



Supervision of the National Bank of Slovakia in the Area of Protection Against Legalization of Income from Criminal Activity

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¹ The term „supervised entities“ is based on the provision Art. 1 para. 3 of the Financial Market Supervision Act and for the purposes of this article, it includes legal persons that carry on business according to laws regulating the financial market (see footnote 2), are subject to the supervision of NBS and are at the same time obliged entities (see footnote 3). These are banks, branches of foreign bank, securities traders, branches of foreign securities traders, the stock exchange, the central securities depository, asset management companies, branches of foreign asset management companies, foreign collective investment entities, insurance companies, reinsurance companies, branches of foreign insurance companies, branches of foreign reinsurance companies, electronic money institutions and branches of foreign electronic money institutions.

² Acts regulating the financial market that are subject-matter of this article are:

- Act No. 483/2001 Coll. on Banks and on amendments and supplements to some acts as amended,
- Act No. 566/2001 Coll. on Securities and Investment Services and on amendments and supplements to some acts (act on securities) as amended,
- Act No. 429/2002 Coll. on the Stock Exchange as amended,
- Act No. 95/2002 Coll. on the Insurance and on amendments and supplements to some acts as amended,
- Act No. 594/2003 Coll. on Collective Investment and on amendments and supplements to some acts as amended,
- Act No. 510/2002 Coll. on Payment System and on amendments and supplements to some acts as amended,
- Act No. 43/2004 Coll. on Retirement Pension Savings and on amendments and supplements to some acts as amended,
- Act No. 650/2004 Coll. on Supplementary Pension Savings and on amendments and supplements to some acts.

Within supervision over the activity of the supervised entities¹, the National bank of Slovakia as the authority for financial market supervision also performs supervision in the area of protection against legalization of income from criminal activity and against terrorism financing. This power of NBS does not result from the act No. 367/2000 Coll. on Protection Against Legalization of Income from Criminal Activity and on alterations and amendments to some acts as amended (hereinafter referred to as “the Act on Protection Against Legalization”), but from special acts regulating the individual areas of the financial market (hereinafter collectively referred to as the „acts regulating the financial market”²), i.e. mainly the areas of banking, capital market and insurance.

Most of the supervised entities are also obliged entities³ under the Act on Protection Against Legalization. Surveillance of the obliged entities with respect to compliance with duties for protection against legalization of income from criminal activity and terrorism financing belongs to the powers of the intelligence unit of the financial police of the Police Corps (hereinafter referred to as the „financial police”). The overlapping of the powers of both authorities – the National bank of Slovakia as the supervisory authority and financial police as the surveillance authority – sometimes meets with lack of understanding on the part of the supervised entities (obliged entities), as well as persons assessing the level of Slovakia’s measures in the area of protection against legalization of income from criminal activity and terrorism financing.

The content of this article is the assessment of the legal regulation and relation of the corresponding acts in the case of protection against legalization of income from criminal activity and terrorism financing, of the powers of both authorities and above all of the importance of the position of the National bank of Slovakia in the performance of supervision in the area of protection against legalization of income from criminal activity and terrorism financing.

1. ISSUE OF THE PROTECTION AGAINST LEGALIZATION IN THE ACTS REGULATING THE FINANCIAL MARKET AND IN THE ACT ON PROTECTION AGAINST LEGALIZATION

The legal regulation of protection against legalization of income from criminal activity and terrorism financing⁴ (hereinafter referred to as “protection against legalization”) in the Act on Protection Against Legalization, as the basic act for this issue, and in the acts regulating the financial market is basically similar, particularly with respect to provisions that have taken over internationally recognized standard to both acts, i.e. 40 basic and 9 special FATF (Financial Action Task Force) recommendations, which are contained in the first two directives of the European Union for protection against money laundering and terrorism financing (Council directive 91/308/EEC and directive 2001/97/EC). These are above all the prohibition of the execution of anonymous transactions, or of the provision of anonymous services, the duty to determine the identity of clients, to determine the ownership of funds used by clients for transactions and financial operations and to preserve records on the identification of clients and on the financial operations performed.

Because of growing requirements regarding the compatibility of laws regulating the issue of the individual segments of the financial market with the requirements of international standards, all “basic” laws regulating the financial market contain also provisions regulating the requirements and duties focused on protection against legalization. Several of them regulate the said institutes in detail and even more strictly than the Act on Protection Against Legalization itself.⁵ For example the Act on Banks imposes on banks the duty to regulate the powers and responsibilities for protection against legalization in the statutes of the company, it regulates the way of determination of the identity of the clients during financial operations in detail, imposes the duty of identification during operations of low financial value and the duty to verify such an identification, it regulates in detail the duty to determine the ownership of funds, used by clients (natural



persons and legal persons) for financial operations and transactions. This act and respective decrees of the National Bank of Slovakia issued by virtue of it also regulate the duty of NBS to determine the ownership and origin of funds when assessing a request for granting of a banking license and a request for obtaining a share in the bank's share capital.

The group of obliged entities according to the Act on Protection Against Legalization, who are active in the financial market and are part of the surveillance of the financial police, is not identical with the group of entities supervised by The National Bank of Slovakia according to the individual acts regulating the financial market and the Act No. 747/2004 Coll. on Financial Market Supervision and on alterations and amendments to some acts as amended (an act regulating the basic principles of the performance of supervision and the procedures of NBS in performing the supervision, hereinafter referred to the "the Supervision Act"). Not explicitly included as obligated entities by the Act on Protection Against Legalization are for example branches of foreign securities traders, issuers of securities, asset management companies, branches of foreign asset management companies, mutual funds, pension management companies, pension funds, supplementary pension companies, supplementary pension funds, electronic money institutions and branches of foreign electronic money institutions. According to the Act on Protection Against Legalization, however, legal persons or natural persons determined by "special laws" (Art. 3 para. j)) are also obliged entities. As the acts regulating the financial market denote the supervised entities as obliged entities according to the Act on Protection Against Legalization, these supervised entities have the status of obliged entities based on acts regulating the financial market.

Similarly, measures for protection against legalization imposed to a supervised entity are not regulated in a uniform way in the acts regulating the financial market, both in terms of content and in terms of extent. The most complex regulation can be found in the Act on Banks and a similar regulation is the regulation of the activities (duties) of securities traders in the Act on Securities and a less complex regulation in the Act on Collective Investment related to insurance companies and collective investment entities. Other acts regulating the financial market regulate the duties of supervised entities in the area at hand only marginally.

As for electronic money institutions and branches of foreign electronic money institutions, these are obliged entities according to the Act on Protection Against Legalization, to which provisions of the act on monetary transactions refer. They have to fulfill fully the duties according to the Act on Protection Against Legalization and are subject to surveillance by the financial police. However, the National Bank of Slovakia supervises them (also in terms of the rules of prudential busi-

ness activities and riskiness of transactions) and can impose remedial measures on them, including fines for violating the duties set by the Act on Protection Against Legalization.

Another regime applies to exchange offices and exchange control offices according to the Foreign Exchange Act, which also stipulates that these entities are obliged entities according to the Act on Protection Against Legalization. The Foreign Exchange Act, as opposed to the regulation of the duties of supervised entities according to acts regulating the financial market, does not set any specific prudential requirements for exchange control offices. The only regulation in the area of protection against legalization relates to the duty of places of foreign exchange to identify their clients for each transaction or service and in the case of exchange offices for transactions exceeding the value of 1000 EUR (Art. 13 para. 8 c)). Since the places of foreign exchange according to this act are not subject to prudential rules like other entities supervised by the National Bank of Slovakia and since the power of NBS to perform supervision over places of foreign exchange in the area of protection against legalization is not stipulated by the Foreign Exchange Act, either, the places of foreign exchange (obvious except banks) are not under the control of NBS, but only of the financial police. In this case, the National Bank of Slovakia can impose sanctions only for violations of the Foreign Exchange Act or of a piece of law issued for the implementation thereof, but not for violations of the Act on Protection Against Legalization.

2. THE POWER OF THE NATIONAL BANK OF SLOVAKIA TO PERFORM SUPERVISION IN THE AREA OF PROTECTION AGAINST LEGALIZATION DERIVED FROM THE POWER OF THE AUTHORITY FOR PRUDENTIAL FINANCIAL MARKET SUPERVISION

The Act on Protection Against Legalization entrusts the authorization to check the compliance with its provisions by obliged entities only to the financial police. It does not entrust the National Bank of Slovakia with the power to perform supervision in the area of protection against legalization over the supervised entities being active in the financial market based on authorizations of NBS. The act only imposes on the central bank to notify, without delay, the financial police of a violation of this act or of an unusual business transaction, if the NBS detects them in the course of the execution of its powers according to "special pieces of law" (Art. 11a). Special pieces of law are, in this context, the acts regulating the financial market. The central bank is not entrusted with the said power by the Act No. 566/1992 Coll. on the National Bank of Slovakia as amended, either. The power of the National Bank of Slovakia to perform supervision in the area of protection against legalization is thus constituted exclusively by the

3 For the purposes of this article, the term „obliged entities“ refers to those of the entities determined by Art. 3 para. 1 of the Act No. 367/2000 Coll. that are subject to surveillance by financial police under act No. 367/2000 Coll. and at the same time carry on business with a license from NBS according to the individual acts regulating the financial market and are subject to supervision by NBS.

4 The area of protection against terrorism financing is connected to the protection against legalization of income from criminal activity in the act No. 367/2000 Coll. The supervisory power of NBS also applies accordingly to this area according to the acts regulating the financial market. The issue of protection against terrorism financing, however, is also subject to acts regulating international sanctions, i.e. to another legal regime, in which NBS does not have the status of a supervisory authority; here, surveillance is entrusted to determined central state administration bodies.

5 For example:

- Act on Banks: duty according to Art. 23 para. 1 to regulate in the statutes of a bank the powers and responsibility for protection against legalization; duty according to Art. 42 para. 1 to preserve data and copies of documents on proving the identity of a client and on determination of the ownership of funds used by the client to execute the transaction and documents in the executed transactions at least 5 years from the end of the transaction, according to Art. 41 para. 4 to present to NBS a revision report containing also an assessment of the results in the area of protection against legalization, according to Art. 89 para. 1 and 4 to demand the proving of the identity of the client for the execution of the transaction before each transaction with a value of at least 15000 EUR, according to Art. 92 para. 6 authorization to mutually provide information on clients, in connection with which an unusual transaction operation has been announced, according to Art. 93a to demand data from the client and their representatives for determination, verification and surveillance for the purposes of the execution of transactions with clients,
- Act on Collective Investment: duties according to Art. 11, 12 para. 1, Art. 19 para. 1 c),
- act on the insurance sector: Art. 38 para. 1 duty to regulate in the by-laws of the company the responsibility for protection against legalization, furthermore duties according to Art. 38 paragraphs 3, 10, 11, 12 and 13, Art. 38a para. 1,
- Act on Securities: duties according to Art. 71a paragraphs 2 and 3 and Art. 73.



provisions of the acts regulating the financial market.

The Power of NBS and Rules of Prudential Business Activities and Risk Management of the Supervised Entities

The Supervision Act and acts on protection against legalization have entrusted the National Bank of Slovakia with the power to perform supervision over the financial market, its individual sectors, subjects and specific activities that these entities carry on based on special permits of NBS.

The performance of prudential supervision by the National Bank of Slovakia in a wider sense includes the following main activities:

- authorization of the performance of special activities in the financial market to new or existing entities, granting of prior approval to the acquisition of a share in the assets of the supervised entities (licensing),
- regulation – proposing legal regulations, issuing of subordinate generally binding legislation, setting of prudential rules and of the rules for secure operation and further requirements for the business activities of the supervised entities, methodological activities,
- on-site supervision – checks in the supervised financial market entities,
- off-site supervision – analyses of information and statements presented by the supervised entities,
- imposition of measures for the correction of detected deficiencies, including sanctions, the introduction of conservatorship and withdrawal of granted licences.

The National Bank of Slovakia performs the supervision on an individual basis over the individual supervised entities, on a consolidated basis over groups of persons and special property associations, part of which are also the supervised entities, and as supplementary supervision over financial conglomerates. The supervision on a consolidated basis and the supplementary supervision does over financial conglomerates does not replace the supervision on an individual basis.

In the execution of the supervision, the National Bank of Slovakia detects important facts with respect to the supervised entities, mainly deficiencies in their activity, the reasons of the detected deficiencies, the consequences of the detected deficiencies, as well the persons responsible for the detected deficiencies. In doing this, the National Bank of Slovakia proceeds according to the Supervision Act, unless the acts regulating the financial market do not prescribe special procedures. Within the performance of on-site and off-site supervision, the National Bank of Slovakia focuses on whether the supervised entities adhere to the conditions and scope of the granted authorizations, the prudential rules set by these acts and decrees of NBS, as well as whether they monitor and sufficiently manage the risks linked

with the performance of their specific activities in the financial market.

The basic acts regulating the financial market, above all the Act on Banks, Act on Securities, Act on Collective Investments and Act on the Insurance regulate the prudential rules of the supervised entities and they authorize the National Bank of Slovakia to issue subordinate regulations that regulate these rules in more detail. At the same time, they regulate a system of management of risks linked with specific activities of the supervised entities in the financial market. The supervised entities are obliged to adequately identify the risks, monitor the risks and to measure and mitigate the size of the risks. A more detailed regulation of this issue for the banking sector can be found in the NBS Decree No. 12/2004 on risks and the risk management system, issued based on the Act on Banks. The decree regulates the terms, system, procedure, strategy and organization of the management of risks with respect to banks and branches of foreign banks. Within the on-site and off-site supervision, the National Bank of Slovakia tackles the assessment of the deficiencies detected in the activity of the supervised entities primarily by assessing the degree of sufficient fulfillment or of violation of the prudential rules by the supervised entities including the assessment of the degree of riskiness of the transactions and financial operations performed by them.

Obligations and rights of supervised entities in the field of protection against legalisation are included in the structure of basic acts regulating the financial market among

- organisation and management rules (e.g. Art. 27 para. 1 lett. h) of the Act on Banks, Art. 71a of the Act on Securities, Art. 14 para. 1 of the Act on Stock Exchange),
- rules of prudent business (e.g. Art. 27 para. 1 of the Act on Banks, Art. 11 and 12 of the Act on Collective Investment, Art. 38 para. 1 and 3 of the Act on Insurance),
- rules for activities (e.g. Art. 19 para. 1 lett. c) of the Act on Collective Investment, Art. 73 of the Act on Securities).

The important point is that the basic acts regulating the financial market include the duty of the supervised entities to regulate and divide the power and responsibility for the protection against legalization in the statutes of the company in the above-mentioned organisation and management rules. Ultimately, not only the first one of the said three groups of legal provisions, but all three of them can be, in a wider sense, seen as prudential rules, set for the supervised entities.

The National Bank of Slovakia understands the risk of embroiling the supervised entities in the legalization of income from criminal activity as part of the operational risk. Operational risk is considered to be, for example in the case of banks, the risks of possible losses caused by inappropriate or defective internal procedures, human factor failure, failure of systems used by the supervised en-



tity or by external events. Potential losses can be considered to be not only direct financial losses, losses incurred in connection with the detection of the participation of the supervised entity in the legalization (for example also financial sanctions), but also the endangering of the reputation of the supervised entity in connection with such unlawful activities. For the said reason, a natural part of the performance of prudential supervision of the National Bank of Slovakia is also the aspect of compliance with duties in the area of protection against legalization, set by the acts regulating the financial market and the Act on Protection Against Legalization. The National Bank of Slovakia therefore pays proper attention to this issue also when performing on-site supervision in the supervised entities and it applies a special own methodology to this supervision.

Duties of the Supervised Entities and the Power of NBS on Protection Against Legalization

The individual acts regulating the financial market contain provisions ordering the supervised entities to "observe the duties resulting from special acts". Because duties result from the Act on Protection Against Legalization for the obliged entities and supervised entities, the supervised entities are obliged to proceed also in accordance with that act. The Act on Protection Against Legalization, among other things, imposes the duty to report unusual business transactions to the financial police; this duty is not imposed by any of the acts regulating the financial market.

In addition to the derivation of the power of the National Bank of Slovakia to perform supervision in the area of protection against legalization from the power to perform supervision over supervised entities, this power of the National Bank of Slovakia can be also derived from further provisions of the acts regulating the financial market. For example, according to the Act on Collective Investment – the provision (Art. 99 para. 2 a)) "subject of the supervision is the observance of the provisions of this act and of other generally binding pieces of legislation related to person that are subject to supervision under this act". Since asset management companies are also obliged entities under "another generally binding piece of legislation", which is the Act on Protection Against Legalization, the subject of supervision of the central bank is also the observance of duties of these entities in the area of protection against legalization. In the Act on the Insurance Sector, an analogous regulation results from the provision Art. 42 para. 2 a).

Provisions of acts regulating the financial market create the power of the National Bank of Slovakia to impose sanctions in the area of protection against legalization also in connection with the imposition of sanctions.

According to some acts regulating the financial market, the National Bank of Slovakia is au-

thorized to impose on the supervised entities sanctions for the violation of the respective act regulating the financial market, as well as of "special acts". These are for example the provisions Art. 50 para. 1 a) and e) of the Act on Banks, Art. 106 of the Act on Collective Investment or Art. 49 para. 1 e) of the Act on the Insurance Sector. Special acts also include the Act on Protection Against Legalization, from which one can derive the power of NBS to impose sanctions not only for violations of duties resulting for the supervised entities from the provisions of acts regulating the financial market, regulating the issue of protection against legalization, but also for violations of duties resulting from the Act on Protection Against Legalization – for example for the failure to report an unusual business transaction, the violation of the duty to maintain confidentiality regarding a reported unusual business transaction etc. It is evident from the formulations in the provision that these sanctions can be not only fines, but also corrective measures. In the past, the National Bank of Slovakia already imposed, on a bank, a fine for the violation of duties in the area of protection against legalization, which where imposed on the bank by the Act on Banks, as well as the Act on Protection Against Legalization.

The above-mentioned types of provisions of acts regulating the financial market and their interconnections with the Act on Protection Against Legalization create the power of the National Bank of Slovakia to perform supervision and surveillance over the fulfillment of duties by the supervised entities in the area of protection against legalization, including the imposition of sanctions for the violation of the corresponding legal provisions. They also imply the authorization of the National Bank of Slovakia to the performance of on-site supervision and to surveillance of the supervised entities also in terms of observance of the individual duties imposed to obliged entities by the Act on Protection Against Legalization.

3. ON THE ISSUE OF THE POWER OF TWO AUTHORITIES FOR THE PERFORMANCE OF SUPERVISION AND SURVEILLANCE. THE FUTURE POWER OF THE CENTRAL BANK IN THE AREA OF PROTECTION AGAINST LEGALIZATION

The above-mentioned legal provisions and relations imply that the National Bank of Slovakia as the authority for financial market supervision is authorized to perform supervision in the area of protection against legalization of income from criminal activities based on acts regulating the financial market. This competence is in line with one of the main objectives of the National Bank of Slovakia, which is the stability of the financial market, its safe and sound working in the interest of maintaining its credibility and in the interest of protection of the clients of the supervised entities being active on the financial market. It can-



not be said that this is a shared power of the central bank and the financial police in the supervision over and surveillance of the same entities. The limit between the powers of both authorities in the given area is not limited by any legal piece of legislation and maybe it is questionable, if this is supposed to remain like that.

Certain reservations against such overlapping of powers or "double" performance of supervision and surveillance in the area of protection against legalization have been also expressed by the MONEYVAL committee of the Council of Europe, which assessed the level of measures in this area in Slovakia in 2001 and 2005. The reason for its concerns was that entrusting two subjects – the authority for prudential supervision and a police unit - with the supervisory and surveillance function in the given area can cause negative or positive competence conflicts in practice.

These concerns, however, have not proved to be justified so far. Apart from the fact that overlapping of the supervisory and surveillance power of two authorities does not violate international standards, the system of "double" supervision and surveillance of the same supervised entities and obliged entities based on the Act on Protection Against Legalization and the acts regulating the financial market has proved its worth and has some advantages. The National Bank of Slovakia and the Presidium of the Police Corps of the Ministry of the Interior of the Slovak Republic entered into a cooperation agreement, based on which they coordinate their supervisory and surveillance activities. Representatives of both authorities exchange information regarding the procedures during checks, including the imposition of fines to the supervised entities or obliged entities.

The valid legal regulation and some relations resulting for the National Bank of Slovakia in the course of performance of the supervision in the areas of protection against legalization of income will change soon. The Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing has been in force since Decem-

ber 2006. The member states of the European Union are supposed to transpose this directive to their legal system until December 15, 2007. The National Council of the Slovak Republic should adopt a new act on the protection against legalization of income from criminal activities and terrorism financing, by which the provisions of the above-mentioned directive and of Directive No. 2006/70/EC laying down implementing measures for Directive 2005/60/EC are being transposed.

By taking over the provisions of both directives by the new act, there will be a considerable change in some basic institutes regulated in the valid Act on Protection Against Legalization. The new Act on Protection Against Legalization of income from criminal activities and terrorism financing will expand the group of obliged entities, which it will also bring in line with the group of entities supervised by the National Bank of Slovakia according to the acts regulating the financial market. It will generally set the duty of obliged entities to assess their clients and their behavior during the performance of financial operations and transactions in terms of the assessment of the riskiness of transactions and business activities of the clients. Although the new act will not regulate the relationship of powers between the central bank and the financial police, cooperation of the National Bank of Slovakia and the financial police will continue based on the above-mentioned cooperation agreement even after the new act takes effect.

The current power and task of the central bank will not weaken upon adoption of the new act in the area of protection against legalization. The opposite is true. The fact that the National Bank of Slovakia performs supervision based on the monitoring of observance of prudential rules and assessment of risk management by the supervised entities confirms the irreplaceable role it plays in the performance of supervision in the area of protection against legalization of income from criminal activities and terrorism financing.