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COMMITTEE OF EXPERTS
ON THE EVALUATION
OF ANTI-MONEY LAUNDERING MEASURES
(MONEYVAL)

THIRD ROUND DETAILED ASSESSMENT REPORT ON THE CZECH REPUBLIC[1]

ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

Summary

[1] Adopted by MONEYVAL at its 24th Plenary meeting (Strasbourg, 10-14 September 2007)

Executive Summary

1. Background Information

1. The Czech Republic is usually perceived as one of the most stable and prosperous of the post-Communist states of Central and Eastern Europe. As the examiners were advised on site, despite the progressive development of modern payment techniques, the economy is still heavily cash-based.

2. Like in previous years, criminal proceeds originate from all types of criminal activities carried out in an organised manner (drug trafficking, human trafficking and smuggling) and economic crimes (particularly fraud, tax evasion, misuse of information in business relations). Other major proceeds generating crimes include criminal offences against property, insurance fraud and credit fraud. Connections between organised crime and ML have been observed mainly in relation with activities of foreign groups, in particular from the former Soviet Union republics, the Balkan region and Asia. The Czech Republic would also be affected by certain llicit financial activities (credit/loan services, money remittance particularly in connection with the Asian community, and illegal foreign exchange business – taking place blatently on certain streets of the capital city).

3. The Czech authorities indicated that the types of financial institutions used for money laundering in the Czech Republic are mainly banks, credit unions, insurance companies and exchange offices, as well as companies/commercial networks operating international money transfer services. The use of cash outside the regulated sector and of businesses without real activity (e.g. restaurants) or where proceeds are mixed up with legitimate profits, and real estate transactions would also be common ways used for ML purposes. According to certain interlocutors, the gaming sector and casino industry would also be exposed to ML and infiltration by criminals.

4. On terrorism and FT, police representatives acknowledged that the Czech Republic is little exposed to this problem, although the country has occasionally been used temporarily by people who had connections to well-known terrorists. About 10 cases of terrorism would have been handled by the courts in the last 11 years; these cases were not politically motivated, but were connected with general serious crime activities (typically, bomb explosions connected with extorsion etc.).

5. There has been no specific strategy adopted on combating money laundering. The priority of the Government in this area is to fulfil the international commitments and to be in compliance with the international standards. The main objectives and tasks of the Czech Republics´ authorities in combating terrorism in general as well as terrorist financing are included in a material called “The National Action Plan to Combat Terrorism” (NAP).

6. Overall, there has been moderate progress since MONEYVAL’s second evaluation round.

2. Legal Systems and Related Institutional Measures

7. Despite some improvements which are commendable, the criminalisation of ML under Section 252a (on “Legalisation of proceeds from criminal activity) of the Criminal Code still does not contain a broad definition and coverage of ML. The position of the Czech authorities according to which it is by a combination of various Sections (Section 252 but also Section

251 on "Participation/sharing" and Section 252 on "Participation/sharing by negligence" that the international requirements pertaining to the ML definition are implemented was found unsatisfactory because of inconsistencies, a dilution of the ML concept (Sections 251, 252 and 252a are individually closer to the classical offence of receiving of stolen property). Furthermore, the Czech Republic has managed to obtain its first (four) convictions for ML, which is commendable. But the jurisprudence available illustrates that to date, Section 252a has mostly (possibly only) been applied to criminal offences which had more to do stolen goods (receiving, trafficking, selling), than with the laundering of proceeds. This raises the issue of effectiveness.

8. Furthermore, as the examiners could find out, there is no unanimity among practitioners about such an interpretation (some prosecutors and judges consider that only Section 252a is ML specific), and this alone shows that in practice, risks exist that ML offences would not necessarily be dealt with in a consistent way and with utmost effectiveness. New provisions (which would not have fundamentally remedied the situation though) were under preparation at the time of the on-site visit[2]. At the moment, there is a need to clearly criminalise the *conversion, transfer, acquisition, possession of property*, to use a simpler, less proof demanding definition of ML, to increase the level of sanctions, to introduce corporate liability.

9. There has been no conviction for FT to date. The efforts of the Czech Republic to progressively improve the legal framework for the criminalisation of FT are commendable. At present, there is a clear provision dealing with the financing of terrorist acts (Section 95 para 2: are punishable those who provide financial, material o rother support to a terrorist act). The financing of terrorist organisations is also present in Czech legislation, through more general provisions on criminal conspiracy (which, however, explicitly refer to the issue of terrorism). The financing of individual terrorists, as such, seems totally absent. Other elements also need to be provided for explicitly (*direct or indirect collection of funds, utilisation of funds in full or in part, prosecutability of the offence without a link to a specific terrorist act and withou the funds having been used effectively).* The examiners believe that a stand-alone provision (or series of provisions) would be preferable reflect the international requirements in a consistent way and with a sufficient degree of legal certainty[3].

10. The regime of final measures is as follows, by virtue of the Criminal Code: Section 51 and 52 regulate the *forfeiture of property*, Section 55 and 56 the *forfeiture of* [a] *thing*. Section 53 and 54 provide for a system of pecuniary punishment which can be used as an alternative punishment. These various measures are conviction-based and besides these, Section 73 provides for a system of *seizure of a thing* , as a final protective measure, also without conviction. Provisional measures are regulated basically by two sets of provisions of the Code of Criminal Procedure, namely Sections 347 and 348, and Sections 78 ("Liability to deliver a thing – production order") and 79, 79a, 79b, 79c ("taking away of a thing", "judicial seizure of a bank account", "securing the booked – immaterialised – securities"). Although there is much to be commended in respect of bits of certain provisions considered individually, at the end, there is an inconsistent and complex framework for seizure and confiscation which

[2] But finally rejected in 2006

[3]The Czech authorities do not consider that the creation of a specific body of offence for terrorism financing would lead to improvements in practice or to an increase in the number of cases prosecuted: "This is only a systems change and at the legislative level; it will not have substantial significance for the area of prosecuting financing of terrorism. In our opinion no relevant reasons based on practice have been given for such a change."

generates mis-matches between temporary and final measures, creates legal loopholes and misses various elements (including direct and indirect proceeds, equivalent confiscation, confiscation of assets held by third persons). The provisions are not applicable to legal persons. The effectiveness issue for confiscation is also at stake.

11. Concerning the freezing of terrorist assets under SR. III, the Czech Republic has extended the preventive ML regime to FT in 2004. But the country relies to a large extent on the EU instruments and a general domestic law would be needed to fully implement in a practical way the various UN requirements as regards listing and delisting, the regime applicable to frozen assets etc. The Czech authorities have produced in the "The National Action Plan to Combat Terrorism (NAP)" a comprehensive list of shortcomings and they are thus aware of these. The evaluators also concluded that there was a lack of guidance and information to the industry and the public in general, the effectiveness/proactivity of detection remains questionable, the coverage of FT needs to be improved in the AML Act.

12. The Financial Analytical Unit (hereinafter FAU) was established on 1 July 1996 as an administrative FIU under the umbrella of the Ministry of Finance. It has been a member of the Egmont Group in 1997. It has its own premises and facilities and is fully dedicated solely to the detection and prevention of ML and FT. The FAU has also overall supervisory competence to ensure the implementation of the AML Act by all obliged entities, which prevents in principle any loopholes in the institutional supervisory arrangements. Comprehensive statistics are kept on its work. The evaluators heard occasionally individual complaints about the quality of the analytical work performed by the FAU. The FAU is not explicitly referred to in the AML Act (the Ministry is) and there is a possible need for better guaranteeing in legislation the autonomy and independence of the FAU (including its Head). At the time of the visit, the FAU produced no annual report[4]. The evaluators found that more guidance on AML (to the non banking sector), and on CFT (to all institutions) should be given.

13. The Czech Republic has designated bodies to ensure that ML and FT-related offences are properly investigated. Unlike the situation in the past, where reports of the FAU were sent to all police bodies, the Illegal Proceeds and Tax Crime Unit is the sole destine of the reports forwarded by the FAU.

14. The examiners had difficulties to draw a clear demarcation line between the main competencies of the Criminal Police and Investigation Service (CPI)s' units, especially the Illegal Proceeds and Tax Crime Unit and the Unit for the Detection of Organised Crime, since both are competent to deal with terrorist financing cases. Overall, the distribution of competencies of the different courts/prosecution services, appears to be quite complex and based on elements which, in the examiners views, are not necessarily available at the very beginning of an investigation dealing with ML and FT (amount of assets and type of proceeds involved etc.). The legal framework for the use of special investigative techniques can be restrictive on occasions, but the evaluators were assured that a general legal mechanism provides for their wide application every time a crime is provided for in an international instrument (which obviously includes ML and FT). At the time o fteh visit, there was a lack of

[4] After the visit, the Czech authorities advised that since 2006, the FAU has been releasing a periodic report on the website of the Ministry of Finance, informing the public about its activities, new AML/CFT legislation and new trends of ML/FT. The first report produced covers the period 1996-2005. Future reports will be released on an annual basis.

staff in certain departments of the prosecution services and Ministry of Justice, especially those dealing with serious crime and mutual legal assistance.

15. Cross-border movements of cash and other instruments are regulated in detail by the AML Law. Art. 5 imposes a declaration duty and Art. 12a provides for a system of sanctions in case of non-compliance. The matter is also regulated by Decree N° 343 of 18 May 2004, which contains a specimen form to be used for declarations. The Czech Republic has opted for a declaration mechanism which is quite broad. It applies to currencies and to means of payments generally, traveller cheques, bearer securities, "any commodities such as precious metals and stones" etc. The Czech Republic has open borders with the European Community, which is in conflict with SR IX – in the absence of particular AML (and CFT) measuresin this area. Other shortcomings include: the reporting duty for suspicions of ML and FT needs to be clearly spelled out, effectiveness issue (low number of ML cases generated by the Customs compared to the criminal activity context of the Czech Republic), Customs need to be made more aware of AML/CFT issues as they rely a lot on the police as regards information in this field.

3. Preventive Measures – Financial Institutions

16. The Anti-Money Laundering Act which provides for the general preventive framework was adopted in 1996[5].Sector specific AML/CFT regulations exist only for the banking sector: in September 2003, the Czech National Bank issued a *Provision of the CNB N°1 on the Internal Control System of a Benk for the Area of Money Laundering Prevention*.

17. In principle, bearer passbooks will have been completely phased out in 2012. Although in general the customer identification procedures (not full CDD measures) are mostly in place, the examiners noted some shortcomings in relation to some criteria for Recommendation 5. Full CDD requirements should be introduced in the AML Act (including on-going due diligence and know-your customer, risk-based approach, consequences of incomplete CDD measures and application of CCD requirements to existing customer etc.), with appropriate guidance. The evaluators also found inconsistencies between the banking regulations and the AML Act on the issue of CDD measures on the occasion of operations with bearer passbooks. Financial institutions are not required to identify the originator and the beneficiary of funds transfers with the full data, and to renew customer identification and verification (if theer are doubts for instance). Also, a general legal requirement is missing on the identification of beneficial owners and on obtaining information about the ownership of all types of legal entities.

18. The issue of PEPs is not addressed through the AML Act. In practice, financial institutions are not complying with this recommendation, including the banking sector who lack guidance in relation to the basic relevant requirement that exists in bankig regulation. The issue of correspondent banking relationships, threats from developing technologies and non-face-to-face business relationships is addressed to some extent in the banking sector only. Recommendations were made by the examiners to address those issues.

[5] A revised draft has been prepared, which is expected to come into force on 15 December 2007

19. Reliance on third parties to perform the CDD process is permitted to a limited extent and possibilities for introduced business are likely to be introduced soon, but for the time being, there are no general provisions allowing for access to customer identification in all cases and no general framework as yet on identification in such cases. Lawyers do act as intermediaries when companies establish first contacts.

20. The AML act suspends to a large extent financial confidentiality and secrecy but there are inconsistencies in regulations. Provisions in the AML Act might need to be clarified in relation with FT (as far as law enforcement/criminal police are concerned).

21. The requirements related to the registration and storing of information are basically in place in the AML Act. However, CNB regulations are less specific – which could create confusions in the sector under the responsibility of the CNB, and therefore, these regulations should be made consistent with the AML Act. Besides identification data, the regulations should also cover explicitly account files, and business correspondence, and any other relevant information (written findings on complex and unusual large transactions etc.). Th examiners also believed there is a need to maintain pressure on financial and other institutions to store data and documents in a computerised way that would allow to retrieve information in a timely manner.

22. The requirements of SR VII on wire-transfers have not been directly addressed in relation to some criteria (no regulation or policies applicable to the handling of transfers in case of incomplete identification data, no requirement to keep the originator information throughout the transfer chain etc.). The issue would need to be re-addressed in the context of the adoption of relevant EU regulations (which will apply automatically in the Czech republic).

23. For the time being, the requirements in respect of complex, unsusual and large transactions (R.11) are addressed satisfactorily in banking regulations. It is therefore recommended to expand the obligation of R.11, beyond the banking sector, to all financial institutions and other obliged entities. The basic requirement related to relationships and vigilance vis a vis risk countries R.21 are implemented in the AML Act and to some extent in the banking regulations also through the measures referred to for R.11. All requirements are not present though and existing measures have little impact in practice since there is over-reliance on the FATF list of NCCT which contained only two or three countries at the time of the on-site visit.

24. The system for reporting ML and FT put in place in the Czech Republic appears to be quite sound, if one excepts the issue of feedback which needs to be addressed. The protection against the consequences of reporting to the FAU does not extend explicitly to the disclosure of information (although it covers the suspension of transactions), beyond the obliged entity, to its management and staff.

25. The matter of internal AML/CFT programmes needs to be re-addressed in the AML Act due to several shortcomings which are only compensated to some extent for the banking sector (internal procedures are needed beyond the mere appointment of a responsible officer, the reporting officer needs to become a compliance officer appointed at managerial level and explicitly entrusted with broader responsibilities, an audit function and screening procedures for employees are needed, AML and CFT should be addressed explicitly and inconsistencies

between the AML Act and the banking regulations need to be reviewed. Effectiveness is also an issue here. There are no explicit general AML/CFT requirements implementing R.22 on the applicability of domestic rules to branches located abroad.

26. Basic requirements are in place that ensure the non existence of shell banks in the Czech Republic. Some improvements are needed to ensure that correspondent banking relationships requirements are extended beyond the banking sector to all financial institutions (e.g. credit unions), and criterion 18.3 needs to be addressed

27. As regards supervision, the AML Act sets clear responsibilities for supervising the financial and other entities, which was very much welcome by the examiners. Supervisors are also required to report suspicions to the FAU. In their case, the fact that the reporting duty is based on the concept of "suspicious transactions" could be an obstacle. For the time being, with the exception of the CSC, financial supervisors seem to take their AML duties seriously and they have the means to do so. However, bearing in mind that supervision has mostly focused so far – with the exception of the CNB – on formal requirements and to a limited extent with technical on-site inspections to verify the implementation of AML measures in practice, the Czech authorities will need to remain vigilant on this issue. The examiners believe that the merger of financial supervisors under the CNB will further raise the standards further in practice and help solve certain issues (staffing and means of supervisors, a more consistent approach throughout the financial sector etc.).

28. Money transfer services provided by the Czech Post and the control of the agents of a license holder need to be better addressed. There are allegations of informal remittance activity in the Czech Republic. These need to be looked at.

4. Preventive Measures – Designated Non-Financial Businesses and Professions

29. The amendment to the AML Act, in 2004, has extended the list of non financial institutions to include those required by Article 2a of the revised EU Directive. The obligations applied to them are to a large extent same as those applied to the financial institutions. This includes identification, record keeping and reporting obligations with regard to suspicious transactions and also to facts of any other kind that might indicate a suspicious transaction. The only sector specific texts adopted that addresses the issue of AML/CFT are those of the Bar Association. One of them is the Resolution of the Board of the Czech Bar Association of June 2004 "defining the procedure to be followed by attorneys-at-law and the control Council of the Czech Bar Association for the purposes of compliance with legislation on measures against the legalisation of proceeds from crime".

30. The concerns expressed and weaknesses identified regarding Recommendation 5 for the financial sector apply also for DNFBPs. There are no particular additional weaknesses or shortcomings identified. In the field of reporting requirements, the application of the relevant FATF Recommendations to the non-financial sector – other entities or DNFBPs – appears to be broad. Specifically for DNFBPs, the problem of insufficient guidance and awarenss raising initiatives to their attention on AML/CFT issues was mentioned. Most of them (including supervisors) aknowledged being at an early stage of awareness or seemed to ignore CFT issues totally. Quite a lot needs to be done in respect of DNFBPs in that area.

31. Certain sectors of activities of DNFBPs are allegedly particularly exposed to ML, but there are no increased efforts from the authorities to address this (e.g. gambling, casinos, possibly accountants).

32. The examiners welcomed that the list of obliged entities goes beyond the international requirements. This being said, the Czech Republic should examine whether it would not be better to put "legal persons or natural persons authorised to broker savings, monetary credits or loans or brokering activities that lead to the signing of insurance or reinsurance contract" under the control of the financial supervisors. Finally, the examiners found that there is room for further measures to encourage the development and use of modern and secure techniques for conducting transactions, that are less vulnerable to money laundering.

5. Legal Persons and Arrangements & Non-Profit Organisations

33. The examiners found that the registration of business entities does not ensure an adequate level of reliability of information registered and of transparency of ownership; companies can issue freely transferable bearer shares (there seem to be no particular AML/CFT counter-measures in place). The interviews held on site have also pointed at integrity problems in the area of registration of companies and that the effectiveness of the measures in place was problematic. This is an important area that the Czech authorities need to look at.[6]

34. The Concept of trusts (and fiduciaries) is not part of the Czech Republic's tradition.

35. As regards Non-profit Orgnaisations, a developed legal framework with controls at the most sensitive levels seems to be in place but no real picture was available of possible AML/CFT strengths and weaknesses. The information is available from different databases only, which can make enquiries somewhat cumbersome. The examiners heard occasionally allegations of misuse of NPOs for criminal purposes but since there was no detailed information available, the Czech authorities may need to examine these further. For the time being, no formal review of the legal framework applicable to NPOs was undertaken.

6. National and International Co-operation

36. National coordination mechanisms are in place and there seem to be bases for an inter-institutional dialogue. The FAU and supervisory bodies manage to coordinate the supervisory work in a way that limits undue risks of overlapping or loopholes. However, for the time being, there is a lack of common understanding on certain issues and of a real concerted approach at national level that would bring on the same path the whole chain of institutions involved in the prevention, detection, investigation and prosecution of economic and other activities involving proceeds from crime. As a result, there are different "AML/CFT languages" spoken in the Czech Republic, with a tendency to transfer the responsibility for the lack of results on others: the industry criticizes the lack of guidance and the standards, the

[6]the Czech authorities advised after the visit that the situation has very much impproved with the new legal changes of Law N° 216/2005, Law N° 79/2006 and the Regulation N° 562/2006 (on the the computerisation of data).

police critizes the FAU, judges critizes the police and prosecutors etc. The need for a strong concertation mechanism and shared responsibilities is obvious.

37. The Palermo Convention and the terrorist financing[7] Convention have not been ratified;

38. The Czech Republic is able to cooperate to a large extent with foreign counterparts in those areas which are relevant for AML/CFT purposes. It would seem that the major limitations to international cooperation are possibly linked to the incomplete Czeck legal framework on seizure and confiscation. Furthermore, certain staffing problems (Ministry of Justice, prosecutor's office) could be an obstacle to timely and effectice cooperation. These issues have already been addressed elsewhere in the report. Legal assistance is provided to the widest extent possible in the absence of dual criminality for less intrusive measures but they are still needed for intrusive measures such as seizure and confiscation. Except in cases where the European Arrest Warrant (EAW) is used, dual criminality is always required for the purposes of extradition.

39. In principle, the various state institutions appear to be able to cooperate broadly with their foreign counterparts. On paper, there seem to be some limitations as regards the use of information from certain financial institutions (Securities and insurancesector) that could hinder cooperation of the prudential supervisors with foreign entities.

7. Other Issues

40. Countries are allowed, under the Methodology, to have a risk based approach when determining priorities and imposing obligations on obliged entities. The examiners noted in this context, that part of the Czech authorities referred to the existence of such a risk based approach – including the FAU. However, there was a tendency to rely on assumptions rather than on assements. One of the results of this is the lack of unanimity on sectors really exposed to, and used for ML purposes. The examiners believed that a consistent risk based approach should be developped, based on accepted evaluations of given situations.

[7] The Czech Republic ratified the Convention on 27 December 2005; it entered into force on 26 January 2006