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IMPACTS OF THE 5TH AML DIRECTIVE ON THE PROVISION OF INVESTMENT SERVICES IN CZECH REPUBLIC

Abstract

This contribution deals with the impact of the Vth AML directive, which updated Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, on the provision of the investment services in Czech Republic. The main aim of the contribution is to confirm or disprove the hypothesis that the Vth AML Directive significantly affected the activities of investment service providers. The author used scientific methods, especially induction and deduction, to confirm or disprove the above hypothesis. The paper also discusses the future regulation of the anti-money laundering area.

Key words: investment services, investment service providers, anti-money laundering policy, money laundering, terrorist financing, AML Directives, implementation, impacts.

JEL Classification: K33

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1. Introduction

The area of anti-money laundering and counter-terrorist financing has been undergoing dynamic development since the 20th century. Money laundering and terrorist financing offences are not a recent phenomenon and over the years have been increasingly associated with international overlap, in particular with the movement of capital across national borders. This area has also been loosened in the context of the introduction of the free movement of capital and services on a European Community basis, with the aim of consolidating the foundations of the single internal market. As capital has been liberalised and cross-border transfers have become easier, it has been necessary to harmonise measures to combat money laundering and terrorist financing, including in relation to cross-border transfers to third countries, i.e. countries outside the European Union.

In addition to the positive effects on the prevention of money laundering and terrorist financing, the attempt to unify this area also has negative effects, in the form of the need for regulation in the individual Member States and the adoption of certain restrictions by private bodies in the course of their activities. Over the last 20 years, five directives have been adopted at European level, reflecting the findings in the area of criminal activity and seeking to prevent criminal activity. In the context of so many legislative acts and, of course, the need to transpose the provisions of the directives, as harmonisation rules, into the national laws of the Member States, the effect that the provisions should have had on crime has been delayed.

This article aims to establish what effects the Vth AML Directive has had on investment services and in the Czech legal system. In view of the heavy regulatory burden on investment service providers themselves, it is useful to determine whether the latest effective directive further increases the burden on investment service providers or whether there is only a partial burden. This objective has been chosen, inter alia, with a view to assessing regulatory developments for investment service providers. The aim of this article is, in addition to identifying the impact of the Vth AML Directive, also to examine the development of regulation in the AML area in more detail and also to assess the possible development of the opt-out in the future.

In relation to the objective of this article, the following hypothesis was set: the Vth AML Directive has significantly affected the activities of investment service providers.

This article first describes the background and history of money laundering and terrorist financing, focusing in particular on the historical development of anti-money laundering regulation within the international community. The following section then focuses on the

narrower area of the international community, namely the harmonisation trends at the European Union level. Within the harmonisation trends, there is a focus on individual legislative acts, culminating in a closer look at the latest anti-money laundering directive. Within this article, there is also a focus on investment service providers and a clarification of the areas where AML/CFT risks are most prevalent. The final sections of the article then focus on the implementation of the legislative acts into the Czech legal system and outlining what specific impacts the Vth AML Directive has had on investment service providers. The last part of the article focuses on the future of anti-money laundering area.

With regard to the aim of this article and the stated hypothesis, the following scientific methods have been used: logical methods of induction and deduction, which refer in particular to the evaluation of the legislation and what conclusions can be drawn from the legislation. This also applies to the derivation of the necessity of adjustments at national level from the validity of EU legislation, as well as proposals for future legislation at European level.

2. Money laundering and terrorist financing: background and history

The concept of money laundering and terrorist financing is widespread globally. To gain insight into the impact of the Vth AML Directive, it is useful to take a brief look at this phenomenon.

It can be simplified by stating that **money laundering**, or so-called laundering of the proceeds of crime, is the concealment of the origin of the property value that was obtained as a result of the crime that was laundered, and at the same time to purify this property value as legally acquired income [Law Dictionary 2009: Šámal]. There are many ways in which money laundering is performed.

For example, the following can be mentioned:

(i) "*Smurfing* involves the use of multiple cash deposits, each smaller than the minimum cash reporting requirement.

(ii) *Misinvoicing* of exports and falsification of import letters of credit and customs declarations can conceal cross-border transfers of, say, the proceeds of drug trafficking.

(iii) *Barter*: stolen property can be exchanged, across national borders or domestically, for illegal substances.

(iv) *Parallel credit transactions* can be used to avoid the formal economy, except for the final use made of the net proceeds of illegal activity to purchase legally marketed goods or services.

(v) *Derivatives* that replicate insider trading opportunities can be used to avoid detection of an unusual change in a listed stock price" [Quirk 1997: 8].

In contrast, in the case of **terrorist financing**, there is no cleansing of the illicit origin of the assets, but it is an activity aimed at a terrorist act. The definition in the Handbook for Legislative Drafting, according to which "financing of terrorism is defined as an offence established when a person by any means, directly or indirectly, unlawfully and wilfully, provides or collects funds with the intention that they should be used or in the knowledge that they will be used in full or in part, in order to carry out" (International Monetary Fund, 2003: 7), can be used.

The term terrorist financing is then characterized by mental element and material elements. In the case of the mental element, it is a deliberate act, regardless of direct or indirect intent. In the case of the material element, it is the financing elements, such as the transfer of funds, and the second element relates directly to terrorist acts against which counter-terrorist financing measures are applied.

Measures against the laundering of the proceeds of crime, as well as measures against terrorist financing, are of inter-national significance, and therefore the tendency of the international community is to ensure more uniform procedures in the case of the detection of these activities, with a view to ensuring the stability of financial systems and preventing devastating economic consequences [Quirk 1997: 7].

Financial institutions in relation to money laundering and terrorist financing can be in three positions, namely the position of a **victim** (when they are exposed to various frauds), a **perpetrator** (when they themselves commit criminal activities in this area and are also e.g. set up to support terrorism) or an **instrument** (when criminal activities are carried out through these institutions) [Johnston, Nedelescu 2005: 3]. This article focuses on the position where financial institutions could become an instrument and therefore what measures institutions need to put in place to prevent the laundering of crime and the financing of terrorism. For a more comprehensive overview, it is useful to list at least the basic criminal activities that financial institutions, specifically investment service providers, can commit.

These activities in the area of securities offerings include:

(i) "*A Ponzi scheme* is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk.

(ii) *A pyramid scheme* is an investment fraud in which participants profit almost exclusively through recruiting other people to participate in the program. Fraudsters simply use money from new recruits to pay off earlier-stage investors.

(iii) In an advance *fee fraud*, an investor is asked to pay a fee before receiving any of the proceeds, stock or warrants involved. The fee may be in the form of a commission, tax, or other incidental expense. Advance fee frauds generally target investors who have already purchased underperforming securities, perhaps through an affiliated boiler room, offering to arrange a lucrative sale of those securities, but first requiring the payment of an "advance fee."

(iv) *High-yield investment programs* are unregistered investments typically run by unlicensed individuals – and they are often frauds. The hallmark of a high-yield investment program scam is the promise of incredible returns at little or no risk to the investor.

(v) *Pump-and-dump schemes* involve the touting of a company's stock (typically so-called microcap companies) through false and misleading statements to the marketplace. Often promoters will claim to have inside information about an impending development to pick stocks. In reality, they may be company insiders or paid promoters who stand to gain by selling their shares after the stock price is "pumped" up by the buying frenzy they create. Once the fraudsters "dump" their shares and stop hyping the stock, the price typically falls, and investors lose their money" [IOSCO 2015: 4].

Given the prevalence of money laundering and terrorist financing in the international arena, the international community has over the years been setting common objectives in this area. The common objectives include (i) the simultaneous protection of the international financial system. (ii) Preventing the use of proceeds of crime, (iii) Preventing the disruption of the stability of governments [Thony 2002 : 5]. The rationale for setting common objectives and policies is based on, among other things, ensuring similar practices across states to avoid the use of particular states for illegal activities.

The starting point for common legislation in this area can be the so-called Vienna Convention, or the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances of December 19, 1988 (hereinafter referred to as "Vienna

Convention"). On the basis of the Vienna Convention, a legal definition of 'money laundering' was established, as well as a common strategy in the fight against organised crime. Within the Vienna Convention, a mechanism for international cooperation was set up with the recognition of criminal activities, also with regard to the consequences in other States joined in the Convention. This Vienna Convention was the first common act in the field of money laundering and terrorist financing. However, it is not the first convention bringing together the international community in international cooperation in the criminal field, which can be clearly identified as the International Convention for the Suppression of Counterfeiting Currency, which was signed on 20 April 1929 at an international conference in Geneva (hereinafter referred to as "Convention for the Suppression of Counterfeiting Currency"), which, like the Vienna Convention, focused on crimes that undermine the economic and financial stability of a state, i.e. on *delicta iuris gentium*, which refers to crimes in the punishment of which all nations have an equal interest.

In relation to the Vienna Convention, we can also refer to the Strasbourg Convention, or the Council of Europe`s Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime, of 1990, which adopts the definition of money laundering from the Vienna Convention and extends international cooperation to all proceeds of crime, as well as to FATF Recommendation No. 10. In addition, the OECD Convention on Corruption, or The Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which was signed in Paris on December 17, 1997, the United Nations Convention against Transnational Organized Crime (known as the Palermo Convention), The Convention for the Suppression of the Financing of Terrorism, as GA Resolution no. A/RES/54/109.

Following, inter alia, the aforementioned Conventions, we come to the regulation of purely European legislation, which culminated the harmonisation tendency in the field of prevention of proceeds of crime and financing of terrorism, as "Ist AML Directive" (hereinafter referred to as "**Ist AML Directive**").

3. Harmonisation tendencies of the European Union in the field of AML

This part of the article provides a brief overview of legislative acts that illustrate the harmonisation tendencies at European level in the area of measures against proceeds of crime and terrorist financing. This chapter does not aim to provide an exhaustive view of the individual legislative acts but aims at giving a brief overview of the developments in the AML field over the course of the 20th and 21st centuries. This brief introduction to developments

in the AML field is a necessary starting point to confirm or disprove the hypothesis in order to determine what changes have been made by the individual acts.

The harmonisation tendencies of the European Union first culminated as Council Directive 91/308/ECC of 10 June 1991 on the prevention of the use of the financial system for the purpose of money laundering. The aim of the Ist AML Directive is "to prevent the utilization of the financial system for money-laundering" [Thony 2002 14]. The Ist AML Directive was drafted at the European Union level mainly to ensure uniform regulation of the protection of financial systems, to avoid insufficient regulation at the national level of individual Member States and also to take into account the inter-national context, where insufficiently regulated cooperation in international coordination would undermine the objectives in the prevention of this crime. It should be stressed that the content of the Ist AML Directive is significantly influenced by the Vienna Convention as well as other related legal acts. This close link can be found, for example, in the definition of 'money laundering', which has been taken legally from the Vienna Convention. However, the concept of money laundering has been extended from drugs to all other proceeds of crime [Council Directive 91/308/EEC, Recital].

The Ist AML Directive concerns in particular the approach of credit and financial institutions. In the case of the definition of a credit institution, reference is made to the definition in First Council Directive 77/780/EEC, according to which a credit institution is "an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account" [First Council Directive 77/780/EEC, Art. 1]. A financial institution is then considered to be "an undertaking other than a credit institution whose principal activity is to carry out one or more of the operations included in numbers 2 to 12 and number 14[1] of the list annexed to Directive 89/646/EEC, or an insurance company duly authorised in accordance with Ist Directive 79/267/EEC. On the basis of the definition of financial institutions, it should be noted that the Ist AML Directive already targeted in part undertakings whose activity consists in the provision of investment services and these undertakings have been regulated in the AML field from the outset. As far as the regulation itself is concerned, it is more a matter of the principles of the prohibition of money laundering and the establishment of basic obligations to be fulfilled by the entities covered

[1] Which means lending, financial leasing, money transmission services, issuing and administering means of payment, guarantees and commitments, trading for own account or for account of customers, participation in share issues and the provisions of services related to such issues, advice to undertaking on capital structure, industrial strategy and related questions and advice and services relating to mergers and the purchase of undertakings, money broking, portfolio management and advice, safekeeping and administration of securities, safe custody services.

by the Directive. In comparison with today's regulation, it can be noted that the Ist AML Directive only regulates a general framework of measures, such as the obligation to identify their clients, record keeping, confidentiality, etc. It is not a list of specific measures.

After almost 10 years, an amendment to the Ist AML Directive was adopted as Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001 amending Council Directive 91/208/EEC on prevention of the use of the financial system for the purpose of money laundering (hereinafter referred to as "**IInd AML Directive**"). The IInd AML Directive was adopted in view of the necessity to amend the Ist AML Directive, firstly in view of newly introduced international practices in the AML field and secondly in view of the need to extend the scope of the Directive to cover more financial sector entities.

The IInd AML Directive thus extends in particular the scope of application to dealers in high-value goods, such as precious stones or metals, or works of art, auctioneers, whenever payment is made in cash, and in an amount of EUR 15000 or more, attorneys, notaries, investment firm[2] and collective investment undertaking marketing its units or shares, auditors, external accountants, tax advisors, real estate agents, casinos, (in view of the FATF findings on the increased use of also non-financial undertakings for laundering the proceeds of crime) [Directive 2001/97/EC, Art. 1]. It also extends the regulation on reporting suspected fraud (excluding reporting of suspicious transactions by lawyers and legal professions), the need to designate a responsible authority for combating money laundering. One of the most striking changes is then "the consideration given to new problems that "direct banking" practices create with respect to the identification of clients. A specific procedure is thus introduced for identifying clients when credit institutions engage in "direct banking" [Thony 2002: 15].

Less than 5 years later, another AML regulation was adopted, namely Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial systems for the purpose of money laundering and terrorist financing (hereinafter referred to as "**IIIrd AML Directive**"). The IIIrd AML Directive introduces substantial changes. In particular, it introduces more detailed and specific procedures in the area of customer identification (i.e. identifying and verifying the identity of the customer) and introduces for the first time the beneficial owner concept, whereby the beneficial owner is considered to be "the natural person(s) who ultimately owns or controls the customer or

[2] Investment firm as any legal person the regular occupation or business of which is the provision of investment services for third parties on a professional basis, or investment firms undertakings which are not legal person if their legal status ensures a level of protection for third parties' interests equivalent to that afforded by legal persons, and they are subject to equivalent prudential supervision appropriate to their legal form.

the natural person for whom the transaction is carried out or the activity is carried out" [Directive 2005/60/EC, Art. 3]. With regard to the introduction of the new institute, the obligations in the identification and due diligence process have also been extended, specifically with regard to the beneficial owner. It also breaks down the control into areas, taking into account the type of client, business relationship, product or transaction, and further defines less risky transactions [Directive 2005/60/EC, Recital]. The IIIrd AML Directive introduces for the first time the concepts of simplified due diligence, basic due diligence, enhanced due diligence, as well as more detailed procedures for controlling the client and the beneficial owner. There are also the first mentions of the risk-based approach and the politically exposed person.

Further adjustments to the measures at the level of the European Union were left to wait for almost 10 years, when in 2015 Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (hereinafter referred to as "**IVth AML Directive**") was adopted, which completely replaced the IIIrd AML Directive (as in the case of the IIIrd AML Directive). The IVth AML Directive, like the IIIrd AML Directive, follows the risk-based approach, introduces new concepts and extends the scope of application, in particular to electronic money, extending definitions (e.g. specifying the concept of beneficial owner on the basis of specified criteria and thus the beneficial owner fiction).

In the case of electronic money, exceptions are provided where certain AML measures do not need to be implemented. Where identification is necessary, the obligations are extended to include persons who supervise clients, legal persons, i.e. the identification of all controlling persons in the ownership structure. There is also a more detailed adjustment of the measures concerning gambling operators (including the possibility of exempting certain gambling operators from the scope of the national rules implementing the AML Directive). A definition of high-risk third countries is introduced, as well as an obligation to link to such designated countries. Furthermore, the possibility of designating, in the case of separate professions, a statutory body within the statutory authority through which suspicious transactions are reported is directly regulated. The Directive also introduces international risk assessments as well as national risk assessments, which obliged persons can use to manage their own activities and, in particular, to better understand the risks [Directive (EU) 2015/849, Art. 6]. As part of the more detailed regulation of the risk-based approach, there is the introduction of risk profiles of clients for which different types of due diligence are identified (as well as the insertion of a demonstrative list of risk factors in the Annex to the Directive). The Directive requires for the first time the development of a system of internal policies,

strategies, controls and procedures, including the designation of a person to monitor AML compliance, from the management levels of the obliged person.

On the basis of the above, it can be noted that over the years and new adjustments, there has been a constant increase in the harmonisation of more detailed AML procedures. In particular, in the case of the Ist and IInd AML Directives, there have been more of a refinement of the principles and scope setting. The IIIrd and IVth AML Directives then provide for more specific rules and procedures to be put in place by obliged persons and to be monitored and enforced by Member States.

Based on the implementation of the IVth Directive into the Czech legal system, the harmonisation rules have been followed in the Czech Republic until 31 December 2020.

4. Vth AML Directive

This part of the article deals with the latest effective directive in the AML area. The aim of this chapter is to look in more detail at the various provisions of the latest Directive and to see what changes it brings.

Less than 1 year after the IVth Directive[3] was set to become enforceable, an update was adopted in the form of Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the system for the purpose of money laundering and terrorist financing (hereinafter referred to as "**Vth AML Directive**"). Almost a year after the signing of the IVth AML Directive, a proposal[4] for its actualisation was tabled on 5 July 2016, *inter alia* due to lingering shortcomings in the case of the supervision of many funds used by terrorists. "This proposal is intended to address these shortcomings while avoiding unnecessary obstacles to the functioning of payment and financial markets for ordinary citizens and compliant businesses, and therefore balancing the need for greater security with the need to protect fundamental rights, including data protection, and economic freedoms", as well as to ensure greater transparency of companies and other legal arrangements with regard to the clear identification of the beneficial owner of clients [Explanatory Memorandum: Directive 2018/843]. The update of the Directive is then intended to address five (5) issues, namely unclear and uncoordinated requirements regarding customer due diligence with regard to risky third countries; insufficient monitoring of suspicious transactions by the authorities in the case of virtual currencies; insufficient measures regarding electronic money (anonymous

[3] The IVth AML Directive was due to be implemented by 26 June 2017.
[4] COM (2016) 450, 2016/0208 (COD).

pre-paid instruments); limitations with regard to ensuring timely access by authorities to information from obliged persons; insufficient/delayed access by authorities to information on the identity of beneficial owners [Impact Assessment Summary, 2016].

The main changes introduced by the Vth AML Directive concern:

(i) *third countries at risk* - establishing a binding list of enhanced due diligence measures and countermeasures (including the designation of third countries at risk by delegated act to avoid "forum shopping[5]");

(ii) *virtual currencies* - extending the scope of the bill of exchange to virtual wallet providers (in particular, it concerns so-called "crypto exchanges", i.e. exchanges between virtual currencies and fiat currencies[6]);

(iii) *electronic money* - lowering the threshold for the need for identification and due diligence (reduction from EUR 250 to EUR 150 in order to limit the anonymity of prepaid instruments);

(iv) *powers of FIUs*[7] - extension of the powers to request additional information from obliged persons (in order to obtain timely access to information from obliged persons to ensure compliance with the law and thus align with international standards);

(v) *beneficial owners* - introduction of an automated register of beneficial owners;

(vi) *trusts* - regulation of the place of monitoring and registration of trusts;

(vii) *electronic identification* - to comply with the eIDAS Regulation and to introduce the possibility of electronic identification of clients, i.e. recognition as valid means of proof of identity on the basis of electronic declaration, confirmation or credentials in accordance with the eIDAS Regulation;

(viii) *extension of the risk-based approach* – elaborates the risk-based approach (hereafter referred to as “RBA”), according to the RBA, the application of due diligence types not only at the beginning of the trade/business relationship, but also in case when the risk category has to be changed when the risk level is identified and therefore a different due diligence type has to be applied as part of ongoing/ad hoc monitoring (Explanatory Memorandum: Directive 2018/843).

In view of the more extensive modifications of the **RBA** (although it was introduced on the basis of the IVth AML Directive), it is appropriate to devote a few more lines to this concept, on which the approach is based. RBA is risk-based, as the very name of the term suggests.

[5] "Forum shopping" means the speculative selection of a jurisdiction according to whether the jurisdiction in question applies more or less stringent regulations to a high-risk third country.
[6] Fiat currency as a currency that has been declared as legal tender.
[7] FIUs as Financial intelligence units.

However, it is the need to identify the risks associated with their activities, including the identification of appropriate resources and procedures to mitigate those risks. According to the Joint Guidelines on Risk-Based Supervision, RBA is defined as "an approach whereby competent authorities and obliged entities identify, assess and understand the money laundering and terrorist financing risks to which the assessed entities are exposed and whereby they take measures against money laundering and terrorist financing commensurate with those risks" [Joint Guidelines ESAs/2016/72, 2017: 4] However, RBA can only be achieved when appropriate procedures and proper systems controls are in place, namely Know-Your-Client ("KYC") and Client Due Diligence ("CDD").

Therefore, the above also aims at identifying potential risks related to clients, including risk assessment and categorization of risk profiles of clients to which the specified measures will apply, as well as proper monitoring of risk factors. In the case of RBA, if higher risks are identified (higher inherent risk) and this risk is not mitigated by the measures in place to an acceptable level of residual risk, enhanced measures should be applied (FSRA Guidance, 2015:14). According to FATF Recommendations, RBA does not apply to the circumstances when CDD should be required but may be used to determine the extent of such measures [FATF Recommendations 2021: 68].

Following the proposal for a new directive, an opinion of the European Central Bank[8] was issued on 12 October 2016. The European Central Bank's opinion deals mainly with the concept of "virtual currency", on which it has comments concerning the very concept of virtual currency in the directive and proposes a modification of the wording to make it clear that it is not a currency and not a means of payment, but as a means of exchange [Opinion of the European Central Bank 2016]. Subsequently, a position was expressed in the 1st reading of the joint committee meeting of 9 March 2017, including amendments, in particular, concerning the recital of the Vth AML Directive and, in particular, the modification of the scope of the Directive, the fiction of beneficial owner if the beneficial owner is not identified in the register, the introduction for the first time of the modification of the sanction lists directly in the Directive, i.e. checking whether the name of the client and the beneficial owner is on the Union sanction list, the obligation for Member States to modify the lists of politically exposed persons, including the list of politically exposed persons, and the obligation to modify the list of politically exposed persons. the need to apply the procedure for politically exposed persons even if they no longer hold public office for at least 36 months (ultimately 12 months were retained), the introduction of procedures in the event

[8] CON/2016/49, 2016/C 459/05.

of ambiguities found by obliged persons in the central registers and information on beneficial ownership obtained in the course of the procedures for checking or investigating a client. After 21 deliberations in the Council, the proposal was adopted by all 28 members on 14 May 2018.

Following the ordinary legislative procedure, the Directive was then adopted on 30 May 2018, with Member States being obliged to implement the Vth AML Directive by 10 January 2020. The Vth AML Directive has already been amended in part, by Directive (EU) 2019/2177 of the European Parliament and of the Council of 18. December 2019, amending Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), Directive 2014/65/EU on Markets in Financial Instruments and Directive (EU) 2015/849 on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing, which mandates Member States to implement the amendments into national arrangements by 30 June 2021 at the latest.

5. AML/CFT risks at investment service providers

This part of the article focuses on AML/CFT risks at investment service providers, in particular how investment service providers are affected by AML/CFT risks in their activities. This section focuses only on an investment service provider in the position of an **instrument** (as described above) and therefore for which areas that provider should put in place measures to prevent money laundering and terrorist financing.

It is only peripherally worth mentioning that investment service providers are generally investment firms, which can be defined as "a legal person whose usual business or activity is the professional provision of one or more investment services to a third party or the professional performance of one or more investment activities" [Directive 2014/65/EU, Art. 4] and whose activities are regulated by Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2004 on markets in financial instruments (hereinafter referred to as "MiFID II"). Investment services are then considered to be the reception and transmission of orders relating to one or more investment instruments; the execution of orders on behalf of a client; proprietary trading; portfolio management; investment advisory services and others listed in Annex 1, Section A of MiFID II as to the financial instruments listed in Annex 1, Section C of MiFID II. If we look at the services that have been subject to the Ist AML Directive as activities at financial institutions, we can find exactly the same features in terms of investment services that have been targeted in the AML area since the beginning of harmonisation tendencies at European level.

In general, it can be said that the securities industry, as well as the provision of investment services to other investment instruments, is "less at risk than the banking sector regarding the placement of laundered funds directly into the securities industry. However, the securities industry is potentially vulnerable to the layering of laundered funds subsequent to the placement phase" [Initiatives by the BCBC, IAIS and IOSCO to combat money laundering and the financing of terrorism 2003: 4]. However, even in this case, specific activities can be found where there is a greater AML/CFT risk, in particular: Employees whose activities knowingly/unknowingly contravene the internal AML risk regime, including with respect to the client relationship; cross-border provision of investment services through financial intermediaries from countries that do not have an effective AML/CFT system (particularly related to acceptance of orders and related funds); wash sales or other fictitious trading schemes to transfer money or value through the clearing and settlement infrastructure [Initiatives by the BCBC, IAIS and IOSCO to combat money laundering and the financing of terrorism 2003: 5].

Among the basic measures that can be taken to reduce the above-mentioned risk areas is, inter alia, the development of a sound system of internal policies taking into account the jurisdictions in which the provision of investment services by connected persons to investment service providers takes place and, of course, according to the applicable legislation. There has also been a greater degree of cross-border capital allocation, large volumes, speed and anonymity over the years. Guidance for a Risk-Based Approach for the Securities Sector by FATF, 2018, identifies other risks associated with the securities sector, such as "differences between jurisdictions in defining securities, securities products and their providers and their AML/CFT regulated status; the global reach of the securities sector; and the speed of transactions across the world. in many onshore/offshore jurisdictions and financial markets; consistent with Initiatives by the BCBC, IAIS and IOSCO, cites the ability to transact products through intermediaries, which can provide a relative degree of anonymity; the common involvement of a large number of securities providers and intermediaries, potentially limiting the ability of a single participant to have full oversight of the providers' transactions" [FATF Securities sector: 2018].

6. Implementation into the Czech legal system

This part of the article focuses on the specific measures adopted by the Czech Republic in connection with the adoption of the Vth Directive and the specific impact of these changes on investment service providers.

Following the adoption of the Vth AML Directive, it was necessary to implement the provisions into the Czech legal system. The Czech Republic has indicated the implementation of 52 measures across the legal order as part of the implementation of the 5th AML Directive. The most significant changes, particularly with regard to the focus of this paper, were Act No. 253/2008 Coll., on certain measures against the laundering of the proceeds of crime (hereinafter referred to as "**AML Act**") and Decree No. 67/2018 Coll., on certain requirements for a system of internal policies, procedures and control measures against the laundering of the proceeds of crime and terrorist financing (hereinafter referred to as "**AML Decree**").

It should be mentioned that the Czech Republic is obliged to implement the provisions on the basis of European acts, however, through the financial market supervisory authority, which is the Czech National Bank, it also accepts the AML standards, which are reflected in the Czech legal system (eIster supplementing the AML Act or the AML Decree). Therefore, for the performance of supervision it also uses the recognised AML standards developed by the FATF (Action Task Force), standards from the creators of the Joint Forum[9] (JT), Basel Committee on Banking Supervision[10] (BCBS), International Organisation of Securities Commissions[11] (IOSCO), International Association of Insurance Supervisors[12] (IAIS) [Official Announcement of the CNB 2009].

The Vth AML Directive has been implemented into the Czech legal system through the AML Act, with effect from 1 January 2021, on the basis of Act No. 49/2020 Coll. (which is the implementing act). It should be mentioned that the amendment to the AML Act implements as of 1 January 2021 also the remaining provisions of the IVth AML Directive, such as enhanced identification and due diligence, which should have been implemented earlier. With regard to the transposition of the IVth AML Directive and its late incorporation into the Czech legal system, infringement proceedings have been initiated with the Czech Republic in this context (under No. 2019/2037).

Within this "double" implementation, the scope of the AML Act is comprehensively modified, and it can be stated that the following units are modified:

[9] The Joint Forum (JF) is an international interest organisation of regulators of banks, insurance companies and capital markets.
[10] The Basel Committee on Banking Supervision (BCBS) acts as a forum for banking supervision issues at the Bank for International Settlements.
[11] The International Organization of Securities Commissions (IOSC O) brings together capital market regulators and supervisors.
[12] The International Association of Insurance Supervisors (IAIS) brings together insurance regulators and supervisors.

(i) the extension of the range of obliged persons and the restrictions associated with this status;
(ii) changes to the process of client identification and due diligence;
(iii) reform of administrative penalties;
(iv) modification of the scope and powers of supervisory authorities;
(v) changes to the data collected in the central register of accounts [Explanatory Memorandum: Act No 49/2020 Coll.].

In case of extension of the range of obliged persons, in particular with regard to investment service providers, there is an extension to all "persons authorised to carry out the administration of an investment fund and/or a foreign investment fund, a legal person that manages assets in a manner comparable to asset management (term introduced in connection with the implementation of the AIFMD[13]) [AML Act, Art. 2]. Under the scope of the suspension, it is made clear that in the case of collective investment, only the person providing the administration, and not the person managing the investment fund, ensures compliance with AML/CFT obligations. There is also a change in terminology, i.e. a change from "virtual currency" to "virtual asset", in line with the ECB Recommendation (as described above), the introduction of a third country regime, minor adjustments to the optional and mandatory features of a suspicious transaction.

Notable changes include the modification of the first identification and due diligence of the client (with the introduction of the concept of “high-risk third country”), the modification of the possibilities for simplified identification and due diligence of the client, the introduction for the first time of enhanced identification and due diligence of the client, the modification of remote identification, the reduction of the threshold for exemptions from the obligation to identify and due diligence the client in the case of electronic money, the modification of the internal policy system as well as the risk assessment, and other minor changes.

As regards the introduction of the enhanced client identification and due diligence regulation, this regulation was introduced on the basis of the IVth AML Directive, also in view of the long-standing and strong criticism of the absence of this regulation by Moneyval and also due to the initiation of infringement proceedings. The explicit introduction of the institute only on the basis of the reproaches from Moneyval and the proceedings initiated can be said to be due to the fact that the Czech Republic considered that the existing regulation contained the conditions for the application of the enhanced identification and

[13] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No. 1060/2009 and (EU) No 1095/2010.

due diligence (in the author's opinion, the explicit introduction of the institute was a necessity and he does not share the views of the Czech Republic regarding this institute). In the framework of the introduction of enhanced due diligence, two possibilities for its use are provided for, namely with regard to the fulfilment of obligatory risk factors in the client (such as a link to a risky third country) and, furthermore, the fulfilment of a combination of facultative features with regard to residual risk (i.e. on the basis of obliged person's own assessment) [Explanatory Memorandum: Act No 49/2020 Coll.].

The significant change introduced by the Vth AML Directive, namely in relation to the concept of beneficial owner, is only incorporated into the Czech legal system by the amendment to the AML Act, as of 1 June 2021, including the procedure for detecting irregularities, and "the wording of the provision thus refers to the definition of beneficial owner in the special law implementing the relevant Article of Vth AML Directive, and for the purposes of the AML Act, provides that the person for whom the trade is conducted is also considered to be the beneficial owner, which is a requirement of Article 3(6) IVth AML Directive" [Explanatory Memorandum: Act No 49/2020 Coll.]. The above is linked to the necessity of drafting a new legislative act at national level, namely Act No. 37/2021 Coll. on the registration of beneficial owners, which has just entered into force on 1 June 2021.

Also, in the framework of the implementation of the Vth AML Directive, the AML Decree has been modified, especially with regard to the adopted measures of enhanced due diligence.

However, in the case of the AML Decree, as in the case of the AML Act, provisions from the General Guidelines on Risk-Based Supervision (issued on the basis of Art. 48 of the Vth AML Directive), the recommendations of the evaluation of the Czech Republic by the Committee of Experts on the Evaluation of Anti-Money Laundering and Countering the Financing of Terrorism (Moneyval) and the International Standard on Combating Money Laundering, Terrorist Financing and Proliferation [FATF Recommendations] have been incorporated over and above the Vth AML Directive.

In general, it can be said that the recent significant changes in the AML area in the Czech Republic resulting from the IVth and Vth AML Directives, entail in particular impacts on all obliged persons, in the form of costs associated with the introduction of systems for identifying suspicious transactions, establishing access to the register of beneficial owners, the allocation of staff responsible for the issue of legalization of proceeds of crime and terrorist financing, and with regard to the extensive change, these facts impact the need to adjust the system of internal policies and risk assessment of obliged persons, including the

system of risk assessment [Explanatory Memorandum, Act No 49/2020 Coll.; and Final Report of the RIA, Regulatory Impact Assessment].

However, apart from such general impacts, can the specific impacts of the Vth AML Directive be isolated in the context of the provisions in the Czech legal order on investment service providers? Singling out these specific impacts is complicated by the "double" implementation under the major amendment to the AML Act. The **major impact** can clearly be identified as the definition that in the case of collective investment only the person providing the administration and not also the person managing the investment fund ensures compliance with AML/CFT obligations (this change was, however, caused by the IVth AML Directive), of course the changes concerning beneficial owners and the extension of the concept of a risky third country. In the case of a risky third country, investment service providers acting in the capacity of an obliged person under the AML Act, in particular in the case of investment fund clients who invest their assets in an investment fund, must examine whether those assets are in any way connected to a risky third country (Opinion of the CNB, 2022). The other changes resulting from the Vth AML Directive are **already marginal** in nature, and it was the IVth AML Directive, which introduced comprehensive regulation of client identification and due diligence, that had a much greater impact on investment service providers.

7. VIth AML directive as part of the new legislative package against money laundering and terrorist financing

This part of the article deals with the future of AML, in particular what we can expect in the event of further rules on money laundering and terrorist financing, although this issue is already regulated in great detail. In the author's opinion, there is already a *hypertrophy of AML legislation*[14].

As of 1 January 2021, the Czech Republic has undergone a significant change in AML regulations. However, already in the course of 2021, namely on 20 June 2021, further harmonisation tendencies in the field of AML have been sharpened by means of an **ambitious package of legislative proposals** to strengthen the EU anti-money laundering and anti-terrorist financing rules. This "package creates a new and more coherent regulatory and institutional framework for the fight against money laundering and terrorist financing within the EU" (Explanatory Memorandum: Proposal for a Regulation of the European Parliament

[14] Hypertrophy of legislation as an ever-increasing number of partial laws regulating a partial area of human activity, which ultimately reduce the effectiveness of legislative norms.

and of the Council on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing). The package also includes a proposal to create a new EU anti-money laundering body. It is part of the Commission's commitment to protect EU citizens and the EU financial system from money laundering and terrorist financing. The aim is to improve the detection of suspicious transactions and activities and to close loopholes used by criminals to launder illicit proceeds or finance terrorist activities through the financial system [Proposal for a Regulation of the European Parliament and of the Council establishing the Authority for Anti-Money Laundering and Countering the Financing of Terrorism: Recital].

This ambitious legislative package includes 4 legislative proposals:

(i) *New EU Anti-Money Laundering Authority (AMLA)* - creation of a new EU body to transform AML/CFT supervision in the EU and strengthen cooperation between Financial Intelligence Units (FIUs), while coordinating national authorities on AML measures;

(ii) *New AML/CFT Regulation* - extracting essential information from the Directives into a directly applicable regulation (self-executing) (hereinafter referred to also as "Regulation");

(iii) *VIth AML Directive* - a new Directive that will repeal the Vth AML Directive and completely change its structure, with respect to the carve-out of basic information on the Regulation, where the Directive only covers rules for national supervisors and FIUs in Member States;

(iv) *Revision of the 2015 Regulation on transfers of funds* - Revision of regulation 2015/847/EU to allow for the tracking of crypto asset transfers.

Ad. (i) The new EU Anti-Money Laundering Authority (AMLA). This authority (a body with legal personality) is to be established on the basis of the Regulation of the European Parliament and of the Council establishing an Anti-Money Laundering and Anti-Terrorist Financing Authority (AMLA)[15]. The establishment of this body is intended to improve the quality and effectiveness of AML supervision in the Union by establishing uniform procedures across Member States and by introducing a consistent approach to cross-border situations. The Authority (AMLA) is intended to become 'the central element of an integrated AML/CFT supervisory system and will consist of the Authority itself and the national authorities with AML/CFT supervisory powers. The Authority will directly contribute to the prevention of money laundering and terrorist financing in the Union by directly supervising

[15] 2021/0240 (COD).

and taking decisions for some of the most risky obliged persons in the cross-border financial sector" [Explanatory Memorandum: Regulation of the European Parliament and of the Council establishing an Anti-Money Laundering and Counter-Terrorist Financing Authority].

The AMLA is also to exercise direct control over selected entities. These selected entities will include the most risky obliged persons. The selection of the entities with direct control will then always be made on a regular basis, every three years, on the basis of objective criteria. In certain cases, an entity may also be included among the direct control entities on an individual basis. "In the case of indirect control, the AMLA is to coordinate and supervise the national supervisors in the field of anti-money laundering and counter-terrorist financing, including the state authorities in some Member States for certain non-financial obliged persons. The authority will have the power to issue instructions, opinions and recommendations to national supervisors and state authorities" [Explanatory memorandum: Regulation of the European Parliament and of the Council establishing an Anti-Money Laundering and Counter-Terrorist Financing Authority].

Ad. (ii) The new AML/CFT Regulation. This regulation was chosen in order to avoid differences in regulation at national level within the private sector. The public law aspect, i.e. the organisation of the institutional system at national level, was left to the Directive. The Regulation not only transfers the provisions of the Vth AML Directive, but also introduces new changes at the level of the whole Union, e.g.: the scope is extended to include crowdfunding and migration operators, more detailed regulation of due diligence measures according to the risk level of the client, requirements in relation to politically exposed persons as well as requirements concerning beneficial owners are specified, alert notifications concerning suspicious transactions are introduced, etc.

The aim of moving the provisions to a regulation is to provide a consistent framework for all Member States, compliance with which will be subject to direct supervision by the new Anti-Money Laundering Authority (AMLA) (Explanatory Memorandum: Proposal for a Regulation of the European Parliament and of the Council on the prevention of the use of the financial system for the purpose of money laundering or terrorist financing).

Ad. (iii) VIth AML Directive. This is the first AML Directive of its kind where specific requirements for the internal policy system are set out in a regulation. The VIth AML Directive then leaves in particular the institutional arrangements, including substantial changes, which are intended to lead to convergence of supervisory practices, including reporting units, at the level of individual Member States, with a view to regulating effective cooperation between competent authorities. The Directive also contains new definitions,

which are, however, not essential for the Regulation itself. In addition to the convergence of supervisory practices, the Directive introduces "specific regulatory requirements to be introduced by Member States for certain sectors in national legislation. In particular, money changers, cheque cashing establishments and service providers to trusts and companies must be subject to authorisation or registration requirements; gambling service providers must be subject to regulation" (Explanatory Memorandum: Proposal for a Directive of the European Parliament and of the Council on mechanisms to be put in place by Member States to prevent the misuse of the financial system for the purpose of money laundering or terrorist financing and repealing Directive (EU) 2015 /849).

In addition to regulatory requirements, the Directive also introduces contact points for use by supervisors based on the use of passporting services. The Directive also introduces the obligation to link registers of beneficial owners and mandatory access to national real estate registers for supervisors across Member States, among many others.

Ad. (iv) Regulation on information on transfers of funds and crypto assets. Regulation 2015/847 is being revised to cover cryptocurrency transfers as well as other services relating to cryptocurrencies. The amended regulation is also intended to reflect "the Financial Action Task Force (FATF) Recommendation 15 on emerging technologies of June 2019 by including 'virtual assets' and 'virtual asset-related service providers' and in particular the new obligations to provide information on the originator and beneficiary at both ends of a crypto asset transfer (the 'travel rule')" (Explanatory Memorandum: Proposal for a Regulation of the European Parliament and of the Council on information accompanying transfers of funds and certain crypto assets). The revision of the Regulation also sets out new obligations, in particular the necessary scope of information on the originator in the context of transfers, the transferor's account, the identification of the client and the originator.

Based on the above list, we can expect even more detailed regulation of the AML area in the future than we have today. It should be underlined that the Commission hopes for a swift legislative process, including the launch of the AMLA function already in 2024. Currently, all legislative acts of the new legislative package are at first reading in the Council of the European Union (last meeting on 28 January 2022)[16].

[16] As of 29 January 2022.

8. Conclusion

This article deals with the adopted directives concerning the prevention of money laundering and terrorist financing as well as the implementation of the provisions primarily of the last two directives into the Czech legal system and in particular the assessment of the impact of the Vth AML Directive on the implementation provisions in the Czech legal system on investment services, especially on the activities of investment service providers. After a more detailed assessment of the impact of the individual European acts, focusing on the last effective anti-money laundering directive, the author concludes that the Vth AML Directive did not have a significant impact on investment service providers. In contrast, the provisions of the IVth AML Directive were identified as having a significant impact. The stated hypothesis was therefore disproved. It was also found that obliged persons, like Member States, have much to look forward to in the future in terms of further anti-money laundering regulation.

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