreement, taking into account the knowledge of the attorney. For such customer, the scope of due diligence will differ from the scope of due diligence that must be applied to a higher risk customer, for example, shell arrangement, on behalf whereof the outsourced accountant is acting.

Not all the customers using the outsourced accountant shall automatically be considered as high-risk customers.

3.4.4. Enhanced due diligence in accordance with the customer risk scoring results

177. On the basis of the customer risk scoring results (score), the institution shall determine the risk scoring threshold level, to which the enhanced customer due diligence is correspondingly applied. The threshold level for the performance of enhance due diligence before the establishment of a business relationship and during the business relationship will be different, just like the applicable enhanced due diligence measures and the scope thereof (depending on the inherent risk).

178. When setting the threshold level and the enhanced due diligence measures applicable thereto, the institution shall ensure that the applicable enhanced due diligence measures and the scope thereof are appropriate and effective enough for the institution to be able to assess and understand the economic or personal activity of the customer.

179. The risk inherent to the customer shall define the frequency of enhanced due diligence, i.e., the lower the risk, the less frequent the enhanced due diligence, and vice versa - the higher the risk, the more frequent the enhanced due diligence.

180. When setting the frequency of enhanced due diligence within the scope of the time period specified in Clause 21 of the Customer Due Diligence Regulations, the institution shall specify the point of reference for calculating the term of one year or six months in the policies and procedures, observing the purpose of the requirement contained in Clause 21 of the Customer Due Diligence Regulations - to ensure the continuity of the period of enhanced due diligence.

3.4.5. Period for which enhanced due diligence is to be performed

181. The institution shall prescribe the period of enhanced due diligence (i.e., the period of time for which the activity of the customer is being assessed, the enhanced due diligence reporting period) in the policies and procedures, observing the circumstances that have formed the basis for the performance of enhanced customer due diligence. Neither the Customer Due Diligence Regulations, nor any other laws and regulations prescribe any particular period, for which enhanced due diligence is to be performed, but they define the purpose of enhanced due diligence - to ascertain that the institution knows the activity of the customer and there are no suspicions present about the MLTPF.

182. As regards the customers subject to enhanced due diligence, upon the occurrence of risk factors under Annex No. 1, the Customer Due Diligence Regulations prescribe the requirement to ensure continuity. Therewith, when setting the frequency of enhanced due diligence, if the risk increasing factor under Annex No. 1 has been detected with respect to the customer, the institution shall specify the point of reference for calculating the term of one year or six months, by observing the purpose of the requirement - to ensure the continuity of the period of enhanced due diligence.

The core principle for setting the period with respect to the risk factors under Annex No. 1 is - the time period since the performance of the last enhanced due diligence (considering the final date of the period of the last enhanced due diligence as the reference point).

Nevertheless, depending on the transactions and the MLTPF risk, there may be situations when it is necessary to also include the period (or a part thereof), for which the due diligence was performed, in order to understand the activity of the customer.

183. If the customer incurs the risk factor under Annex No. 1 and previously the standard due diligence was performed, but enhanced due diligence was not performed, then the institution shall set the enhanced due diligence period from the last performed standard customer due diligence.

Nevertheless, depending on the transactions and the risk, it might be necessary to also include the period, for which the due diligence was already performed.

184. If no MLTPF risk is detected and there are no other risk increasing factors, it may be commensurate to perform enhanced due diligence less frequently than specified in Clause 21 of the Customer Due Diligence Regulations. Such approach is permissible, in the case of meeting the conditions that the institution ensures risk monitoring, is able to identify increased risk and ensures timely and appropriate risk identification and mitigation measures.

185. As regards the period for which enhanced due diligence is to be performed, if in accordance with Annex No. 2 a risk increasing factor has been detected, the institution shall take into account the MLTPF risk inherent to the customer and the detected factor or the time of the previously performed enhanced due diligence, if any has been previously performed with respect to the customer (enhanced due diligence is to be performed, in order to understand whether the particular risk factor creates suspicions about the MLTPF or risk increase, therewith the period is to be set according to the risk factor).

Example

The indication occurs: *the customer orders asset investment in a financial institution of the jurisdiction with high money laundering and terrorism and proliferation financing risk*.

This factor refers to the cases, when the customer orders asset (monetary funds, financial instruments, etc.) investment in a financial institution located in a higher risk jurisdiction (insofar as the institution knows that it is the financial instruments' investment).
The institution shall apply the enhanced due diligence measures for such period that enables an understanding of whether such order of the customer creates suspicions about the MLTPF or risk increase. To set the period, it shall be necessary to assess the information about the customer at the disposal of the institution - whether the institution understands the activity of the customer, whether such transactions are typical for the customer, whether and when the enhanced due diligence was performed for the customer, etc.

The core principle for setting the period with respect to the risk factors under Annex No. 2 - the MLTPF risk of the customer and the detected risk factor.

3.4.6. Determination of groups of related customers

186. Upon the commencement of a business relationship, the institution, by means of a risk-based approach, shall verify, assess and document whether the customer belongs to a group of related customers according to the criteria set in Clause 5.7 of the Customer Due Diligence Regulations. The higher the MLTPF risk inherent to the customer, the greater attention must be paid to the criteria.

187. Based on the MLTPF risk inherent to the customer, there might be a situation when the criteria set in Clause 5.7 of the Customer Due Diligence Regulations are not to be applied at all or attention must be paid to separate criteria. Particular criteria and in the situations of what type of

risk they shall be applied, in order to determine the group of related customers, shall be defined by the institution.

Criteria shall be assessed on the basis of the risk. There is no requirement set to perform the assessment of all criteria with respect to all customers of the institution.

188. Detection of a group of related customers in cases when an increased risk is present, enables the institution to assess the transaction scheme as a whole, thus ensuring more comprehensive assessment about the performed transactions and detection of suspicious transactions. When assessing transactions of a single customer separately, information about transactions is narrower, therewith the indications of potentially suspicious transactions might as well not be detected. In turn, the broader the information about the transactions (*inter alia*, intra-group transactions), the more comprehensive the assessment possible to determine whether the transactions have economic justification and purpose and whether the transactions are not such that point out the performance of suspicious transactions.

189. There might be situations, when the criteria for the group of related customers can be detected automatically (for example, the customers have one and the same BO). Nevertheless, part of the criteria can only be detected within the scope of enhanced due diligence - manually (for example, family relationship (family ties) between the BO, the customer uses a loan, the collateral whereof is another customer's financial instruments).

190. The institution in the policies and procedures shall set the requirements as to when and which of the indicative criteria of the group of related customers referred to Clause 5.7 of the Customer Due Diligence Regulations shall be assessed by it. The institution shall be liable for justification of the implementation and adequacy of the set requirements.

191. The Customer Due Diligence Regulations do not provide that, upon the detection of any of the criteria referred to in Clause 5.7 of the Customer Due Diligence Regulations, it shall be automatically considered that the customers comprise the group of related customers. In cases where two or more customers have a common BO, these customers would have to be considered as a group of related customers. Whereas in cases where family ties of the BOs, a coincidence of the authorised representative or contact information is identified for two or more customers, the institution must, first of all, assess these characteristics and, in case of necessity, must obtain additional information, taking into consideration the fact that they may indicate the existence of a group of c related customers.

Example

Situation No. 1
Several customers of one and the same institution are detected, whose actual addresses coincide.

Possible conduct: to clarify what kind of building is at the particular address - private house, office building - and whether there are any suspicions present as to the use of a letterbox address.

In this case it should be assessed whether there is a connection between the customers (for example, it is planned to carry out interrelated transactions), in order to determine whether the customers are considered to be a group of related customers.

Situation No. 2
Customer A of the institution is an enterprise engaged in dairy farming and supplies its products to another customer of the institution - customer B, whose economic activity is the manufacture of dairy products. Customer A performs various payments for the expenses and maintenance of the farm, while the incoming transactions are mainly (~85%) payments from customer B for the supplied products.

Possible conduct: the institution detects that the transactions of customer A and customer B correspond to the indication of the group of related customers "the mutual transactions form at least 30 per cent of the customer's monthly turnover", however, having assessed the economic activity and performed transactions of customer A and customer B, there are no grounds to consider that customer A and customer B form a group of related customers.

Situation No. 3
Apartment owners of a multi-apartment house have established the association for the management of the house. The BO of the association is presumed to be its Executive Board, consisting of the owners of five apartments.

Apartment owners, considering the fact that their actual address coincides, would not be considered to be a group of related customers.

192. When assessing whether a group of related customers exists, the institution shall assess both the indications referred to in Clause 5.7 of the Customer Due Diligence Regulations and also the transactions of potential participants of the group (*inter alia*, payments, mutual loans, transactions in financial instruments, mutual guarantees (sureties), etc.).

Example

Customer A and customer B of the institution own a joint company *Kļava*. Customer A is the BO of the company *Bērzs*. In turn, customer B is the BO of the company *Ozols*.

The economic activity of the company *Kļava* is catering services. The economic activity of the company *Bērzs* is construction services. In turn, the economic activity of the company *Ozols* is related to the sale of real estate.

To assess the existence of the group of related customers, the institution shall consider the circumstances that the enterprises are operating in the sector featuring increased risk with respect to the use of cash, as well as the circumstances that the company *Kļava* has two BOs, each of which is also the BO in another company.

To ascertain whether or not the company *Kļava* is related to the companies *Ozols* and *Bērzs*, the institution shall assess both the types of economic activity of the companies, and whether or not the companies perform mutual transactions (payments, loans, guarantees (sureties), etc.).

Considering the fact that the companies demonstrate an indication with respect to a common BO, the institution shall form the mutually related group or groups:
1) including all the companies in one group;
2) including the companies *Kļava* and *Ozols* in one group and the companies *Kļava* and *Bērzs* in the second group.

When selecting which of the group formation options to apply, the institution may be guided by the number of participants of the group and the substance (nature) of participants of the group (for example, if each BO has its own holding, it is reasonable to form separate groups for each holding company).

193. Having identified a group of related customers, the institution shall document the role of each customer in the group and shall schematically depict the flow of money and goods within the group and with the counterparties outside the group, in order to understand the role and meaning of each participant in the group. If one BO has several companies with the same direction of economic activity, then the institution, on the basis of the risk, shall clarify and document the reason for setting up several companies with the same economic activity and the economic substance of such conduct.

194. When documenting the participants of the group of related customers and their role within the group, the institution shall ensure that each participant has information at its disposal that the customer is in the composition of the group (specifying the relevant group) and when the activity of the group was generally assessed, but it shall not be necessary to include the rating itself in the file of each participant. It shall be necessary to ensure the traceability of the rating and retrieval thereof in the case of necessity, for example, if an independent external audit of the verification of the Commission is being performed.

195. Upon the detection of a group of related customers, the score of each participant of the group shall be defined according to the customer risk scoring system. Therewith, the risk of the participants of the group may differ (if one participant of the group has a high risk, it shall not automatically mean that all participants of the group have a high risk and the activity of the group and the risk inherent thereto is to be assessed as a whole.

3.4.7. Enhanced due diligence for the group of related customers

196. The institution, by means of a risk-based approach, must prescribe in the policies and procedures the frequency at which it is necessary to perform not only the enhanced due diligence of a particular customer, but also the enhanced due diligence of the customers forming the group of related customers with the relevant customer, i.e., to study the activity of the group of customers as a whole within the scope of the institution (attention must be paid not only to the incoming and outgoing payments of the group, but also to intra-group transactions). The purpose of this requirement is to ensure that the institution knows not only the economic or personal activity of the customer, but also the activity of all customers forming the group of related customers, thus obtaining a more complete understanding of the performed transactions (the transactions of each separate customer may also not be indicative of suspicious transactions, in turn, by assessing the transactions of the group as a whole, it is possible to better understand the substance of transactions and to detect suspicious transactions).

197. If the customer belonging to a group of related customers incurs the risk factor under Annex No. 1, in order to determine whether the enhanced due diligence is to be performed for the entire group of related customers, the institution **shall assess the role of the relevant customer within the group and shall consider the date and results of the last enhanced due diligence performed for the entire group of related customers**[21]:

197.1. if the role of the customer is significant and enhanced due diligence has not been performed for the group within the term set by the institution, enhanced due diligence shall be performed for all customers belonging to a group of related customers;

197.2. if the role of the customer is significant and enhanced due diligence has been performed for the group within the term set by the institution, enhanced due diligence shall be performed for the customer who has incurred the risk factor under Annex No. 1;

197.3. if the role of the customer within the group is not significant, enhanced due diligence shall be performed for the customer who has incurred the risk factor under Annex No. 1;

197.4. if, when performing customer due diligence, unclear issues or discrepancies with the activity of the group of the customer as a whole have been detected, enhanced due diligence shall be performed for the entire group of customers according to the identified unclear issues, discrepancies.

The circumstance determining the performance of enhanced due diligence for the entire group or for a separate customer incurring the factor under Annex No. 1 is the role (influence) of the customer within the group and the date and result of the previously performed enhanced due diligence of the group. In turn, if, when performing the due diligence of a customer belonging to the group of customers, unclear issues or discrepancies with the activity of the group of customers as a whole are detected, it may form grounds for performing due diligence for the entire group of customers.

[21] If risks were detected during due diligence that require more frequent transaction analysis, enhanced due diligence shall be performed more often. The criterion of significance and the results of the last due diligence must be viewed in a complete way, in order to avoid the situation where under the influence of the significance of various participants of the group, enhanced due diligence for the entire group must be performed incommensurately often.

198. The institution shall determine the significance (influence) of the role of the customer within the group, by assessing the activity of the customer, its BO, volume of transactions, purposes of transactions, risk increasing factors, etc. For example, when determining the significance of the role within the scope of holding companies, it must be taken into account that only one of the holding companies might have a significant turnover, which does not automatically mean that enhanced due diligence must be performed for one company only. It shall be necessary for the institution to evaluate whether there are any risk increasing factors present, for example, whether the BO of the holding is a PEP, what the purpose of the performed transactions is, for example, a holding company receives money once a month in accordance with the consulting agreement, by assessing whether the institution has sufficient information and understanding of the lawful purpose of the transaction at its disposal.

199. If, based on the result of the customer risk scoring system, it is necessary to perform enhanced due diligence for the customer, the institution shall assess the group of customers as a whole and shall understand the role of each participant of the group of related customers and the influence thereof on the entire group. In cases when the institution can justify that such separate customers form the group of related customers do not influence the group as a whole, not all of the customers belonging to the group of related customers should be subjected to enhanced due diligence, but only those having influence on the group.

200. When commencing a business relationship with a new participant of the group of related customers, the institution shall assess the role of the new participant in the group and the regularity of the enhanced due diligence prescribed for the group of related customers - if the customer does not have a significant role in the group and the group has undergone enhanced due diligence in accordance with the prescribed regularity, it shall not be necessary to perform enhanced due diligence of all customers. If the role of the new participant is significant, it shall be necessary for the group to perform enhanced due diligence of all customers belonging to a group, if enhanced due diligence has not been performed for the group in accordance with the prescribed regularity.

201. Upon the occurrence of the factor under Annex No. 2, it shall not be necessary to perform enhanced due diligence of all related customers every time, however it may be necessary, if during the due diligence of the relevant factor the institution detects an influence on the entire group of related customers.

3.4.8. Measures within the scope of enhanced due diligence

202. Within the scope of enhanced due diligence, it is necessary to obtain additional (more detailed) information about the economic or personal activity of the customer. Thus, based on the risk assessment, the institution shall not only obtain the name of the type of customer's economic or personal activity (for example, trade, intermediation in trading activities), but also more detailed information about it, for example:

202.1. how the customer organises its economic or personal activity;

202.2. what the actual place of the economic activity is;

202.3. what the number of employees in the company is;

202.4. what the distribution channels of goods and services are;

202.5. what the economic activity of the previous periods is (turnover, profit, partners, etc.);

202.6. ascertain that the customer has a licence or special permission, if the customer's declared economic or personal activity provides for the obtaining of such a licence and it is connected with a high risk industry that impacts the customer's risk assessment[22].

203. The institution, based on the risk assessment, shall also obtain the documents confirming this information. Based on the risk assessment the institution may require the submission of supporting documentation of transactions or account statements for the previous period of activity, which enables one to assess the customer's previously conducted transactions, counterparties, volume of transactions and compare it with the information declared by the customer with the institution. In addition, the institution may obtain other information from public and independent information sources, in order to gain a complete understanding about the customer's economic activity and its volume.

Example

Situation No. 1

In the case if the customer issues loans and it is not its declared economic activity, by means of a risk-based approach (for example, if the customer is registered in a high risk jurisdiction and its economic activity is not related to lending, the loans are issued to persons from high risk jurisdictions), it shall be necessary for the institution to follow up on whether the loans issued during previous years are being repaid. For example, the customer issued a loan in 2016, with the repayment term expiring in 2017. The institution conducts enhanced customer due diligence in 2017 and only assesses the transactions performed in 2017, but is no longer assessing the transactions of 2016, in accordance with which the repayment of the loan would have to be received in 2017. Repayment of the loan is not received in 2017. The customer continues issuing new loans, which, probably, will never be repaid, and it is not planned that they would be repaid. These circumstances may be indicative of a fictitious activity.

Situation No. 2

On 26 February 2019, the customer *SD Ltd* transfers to the institution for management (fiduciary transaction), financial resources in the amount of EUR 700, 000 in favour of the company *AB LP*. One and the same BO is specified for both companies - A.S.

On 26 February 2019, the institution issues the company *AB LP*, a loan in the amount of EUR 700, 000, which it, in turn, transfers to Spanish companies *X S.L.* (3 March 2019, EUR 400 000), *Y S.L.* (4 April 2019, EUR 150, 000) and *Z S.L.* (4 April 2019, EUR 150, 000) with the purpose of the payment - *payment for replenishment of the authorised capital* (all companies have accounts in the credit institution in Spain).

Within the scope of enhanced due diligence, it is necessary to clarify the economic substance and lawful purpose of the referred to transaction scheme:

[22] Ascertaining the existence of a licence shall refer to the cases when the legal nature of the activity of the customer is related to transactions exposed to a higher MLTPF risk (for example, provision of financial services, organisation of gambling, etc.).

- when concluding a transaction with a fiduciary loan, it was clarified that the company *AB LP* needs the loan for an investment project in Spanish companies (without specifying the firm name of particular companies), further performing the acquisition of the investment object. The company SD Ltd places the available financial resources in deposit for the purposes of receiving interest income.
The customer has submitted an explanation as to this situation, which has been accepted, that it is not considered correct for the one company to issue the loan to the other company, because then it would be the financing of investment activities of one company on the account of current assets of the other company.
Upon the receipt of an explanation from the customer, it shall be essential for the institution to itself ascertain the appropriateness and justification thereof, assessing the conformity of the explanation to the sectoral practice, by verifying information in public sources, etc. It is important to document the justification of a conclusion:
- in addition, within the scope of enhanced due diligence, it would be necessary to assess whether the scheme of fiduciary transactions is used to conceal the actual origin of the financial resources used for investments, which come from the companies *C. Inc., L.M. Ltd* and *A.O. L.P.* (financial resources from these companies have been paid into the account of the customer *SD Ltd* and the transactions of the customer *SD Ltd* with the referred to companies are of a one-off nature).

Supporting documents have been requested with respect to this situation. They have been received in the Spanish language, and on the due diligence checklist it was specified with respect thereto that they are in regard to an agreement on the acquisition of real estate in Spain.

To ascertain the content of the documents and to assess it, the institution needs a document in a language that the employee of the institution understands - the customer may be asked to submit such or the institution may translate the documents itself. It shall be necessary for the institution to ascertain that the documents support the transactions performed in the account of the customer.

Situation No. 3
The customer *WA LP* is a company registered in a European Union Member State, with the account being opened in 2015, type of economic activity - investment activity.

In 2017, several fiduciary agreements have been concluded between the institution and the customer *WA LP* on the financing of several loans. The customer has taken over the liabilities of another customer of the institution - *DX LLP*. The customer *DX LLP* has invested into the fiduciary transaction, the financial resources received in the form of the loan from another customer of the institution - *OL Ltd*, in accordance with the loan agreement concluded in 2014 on the issuance of the loans in the amount of USD 1.2 million and EUR 700, 000 for the term of three years.

Within the scope of enhanced due diligence, it is necessary to clarify the initial origin of the financial resources, invested into the fiduciary transaction and lent by another customer of the institution *OL Ltd*.

Situation No. 4

The customer ABC LTD is a company registered in a European Union Member State, for whom the institution ensures the payment acceptance services. *ABC LTD* is selling food supplements on internet sites. The institution transfers the funds from card users received within the scope of payment acceptance to the account of *CDE LTD* in another financial institution. A large number of complaints have been detected in the public environment regarding the fact that after the performance of purchases on the trading sites of *ABC LTD* unauthorised payments are being charged from the cards of the purchasers or that the received goods are of improper quality. Likewise, within the scope of transaction screening, it has been detected that 90% of the received card payments are performed with the payment cards issued by another country (other than the European Union Member State and not considered to be a high risk third country). In the questionnaire, the customer *ABC LTD* has specified that the key cooperation partner thereof is *CDE LTD*, which ensures telemarketing services.

Within the scope of enhanced due diligence, considering the risk increasing factors, it is not sufficient to be limited by the conclusion that the activity of the customer - online trading - corresponds to the activity declared in the questionnaire, but the scheme of the activity of the customer must be assessed as a whole, incl., what measures have been taken to ensure that unauthorised payments are not charged. The institution must obtain information and documents characterising the key cooperation partners of the customer, *inter alia*, it must assess how the customer acquires and performs payment for the goods sold on its internet sites, and whether the customer has alternative channels of income, taking into account the fact that the entire income from acceptance of the payment cards is transferred for the telemarketing services only. The institution must also assess information at its disposal about the actual place of performance of economic activity of the customer, considering the fact that card transactions demonstrate that the main target audience of online trading are purchasers not from the European Union Member State, but another country (other than the European Union Member State and not considered to be a high risk third country).

3.4.9. Enhanced due diligence, when performing an occasional transaction

204. The Law prescribes that the institution shall conduct enhanced customer due diligence, when commencing and maintaining a business relationship or when performing an occasional transaction with the customer with increased inherent MLTPF risk.

205. **It shall be necessary** for the institution, **before the execution of an occasional transaction, to obtain information about the purpose and substance of the occasional transaction to the extent necessary to determine whether the transaction features any risk increasing factors and whether it is necessary to perform enhanced due diligence before the execution of the transaction** (for example, in accordance with the operation of and services offered by the institution, particular risk factors or the set thereof shall be determined, upon the occurrence whereof enhanced due diligence is to be performed, as well as by prescribing the level of detail of due diligence, based on the set of risk factors inherent to the customer.

Example

When offering contactless cash transfers to the higher risk jurisdiction, such transaction (depending on the sum and other circumstances) would have to be subject to enhanced due diligence to an extent adequate to the specific nature of the transaction, besides, performing it prior to the execution of the transaction, considering the fact that after execution it might not be possible to find the customer (for example, by clarifying what the purpose of performance of the transfer to the higher risk jurisdiction is, what the origin of the funds used in the transaction is, etc.).

3.5. Beneficial owner (BO)

3.5.1. Determination of the BO

206. In accordance with the Law, when conducting customer due diligence, the institution shall, in all cases, determine the BO of the customer. In cases when the risk is higher, the institution shall also ascertain whether the determined BO is the ultimate BO.

207. Section 1, Clause 5 "a" of the Law states that the BO is a natural person who is the owner of the legal person or who controls the customer, or on whose behalf, for whose benefit or in whose interests the business relationship is being established or an individual (occasional) transaction is being executed, and it is at least regarding legal persons - a natural person who owns, in the form of direct or indirect shareholding, more than 25 per cent of the capital shares or voting stock of the legal person or who directly or indirectly controls it.

208. The BO is always a natural person who owns, or in whose interests the particular legal person is established or operates, or who directly or indirectly[23] implements control over the legal person. The BO is a natural person, who ultimately owns or who controls the customer, or a natural person, for whose benefit the transaction is performed, therewith this notion entails persons who implement ultimate control over the legal person, namely, ownership or control is being implemented not only by the ownership right, but also via other means of control, which are not considered to be direct control. The purpose of disclosure of the BO is to determine the natural person who actually owns the legal person or who has actual possibilities to control it, irrespective of whether or not the person is the owner of the legal person and whether or not it holds any official position in the legal person. **The significant feature of the definition of the BO is that it is applicable to the actual control - based on the actual situation, it can exceed the legal ownership and the limit of control.**

Example

100% of capital shares of the customer - legal person is owned by person X. According to the information at the disposal of the institution (information obtained both from public sources and

[23] In the case of a direct shareholding or control, the BO controls the legal person directly, while in the case of an indirect shareholding or control, the control is implemented through the intermediation of another - natural or legal - person.

from the customer, within the scope of cooperation), the actual control over the customer is implemented by person C, who is the husband of person X.

It shall be necessary for the institution to assess whether there are reasonable doubts as to the BO.

If, having assessed the economic activity of the customer (whether it is understandable for the institution and the performed transactions do not create suspicions as to the MLTPF, or any information of a negative nature is available), the institution detects that the disclosure of such BO within the scope of the family is understandable (for example, husband has a board business and several companies, where family members are specified as BOs, who correspondingly also implement control or gain benefit in each company, nevertheless, in parallel, the husband also implements control or gains benefit), the institution, based on the results and conclusion of due diligence and by documenting them, may specify both persons as the BO. It shall not be necessary for the institution to obtain the consent of the customer with the results of the performed customer due diligence.

In turn, in cases when the institution, having assessed the activity of the customer and information about the specified BO, incurs doubts (it does not obtain information about the actual ability of the specified BO to be the BO - no sufficient knowledge, no information that would demonstrate that the BO controls or gains benefit from the customer), the institution, if it cannot obtain information about the actual BO, shall act in accordance with the provisions of the Law and shall terminate or not commence a business relationship with such customer and in cases when there are suspicions about the MLTPF, reports it to the Financial Intelligence Unit.

209. In cases when none of the natural persons owns more than 25 per cent of the capital shares or voting stock of the legal person and it is not possible to determine which natural person controls the customer (for example, the association formed for the purposes of management of the multi-apartment house), the senior management of the legal person may be regarded as the BO, if the doubts that there is another BO are excluded (please see more details regarding this issue in Sub-chapter 3.6.4).

210. The institution, in its policies and procedures, shall prescribe detailed requirements for the manner of determination and the conformity check of the BO.

211. In accordance with the requirements of the Law the institution shall determine the BO of the customer, using information or documents from the Enterprise Register. In addition, on the basis of risk assessment, the institution shall determine the BO of the customer in one or several of the following ways:

211.1. by receiving a statement on the beneficial owner approved by the customer[24];

211.2. by using information or documents from the information systems of the Republic of Latvia or foreign countries;

[24] In accordance with Section 195.[1] of the Criminal Law of the Republic of Latvia a person who knowingly commits the provision of false information to a bank which is authorised by law to request information regarding the BO may be held criminally liable and a criminal penalty may be imposed thereto.

211.3. by determining the BO on its own if the information regarding him or her cannot be obtained in any other way.

212. From the requirements of the Law, it derives that obtaining information from the Enterprise Register is mandatory. In cases when the customer risk is low, it shall be sufficient to determine the BO according to the ownership rights, by using information from the Enterprise Register. On the basis of the risk assessment, the institution must also take other measures for verification of the BO (for example, a self-declaration approved by the customer would be permissible in cases of a lower risk, in turn, in cases of a higher risk, it would not be sufficient, if the self-declaration is used as the only measure for the verification of the BO). The lower the risk, the less complicated form of verification is permissible.

213. As regards the use of information and documents from the registers or internet resources, the institution must observe the risk assessment-based approach, meaning that it must ascertain whether the referred to manner of determination of the BO is sufficient and whether there are any reasonable doubts about the conformity of the obtained information (please see the ways of obtaining information necessary for customer due diligence in Sub-chapter 3.1.1.2.). It shall be necessary to mandatorily verify the information, if there are data at the disposal of the institution, which contradict that which is specified in the registers.

214. In the event of an increased MLTPF risk (for example, the company is registered abroad and its economic activity is associated with high risk, the customer's behaviour creates doubts as to the authenticity or justification of the provided information, etc.) it shall be insufficient to merely clarify the percentage breakdown of the capital shares of the customer, which is an indicative parameter for determination of the BO and does not automatically mean that a person who owns at least 25 per cent of the company is its BO. The BO may also be another – third-party. The institution shall determine whether the specified BO is formal and whether the customer is **controlled in any other manner by** another person or the business relationship is established in the favour and in the interests of another person. The institution shall take commensurate measures in accordance with the MLTPF risk, in order to determine a person controlling the customer, for example, shall obtain additional information from the customer, shall verify information in the publicly available sources, etc.

215. In cases of an increased risk, when one natural person owns the majority of capital shared (51 per cent and more), it might be necessary to also determine other natural persons who own the capital shares of the customer (for example, publicly available information shows that a person who owns less than 51 per cent of capital shares is the BO of the customer). If the institution incurs doubts as to whether a person who owns the largest number of capital shares is the person who controls the customer, and if the increased risk is inherent to the customer, it would be necessary to also determine and assess other persons who own the capital shares of the customer, in order to determine a person who ultimately controls the customer (for example, to assess whether there are any family ties, personal ties among such persons that may be used to conceal the ultimate BO).

216. Taking the structure of the enterprise into account, if possible, it might be important to identify all the shareholders in cases where none of the shareholders (owners of capital shares) holds 25% and the shareholders have the rights to represent the customer individually or jointly

with other persons, since the control of shareholders over the customer is implemented through the representation rights. Thus, it shall be necessary for the institution to assess which shareholder has control over the customer (for example, five natural persons each hold 20% of the capital shares and three out of five holders, are on the customer's Executive Board, and each of them has the right to represent the customer individually).

3.5.2. Ascertaining the BO

217. The institution, in its policies and procedures, on the basis of risk assessment, must set the criteria, in which cases and under which procedure it ascertains the genuineness of the determined BO, *inter alia*, must define the features which might be indicative of the possibility that the customer or the BO thereof acts in favour of a third person (for example, the registered owners and BOs of the company in the public registers does not coincide with the ones specified to the institution, the customer or the BO is unable to provide a motivated explanation about the origin of wealth and funds, the BO does not gain benefit from the company or it is of a minimum amount and is not proportionate to the turnover of the company; the company has large planned turnover, but the previous activity of the BO is not related to the relevant field of business).

218. As regards the gaining of benefit by the BO, the institution must take into account the fact that, based on the economic activity and the form of the customer, the BO does not always gain benefit from the company in monetary expression. The institution would have to assess what kind of benefit the BO gains. If the profit of the BO is of minimum amount, the institution shall assess why the profit is not generated and whether the absence of profit is appropriate and normal practice in the relevant field.

219. When defining the cases and actions to be taken, in order to ascertain the BO, the institution must use the risk assessment-based approach. In cases when a low MLTPF risk is present, the ownership structure of the customer and its economic activity is transparent and economically justified and the volumes are insignificant, the institution may as well not take additional measures for verification of the BO.

Example
The customer is a resident of the Republic of Latvia, the company has been operating for a long time already, the risk thereof is low, the type of activity is not to be classified as an increased risk activity, no risk increasing factors are detected, the volume of transactions is insignificant. The customer is registered in the Republic of Latvia, the economic activity of the customer is not of an increased risk, and no material tangible investments are necessary for carrying out the economic activity of the customer, it is a company engaged in the creation and selling of handicrafts.

220. Upon the detection of the specified indications, it shall be necessary to perform additional due diligence. In cases when the additional due diligence does not eliminate the suspicions regarding the activity of the customer in the interests or in favour of another person, the business

relationship shall not be commenced or shall be terminated, or the occasional transaction shall not be performed.

221. The purpose of ascertaining the BO is for the institution to obtain confirmation that the specified BO is not specified formally and is really gaining benefit from the activity of the company. When ascertaining the BO, the institution, on the basis of risk assessment, shall apply various measures. One of the possible measures to be applied, if it corresponds to the actual circumstances, is to obtain additional information about, for example, previous professional experience and education of the BO and to compare it to the publicly available information or to clarify the property status of the BO, by obtaining information about the tax payments performed by the BO (for example, by obtaining the tax returns submitted in the country of residence of the BO).

222. By obtaining additional information, the institution may ascertain that the specified BO is the actual BO, or, to the contrary - assessing information, *inter alia*, documents, the suspicions that the specified BO is not the ultimate BO can be proven. To ascertain the genuineness of the BO, it is important not only to obtain documents and information, but also to verify them on their merits and in terms of logic, for example, by comparing information obtained from the customer and from public registers with the substance and volume of transactions performed by the customer and the cooperation partners of the customer[25].

223. It shall be necessary to assess the documents and information, and the documented final conclusions of the due diligence must be well-reasoned and justified with particular facts, namely, how the information and documents obtained by the institution justify the fact that the BO determined by the institution really is the BO of the customer.

224. One of the criteria for ascertaining the conformity of the BO of the customer, which is applied on the basis of risk assessment (for example, in cases, when the institution has reasonable doubts as to the genuineness of the BO of the high-risk customer or increased risk customer, whose BO concurrently is the authorised person of the customer), and which can be analysed, is the IP addresses, from which the login to the internet bank is performed. Nevertheless, in such a case it shall also be necessary to assess, whether the persons using the internet bank are the legal representatives of the customer, namely, authorised signatories, accountants, etc. (hired persons). The use of IP address check is an effective way to ascertain the conformity of the BO to the results of the due diligence of the institution, to detect the country of residence of the customer, as well as to help detect the groups of related customers and to better understand the transactions performed by the customers. For example, when detecting that legally unrelated business partners or customers perform login to their internet bank from the same IP addresses, it must be assessed whether it is indicative of the fact that these customers are actually managed (and the benefit is gained) by the same persons.

[25] Please see more about the ways of obtaining information in Sub-chapter 3.1.1.2.

Example

Determination and assessment of the property status of the BO: it is necessary to obtain and assess information that the property status of the determined BO is proportionate and corresponding to the volume of transactions of the customer and the specified BO can really be the BO of the customer. By requesting information of documents supporting the wealth of the BO, the institution shall assess and set the period for which the information or documents are required for it, considering the actual circumstances, to be able to understand and ascertain the property status of the BO. If the wealth of the BO has been formed many years ago (for example, 15 years ago), it shall be necessary for the institution to also consider the regulation in effect at the time, when requesting information (whether according to the regulation there must have been documents about the specific transaction, whether there is a duty to retain them, to submit them to corresponding public authorities, whether the BO has already declared his or her income to the tax administration, etc.).

The verification of gaining benefit from the activity of the company by the BO is one of the elements that may serve as measures for ascertaining the BO. Nevertheless, gaining benefit in property terms is not necessarily present in all cases. Please see also Clause 218 herein above.

225. It shall be necessary to describe in the policies and procedures of the institution the actions and processes to be performed exactly according to the specificity of operation of the institution and the customer risk (for example, when the documents are necessary, when it is sufficient to obtain the explanation of the customer, when - information from public sources, to what extent, etc.).

226. With respect to the BO verification, by using the risk-assessment based approach, it shall be necessary to also ensure sufficiently documented and clearly justified conclusions about essential issues, such as origin of funds, origin of wealth, obtaining property benefit from the customer or explanation about the circumstances, why the property benefit is not being obtained, affiliation between the customer and the country where the business relationship is established or occasional transaction or economic activity is performed. It shall be necessary to assess whether information gathered by the institution contains contradictions and creates suspicions that the ultimate BO is being concealed.

Example

The BO of the customer gas changed, and the indications inherent to the changes cause suspicions about the concealment of the BO.

Situation No. 1

The customer *P.Limited*, at the moment of opening of the account in February 2017, specified V.T. as the BO. In the customer due diligence conducted by the institution in 2017 it was concluded that the change of the BO has taken place and the BO of the customer is D.Z.

As a result of the customer due diligence, the institution has documented that, considering the fact that since the moment of opening of the account the company has not been very active and it was not intended to be used within the structure of the group of companies, V.T. and D.Z. are long-term friends and business partners, they have been working together in the nineties of the twentieth century in a foreign company X, V.T. transferred the ownership rights in the company *P.Limited* to D.Z. without remuneration.

In such a situation, when ascertaining the BO, it would be necessary to assess whether the transfer of ownership rights of the company without remuneration is not a formal conduct, also additionally assessing publicly available information.

Situation No. 2
The customer is a foreign company, the type of economic activity - investment activity in IT projects. The BO specified by the customer was born in 1945. The BO of the customer is a housewife, the origin of funds - borrowed funds. The son-in-law of the BO is specified as a consultant in the planned business, on whom there is public information available that he is an entrepreneur in another country and has established and is managing several large companies.

Factors to focus on in this situation:
- the type of activity of the customer is investments in IT projects and the customer has specified that the borrowed financial resources will be used for the performance of the activity;
- the son-in-law of the BO specified by the customer will provide consultations with respect to the activity of the customer.

Within the scope of customer due diligence, it would be necessary to assess whether the BO specified by the customer is acting in the interests of a third person, for example, son-in-law, by obtaining information about the economic or professional activity, education, previous professional experience of the BO, to ascertain that the BO has corresponding knowledge and experience, in order to operate in the field of investments with respect to the IT projects.

3.5.3. Determination of a complex customer structure

227. Aspects that may be indicative of a complex structure entail several levels of owners,;moreover, the owners come from various jurisdictions (for example, legal person owned by several other legal persons, which, in turn, are also owned by further companies) and such companies are registered in various jurisdictions.

228. On the basis of risk assessment, if the company has a complex ownership and governance structure (for example, the customer is registered in the country, where no public registers of shareholders are available and there are several nominal owners within the censorship structure; the customer is the company registered in a European Union Member State and it has several owners - legal persons, whose legal form encumbers the determination of their owners and BOs (for example, the funds)), the institution would have to request that the customer submits the scheme of ownership and governance structure. In such cases, it is important to understand each level within the company structure.

229. Where the ownership structure is complex but traceable, and it is possible to determine the BO of the customer, such customer per se would not be automatically considered as an increased risk customer, because a complex ownership structure may be justified by business specificity and is not prohibited per se.

230. To determine whether or not the ownership structure of the customer is to be considered as complex and such that increases the customer risk, it shall be necessary to assess not only the number of levels of ownership structure and the jurisdictions of the owners, but also whether or not such structure allows for the determination of the BO. If, notwithstanding several levels of owners and their jurisdictions, it is still possible to determine the BO of the customer, besides the economic activity of the customer is understandable and does not create doubts for the institution, the structure of the customer alone should not increase the customer risk. The structure might be complex, but still transparent. In turn, in cases when the structure is complex and the determination of the BO of the customer is encumbered, this is to be deemed as a factor increasing the customer risk.

Example

Situation No. 1
The customer, who is a SIA (Limited Liability Company) registered in the Republic of Latvia and owned by another company registered in the Republic of Latvia, which, in turn, is further owned by the company registered in a Scandinavian country (the ownership structure of several levels is present), with information about the BO whereof being available in the public registers of the relevant country and whose economic activity is clear (for example, wholesale network with chain stores throughout the Republic of Latvia), would not have to be automatically considered as an increased risk customer, on the basis of its ownership structure.

Situation No. 2
The customer- legal person owned by another company registered in the Republic Latvia, which, in turn, is owned by an offshore company with nominal directors and with respect whereto there is no information about the BO available in the registers of the relevant jurisdiction, may be considered to be a customer with a complex ownership structure, which increases the customer risk. In addition to this circumstance, it would be necessary to also assess the economic activity of the customer and other information obtained within customer due diligence, in order to assess whether any other circumstances are existing that would demonstrate an increased MLTPF risk or create suspicions about the MLTPF (for example, having assessed the economic activity and ownership structure of the customer, the reasons for the formation of such structure are not clear).

3.5.4. The BO - person holding the position in the senior management body

231. Only in cases where all the possible means of clarification have been used and it is not possible to clarify the BO, and also doubts are excluded that the legal person or legal arrangement has a different BO, may the institution consider the person holding the position in the customer's senior management body to be the BO of the customer. In such a case the institution shall justify and document the actions that it has performed to clarify the customer's BO. It shall not be

necessary for the institution to obtain the consent from the person holding a position in the senior management body of the customer, for him or her to be specified as the BO.

Example

The fund manager registered in the Republic of Latvia acquires the units of the fund registered in a European Union Member State and being correspondingly supervised and controlled. The fund is public and operates in the regulated market. The fund securities are being bought by various persons through the intermediation of a credit institution in a European Union Member State. Forests in Latvia are being bought for the obtained money.

Taking into account the possibility of the fund manager to determine the BO of the fund is encumbered, the fund manager may consider the senior management of the fund to be the BO of the fund, correspondingly justifying and documenting the actions taken for the determination of the BO of the customer.

232. A person holding a position in the senior management body is a person controlling the company and adopting decisions on behalf of the company. For example, in the case of a joint stock company, such person is the chairperson of the Executive Board, the member of the Executive Board (depending on the authorisation to act, for instance, if the Executive Board consists of five members, each of whom is entitled to represent the customer separately, all members of the Executive Board shall be specified); as regards the capital company established by the state, the senior management of the capital company would have to be considered to be the BO, namely, the Executive Board; in the institutions or public authorities where decisions on behalf of the authority are adopted by the Supervisory Board - members of the Supervisory Board.

233. In cases when a person holding a position in the senior management body of the customer is to be considered to be the BO of the customer, when carrying out enhanced customer due diligence and ascertaining whether the determined BO of the customer is the BO of the customer, it shall not be necessary to obtain information of the same nature as in cases when the customer has the BO, who gains actual benefit from the activity of the company. It shall be necessary to ascertain that there is no change in the circumstances under which the BO of the customer, who is a legal person or legal arrangement, has been identified by the institution as a person having a position in the senior management body of the customer, and whether the actual BO is being concealed.

234. The institution would have to use the risk-assessment based approach and describe in its policies and procedures the necessary volume of information to be analysed and documented, for the institution to be able to confirm that it has performed the gathering and analysis of information corresponding to the risk, which gives confidence and does not create any doubts as to the ultimate BO, namely, there are sufficiently documented conclusions and the gathered information does not contain any contradictions and no suspicions arise that the ultimate BO is being concealed.

3.5.5. The determined BO does not correspond to the BO registered in the Enterprise Register

235. Taking into account the fact that within the determination of the BO, by verifying data in the Enterprise Register (hereinafter, the ER), it shall be necessary for the institution, on the basis of risk assessment, to apply additional measures for the determination of the BO, there might be situations where the institution detects that the publicly available information about the BO contradicts the information obtained by the institution, by taking additional measures for the determination of the BO. The referred to circumstance is to be assessed as a risk increasing factor, and it shall be necessary to take corresponding due diligence measures for the management thereof.

236. The term for the performance of the measures laid down in Clause 235 herein above is the same as the one defined with respect to due diligence of risk increasing factors contained in Annex No. 2 - 35 business days with the possibility to extend it, documenting and justifying it, if additional time is required for carrying out comprehensive enhanced due diligence due to objective reasons. Only upon completion of the enhanced due diligence measures and having obtained confidence that the detected information about the BO does not correspond to information registered in the registers maintained by the ER, the term prescribed in Paragraph 3.[1], Section 18 of the Law occurs for the duty to immediately, but no later than within a period of three business days, report the discrepancy to the ER.

237. In the case of a discrepancy between the information in public registers and that which is provided by the customer, the institution applying the enhanced due diligence measures, may also ask to submit additional information and carry out additional due diligence measures, to ascertain that the information provided by the customer about the BO is true.

238. The circumstance that the information specified in the ER does not correspond to the information obtained and clarified by the institution, is also to be assessed as an increased risk in the further management of the risks inherent to the customer. If, as a result of the enhanced due diligence, the institution detects a suspicious transaction, it shall report it to the Financial Intelligence Unit and resolve upon the termination of the business relationship.

239. In addition, the institution, pursuant to the provisions of the Law, shall report the discrepancy between the information about the BO of the ER and the information about the BO clarified by the institution to the ER, under the procedure prescribed by the ER guidelines.

240. The institution must distinguish the nature of the discrepancy:

240.1. whether the detected discrepancy is, for instance, a spelling mistake or other type of mistake;

240.2. whether it is a discrepancy, in terms of substance.

241. The ER guidelines provide for the explanation of the ER as to the situations in which, and how to report that information is probably incorrect in terms of substance, and when - that a spelling mistake is detected in the information. Additionally, the ER has also explained the situations, when the difference in information shall not be considered as a mistake and, therewith, it shall not be necessary to report the discrepancy. The explanation is available here: https://www.ur.gov.lv/lv/patieso-labuma-guveju-skaidrojums/kludas-metodika/.

242. When detecting that information about the BO at the disposal of the institution does not correspond to the information about the BO registered in the ER (spelling mistake, incl., insignificant differences in information identifying the person, *inter alia*, information of the personal identification document) and such discrepancy does not create suspicions that the BO of the customer specified in the ER might be another person, the institution shall inform the ER about the detected discrepancy.

243. In situations when the institution has determined and ascertained the BO in accordance with Paragraph 7, Section 18 of the Law (the BO shall be considered to be a person holding the position in the senior management body of a legal person or a legal arrangement), but the registers maintained by the ER contain the feature that "it is not possible to determine the BO" or "the BO is the shareholder in the joint stock company with the stock being listed on a regulated market, and the type of implementation of control over the legal person arises out of the shareholder's status", it is not justified to report possibly false information about the BO.

244. In addition, in practice the situations are possible, when the discrepancy has been detected between the BO presumed by the institution, within the meaning of Paragraph 7, Section 18 of the Law, and the BO specified in the ER. For example, pursuant to Paragraph 7, Section 18 of the Law, the institution specifies as the BO a person holding the position in the senior management body of such legal person; in turn, the head of the management body of the holding company of such legal person is registered as the presumed BO in the ER. In such cases, the discrepancy shall not be assessed as a discrepancy in terms of substance, but rather as the difference in the information about the presumed BO at the disposal of institution and the one registered in the ER. Thus, it shall not be necessary to report the discrepancy in terms of substance.

245. When detecting the discrepancy in terms of substance, the institution would have to assess what further measures are to be taken to manage the risk. If the institution has taken appropriate measures and has ascertained that the determined BO is the BO (for example, the change of the BO has recently taken place, the customer has submitted the documents attesting thereto and the institution has assessed them and ascertained the conformity thereof), then it shall be necessary to report the discrepancy to the ER. The ER shall correspondingly assess whether the recently performed change of the BO has been applied for registration and would be resolved upon the submission of a further report to the State Police. In such situations, it shall not be necessary to mandatorily apply the risk management measures, for example, enhanced supervision. In turn, in cases when it is not possible to ascertain the BO or the submitted information is not sufficient to ascertain this, the institution shall report it to the ER and consider this circumstance when assessing further cooperation with the customer and determining the applicable types of risk management measures, for example, enhanced supervision, in the case if the cooperation continues. Detection of the discrepancy per se shall not automatically mean the termination of a business relationship with the customer; however, such decision of the institution is possible, on the basis of risk assessment.

246. When detecting the record in the ER that the discrepancy is existing between the BO determined by the ER and by another subject of the Law, it must be noted that there is no information available as to the justification of such discrepancy. Therewith, the record per se shall not be considered to constitute the requirement to terminate the business relationship with the

customer, on whom there is a record in the ER that another subject of the Law has detected a discrepancy. Primarily, the determination of the BO remains the duty of the subject of the Law within the particular business relationship, and the circumstance that the referred to record has been detected, forms an additional element within the scope of the due diligence to be assessed jointly with other circumstances, in order to conduct a holistic customer assessment.

247. Upon coming into effect of the requirement of the Law to report to the ER regarding the non-conformity of the BO to the one specified by the ER (from 1 July 2020), there is not duty imposed on the institution to carry out the reassessment of the entire existing customer base. At the same time, it should be noted that Paragraph 3, Section 18 of the Law prescribes that, when determining the BO of the customer, information and documents from the ER shall be mandatorily used. Therewith, the institution, as soon as the necessity of any type or the duty arising out of laws and regulations occurs to clarify or update information about the BO (for example, within the scope of a periodic enhanced due diligence), must be used and the information about the BO registered in the registers maintained by the ER and the corresponding actions must be taken in the case of discrepancies in information.

3.6. Business relationship with the customer, who is a politically exposed person (PEP)

3.6.1. Determination of the PEP

248. The enumeration of the PEP positions specified in the Law is of a descriptive nature and is not exhaustive, because it is not possible to enumerate all possible positions which are to be considered as exposed.

249. When assessing the question of significance (exposure) of a position held by the person, it is necessary to assess whether the position enables the person to influence the decision-making in public sector that could serve as a basis for other people to be interested in corrupting or bribing the relevant person or the person could use the publicly significant powers granted thereto for obtaining personal benefit in another manner (abuse of public power).

250. The circumstance that the PEP may dispute the decision and the adopted decision is not final, shall not affect the fact that a person holding positions prescribed by the Law or another significant (exposed) public position, would not have to be considered as the PEP. The PEP status shall not be applicable to the middle level and lower level officers.

Example

Situation No. 1
Land Registry judges

The Law prescribes that the judge of the Constitutional Court, the Supreme Court or the court of other level (member of the court authority) shall be considered to be the PEP. The Land Register's departments are also included in the composition of the district city courts. They record the real estate objects in the Land Register sections and corroborate or register the rights

related to such real estate objects. Rights (title) to the real estate are corroborated on the basis of the decision of the judge of the Land Register.

When determining whether the Land Register judge is to be regarded as the PEP, it shall be necessary for the institution to assess whether this position allows the influencing of decisions in the public sector. The circumstance that the Land Register departments are included in the composition of the district city courts does not mean that the Land Register judges are to be regarded as PEPs. At the same time, given the presence of certain factors (for example, high customer risk, certain volume of transactions of the customer and the model of performed transactions), the institution may consider the customer, who is the Land Register judge, to be a PEP.

Situation No. 2
Honorary consul

When determining whether the honorary consul of the Republic of Latvia in a certain country would have to be considered a PEP, it shall be necessary for the institution to assess whether such position allows the influencing of any important decision. The honorary consul or general consul of the Republic of Latvia shall be a person to whom the Republic of Latvia entrusts the performance of state representative and consular functions, on the basis of a special mandate of the Minister for Foreign Affairs (the State Secretary of the Ministry of Foreign Affairs), thus such person fulfils representative and consular functions without any decision-taking powers.

251. Even though the Law provides for enumeration with respect to persons considered to be family members of a PEP, it must, nevertheless, be considered that a person not included in the number of persons considered to be a family member of a PEP, may be a person closely related to a PEP (for example, if a PEP and a person are in an unregistered marriage). The institution shall apply the notion "other close relations" individually, based on the assessment of information at its disposal and risk assessment. When adding content to the notion of a "person closely related to a PEP", the institution must assess whether there are such trust and commitment relations existing between its customer and a PEP that may form the grounds for a PEP, through such person, to conceal the abuse of public authority for gaining private benefit. To determine whether the customer corresponds to the status of a person closely related to a PEP, information at the disposal of the institution would have to be assessed within the context of the transactions planned by the relevant customer and the volumes thereof, to assess whether the cooperation may create the MLTPF risk.

3.6.2. Scope of enhanced due diligence to be applied to a PEP

252. In accordance with the Law a PEP, a family member of a PEP or a person closely related to a PEP shall be subject to enhanced due diligence. Nevertheless, the enhanced due diligence measures shall also be applied to a different level of depth, based on the risk - depending on the actual circumstances, information obtained within the scope of the customer due diligence and transactions performed by the customers.

Example

The customer is the state capital company or the local government, and the BO thereof is considered to be a person holding a position in the management body of the capital company or the local government, for example the mayor of the city municipality.

In such a case, the officer of the senior management body, when fulfilling the official duties entrusted thereto, is acting in the interests of the public. The manifestation of risk from a business relationship with the customer, who is, for instance, the local government, even though its BO is to be considered to be a person deemed to be a PEP, differs from the risk inherent to the customer, who is, for instance, the company registered offshore, whose BO is the member of parliament of a foreign country, gaining benefit as the actual BO. Therewith, the risk for the customer whose BO is a PEP actually gaining benefit from the activity of the customer differs from the risk present in the situation, when the BO of the customer is considered to be a person holding position in the senior management body of the customer and exactly due to such position is to be deemed a PEP. Thus, the measures applied to the institution in such situations must correspond to the risk.

253. The risk and, therewith, the applicable enhanced due diligence measures may also differ, by assessing which jurisdiction the PEP comes from - the Republic of Latvia, a European Union Member State, a third country. For example, the risk of the customer, who is a company registered offshore and whose BO is the resident - PEP - of a country with high corruption risk, may be higher than that of the customer, who is a resident of the Republic of Latvia and whose BO is the resident of the Republic of Latvia and considered to be a PEP, because there is a risk present that the company, whose BO is a PEP in the country with high corruption risk, through such a company, attempts to launder funds outside the borders of the country, the origin whereof is probably related to corrupt practices. To assess the risk, it shall be necessary not only to consider the circumstance that the BO is a PEP, but also to assess the activity of the customer as a whole (economic activity, substance of transactions). Not all of the customers, who are themselves (natural persons) or whose BOs (legal persons) are considered to be PEPs, have an identical risk, therefore the scope of the applicable due diligence would differ as well, based on the risk of the particular customer.

254. The Commission has provided its recommendations with respect to the determination, due diligence and transaction screening of PEPs, their family members and persons closely related thereto in its Recommendations No. 55 of 2 March 2016 "Recommendations for Credit Institutions and Financial Institutions to Establish and Research Politically Exposed Persons, their Family Members, and Closely-related Persons and to Monitor Transactions" (available at: https://www.fktk.lv/tiesibu-akti/kreditiestades/fktk-izdotie-noteikumi-2/citi-ieteikumi/ieteikumi-kreditiestadem-un-finansu-iestadem-politiski-nozimigu-personu-to-gimenes-loceklu-un-ar-tam-ciesi-saistitu-personu-noskaidrosanai-izpetei-un-darijumu-uzraudzibai/). The referred to recommendations can be used not only by credit institutions, but also by other institutions, insofar as that which is stated therein is applicable to the activities of such institutions.

3.7. Origin of funds and origin of wealth

255. Verification of the origin of funds and wealth of the customer is the risk assessment-based measure. The institution, based on the MLTPF risk of the customer, shall define the applicable measures, and it shall be the duty of the institution to prove that the measures taken by it (for example, the obtained explanation of the customer, obtained documents or publicly available information) correspond to and are commensurate with the risk inherent to the customer.

256. One of the measures with respect to the verification of the origin of wealth of the customer that the institution may apply is to ascertain that the customer has submitted the tax administration authority the returns required in accordance with the regulation of the country of residence thereof, for example, the so-called zero declarations (returns) (such measure shall be used by the institution, when it corresponds to the circumstances, for example, the customer carries out the significant transfer of funds to the account and explains it as the transfer of the previously declared funds and the institution ascertains that, by using the services of the institution, it is not used for money laundering). It shall be necessary to assess such returns, as well as, *inter alia*, to ascertain whether the declared amount of funds corresponds to the amount of funds under circulation in the institution, during the use of the services of the institution.

257. The institution shall prescribe in its policies and procedures the cases, information and documents and the manner of obtaining them in accordance with the customer risk in order to ascertain the origin of funds and wealth of the customer, at the same time observing the principle of proportionality - the scope of information to be obtained shall correspond and be proportionate to the transactions performed by the customer and the economic or personal activity thereof. For example, if the origin of wealth generated 10 years ago is being verified, the institution shall take into account and assess information and documents in a holistic way, *inter alia*, shall consider the legal framework in effect in the particular field and time. Where the customer specifies that he/she has no documents that would attest to the origin of wealth, because he/she as a private individual has no duty to store such documents, the institution shall assess the explanation provided by the customer and shall ascertain the conformity thereof to the legal framework. Where the explanation of the customer creates doubts or does not correspond to the truth, the institution shall resolve on whether it is able to ensure the information necessary for fully-fledged customer due diligence, in order to continue the cooperation with the customer.

258. It shall be the duty of the institution to ascertain the origin of funds used in the transactions of the customer, and it cannot in all cases (irrespective of the risk) rely merely on the publicly available information about the property status of the customer, to come to the conclusion as to whether or not the origin of funds of the customer is related to the MLTPF. The circumstance that the customer is financially well off, shall not mean that the origin of funds received in the account of the customer or on behalf or in favour thereof is legal and that they cannot be related to the MLTPF. Information obtained from public resources about the property status of the customer, in certain cases may only be assessed as additional information, and it cannot in all cases serve as the basis for drawing conclusions as to the legality of the origin of funds.

Example

The customer - natural person and foreign resident, has performed the cash payment in the amount of EUR 50, 000. The occupation of the customer - public sector official in a foreign country.

The institution, when determining the origin of funds, receives the explanation from the customer that the paid in money comes from sold real estate in the country of residence that the customer received as inheritance form his or her father. The transaction has been performed in cash with the resident of the same foreign country in the Republic of Latvia. The customer is currently staying in another country and, in order to obtain the inheritance documents, he or she must fly to the country where the real estate is located. The real estate purchase agreement is being additionally submitted to the institution, the agreement of which does not provide for the corroboration of the title to the real estate.

The institution, when assessing the explanation of the customer, shall ascertain that the legal framework of the relevant country does not provide for the corroboration of the title to the real estate, and shall additionally assesses whether the customer has declared the cash in customs, and shall clarify whether it is at all permitted to sell the real estate in cash in such an amount in the relevant country.

The institution shall resolve upon further cooperation with the customer and the need to report the suspicious transaction, considering the logical rationale of the explanation provided by the customer and information clarified during the enhanced due diligence, to be assessed within the context of risk increasing factors.

259. When assessing the origin of wealth of the customer, the circumstance of whether the customer has declared the funds can also be taken into account. If the origin of wealth generated 10 years ago is being verified and the customer submits a document that he or she has declared his or her income in the tax administration of the relevant country, it shall be necessary for the institution to assess the declared amount - whether it corresponds to the volumes of transactions in the institution and whether there are any other risk increasing factors present.

260. It shall be neither necessary nor proportionate to determine that, with respect to all transfers from anther credit institution, the customer account statement must be submitted from the credit institution from which the transfer has been received. The institution may set such requirements, upon the occurrence of certain criteria (for example, for higher risk customers, when reaching the transaction limit defined in line with the risk assessment of the institution or when detecting other circumstances that may be indicative of the increased risk or evasion from the limits.

Example

Situation No. 1
The customer is a resident of the Republic of Latvia - natural person, a paid employee with the average monthly credit turnover in the amount of EUR 3, 000. The customer transfers the amount of EUR 40, 000 into his or her account from another institution.

The institution, within the scope of customer due diligence, clarifies that the transferred funds represent a deposit held by the customer in another credit institution, but now he or she has decided to keep the funds in the institution. Additionally, it was clarified that, in 2012, the customer has submitted the property status declaration (the so-called zero declaration), specifying the savings in the amount of EUR 30, 000.

Having assessed all the information available about the customer and detecting no risk increasing factors, as well as having assessed that the further allocation of funds is corresponding, information obtained within the scope of customer due diligence might be appropriate and proportionate to the customer risk.

Situation No. 2
The customer is a resident of a higher risk country - natural person, the owner of several enterprises, with the average monthly credit turnover in the amount of EUR 1, 000, 000, the funds are being transferred from the customer accounts in other institutions outside the borders of the Republic of Latvia.

The institution, within the scope if the customer due diligence, clarifies that the customer owns several enterprises registered in the country where high corruption risk is present and it is not possible to obtain additional information about the volumes of economic activity of such enterprise from public sources. The customer specifies revenue from the activity of his or her enterprises as the source of origin of wealth and submits the extracts from returns submitted to the tax administration of the relevant country for the years 2016 and 2015 for the sum equivalent to EUR 700, 000.

Information obtained within the scope of customer due diligence is not sufficient for clarifying the origin of wealth. In addition, it would be necessary to obtain information about the economic activity of the enterprises owned by the customer (for example, information contained in public registers, financial statements of the enterprises), the volumes thereof, in order to ascertain that the economic activity of the referred to enterprises is carried out to such an extent that allows the customer as the BO to gain benefit in the amount transferred to the account of the customer. The submitted declarations do not justify the origin of funds held in the account of the customer in the institution.

Situation No. 3
The institution commenced cooperation with the customer E.D., who is a resident in the country where a high corruption risk is present. E.D. transferred into the management of the institution, the financial instruments in the value of EUR 5, 000, 000, having been transferred from the account of company *M* owned by E.D. (country of registration – a European Union Member

State, where the services of companies of legal establishment are widely used for the purposes of establishing the enterprises), opened with credit institution *L*. The institution, in order to ascertain the origin of financial instruments owned by E.D., has obtained the documents which, in its opinion, attest to the economic activity of company *M* - an edited statement of the account of company *M* with credit institution *L*, demonstrating separate incoming transactions about the receipt of the payment from the partner of *M*, agent's agreement on the provision of intermediation services to the partner of *M*, from whom the funds were received, separate acceptance and delivery acts on the supply of goods in the country where a high corruption risk is present, and several invoices issued by company *M* to the partner.

Documents obtained within the scope of the enhanced customer due diligence are not sufficient to ascertain the origin of the financial instruments. The referred to documents merely reflect the possible fact of cooperation between the shell company owned by the customer and the partner thereof, besides the submitted statement of account demonstrates the receipt of monetary funds in separate transactions, but it is not possible to ascertain whether the relevant financial instruments have been acquired exactly from the referred funds. Within the scope of enhanced due diligence, considering the increased risks inherent to the customer, it would be necessary to assess the need to also obtain an unedited statement of the account that would attest that the relevant financial instruments have been acquired with the funds held therein, and it must be assessed whether the transactions, as a whole, do not have the indications of suspicious transactions, if it were to be detected that company *M* would allocate all funds received for intermediation services for the acquisition of financial instruments, which is not characteristic for normal economic activity and might be indicative of the MLTPF.

261. The Commission has provided recommendations with respect to evaluating the origin of funds of the customer and origin of wealth characterising the property status of the customer in its "Recommendations to Credit Institutions for Determining the Source of Customer Funds and Wealth" (available at https://www.fktk.lv/tiesibu-akti/kreditiestades/fktk-izdotie-noteikumi-2/citi-ieteikumi/ieteikumi-kreditiestadem-klientu-lidzeklu-un-labklajibas-izcelsmes-noteiksanai/). The referred to recommendations for determining the source (origin) of customer funds and wealth can be used not only by credit institutions, but also by other institutions, insofar as that which is stated therein is applicable to the activities of such institutions.

3.8. Storage of documents

262. In accordance with the requirements of the Law, it shall be necessary to make copies from the documents, on the basis whereof the customer identification was performed. Copies of the documents shall be used for the institution to be able to prove the grounds, on which the identification was performed, and to further use them to ascertain that the customer, who has arrived in the institution is the same person (for example, when the customer is willing to perform the transaction, the institution, before serving the customer, shall ascertain that the customer presenting the personal identification document is the same person who has already been identified as the customer of the institution, by comparing the personal data of the customer specified in the presented personal identification document with the data in the copy of the personal identification document of the customer, which is at the disposal of the institution). If the institution can ensure

that the system contains information about who has performed the customer identification and scanned the relevant document and when, it shall be acceptable that the identification documents are scanned and not copied.

263. The institution, for a period of five years[26] after the termination of a business relationship or performance of an occasional transaction, shall store the entire information obtained during customer due diligence, as well as information about all payments performed by the customer and correspondence with the customer, *inter alia*, electronic correspondence.

3.9. Supervision of business relationship

264. The institution shall ensure constant supervision of the customer and the transactions performed by the customer, entailing diligent monitoring of the transactions performed by the customer, in order to ascertain that they correspond to the information at the disposal of the institution about the economic or personal activity of the customer and the MLTPF risk level initially determined and assigned to the customer.

265. Depending on the scale, nature of the activities of the institution, number of customers and the share of risk inherent thereto and the volume and number of transactions performed by the customers, it shall be necessary for the institution to introduce such system of transaction supervision that enables the effective detection of suspicious transactions, as well as enables mitigating and preventing the risk for the institution to become involved in the MLTPF or the attempt of such actions. It shall be necessary for institutions with a large number of customers or large number of performed transactions or occasional transactions, or a large share of customers for whose transactions enhanced supervision must be ensured, in order to ensure the effective fulfilment of the AML/CTPF requirements, to introduce an automatic solution for the supervision of transactions performed by the customers. In turn, in institutions with a small number of customers and small volume of transactions performed by the customer, it shall be permissible that the transactions performed by the customers are supervised, by means of manual or partially automated solutions.

266. The institution would have to introduce automatic solutions for the purposes of ensuring that it does not commence a business relationship, as well as does not execute the transactions, within the scope whereof the customer or its cooperation partner is a person against whom any financial restrictions are set. The system of supervision of the actions and transactions of the customers established by the institution must enable one to identify transactions (payments) and conduct untypical for the customer, on the basis whereof the due diligence of the particular situation or transaction would have to be performed, in order to ascertain whether or not the transaction is to be considered as suspicious.

267. To perform high-quality and effective supervision of the customers and transactions performed by them, the institution, when commencing a business relationship, must correspondingly assess the customer risk level and obtain information corresponding to the risk level about the customer and the economic or personal activity thereof, so that during the business

[26] In accordance with the provisions of Section 37 of the Law.

relationship it would be able to correspondingly carry out the supervision of the customers and the transactions performed by them.

268. If the transaction supervision is not ensured by means of various scenarios generating alerts on possibly suspicious transaction, it is essential that the transaction scenario algorithms are developed in accordance with the products and services offered by the institution and the risks inherent to the customers, and that they are able to timely identify potentially suspicious transactions, enabling the institution to carry out the due diligence thereof and, if necessary, abstain from the transaction or file a suspicious transaction report to the Financial Intelligence Unit.

269. The institution, in its policies and procedures, shall develop a detailed procedure for the performance of transaction supervision, inter alia, shall prescribe the procedure for the review of the scenarios, their effectiveness, for defining the fields of responsibility, etc.

3.10. Correspondent (banking) relationship

270. In accordance with the requirements of the Law it shall be necessary for the institution to perform enhanced due diligence, upon establishing and maintaining the correspondent (banking) relationship with the credit institution or financial institution (respondent). In accordance with the Law the correspondent (banking) relationship shall also be deemed to include the relationship between credit institutions and financial institutions or the relationship between financial institutions, if the correspondent institution provides the respondent institution with the services, including services involving the performance of payments and settlements, or the services similar thereto, according to a mutually concluded contract. Therewith, the financial institution, other than the credit institution, for example, payment institution, when providing payment services to another financial institution, on the basis of a mutually concluded contract, must also observe the requirements set for the performance of enhanced due diligence, correspondingly developing the requirements for the performance of enhanced due diligence for such relationship in its policies and procedures. The purpose of the requirement is to ascertain that the respondent has established an appropriate ICS and, thereby, mitigate the risk that the institution might be used for the MLTPF, when executing the payments performed by the customer of the respondent.

271. The institution, when maintaining the business relationship with another financial institution, shall ensure the observance of the "know your client" principle. If the credit institution has defined the customer categories it does not cooperate with, for example, non-licensed gambling organisers, then the credit institution must assess whether the payment or electronic money institution is not serving such customers.

4. Reporting and information disclosure to authorities

4.1. Reporting to the Financial and Capital Market Commission (quarterly reports, requests)

272. Frequently asked questions of the credit institutions and responses of the Commission regarding the preparation of the "Report on the MLTPF Risk Exposure Description" (hereinafter -

the Report) (other institutions shall observe these principles in manual request report, whenever applicable):

Question	Explanation by the Commission
"On the definition of the "customer":	
a) whether it shall also entail the persons having no deposits in the credit institution	The definition of a customer shall entail, and the Report shall specify all persons whom the financial institution provides financial services to according to the provisions of the Credit Institution Law. This means that, if the credit institution has established a business relationship with the customer, it shall be specified in the total number of customers. Persons carrying out occasional transactions in the credit institution (for example, currency exchange conversion/payment of public utilities/tax payments/fines, etc. payments without establishing business relationship) in accordance with the Commission Regulations on the MLTPF Risk Management, shall not be considered to be customers.
b) whether the number of customers includes customers whose accounts in the credit institution have been closed, but there is an account balance remaining	The Report must also specify data about the customers, with respect whereto the credit institution has taken a decision to terminate the cooperation (customers, whose accounts are closed, but there is an account balance remaining).
c) credit obligations and the assignment agreement taken over form other credit institutions - should they be included in the number of customers (i.e., a person has no current account in the credit institution, a separate loan repayment account is being opened for each customer and the credit institution gains income)	If the credit institution has taken over the credit obligations from another credit institution or under the assignment agreement, and henceforth the credit institution performs the supervision of repayment of such loans, the borrowers taken over shall be regarded as the customers of the credit institution and data about them shall be specified in the Report.
d) whether the number of customers entails customers with temporary accounts	The customer having accounts opened for the registration of a share capital before the enterprise is being registered with the ER and where the amount of the share capital has been paid into (it is not possible for the enterprise to perform any outgoing payments before the enterprise is registered in the ER), shall be reflected in Annex No. 1 to the Report both in the total number of the customers and in the assets and turnover thereof, but the country of the BO of such customers

	may be specified in Annex No. 6 to the Report according to the country of registration of the enterprise.
e) whether the group companies of the credit institution with the accounts opened in the credit institution are considered to be customers	The group companies of the credit institution shall be considered to be customers.
As regards deposit platform customers. Such customers shall be identified by the credit institution of the European Union Member State and they shall only have deposit accounts opened, without access to any other services of the credit institution. Must the deposit balances of such customers be disclosed in the Report as "customers identified by intermediaries"?	Deposit balances of the customers identified by the credit institution of the European Union Member State must be specified in the Report in the Section "Customers identified by intermediaries" (also specifying data in the relevant fields of row 010 "Total customers" of Annex No. 1).
Income disclosure in column 110 - 140 of Annex No. 1 to the Report)	Income gained from the customers/customer transactions shall be disclosed (income from economic activity of the credit institution shall not be included in the Report).
What should one do, if the customer has changed the country of residence during the reporting period - which country must the relevant customer be referred to?	The institution must assess the country of residence of the customers/BOs of the customers, as well as the legal form of the customers at the end of the reporting period and must specify the relevant data (number, balance, turnover, income). For example, if during the reporting period the customer has changed the legal form and at the end of the reporting period the customer has become a financial institution, the turnover (and income) for the entire reporting period shall be referred to the financial institution.
Completion of Annex No. 6	Annex No. 6 to the Report is comprised of three separate tables with different information, using the county code as the uniting element, to be specified in column 010. The first table, where information about the BO is to be specified in breakdown by countries, contains column 020-040. The second table, where (irrespective of the data in the first table) information about the PEP shall be specified, contains column 050-070. The third table (irrespective of information specified in the first two tables) shall specify

	information about the enhanced due diligence customers in breakdown by countries.
Disclosure of BOs and PEPs in Annex No. 6 in the Report	When disclosing data about the number of BOs of the customers-legal persons and, correspondingly, assets and credit turnover, the proportionality principle shall be applied, namely: - if one customer (legal person) has one BO, the credit institution shall indicate 1 in the Report for the relevant country of registration; - if one customer (legal person) has two BOs from different countries of registration, the credit institution shall proportionately indicate 0.5 in the Report for the relevant country of registration (for example, RU 0.5 and LV 0.5); - if one customer (legal person) has three BOs from different countries of registration, the credit institution shall proportionately indicate 0.33333 in the Report for the relevant country of registration (for example, RU 0.33333, UA 0.33333 and LV 0.33333), etc. The sum of all decimal parts shall be specified in the Report opposite the relevant country. The assets and volumes of turnover shall also be disclosed in an analogous way. Column 050, 060, 061, 070 of Annex No. 6 to the Report (customers based on the PEP status) shall disclose data in breakdown by countries of registration about the customers - natural persons, who shall themselves be considered to be PEPs, or family members of PEPs, and/or persons closely related to a PEP, as well as about the BOs (natural persons) of the customers legal persons and legal arrangements, which are to be considered to be PEPs, in breakdown by countries, applying the same proportionality principles as the one applied to the BOs of the customers.
Completion of Annex No. 7	The credit institution, when completing (filling out) Annex No. 7 to the Report, shall provide information about the customers (shell arrangements and other) at the end of the reporting quarter, with respect whereto it has adopted the decision on termination of the business relationship (after assessing the MLTPF risk) and who still have the balance, namely, with respect to

	all (closed accounts with the balance), irrespective of whether the decision was adopted in the first, second or another reporting quarter.

4.2. Reporting to the Financial Intelligence Unit

273. The institution shall ensure that the reports to the Financial Intelligence Unit are submitted in due time and due quality and contain a detailed description evidencing the suspicious nature of the transaction.

4.3. Reporting to the State Security Service

274. In accordance with the positions of Paragraph 1, Section 17 of the Law on International Sanctions and National Sanctions of the Republic of Latvia, an institution shall be obliged to immediately, but no later than on the next working day, report to the State Security Service on the violation of the sanctions or an attempt to violate them. The report shall be prepared in free form, specifying the information identifying that which is submitted, explaining the violation of the sanctions on the part of the customer and attaching the customer due diligence information, and shall be sent to the e-mail address: sankcijas@vdd.gov.lv.

Final Provision

With the coming into force of these Recommendations, the following are repealed:

1) Commission's recommendations of 20 December 2017 No. 210 "Recommendations for Credit Institutions on Customer Due Diligence Before Commencing a Business Relationship and During a Business Relationship"
2) Commission's recommendations of 6 December 2013 No. 268 "Recommendations for Payment Institutions and Electronic Money Institutions in the Area of the Prevention of Money Laundering and Terrorist Financing"

Chairwoman of the Financial and Capital
Market Commission S. Purgaile

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WITH A SECURE ELECTRONIC SIGNATURE AND CONTAINS A TIME-STAMP