

THE WORLD BANK

INTERNATIONAL MONETARY FUND

CZECH REPUBLIC

**Report on Observance of Standards and Codes
FATF Recommendations for Anti-Money Laundering and Combating the Financing
of Terrorism**

Prepared by the Financial Sector Vice Presidency, World Bank
and the Monetary and Financial Systems Department, IMF

December 9, 2003

EXECUTIVE SUMMARY

This report provides a summary of the assessment of the Czech Republic's observance with the FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations on Combating the Financing of Terrorism (FATF 40+8 Recommendations) based on the discussions held in the Czech Republic, as well as the responses and other documents provided by the authorities.

The Czech Republic has made very important progress in the past few years in bringing the anti-money laundering regime into compliance with international standards. Overall, a comprehensive legal and institutional framework is in place, and the Czech Republic complies well with the FATF 40 Recommendations for anti-money laundering.

Several shortcomings were noted in the area of combating the financing of terrorism and the supervision of AML/CFT compliance in the insurance sector. However, amendments to legislation are under preparation, and if enacted, would bring the Czech Republic into better compliance with the FATF 40+8 Recommendations. *In addition, the assessment showed there is an absence of law enforcement results in terms of specific money laundering prosecutions, convictions and asset recovery.*

Contents	Page
Acronyms	3
I. Introduction	4
II. Information and methodology used for the assessment	4
III. Main findings	4
A. Criminal Justice Measures and International Cooperation	5
B. Preventive Measures for Financial Institutions	7
C. Summary Assessment Against the FATF Recommendations	9
 Text Tables	
1. Recommended Action Plan to Improve Compliance with the FATF Recommendations ..	9
2. Other Recommended Actions	11

ACRONYMS

AML	Anti-Money Laundering
AML Act	Act No. 61 of February 15, 1996 on Selected Measures Against Legitimization of Proceeds from Criminal Activities
CFT	Combating the Financing of Terrorism
CNB	Czech National Bank
CSC	Czech Securities Commission
CUSA	Credit Union Supervisory Authority
CZK	Czech Koruna
FATF	Financial Action Task Force on Money Laundering
FAU	Financial Analytical Unit
FIU	Financial Intelligence Unit
FT	Financing of Terrorism
IAE	Independent AML/CFT Expert
ML	Money Laundering
MOU	Memorandum of Understanding
OPDT	Office for Personal Data Protection
UNSCR	UN Security Council Resolution

I. INTRODUCTION

1. This Report on the Observance of Standards and Codes for the *FATF 40 Recommendations for Anti-Money Laundering and 8 Special Recommendations on Combating the Financing of Terrorism* was prepared by a team composed of staff of the International Monetary Fund and the World Bank, and an independent expert not under the supervision of the Bank and Fund staff who was selected from a roster of experts in the assessment of criminal law enforcement and non-prudentially regulated financial activities.¹

2. The report provides a summary of the level of observance with the FATF 40+8 Recommendations and provides recommendations to strengthen observance. The views expressed in this document are those of the assessment team and do not necessarily reflect the views of the government of the Czech Republic or the Boards of the IMF or the World Bank.

II. INFORMATION AND METHODOLOGY USED FOR THE ASSESSMENT

3. In preparing the detailed assessment, Bank and Fund staff reviewed the relevant anti-money laundering/combating the financing of terrorism (AML/CFT) laws and regulations and supervisory and regulatory systems in place to deter money laundering and the financing of terrorism among prudentially regulated financial institutions. The independent expert not under the supervision of the Bank and Fund staff reviewed the capacity and implementation of criminal law enforcement systems. The assessment is based on the information available at the time the assessment was completed on June 6, 2003.

III. MAIN FINDINGS

4. The Czech authorities have made impressive progress in the past few years in bringing the AML regime of the Czech Republic into compliance with both European and international standards. In the Czech Republic, AML provisions can be traced back to 1996 with the enactment of Act No. 61 of February 15, 1996 on Selected Measures against Legitimization of Proceeds from Criminal Activities (AML Act). Since that time, the Czech authorities have undertaken important steps towards completing the legal and institutional framework to fight money laundering, and have begun concrete implementation of the AML regime in the various relevant financial sectors. Further efforts by the government to improve the country's AML legal and institutional framework and effective supervision have resulted

¹ The assessment was conducted by Ms. Maud Bökkerink (IMF), Mr. Alain Damais, Ms. Bess Michael and Ms. Tracy Tucker (World Bank), and the independent AML expert Mr. Boudewijn Verhelst (Deputy Director of the Belgium FIU, Cellule de Traitement des Informations Financières—Cel voor Financiële Informatieverwerking, CTIF-CFI). Throughout this report, portions of the assessment attributable to the IAE are shown in italicized text.

in the enactment of major legislation. These new legislative initiatives represent major progress and have brought the Czech Republic into compliance with most of the legal requirements of the FATF AML standard. The authorities are currently undertaking further amendments to strengthen CFT legislation, which is not yet in line with the FATF CFT standard.

5. The government has created and designated various competent authorities to ensure the effective implementation of these laws. The main institutions responsible for fulfilling these obligations are the Financial Analytical Unit (FAU), the police, and the Office of the Public Prosecutor. The Czech National Bank (CNB), the Ministry of Finance, and the Czech Securities Commission (CSC) are the primary financial regulators, and along with the FAU, play the critical role in monitoring of AML/CFT compliance by banks, insurance and securities firms and other intermediaries.

A. Criminal Justice Measures and International Cooperation

6. The legal provisions for the criminalization of money laundering are in place in a manner which is largely consistent with the FATF standard. However, the scope of the money laundering offence appears narrower than established by UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances 1988 (Vienna Convention), the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime 1990 (Strasbourg Convention) and the UN Convention against Transnational Organized Crime 2000 (Palermo Convention). The mission recommends that the criminal definition of money laundering be aligned with the definition contained in the aforementioned conventions. Moreover, there is no specific and explicit offence criminalizing the financing of terrorism for which the authorities should take prompt remedial action.

7. Measures to confiscate the proceeds of crime or the property used to finance terrorism are in place when the proceeds of crime or property are linked to terrorist-related offences. However, there is no provision for the mandatory and systematic confiscation or forfeiture of the object of the offence, i.e. the laundered money or property, which may lead to situations where the object of the offence would not be confiscated/forfeited. The authorities should consider adding mandatory provisions in this regard to the existing forfeiture/confiscation regime. *The lack of specified and itemized statistics on ML and FT related to seizure and confiscation should also be addressed.*

8. The Czech Republic has signed several international conventions, but ratification remains a challenge. The Czech Republic has signed and ratified the Vienna Convention. The Palermo Convention and the UN International Convention for the Suppression of the Financing of Terrorism have been signed, but ratification and full implementation are incomplete.

9. The Czech Republic provides a wide range of international cooperation and mutual legal assistance with a significant number of partners throughout the world. The authorities

can assist foreign counterparts on the basis of numerous existing multilateral and/or bilateral treaties or conventions. *To further improve international cooperation, the FAU should be able to cooperate with its foreign counterparts on a reciprocal basis, even in the absence of a treaty or convention. If enacted, the draft amendment to the AML Act would allow the FAU to cooperate fully with foreign counterparts on a reciprocal basis.*

10. With respect to the freezing of assets suspected of being related to terrorism, the supervisors and the FAU have distributed the UN and European Union lists of terrorist individuals and organizations to Czech financial institutions. However, it appears that the Czech authorities are not yet fully able to freeze without delay funds or property of terrorists and of those who finance terrorism and terrorist organizations in accordance with the United Nations Security Council Resolutions (UNSCRs). Therefore the mission recommends that the Czech authorities expeditiously amend their legislation to allow for the unconditional freezing of funds and property in accordance with the UNSCRs and the FATF Special Recommendation III.

11. The authorities are working on key draft legislative reforms at this time to bring their AML/CFT regime into full compliance with the requirements necessary for the Czech Republic's accession into the European Union. Most of the issues identified in this report are being addressed by the legislative changes that are underway and should be brought into force in 2004. The mission welcomes and supports these efforts towards their final adoption. In particular, the authorities are preparing amendments to legislation which include: (i) criminalizing the financing of terrorism; (ii) authorizing criminal liability for legal persons; and (iii) enacting other provisions related to the fight against the financing of terrorism.

12. The Czech Republic created the FAU in 1996, which meets the Egmont Group FIU definition. The FAU's main tasks are to receive, analyze and disseminate reports on suspicious transactions from financial institutions. It has been a member of the Egmont Group since 1997, and cooperates with a significant number of counterparts. The FAU is actively participating in awareness raising and training activities among financial intermediaries. However, the FAU has not yet issued guidelines to assist financial institutions to identify patterns of suspicious transactions, and should consider issuing such guidelines.

13. *The reporting system has reached an acceptable level of performance. The FAU, as a mature and experienced FIU, is adequately fulfilling its selective and supportive function as required by law. As yet, the valuable work of the FAU has, unfortunately, not been met with an effective law enforcement response. Apart from its supervisory responsibilities and in light of the number of disclosures, the FAU seems reasonably resourced to perform its analytical task. The FAU should, however, endeavor to manage the available resources more effectively and to speed up the analytical process whenever it is not dependent on outside factors beyond its control. The self-evaluation of the reporting system would benefit from more detailed statistics on the performance and characteristics of all the components of the anti-money laundering effort.*

14. The law enforcement and prosecution authorities are able to use a wide range of investigative techniques (under the rules of the Criminal Procedure Code) and have the ability to compel production of bank account and financial transaction records. *Tracing back the assets to a specific predicate offence (especially when committed in a foreign country) was identified as the main challenge in the investigation of money laundering cases. Customs monitors the cross-border movement of cash and bearer instruments over CZK 350,000 subject to mandatory declaration, but cannot seize funds under the established threshold, even if circumstances raise suspicion of illegal proceeds.*

15. *Although the legal resources seem adequate enough and the AML system has all its components functioning, there is a total absence of any law enforcement results in terms of specific ML prosecutions, convictions and asset recovery. This is a matter of grave concern and should be addressed forthwith. Efforts have been made to remedy the situation with the creation of a specialized police unit for money laundering and the establishment of an interdepartmental task force (“Clearing House”), but there is still a need for specialized training, particularly for the judiciary. Beside a change of mentality and opening up to new concepts and approaches, it is important to create case law and jurisprudence to test the adequacy of the money laundering offence and identify in a certain manner the position of the courts with respect to evidentiary requirements. Furthermore, the penalties for ML do not seem to be sufficiently proportionate and dissuasive and should be brought up to international standards. As far as CFT is concerned, prosecution and mutual legal assistance are still jeopardized by the absence of a formal and comprehensive legal basis. Otherwise, international cooperation in all its forms is solid.*

B. Preventive Measures for Financial Institutions

16. The FAU has been designated as the main authority responsible for auditing compliance of financial institutions with the AML Act. In addition, since 2000, the CNB, the CSC and the Credit Union Supervisory Authority (CUSA) also have a function under the AML Act to audit compliance by banks, investment companies, investment funds, pension funds, securities traders, and credit unions, respectively. The FAU inspects banks, securities companies and credit unions on an ad hoc basis for compliance with AML/CFT requirements but leaves the majority of the supervision regarding AML/CFT to the CNB, CSC and CUSA.

17. The team noted the positive recent efforts and improvements by the CNB to increase AML targeted on-site inspections and to issue the CNB provision on internal management and control systems of banks in the area of money laundering prevention. The CSC has incorporated AML within their on-site and off-site inspections of securities dealers since 2002. The FAU has a high number of entities under its supervision, and lacks adequate staffing resources to perform its duties satisfactorily. Therefore, the FAU could benefit from an increase in resources, especially for its supervisory function.

18. AML/CFT regulation and supervision in the insurance sector is insufficient and needs to be bolstered. The insurance supervisor, the Office of the State Supervision in Insurance

and Pension Funds, which is part of the Ministry of Finance, has not focused its inspections on AML/CFT issues because it does not have any legal obligation to do so. The mission welcomes the current efforts to task the insurance supervisor with AML/CFT supervision and urges the authorities to prioritize greater supervision of the related entities. It also encourages the Czech authorities to strengthen the Office's knowledge and expertise in AML/CFT.

19. The financial supervisors have adequate powers to check the integrity of management and major shareholders and can prohibit criminals from taking control of financial institutions. In addition, the FAU, CNB and CSC have sufficient enforcement powers to enforce compliance with the AML Act. The insurance supervisor, however, should be granted wider powers for remedial actions. The Ministry of Finance/FAU, the CSC and the CNB have entered into an agreement on cooperation in February 2003. The financial supervisors have no restrictions in providing the FAU with information on the entities under their supervision. However, except for the CNB, the FAU cannot convey information on the reporting institutions to the financial supervisors; they need this information to perform their supervisory task in the field of AML/CFT. The FAU should be allowed to supply information on financial institutions' reporting behavior to the relevant supervisors. The draft amendment to the AML Act, if passed, would resolve this and allow the FAU to supply information to relevant supervisors.

20. The AML Act provides for sufficient requirements with respect to customer identification and record keeping. Although addressed in the draft amendment of the AML Act, the law does not currently address the renewal of customer identification information when doubts appear as to their identity in the course of a business relationship or the identification of beneficial owners of legal entities. Especially when lawyers or notaries act on behalf of their clients, confidentiality requirements prohibit financial institutions from properly identifying their clients. The authorities are encouraged to remove these impediments for financial institutions to properly know their customers. Moreover, existing legislation does not require financial institutions to include accurate and meaningful originator information on funds transfers and related messages, which in accordance with FATF Interpretative Note to Special Recommendation VII should be completed by end 2004.

21. Unlike banks, which are currently required under the new CNB provision to pay attention to high risk customers and persons and legal entities in jurisdictions that do not have adequate systems in place against money laundering, financial institutions in general are not so required. It would be beneficial to include this in the AML Act, as well as a requirement for financial institutions to pay special attention to all complex, unusual large transactions, and unusual patterns of transactions, that have no apparent or visible economic or lawful purpose.

22. The system for reporting suspicious transactions is comprehensive and largely meets international standards. The AML Act requires financial institutions to submit to the FAU transaction reports and all relevant customer identification data where there are suspicions of money laundering. However, there is not a similar requirement for the reporting of suspicions of terrorist financing; the authorities indicate that amendments are pending. The financial

supervisors and the FAU have distributed the UN and EU lists of terrorist individuals and organizations to financial institutions, and are encouraged to report the related transactions to the FAU.

23. As required by the AML Act, all financial institutions have drafted and submitted to the FAU internal procedures and control measures to prevent money laundering and have appointed a contact person who is in charge of coordination and information exchange with the FAU, as well as compliance with the reporting duty. Neither the FAU nor the supervisors have issued practical guidelines to assist and guide financial institutions in detecting patterns of suspicious financial activity. The FAU, in cooperation with the supervisors, should provide the financial institutions with more guidance on complying with the AML/CFT requirements to raise awareness of money laundering and the financing of terrorism.

24. The mission welcomes the decision of the authorities to address several concerns identified in the assessment by introducing the new CNB regulation on internal management and control systems of banks in the area of money laundering prevention and draft legislation to amend the AML Act which is expected to come into force in January 2004. This amendment to the AML Act should bring the Czech Republic into greater compliance with requirements for customer identification, record keeping and reporting of suspicions of terrorist financing.

C. Summary Assessment Against the FATF Recommendations

25. The assessment shows the Czech Republic's high level of compliance with the FATF 40 Recommendations for AML. Shortcomings have mostly been identified in the areas of combating the financing of terrorism and the supervision of AML/CFT compliance in the insurance sector, where amendments to bring the Czech legislation into compliance are underway. Together with others, these amendments, if enacted, would bring the Czech Republic into even closer compliance with the FATF 40+8 Recommendations. *However, this high level of compliance has not yet translated into law enforcement results.*

Table 1. Recommended Action Plan to Improve Compliance with the FATF Recommendations

Reference FATF Recommendation	Recommended Action
40 Recommendations for AML	
Scope of the criminal offence of money laundering (FATF 4-6)	Enlarge the scope of section 252a of the Criminal Code, to bring it into line with the concept of money laundering established by the Vienna, Strasbourg and Palermo conventions and with a view to cover the situation of "acquisition, possession, use or disposition of assets with the knowledge that such assets originate from a criminal activity".

Reference FATF Recommendation	Recommended Action
Provisional measures and confiscation (FATF 7)	Consider giving a mandatory nature to the forfeiture/confiscation regime (Section 55 of the Criminal Code), as explained above.
Customer identification and record-keeping rules (FATF 10-13)	Pass the draft amendment to the AML Act in order to introduce new requirements regarding the updating of identification information of customers when doubts appear as to their identity in the course of a business relationship, and the identification of the beneficial owner when the customer is a legal person. Ensure that lawyers and notaries cannot invoke their confidentiality requirement in relation to financial institutions when acting on behalf of a client.
Increased diligence of financial institutions (FATF 14-19)	Introduce requirements in the AML Act regarding ongoing monitoring of accounts and transactions.
Measures to cope with countries with insufficient AML measures (FATF 20-21)	Introduce in the AML/CFT legal framework, through enactment of the draft amendment to the AML Act, the necessary provisions to require that financial institutions pay special attention to business relations and transactions with persons (including legal entities) in jurisdictions that do not have adequate systems in place to prevent and deter ML or FT.
Implementation & role of regulatory and other administrative authorities (FATF 26-29)	Establish the Office of the State Supervision in Insurance and Pension Funds as the overall AML/CFT supervisor for the insurance sector. Ensure that there are no legal impediments for cooperating by the FAU with other relevant supervisors. Issue guidelines to help financial institutions in implementing the AML/CFT requirements and in detecting and reporting suspicious patterns of transactions.
Administrative Cooperation – Exchange of information relating to suspicious transactions (FATF 32)	<i>Enact the draft amendment to the AML Act to allow the FIU to cooperate with its foreign counterparts even in the absence of a treaty or convention.</i>
8 Special recommendations on terrorist financing	
I. Ratification and implementation of UN Instruments	Ratify and implement fully the UN International Convention for the Suppression of the Financing of Terrorism.
II. Criminalizing the financing of terrorism and associated money laundering	Introduce in legislation a criminal offence of financing of terrorism consistent with the definition given by the UN International Convention for the Suppression of the Financing of Terrorism.
III. Freezing and confiscating terrorist assets	Amend legislation to unconditionally allow for freezing of funds and property in accordance with the UNSCR.
IV. Reporting suspicious transactions related to terrorism	Introduce in legislation a duty to report financial transactions suspected of being related to the financing of terrorism.
VII. Wire transfers	Take measures to require financial institutions to include accurate and meaningful originator information on funds transfers and related messages.

Table 2. Other Recommended Actions

Reference	Recommended Action
Funding and staffing of supervisors/regulators	<p>In light of the large number of entities under the supervision of the FAU, the FAU should benefit from additional staffing, in particular, for its supervisory function.</p> <p>With regard to enhancing the efforts in the field of AML/CFT supervision by the insurance supervisor, more resources and training for inspectors are necessary to strengthen investigative capabilities and enhance skills and expertise in dealing with money laundering and financing of terrorism inspections.</p>
<i>Law enforcement results</i>	<p><i>Make more effective use of the cases and information supplied by the FAU.</i></p> <p><i>Create case law and jurisprudence to test the adequacy of the money laundering offence and identify in a certain manner the position of the courts with respect to the evidentiary requirements.</i></p>
<i>Sanctions</i>	<p><i>The penalty for ML should be made consistent with at least the applicable standards established by the European Union Council Decision of June 2001, which established a four-year minimum for money laundering offences</i></p>