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**EUROPEAN COMMITTEE ON CRIME PROBLEMS
(CDPC)**

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

THIRD ROUND REPORT ON

HUNGARY¹

***ANTI-MONEY LAUNDERING
AND COMBATING THE FINANCING OF TERRORISM***

SUMMARY

Memorandum
prepared by the IMF

¹ Adopted by MONEYVAL at its 17th Plenary meeting (30 May – 3 June 2005)

EXECUTIVE SUMMARY

I. Introduction

1. This Report on the Observance of Standards and Codes for the *FATF 40 Recommendations 2003 for Anti-Money Laundering (AML) and 9 Special Recommendations on Combating the Financing of Terrorism (CFT)* was prepared by a team composed of staff of the International Monetary Fund and an expert under the supervision of Fund staff,² using the AML/CFT Methodology 2004. It provides a summary of the level of observance with the FATF 40+9 Recommendations and recommendations to strengthen observance.

2. In preparing the detailed assessment, the team reviewed the legal, regulatory, and institutional frameworks and systems pertaining to AML/CFT in financial institutions and designated nonfinancial business and professions (DNFBPs) and examined the capacity, the implementation, and the effectiveness of these systems. The assessment is based on the information provided at the time of on-site visit by the team from February 21–March 4, 2005 and immediately thereafter.

II. Main Findings

3. The Hungarian authorities have made significant progress in strengthening their AML regime in the four years since the last assessment. The most important step was the passage of a revised AML Act of 2003, replacing the 2001 revision of the original 1994 AML Act. With this, the legislative framework for AML is in place and has been extended to nonfinancial businesses and professions. Financial institutions' compliance with the AML requirements is well-supervised and they are well aware of their obligations under the Act.

4. These impressive efforts notwithstanding, some important gaps remain in the legislative framework for CFT and the implementation of AML measures needs to be improved. The authorities have indicated their intention to address these issues in the context of the implementation of the Third European Union (EU) Directive on money laundering (ML), which is in final stages of preparation in Brussels³. Nonetheless, work on some of these issues could commence immediately.

General

Situation of Money Laundering and Financing of Terrorism

5. The Hungarian authorities report only seven prosecutions for money laundering in the last four years with the predominant predicate offenses being fraud, misappropriation, and illegitimate financial service activity. Hungarian criminal statistics and reports of international organizations indicate that other profit-making crimes (e.g., drug-related offenses) take place and additionally testify to the presence of organized crime families in Hungary.⁴ It would seem reasonable to expect that there should be more money-laundering prosecutions on the basis of such profit-making crimes.

² The assessment team was composed of Kiyotaka Sasaki and Paul Ashin (both MFD), Giuseppe Lombardo (LEG) and Dirk Merckx (Public Prosecutor of Belgium).

³ The Third Directive was approved by the EU Parliament on May 26, 2005.

⁴ MONEYVAL, "Mutual Evaluation/Detailed Assessment Questionnaire—Hungary" (Budapest, January 31, 2005), Annex 1; MONEYVAL, "Second round evaluation report on Hungary," (Strasbourg, December 13, 2002), pp. 5–8; United States Department of State, "International Narcotics Control Strategy Report - 2003 (March, 2004), Hungary sections in Parts I and II.

6. Few terrorist-related cases have been encountered in Hungary and those were not related to international terrorism in the strict sense, but rather to forms of domestic terrorism in a broad meaning, including offenses as hostage-taking or other serious offences endangering public order.

Overview of Financial Sector and DNFBPs

7. As of September 2004, the Hungarian financial system was composed of 32 banks, 5 specialized credit institutions, 178 cooperatives, 199 financial enterprises, 18 investment enterprises, 24 investment funds, 65 insurance companies, and 168 pension/health related funds. They are all supervised by the Hungarian Financial Supervisory Authority (HFSA). Money transfer services and currency exchange activities are also licensed and supervised by the HFSA.

8. The HFSA was established on April 1, 2000 as a single supervisor of the financial sector. Hungary's legal system does not provide the HFSA with the power to issue legally-binding rules and regulations to the financial sector. However, the HFSA has a power to issue guidelines, recommendations, and model rules for the financial institutions, supported by its power to invoke sanctions for noncompliance. The HFSA also plays an important role along with the National Bank of Hungary (NBH) in the drafting of a legally-binding Decree issued by the Ministry of Finance (MOF).

9. For AML/CFT purposes, Hungary's DNFBPs can be divided into three categories, based on the type of oversight. Casinos are directly under the supervision of the Hungarian Gaming Board (HGB); lawyers, notaries, and auditors are supervised by their respective professional bodies or chambers; and other businesses and professions (accountants, real estate agents, high-value goods dealers, etc.) directly by the Financial Intelligence Unit (FIU). The latter group is the most numerous, comprising some 50,000 individuals and businesses. The Chambers range in size from the Notaries (304 members), through the Auditors (5,900), to the lawyers (9,000). Hungary's six casinos had a net gaming income (bets minus winnings) of HUF 10.1 billion (US\$50 million).

10. There are some 49,000 non-profit organizations (NPOs) in Hungary, which took in over HUF 731 billion (US\$3.26 billion) in 2003. Key characteristics of the sector are the relatively high level of state support and the relatively low level of private party donations.

Legal Systems and Related Institutional Measures

11. Hungary has a substantial AML legal and institutional framework for combating ML including preventive measures for a wide range of service providers (SPs) and law enforcement measures. There are a number of areas which can be strengthened. The scope of criminalization of ML should be enlarged to take into account fully the requirements of the international conventions. The criminal provisions regarding financing of terrorism (FT) should be revised in order to include the financing of individual terrorists. The suspicious transaction reporting (STR) system, including the guidelines for DNFBPs, should cover transactions which are suspected to be aimed at FT. Lastly, the asset-freezing mechanisms should be enhanced particularly with respect to FT.

12. The ML offense, while it addresses self-laundering, covers only using the proceeds of crime in the business activity of the perpetrator or in a bank or financial transaction. The scope of the offense should be enlarged to cover all the circumstances set forth by the Vienna and Palermo conventions.

13. The relevant provisions regarding FT are quite complex and contained within the definition of acts of terrorism. Moreover, the offense is defined in relation to the financing of the activities of terrorist groups, while the financing of individual terrorists is only covered through ancillary offenses.

The criminal provision should cover all conduct constituting terrorist financing as set forth in the UN International Convention for the Suppression of the Financing of Terrorism.

14. There is no legal obligation in the current Hungarian legislative framework to report a transaction on the basis of a suspicion that the funds involved may be relevant to terrorism⁵. SPs—normally a key source of information—are thus not directly engaged in the identification and detection of terrorist-related funds, which decreases the chances of detection and forfeiture. The AML Act also lacks any provision for suspending a transaction based on suspicions of FT (as opposed to ML) which eliminates the option of freezing assets in such a case.

15. Similarly, unlike in the case of ML and of large-value movements generally, the Hungarian Customs and Finance Guard (HCFG) is not under a reporting obligation regarding suspicious cross-border movements of valuables related to FT, nor do they appear to have the right to freeze such assets. While the EC Regulations 881/2002 and 2580/2001 are self-executing in Hungary as an EU member state, there is no domestic legislation implementing the United Nations Security Council Resolutions (UNSCRs) 1267 and 1373, which is especially problematic in relation to the freezing of nonbanking/financial assets.

16. It is recommended that a clear legal basis for the obligation to report suspicious transactions (STs) related to FT be established and that relevant requirements and supervisory oversight by the competent authorities also be imposed in the case of FT. Measures should be taken to authorize the immediate freezing of terrorism-related assets. The powers of the HCFG and the sanctions available to them should also be strengthened.

17. The STR system should be reviewed. Currently, the system is producing a high volume of relatively low quality STRs from financial institutions and a negligible number of STRs from DNFBPs. The potential over-reporting from financial institutions could be linked to the criminal liability for both wilful and negligent non-reporting under the Hungarian Criminal Code (HCC), which was also a concern for all SPs. It is recommended that the penalties for criminal non-reporting be more proportionate to the offense, especially in the case of negligence, for instance by imposing appropriate fines.

18. The FIU at the National Police Headquarters (NPHQ) bears the brunt of the over-reporting and consequently may not be sufficiently staffed to both perform its core functions and to take on the supervisory role for DNFBPs without state or professional supervision that has been assigned to it by the AML Act. These supervisory functions might fit poorly in a police-based FIU, due to the high potential for blurring of supervisory, investigatory, and enforcement roles. Authorities should consider finding another institutional framework for supervising these SPs. On the other hand, the FIU should be given a clear competence in CFT, with a repository and analysis function also over the STRs for FT.

19. The Hungarian pre-investigative and criminal procedure provisions provide a modern and coherent set of rules for the authorities to conduct ML and FT investigations, comprising all necessary ordinary and specific investigative techniques. However, despite this ready-to-use system, and despite the ample training given to the judiciary as well as the police, there are hardly any convictions in these areas. As far as FT is concerned, this might be a consequence of the reality that, according to the evaluation of the Hungarian authorities, there seems to be very little terrorist activity

⁵ However, the Recommendation of the President of the HFSA 1/2004 provides that financial institutions should pay increased attention to the lists of terrorists and terrorism organizations and that they should immediately report to the competent investigation authorities in case of a suspicion on FT.

on their territory. However, in the area of ML, the lack of effective enforcement of the existing system is a major shortcoming that will have to be addressed by the authorities

20. The complex rules criminalizing ML, the limited notion of “financial transaction,” and the especially complex rules on the FT offenses could be among the reasons these offenses are difficult to prosecute in Hungary.

21. An even more significant reason could be that the authorities do not pay sufficient attention to the link between profit-making predicate offenses, especially those related to organized crime, and ML. Although specialized organs have been created to gather intelligence on organized crime, this information appears not to have been widely used to attack these criminal profits through ML prosecutions and the seizing and confiscating of assets. However, the number of prosecutions for such predicate offenses clearly indicates that a significant increase in ML investigations is possible.

Preventive Measures—Financial Institutions

22. The AML Act mandates comprehensive preventive measures for financial institutions including customer due diligence (CDD), record keeping, suspicious transaction reporting, and internal controls for AML. In addition, the Recommendation of the President of the HFSA No.1/2004 provides more detailed requirements and guidance for AML compliance by financial institutions. The HFSA reviews and updates this Recommendation to cover new issues and requirements in the international standards, including the revised FATF Recommendations as well as the CDD paper by the Basel Committee.⁶

23. Under the AML Act, the HFSA issued model rules to help institutions in each financial sector develop internal procedures/regulations for AML and has reviewed and approved the internal procedures/regulations for AML prepared by all the financial institutions. The HFSA ensures compliance by conducting off-site monitoring and on-site inspections to review the effectiveness of internal AML controls, including the implementation of these internal procedures/regulations, and by taking administrative actions/sanctions necessary to rectify any deficiencies identified.

24. Apart from the AML Act, the relevant legislation for each financial sector, (including the Act on Credit Institutions and Financial Enterprises, the Act on Insurance Institutions and the Insurance Business and the Capital Market Act,) institutes measures to prevent criminals and their associates from holding ownership and control of the financial institutions. The HFSA reviews the fitness and properness of owners, shareholders, other stakeholders, and senior management during the licensing process and subsequent on-going supervision.

25. One weakness in an otherwise robust CDD and record-keeping system—for both financial institutions and DNFBPs—is the treatment of beneficial owners. According to the AML Act and most of the model rules issued by the supervisory bodies, when a client states that he or she is acting on behalf of another party who is the actual owner of the assets in question, the SP only has to collect a limited amount of information concerning that beneficial owner. Such a significant difference between the data collected on direct clients as opposed to those who come to a service provider through a third-party would need to be better justified.

26. In addition, as noted above (Paragraph 18), Section 303/B of the HCC is applied also to negligent non-reporting of STs. This regime appears to have led to a large amount of “defensive

⁶ The HFSA updated the Recommendation relating to CDD requirements for correspondent banking relationship in April 2005 immediately following the on-site visit by the assessment team.

reporting,” rather than attempts to identify the real suspicious ones, as very few of the STRs have led to investigations and none to prosecutions. Out of 14,120 STRs received in 2004, only 20 cases turned into investigations and no prosecution was ever started out of an investigation arising from an STR. It is recommended that the current regime of imposing terms of imprisonment for negligent non-reporting of STs be reviewed and measures taken to improve the quality of STRs.

Preventive Measures—Designated Non-Financial Businesses and Professions

27. DNFBPs, like other SPs, are subject to CDD, record-keeping, and STR requirements. The problem of CDD information for beneficial owner identified in Paragraph 26 also applies to DNFBPs. In addition, high-value goods dealers are required to record cash transactions above a HUF 2 million threshold (US\$11,000). Each entity must establish internal AML/CFT rules, based on models circulated by their supervisory authority, and businesses with more than 10 employees must have a compliance officer and conduct training. Supervisory bodies are obliged to conduct on-site checks of compliance with these requirements. In addition, DNFBPs have not been uniformly alerted to the enhanced due diligence requirements for politically exposed persons (PEPs) and jurisdictions of concern.

28. A more operational weakness in the Hungarian DNFBP AML/CFT regime is that relatively few have filed any STRs. This state of affairs may reflect the relative novelty of AML/CFT issues in these sectors compared to financial institutions. Fully incorporating these businesses and professions into the AML/CFT system will require active outreach, training, and awareness-raising activities on the part of the authorities, working where possible with the professional organizations and supervisory bodies.

29. The strength of supervision varies between these businesses and professions. Casinos are under the most vigorous and consistent supervision. The professional Chambers are aware of their responsibilities, have disseminated materials to their members, and claim to check on compliance (although this oversight has not resulted in any sanctions).

Legal Persons and Arrangements and Non-Profit Organizations (NPOs)

30. The Hungarian authorities have not yet undertaken a review of the vulnerabilities of their NPO sector, although the draft of Second National Action Plan of the Inter-ministerial Task Force on Counterterrorism is reported to contain plans for such a review. Until such a review is completed, they cannot be considered compliant with SR VIII. One aspect of the review, consistent with the FATF best practice paper’s concern with “raising and distributing funds (Paragraph 3)” could be whether the act of raising funds from the public is adequately regulated under current Hungarian law. More generally, the regime for NPO oversight relies in large measure on a prosecutorial authority that pre-dates the establishment of an NPO sector in Hungary and may not be adequate for the current size of the sector.

National and International Cooperation

31. The Hungarian government set up an Inter-ministerial Committee on Anti-Money Laundering in 2001 and an Inter-ministerial Working Group against Terrorism under the direction of the Minister of Interior to implement the EU policy in the fight against terrorism and to meet other related international obligations. It adopted a National Action Plan against terrorism, whose most significant unmet goals include ratifying the Palermo Convention, improving the exchange of intelligence and cooperation among international police forces, adopting domestic legislation to allow freezing of

intangible, real, and tangible assets of suspected terrorists, and amending the existing provision pertaining to the freezing of financial assets.

32. The implementation of the UN Convention on FT and UNSCRs 1267, 1269, 1333, and 1390, however, still appears to pose some issues. Even though EU regulations regarding CFT would be immediately applicable in Hungary as an EU member state, domestic legislation is needed to impose sanctions for the violation of the EU CFT obligations. There are also some issues concerning the freezing of real goods, (related to the practical implementation of the freezing obligation set forth in the EU regulations) which are not currently covered by domestic legislation. Besides the Government Decree 306/2004 which deals with unfreezing, there is no other domestic legislation implementing neither UNSCR 1267 nor UNSCR 1373.

33. The Authorities have acknowledged these issues in the National Plan of Action to Combat Terrorism. It is recommended that Hungary ratify the Palermo convention and adopt domestic legislation to implement UNSCR 1267 and 1373.

III. Summary assessment against the FATF Recommendations

34. Overall, the current framework in Hungary to prevent ML is extensive and Hungary complies well with most of the FATF 40 Recommendations, but some important gaps remain in the legislative framework for CFT and in AML implementation. The following Table summarizes recommended actions in areas related to the FATF 40+9 Recommendations.