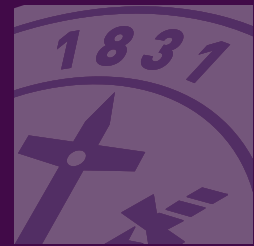




Royal United Services Institute  
for Defence and Security Studies

Conference Report

**Euro SIFMANet: European  
Sanctions and Illicit Finance  
Monitoring and Analysis Network  
Prague Report**



# Euro SIFMANet: European Sanctions and Illicit Finance Monitoring and Analysis Network Prague Report

RUSI Conference Report, December 2022



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**Royal United Services Institute**  
for Defence and Security Studies  
Whitehall  
London SW1A 2ET  
United Kingdom  
+44 (0)20 7747 2600  
[www.rusi.org](http://www.rusi.org)  
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# Euro SIFMANet: European Sanctions and Illicit Finance Monitoring and Analysis Network: Prague Report

**I**N LATE NOVEMBER 2022, the Centre for Financial Crime and Security Studies at RUSI convened a roundtable discussion in partnership with the Prague Security Studies Institute, as well as a series of one-on-one meetings with representatives from government ministries and agencies, the private sector (such as banks, law firms and other organisations exposed to sanctions implementation) and civil society in Prague. These events are part of RUSI's ongoing study of EU sanctions implementation and wider responses to illicit finance (Euro SIFMANet) funded by the National Endowment for Democracy.

## Background

As with previous engagements under the Euro SIFMANet programme, the evaluation of the Czech Republic by the Financial Action Task Force (FATF) underpins any discussion about illicit finance. The most recent evaluation of the Czech Republic by Moneyval – the relevant regional body of the FATF, the global standard setter on anti-money laundering and combating the financing of terrorism (AML/CFT) – was published in 2018. Given the deficiencies identified in the Mutual Evaluation Report (MER),<sup>1</sup> the Czech Republic was placed in enhanced follow-up, with the third follow-up report released in November 2022.<sup>2</sup>

These reports show that the Czech Republic is committed to strengthening its AML/CFT regime. Yet, despite not being a major international financial centre, the country faces prominent threats, in particular: tax crime and related laundering activity; risks posed by trusts; low awareness of the risks posed by some non-financial sectors (such as tax advisers, lawyers and public notaries, known by the FATF as designated non-financial businesses and professions); unsatisfactory monitoring of cash deposits and money transfers; and risks posed by corruption in both the public and private sectors. Furthermore, the AML/CFT response to these threats falls short. For example, the MER reveals a low number of convictions for money laundering and raises concerns about the risks posed by insufficient criminalisation of the terrorist-financing offence.

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1. Moneyval, 'Anti-Money Laundering and Counter-Terrorist Financing Measures: Czech Republic', Fifth Round Mutual Evaluation Report, December 2018, Strasbourg.
  2. Moneyval, 'Anti-Money Laundering and Counter-Terrorist Financing Measures: Czech Republic', 3<sup>rd</sup> Enhanced Follow-Up Report and Compliance Re-Rating', November 2022.

Despite these risks and vulnerabilities, the MER describes all reporting entities as having a good understanding of AML/CFT requirements – and new amendments have been introduced to overcome shortcomings in the national legislation. These amendments notably relate to asset seizure and confiscation which represent policy priorities for Czech authorities that recently introduced improvements in the legislative and institutional framework (for example, access to relevant databases and introduction of ‘extended confiscation’<sup>3</sup>) in support. Trust and Beneficial Ownership Registers have also recently been introduced but are still not fully populated with the relevant data and information, which hinders accurate data collection and statistical outputs. Thus, despite positive developments, the country has not been able to fulfil the three-year post-MER deadline to address its technical-compliance deficiencies, with a ‘partially compliant’ rating in five FATF Recommendations<sup>4</sup> in its latest follow-up report. For this reason, the Czech Republic will remain in enhanced follow-up.

Notwithstanding the ongoing issues facing the Czech Republic in meeting its FATF requirements, the most striking feature of the discussions in Prague was the considerable focus placed on the Czech Republic’s relationship with China, and the resulting scrutiny of the financial dealings of leading political figures and connections with Chinese investment. Dependency on Chinese supply chains and the influence posed by Chinese funding of media outlets to sway Czech public perception in its favour were also highlighted by representatives of civil society. In this context, PSSI, the Czech SIFMANet partner organisation, has been highlighting the presence of US-sanctioned Chinese companies in the EU’s capital markets: specifically, how the lack of proper oversight and regulation from the perspective of national security (state-owned arms manufacturers), human rights (use of forced labour) and investor protection (lack of proper disclosure) create risks not only for involved European retail investors, but for Europe’s national security and fundamental values. This dimension of finance and security was not something that had featured in previous SIFMANet country visits and provided an interesting additional dimension to many of the conversations during the research team’s trip.

Despite this focus on China, the proximity of Russia, and the resulting trade and financial connections present the Czech Republic with considerable sanctions-implementation challenges, challenges that formed the main basis of the roundtable discussion that is elaborated further below.

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3. Extended confiscation refers to the ability in criminal proceedings to confiscate assets beyond the direct proceeds of a concrete criminal offence for which the defendant is prosecuted, unless the defendant can prove their legal origin. The concept of ‘extended confiscation’ is included in the Financial Action Task Force Best Practices Paper on Confiscation and it became a part of the EU Directive 2014/42.
  4. R.6 on targeted financial sanctions related to terrorism and terrorist financing; R.7 on targeted financial sanctions related to proliferation; R.15 on new technologies; R.32 on cash couriers; and R.33 on statistics.

## Czech Challenges

During the roundtable, Czech payment institutions, and other forms of financial services provider, were keen to highlight the ways in which they have been heavily affected by the imposition of sanctions on Russia. In particular, private sector representatives noted that individual financial sanctions are straightforward in their implementation, and they are also familiar with sanctions on trade that affect their clients. However, the financial sector sees a challenge in the implementation of broad and undefined sanctions, for example **sanctions targeting a group of people** – Russian nationals – rather than specific individuals. In the Czech Republic, consistent with the requirements of the EU, Russian nationals who do not have a Czech residency permit have a limit of €100,000 they can manage per account per individual. This combination of nationality and residency presents a challenge, as well as what is intended to be included in the restricted amount (for example, securities). The idea of controlling Russians introducing money into the EU is clear to the country's private sector, but its implementation is much harder. Furthermore, there is an indirect impact on all clients, not just those sanctioned, as a result of connections that these directly affected individuals may have with non-Russian citizens.

Another challenge addressed by the banking sector is the **complexity of the trade sanctions**. Trade-focused restrictive measures have many technical specifications that make the identification of what exactly lies under the restriction extremely challenging. For this reason, there is clearly a concern that client activity is unchanged given that their activities do not, on the face of it, meet the specific details of the sanctions packages. For example, if the correct product codes are not provided on trade-finance transactions and therefore do not match those on the sanctions list, a bank is unable to stop payments as the sanctions-screening systems will not provide an alert.

Private sector participants at the roundtable also drew attention to the unintended consequence of the expulsion of some Russian banks from SWIFT, the global payment messaging system. **SWIFT sanctions** were only placed on only certain banks, removing their access to the international financial system. However, some Russian banks still operate via SWIFT – mainly acting as conduits for energy payments. The result is that those banks that continue to have access can act as a conduit for payments that are destined for those banks that are no longer connected, thus facilitating sanctions circumvention. And on the other hand, this restriction of SWIFT access means that those banks in the EU that are owed payments by restricted Russian banks are not able to receive payment as the circumvention conduit most often only works in Russia's favour – that is, to receive payments from the West.

Representatives from the Czech public sector praised the national banking sector for the high standard of its reporting. However, they noted the gaps presented by the non-financial sectors including real estate, accountants, tax advisers and lawyers. **Non-financial companies** had little prior active experience of engaging with AML and no sanctions experience. One participant met during the visit noted that although previous sanctions regimes exist, 'this is the first time that an EU sanctions regime has actually affected Czechia in a way that means we have to take action'. This sentiment was typical and led participants at the roundtable to believe that 80%

are still ignoring their responsibility to check who they are doing business with, either through ignorance, lack of capacity or, in some cases, a desire to continue to make profits. The insurance sector was given as one example that has particularly struggled with implementation, not having been subject to much AML scrutiny previously. Notably, non-life insurance businesses have struggled with the insurance of imports/exports, including those insuring Russian oil transport or Russian vessels. Overall, there was concern regarding the complexity of the sanctions regime, which no longer involves just screening sanctions lists, but also looking into different streams of data to understand the detailed activities of customers and clients. As the EU develops a further sanctions package, a number of participants feared that further sanctions, such as those imposing an oil price cap, would add a further layer of complexity.

The way **supervision** is conducted has also changed completely. As noted above, sanctions have not previously been a priority and have been overshadowed by the need for AML compliance. Precisely, in the last follow-up report, the Czech Republic was rated 'partially compliant' with FATF Recommendation 6 on targeted financial sanctions related to terrorism and terrorist financing and Recommendation 7 on targeted financial sanctions related to proliferation. After the full-scale invasion of Ukraine by Russia in February 2022, institutions had to start investigating issues such as beneficial ownership, company management structures and the genuine nature of changes undertaken to be compliant with the rapid increase in sanctions-related requirements. The challenge was not imagined for the Czech Republic as, historically, the country has acted as a significant conduit for the flow of both licit and illicit trade and funds into Russia. There are numerous Russian citizens in the Czech Republic, with many making use of local money-sending providers. Czech financial institutions also shared prudential concerns about investment firms that held assets in Russia and noted that investments on Russian stocks are now frozen and thus these funds face liquidity risks.

Czech state authorities were described in the roundtable as proactive and communicative. The banking sector congratulated the financial intelligence unit (FIU) for its rapid management of new sanctions packages and the speed with which it convened gatherings to provide guidance on the rapid issuance of restrictive measures by the EU. The regulator and public sector in general were praised for their great work understanding new measures and providing support, having held seminars, for example, for Czech companies exporting to Russia. Participants also noted that working groups were established but they were not sufficiently flexible, so unofficial channels and procedures had to be created to deal with this. Yet, despite this collaboration, both the public and private sector agreed that **capacity** dedicated to sanctions implementation is still not sufficient. Staff numbers have remained unchanged despite the growing number of responsibilities and volume of work. AML teams in banks reported the need to reallocate resources from other teams to manage the increased need to conduct manual reviews which created gaps. Some noted that they had hired consulting services to support this need for additional capacity, but this expense was not considered useful as knowledge on new sanctions was limited for everyone. Where staffing growth is anticipated is in the Czech Ministry of Foreign Affairs (MFA) once the Czech version of the Magnitsky Act is passed. Furthermore, **expertise** within the public sector is uneven. For example, representatives from the private sector

explained that consulting a section of the Czech police force will result in different outcomes than when consulting another branch of government.

Public–private collaboration in the country is quite highly regarded by all involved. However, **cross-country cooperation** remains a challenge. The MFA has intensified cooperation with third countries such as the UK, Germany, the Netherlands and Poland. The UK, in particular, delivered trainings on policymaking, designation design and evidence collection. Still, the FIU has struggled to find sanctions counterparts with which to exchange information, as there is no network for sanctions collaboration in the same way as FIUs collaborate on broader financial crime matters via the Egmont Groups of FIUs. It was suggested that one reason for this is that different bodies are responsible for sanctions implementation in each member state. The result is that the usual partner-country bodies that normally act as operational counterparts are not relevant for sanctions.

There is an EU framework for the screening of foreign direct investment (FDI)<sup>5</sup> so the European Commission and member states can coordinate their actions on foreign investments which offers some element of synergy on certain forms of sanctions implementation. Stemming from Regulation 2019/452, the mechanism became operational in October 2020 and is currently used by member states to share information on the screening of listings and other sanctions-related communication. Despite this tool, cross-border cooperation remains a considerable challenge for both the public and private sectors, as the same sanctions are currently implemented in different ways creating harmonisation gaps and, thus, sanctions-evasion opportunities.

Public and private sector representatives also shared concerns about the **quality of data** in the company registry and whether company ownership is correctly recorded – inadequacies here facilitate sanctions evasion. It was noted that information sharing is only useful if institutions have accurate information. Czech civil society highlighted that, currently, indirect datapoints that identify Russian nationals as beneficial owners are often seen as insufficient for the banking sector to take action. Red flags can be identified but actual solid information is difficult to come by and thus banks face difficulties making freezing decisions. Another challenge in this regard is that there is no common definition of beneficial owner in the EU and member states can come up with their own – again, the lack of harmonisation undermines the effectiveness of sanctions implementation. Thus, if the Czech Republic identifies an individual as the beneficial owner, it may not be recognised as such in another EU country. As one roundtable participant noted: ‘The Russians identified are those that did not pay their lawyers enough’.

## Looking to the Future

As one participant noted, although many EU sanctions regimes exist, this is the first time sanctions have really mattered for most businesses in the Czech Republic: the first time that they have

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5. European Commission, ‘EU Foreign Investment Screening Mechanism Becomes Fully Operational’, press release, 9 October 2020, <[https://ec.europa.eu/commission/presscorner/detail/en/ip\\_20\\_1867](https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1867)>, accessed 28 November 2022.



had to genuinely care about and implement sanctions. As a result, as this participant noted, historically sanctions have ‘played second fiddle’ to AML. This has presented very significant operational challenges. These challenges led participants to make a strong call for **operational information sharing**. The amendments to the sanctions legislation entered into force in September which enhanced the capabilities of the FIU, increasing its access to information from law enforcement and intelligence services. Nevertheless, it is expected that next year further amendments will be introduced to provide more depth to the preceding quick amendment. There was agreement across sectors that investment in digital innovation is needed to facilitate information sharing and investigations.

Another suggestion shared in the roundtable was that despite the large number of people currently on the **sanctions list** (1,200 individuals), it by no means includes everyone involved in or connected with the Russian regime and its war in Ukraine. The focus has been on leading figures of companies supporting the Russian war economy. However, individuals involved in disinformation and propaganda, United Russia party members, and, most importantly, mid-management positions in those companies that are actually designing and developing weapons and other tools for waging war are not on the list and should be added. Most of these individuals are currently able to travel and move their assets freely, despite their connection with the war. In this regard, it was suggested that sanctions lists should include these positions, rather than the individual names of the current jobholders, as these roles are key facilitators in the current war and might constitute the infrastructure for future atrocities.

The official line of the MFA is that more sanctions are needed, but in the roundtable discussions the public sector recognised that what is important is the unity of member states in their **implementation**. As such, circumvention of sanctions through third countries was also described as a great challenge. To tackle this challenge, the Czech version of the Magnitsky Act aims to facilitate the listing of people on its own national sanctions list and freeze their assets in cases where consensus at the EU level has not been achieved. This would also allow the Czech Republic to cooperate with other countries that have established analogous regimes. This measure would enable the country to look into national lists from other countries to identify individuals that others believe should be subject to sanctions.

There are ongoing discussions in the Czech Republic on introducing mechanisms that **reverse the burden of proof** in the country in the case of illicit-finance cases. This would relieve authorities from collecting evidence that an asset is owned by a Russian oligarch and was purchased with illicit money, instead, placing responsibility on the targeted individual or entity to prove the legitimacy of funds.

Another relevant matter raised by Czech civil society is that Russian companies are now banned from competition for public procurement, but not from receiving **EU grants and subsidies**. For example, one Russian company – described as being in charge of censorship in Russia – was said to own a particular Czech company, which receives subsidies from the EU. This is not currently illegal, and it has proven difficult to identify. A proposed solution is to develop a mechanism that

questions companies on who the ultimate beneficial owner is before any subsidy is provided. This measure is technologically feasible; however, data availability was noted as a major obstacle.

## Conclusion

The roundtable made clear the strong commitment to achieving the effective implementation of sanctions by both the Czech government and the private sector. Furthermore, in general, sanctions are viewed positively in Czech society and citizens are willing to bear the cost. However, greater support is needed in building implementation capacity and ensuring that all relevant bodies (not just banks and exporters) are informed of their sanctions obligations. As for many other member states, the country faces a shortage of qualified personnel and resources. Representatives from all sectors voiced their concerns regarding the great challenge that the current lack of harmonisation across the EU poses to achieve any effectiveness in the implementation of sanctions, and the extent to which a lack of data and operational collaboration across borders reduces effectiveness.

The efforts being undertaken by member states need to be supported by an increase in coordination and assistance from the EU and a commitment to unity across its member states in achieving the common goal of building a uniform and effective sanctions response to Russia's full-scale invasion of Ukraine and 'cleaning up the Augean stables' of illicit finance in Europe.