Strasbourg, 9 November 2005

COUNCIL OF EUROPE CONSEIL DE L'EUROPE

MONEYVAL (05) 17 – I

EUROPEAN COMMITTEE ON CRIME PROBLEMS
(CDPC)

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

THIRD ROUND REPORT ON

HUNGARY[1]

ANTI-MONEY LAUNDERING
AND COMBATING THE FINANCING OF TERRORISM

Memorandum
prepared by the IMF

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

Hungary

Report on Observance of Standards and Codes—FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)

I. Introduction

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

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

II. Main Findings

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

These impressive efforts notwithstanding, some important gaps remain in the legislative framework for CFT and the implementation of the AML measures needs to be improved. The authorities have indicated their intention to address these issues in the context of the implementation of the Third European Union (EU) Directive on money laundering (ML), which was approved by the EU Parliament on May 26, 2005. Nonetheless, work on some of these issues should commence immediately.

General

Situation of Money Laundering and Financing of Terrorism

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

The Hungarian authorities report only seven prosecutions for money laundering in the last four years with the predominant predicate offenses being fraud, misappropriation, and illegitimate financial service activity. Hungarian criminal statistics and reports of international organizations indicate that other profit-making crimes (e.g., drug-related offenses) take place and additionally testify to the presence of organized crime families in Hungary.[3] It would seem reasonable to expect that there should be more money-laundering prosecutions on the basis of such profit-making crimes.

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

Overview of Financial Sector and DNFBPs

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

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

For AML/CFT purposes, Hungary's DNFBPs can be divided into three categories, based on the type of oversight. Casinos are directly under the supervision of the Hungarian Gaming Board (HGB); lawyers, notaries, and auditors are supervised by their respective professional bodies or chambers; and other businesses and professions (accountants, real estate agents, high-value goods dealers, etc) directly by the Financial Intelligence Unit (FIU). The latter group is the most numerous, comprising some 50,000 individuals and businesses. An additional 15,000 professionals are supervised by their Chambers. Hungary has six casinos.

---

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

There are some 49,000 nonprofit organizations (NPOs) in Hungary, which are characterized by a relatively high level of state support and a relatively low level of private donations.

Legal Systems and Related Institutional Measures

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

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

The relevant provisions regarding FT are quite complex and contained within the definition of acts of terrorism. Moreover, the offense is defined in relation to the financing of the activities of terrorist groups, while the financing of individual terrorists is only covered through ancillary offenses. The criminal provision should cover all conduct constituting terrorist financing as set forth in the UN International Convention for the Suppression of the Financing of Terrorism.

There is no legal obligation in the current Hungarian legislative framework to report a transaction on the basis of a suspicion that the funds involved may be relevant to terrorism[4]. SPs—normally a key source of information—are thus not directly engaged in the identification and detection of terrorist-related funds, which decreases the chances of detection and forfeiture. The AML Act also lacks any provision for suspending a transaction based on suspicions of FT (as opposed to ML) which eliminates the option of freezing assets in such a case.

Similarly, unlike in the case of ML and of large-value movements generally, the Hungarian Customs and Finance Guard (HCFG) is not under a reporting obligation regarding suspicious cross-border movements of valuables related to FT, nor do they appear to have the right to freeze such assets. While the EC Regulations 881/2002 and 2580/2001 are self executing in Hungary as an EU member state, there is no domestic

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

legislation implementing the United Nations Security Council Resolutions (UNSCRs) 1267 and 1373, which is especially problematic in relation to the freezing of nonbanking/financial assets.

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

The STR system should be reviewed. Currently, the system is producing a high volume of relatively low quality STRs from financial institutions and a negligible number of STRs from DNFBPs. The potential over-reporting from financial institutions could be linked to the criminal liability for both willful and negligent nonreporting under the Hungarian Criminal Code (HCC), which was also a concern for all SPs. This regime appears to have led to a large amount of "defensive reporting," rather than attempts to identify the real suspicious ones, as very few of the STRs have led to investigations and none to prosecutions. Out of 14,120 STRs received in 2004, only 20 cases turned into investigations and no prosecution was ever started out of an investigation arising from an STR. It is recommended that the penalties for criminal nonreporting be more proportionate to the offense, especially in the case of negligence, for instance by imposing appropriate fines and measures taken to improve the quality of STRs.

The FIU at the National Police Headquarters (NPHQ) bears the brunt of the over-reporting and consequently may not be sufficiently staffed to both perform its core functions and to take on the supervisory role assigned to it by the AML Act over those DNFBPs that lack state or professional supervision. These supervisory functions might fit poorly in a police-based FIU, due to the high potential for blurring of supervisory, investigatory, and enforcement roles. Authorities should consider finding another institutional framework for supervising these SPs. On the other hand, the FIU should be given a clear competence in CFT, with a repository and analysis function also over the STRs for FT.

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

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

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

Preventive Measures—Financial Institutions

The AML Act mandates comprehensive preventive measures for financial institutions including customer due diligence (CDD), record keeping, suspicious transaction reporting, and internal controls for AML. In addition, the Recommendation of the President of the HFSA No.1/2004 provides more detailed requirements and guidance for AML compliance by financial institutions. The HFSA reviews and updates this Recommendation to cover new issues and requirements in the international standards, including the revised FATF Recommendations as well as the CDD paper by the Basel Committee.[5]

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

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

One weakness in an otherwise robust CDD and record-keeping system—for both financial institutions and DNFBPs—is the treatment of beneficial owners. According to the AML Act and most of the model rules issued by the supervisory bodies, when a client states that he or she is acting on behalf of another party who is the actual owner of the assets in question, the SP only has to collect a limited amount of information concerning that beneficial owner. Measures need to be taken to require full information for the identification of beneficial owners.

---

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

Preventive Measures—Designated Non-Financial Businesses and Professions

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

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

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

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

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

National and International Cooperation

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

The implementation of the UN Convention on FT and UNSCRs 1267, 1269, 1333, and 1390, however, still appears to pose some issues. Even though EU regulations regarding CFT would be immediately applicable in Hungary as an EU member state, domestic legislation is needed to impose sanctions for the violation of the EU CFT obligations. There are also some issues concerning the freezing of real goods, (related to the practical implementation of the freezing obligation set forth in the EU regulations) which are not currently covered by domestic legislation. Besides the Government Decree 306/2004 which deals with unfreezing, there is no other domestic legislation implementing UNSCR 1267 nor UNSCR 1373.

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

III. Summary assessment against the FATF Recommendations

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

Table : Recommended Action Plan to Improve the AML/CFT System

FATF 40+9 Recommendations	Recommended Action (listed in order of priority)
1. General	No text required
2. Legal System and Related Institutional Measures	
Criminalization of Money Laundering (R.1 & 2)	• Enlarge the scope of the ML offense so that it covers all the circumstances set forth by the Vienna and Palermo Conventions. • Harmonize Article 303 and 303A so that the same definition of "item" will be formally applicable to both provisions.
Criminalization of Terrorist Financing (SR.II)	There should be a separate provision for FT, particularly for the case of financing terrorist acts which are not to be committed or intended to be committed by a terrorist group.

Confiscation, freezing and seizing of proceeds of crime (R.3)	• Consideration should be given to providing the FIU with statutory authorization to freeze assets and suspend transactions. • Consideration should be given to creating a system of administrative freezing, granting the FIU, Police and Prosecutor a reasonable period of time to check the facts of the case in detail, without immediately having to open a criminal investigation. • Much more consideration should be given to the taking away of the proceeds of crime. The number and amounts of seizures and confiscations should increase noticeably, given the high number of prosecutions for economic crime. Operational practice should more consistently and systematically link seizure/confiscation with investigations.
Freezing of funds used for terrorist financing (SR.III)	• Create legal authority for the financial institutions to freeze upon suspicion of terrorist financing. • Provide the FIU, Police and Prosecutor with an autonomous competence to freeze in cases of suspicious transactions possibly linked to FT. • Provide a sufficient period of freezing in order to do serious checks before having to start criminal investigations. • Provide clear procedures for de-listing and un-freezing also for the UNSCR.
The Financial Intelligence Unit and its functions (R.26, 30 & 32)	Placing responsibility for CFT matters with the FIU and establishing a clear obligation to report to FIU STRs related to FT. • Consideration should be given to: • Given the Police nature of the FIU and number of staff, placing the supervisory function over DNFBPs outside the FIU; • The FIU continuing to upgrade its software; • The analysis of STRs by the FIU identifying as much as possible underlying predicate offences; and • Having the statistics of STRs compiled by the FIU provided in greater detail and containing references to predicate offence where possible.
Law enforcement, prosecution and other competent authorities (R.27, 28, 30 & 32)	• Strengthening the HCFG competences in AML/CFT, specifically placing more emphasis on the financial angle of the investigations. • The investigations on organized crime should focus more on potential ML offenses and be more closely coordinated with ML investigations. • Law Enforcement officials must gain more practical experience in ML investigation and prosecution through a more generalized and aggressive prosecution policy and a more innovative and daring use of the existing tools is necessary.

Cash couriers (SR IX)	• Identification, record keeping and reporting requirements should apply also in the case of FT. • HCFG should be given the authority to stop/restrain the cash to ascertain whether evidence may be found for ML/FT. • Sanctions should be more effective and dissuasive. • Immediate seizure should be available in the case of cash and valuables related to ML/FT.
3. Preventive Measures– Financial Institutions	
Customer due diligence, including enhanced or reduced measures (R.5 to 8)	• Measures need to be taken to require full information for the identification of beneficial owners, for example by the AML Act and the supervisory rules by the HFSA. • There should be explicit requirements regarding approval by senior management of continuing business relations with persons becoming PEPs after the establishment of a business relationship.
Record keeping and wire transfer rules (R.10 & SR.VII)	Ensure that, for the payment form in domestic ICS system, sufficient space for information on the originator (name, address and account number) should be allowed as planned.
Monitoring of transactions and relationships (R.11 & 21)	The authorities may consider requiring explicitly that financial institutions keep records of findings of screenings.
Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)	• A clear legal basis for the obligation to report suspicious transactions relating to the financing of terrorism should be established. • Further efforts are needed to improve the capabilities of financial institutions to detect STRs related to ML and FT. • Reporting STRs should be in electronic format.
Internal controls, compliance, audit and foreign branches (R.15 & 22)	The authorities may consider introducing more explicit requirements to require financial institutions to ensure their foreign branches and subsidiaries observe AML/CFT measures in Hungary and inform the HFSA when they are unable to observe AML/CFT measures in foreign jurisdictions.
The supervisory and oversight system–competent authorities and SROs (R. 17, 23, 29 & 30).	• The authorities should review the effectiveness of the current regime of imposing terms of imprisonment for negligent non-reporting of suspicious transactions under the Section 303/B of the HCC. • A clear legal basis for STR obligation relating to FT should be established to ensure effective supervisory oversight for CFT.
Ongoing supervision and monitoring (R.23, 29 & 32)	A clear legal basis for STR obligation relating to FT should be established to ensure effective supervisory oversight for CFT.
4. Preventive Measures–	

Nonfinancial Businesses and Professions	
Customer due diligence and record-keeping (R.12)	• The rules and practices of notaries should be reviewed to ensure that the notary collect full CDD information for any third party to whom he or she may transfer money, valuables, or securities. • The beneficial owner identification process should be strengthened both in the AML legislation and in the various directives and guidelines, to require full information for natural and legal persons.
Monitoring of transactions and relationships (R.12 & 16)	Enhanced due diligence for PEPs and wider and more systematic dissemination to DNFPBs of information about international compliance with the FATF standards are needed.
Suspicious transaction reporting (R.16)	• Active measures should be taken to increase the quantity and quality of STR reporting from the DNFBPs. This will require systematic and continued outreach and improved guidance on suspicious transaction reporting – especially to DNFBPs that are not organized within SROs to overcome existing habits and to ensure that all service providers are aware of their responsibilities. • A clear legal basis for the obligation to report suspicious transactions relating to the financing of terrorism should be established.
Regulation, supervision and monitoring (R.17, 24-25)	• The authorities should review the tendering process for Gaming establishments to ensure that protections against the involvement of criminal associates is strong enough. Improved feedback to the DNFBPs should be part of ongoing awareness-raising and education efforts. Issue guidance on CFT for DNFBPs. • Increase the resources available for supervision of non self-regulated DNFBPs.
5. Legal Persons and Arrangements & Nonprofit Organizations	
Nonprofit organizations (SR.VIII)	• The authorities need to conduct a review of the sector in order to be fully compliant with the FATF recommendations. That examination should look broadly at increasing the transparency in the sector, strengthening the legal basis for supervision and oversight over NPO fundraising. • Authorities should consult widely with the sector on ways of improving transparency and reporting.
6. National and International Cooperation	

The Conventions and UN Special Resolutions (R.35 & SR.I)	• Ratify and fully implement the Palermo Convention • Fully implement Vienna and UN Convention on FT • Provide for domestic legislation implementing the UN Resolutions
Mutual Legal Assistance (R.32, 36-38, SR.V)	• More detailed and precise statistics must be kept to track ML / FT cases. • Consideration should be given to asset-sharing provisions.
Other Forms of Cooperation (R.32 & 40, & SR.V)	• More detailed and precise statistics must be kept to track ML / FT cases.

Hungary

DETAILED ASSESSMENT REPORT
ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM

Contents **Page**

ACRONYMS

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
AML Act	Act XV of 2003 on the Prevention and Combating of Money Laundering
CDD	Customer Due Diligence
CPC	Criminal Procedure Code
DNFBP	Designated nonfinancial businesses and professions
EU	European Union
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSRB	FATF-style Regional Body
FT	Financing of terrorism
GPO	General Prosecutor's Office
HCC	Hungarian Criminal Code
HCFG	Hungarian Customs and Finance Guard
HCPC	Hungarian Criminal Procedures Code
HFSA	Hungarian Financial Supervisory Authority
HUF	Hungarian Forint
HGB	Hungarian Gaming Board
KYC	Know your customer/client
LEA	Law Enforcement Agency
LEG	Legal Department, IMF
MFD	Monetary and Financial Systems Department, IMF
ML	Money Laundering
MLRO	Money Laundering Reporting Officer
MoE	Ministry of Economy
MoF	Ministry of Finance
MoFA	Ministry of Foreign Affairs
MoI	Ministry of Interior
MoJ	Ministry of Justice
NBH	National Bank of Hungary
NCA	National Communication Authority
NCCT	Non-Cooperative Countries and Territories
NPHQ	National Police Head Quarters
NPO	Non-profit organization
PBO	Public-benefit NPO
ROSC	Report on Observance of Standards and Codes
SPs	Service Providers
ST	Suspicious Transactions
STR	Suspicious Transaction Report
UN	United Nations
UNSC	United Nations Security Council
UNSCR	United Nations Security Council Resolution

I. PREFACE

1. An assessment of the anti-money laundering (AML) and combating the financing of terrorism (CFT) regime of Hungary was based on the Forty Recommendations 2003 and the Eight Special Recommendations on Terrorist Financing 2001 of the Financial Action Task Force (FATF), and was prepared using the AML/CFT Methodology 2004.[6] The assessment considered the laws, regulations, and other materials supplied by the authorities and information obtained by the assessment team during its mission from February 21 to March 4, 2005. During the mission, the assessment team met with officials and representatives of all relevant government agencies and the private sector.[7] A list of the bodies met is set out in Annex 1 to the detailed assessment report.

2. The assessment was conducted by a team of assessors composed of staff of the International Monetary Fund (IMF) and an expert under the supervision of IMF staff. The evaluation team consisted of: Mr. Kiyotaka Sasaki and Mr. Paul Ashin, MFD, who addressed financial sector and designated nonfinancial business and professions (DNFBP), respectively; Mr. Giuseppe Lombardo, LEG, who addressed legal and legislative aspects and financial intelligence; and Mr. Dirk Merckx, Public Prosecutor of Belgium, who addressed law enforcement aspects. The assessors reviewed the institutional framework, the relevant AML/CFT laws, regulations, guidelines and other requirements, and the regulatory and other systems in place to deter money laundering (ML) and the financing of terrorism (FT) through financial institutions and DNFBPs, as well as examining the capacity, the implementation, and the effectiveness of all these systems.

3. This report provides a summary of the AML/CFT measures in place in Hungary as at the date of the mission or immediately thereafter. It describes and analyzes those measures and provides recommendations on how certain aspects of the system could be strengthened (see Table 3). It also sets out Hungary's levels of compliance with the FATF 40+9 Recommendations (see Table 2).

---

[6] The assessment also included Special Recommendation IX of October 2004 concerning cash couriers, using the updated Methodology for the Special Recommendation IX of February 2005.

[7] The assessment team worked in collaboration with an assessor from MONEYVAL, Mr. Herbert Zammit LaFerla (Central Bank of Malta) who joined the mission on February 21–22, 2005 to evaluate compliance with the European Union (EU) AML Directives where these differ from the FATF 40 Recommendations.

II. EXECUTIVE SUMMARY

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

5. These impressive efforts notwithstanding, some important gaps remain in the legislative framework for CFT and the implementation of AML measures needs to be improved. The authorities have indicated their intention to address these issues in the context of the implementation of the Third European Union (EU) Directive on money laundering (ML), which is in final stages of preparation in Brussels[8]. Nonetheless, work on some of these issues could commence immediately.

General

Situation of Money Laundering and Financing of Terrorism

6. The Hungarian authorities report only seven prosecutions for money laundering in the last four years with the predominant predicate offenses being fraud, misappropriation, and illegitimate financial service activity. Hungarian criminal statistics and reports of international organizations indicate that other profit-making crimes (e.g., drug-related offenses) take place and additionally testify to the presence of organized crime families in Hungary.[9] It would seem reasonable to expect that there should be more money-laundering prosecutions on the basis of such profit-making crimes.

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

Overview of Financial Sector and DNFBPs

8. As of September 2004, the Hungarian financial system was composed of 32 banks, 5 specialized credit institutions, 178 cooperatives, 199 financial enterprises, 18 investment enterprises, 24 investment funds, 65 insurance companies, and

---

[8] The Third Directive was approved by the EU Parliament on May 26, 2005.

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

168 pension/health related funds. They are all supervised by the Hungarian Financial Supervisory Authority (HFSA). Money transfer services and currency exchange activities are also licensed and supervised by the HFSA.

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

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

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

Legal Systems and Related Institutional Measures

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

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

14. The relevant provisions regarding FT are quite complex and contained within the definition of acts of terrorism. Moreover, the offense is defined in relation to the financing of the activities of terrorist groups, while the financing of individual terrorists is only covered through ancillary offenses. The criminal provision should cover all conduct constituting terrorist financing as set forth in the UN International Convention for the Suppression of the Financing of Terrorism.

15. There is no legal obligation in the current Hungarian legislative framework to report a transaction on the basis of a suspicion that the funds involved may be relevant to terrorism[10]. SPs—normally a key source of information—are thus not directly engaged in the identification and detection of terrorist-related funds, which decreases the chances of detection and forfeiture. The AML Act also lacks any provision for suspending a transaction based on suspicions of FT (as opposed to ML) which eliminates the option of freezing assets in such a case.

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

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

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

---

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

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

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

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

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

Preventive Measures—Financial Institutions

23. The AML Act mandates comprehensive preventive measures for financial institutions including customer due diligence (CDD), record keeping, suspicious transaction reporting, and internal controls for AML. In addition, the Recommendation of the President of the HFSA No.1/2004 provides more detailed requirements and guidance for AML compliance by financial institutions. The HFSA reviews and updates this Recommendation to cover new issues and requirements in the international standards, including the revised FATF Recommendations as well as the CDD paper by the Basel Committee.[11]

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

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

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

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

27. In addition, as noted above (Paragraph 18), Section 303/B of the HCC is applied also to negligent nonreporting of STs. This regime appears to have led to a large amount of "defensive reporting," rather than attempts to identify the real suspicious ones, as very few of the STRs have led to investigations and none to prosecutions. Out of 14,120 STRs received in 2004, only 20 cases turned into investigations and no prosecution was ever started out of an investigation arising from an STR. It is recommended that the current regime of imposing terms of imprisonment for negligent nonreporting of STs be reviewed and measures taken to improve the quality of STRs.

Preventive Measures—Designated Non-Financial Businesses and Professions

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

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

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

Legal Persons and Arrangements and Non-Profit Organizations

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

National and International Cooperation

32. The Hungarian government set up an Interministerial Committee on Anti-Money Laundering in 2001 and an Interministerial Working Group Against Terrorism under the direction of the Minister of Interior to implement the EU policy in the fight against terrorism and to meet other related international obligations. It adopted a National Action Plan against terrorism, whose most significant unmet goals include ratifying the Palermo Convention, improving the exchange of intelligence and cooperation among international police forces, adopting domestic legislation to allow freezing of intangible, real, and tangible assets of suspected terrorists, and amending the existing provision pertaining to the freezing of financial assets.

33. The implementation of the UN Convention on FT and UNSCRs 1267, 1269, 1333, and 1390, however, still appears to pose some issues. Even though EU regulations regarding CFT would be immediately applicable in Hungary as an EU member state, domestic legislation is needed to impose sanctions for the violation of the EU CFT obligations. There are also some issues concerning the freezing of real goods, (related to the practical implementation of the freezing obligation set forth in the EU regulations) which are not currently covered by domestic legislation. Besides the Government Decree

306/2004 which deals with unfreezing, there is no other domestic legislation implementing UNSCR 1267 nor UNSCR 1373.

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

III. GENERAL

General information on Hungary

35. The Hungarian Republic is located in East-Central Europe (bordering Austria, Slovakia, Ukraine, Romania, Serbia, Croatia, and Slovenia). The land area of the country is 93,030 square km; its population is 10,300,000; its capital is Budapest (2 million inhabitants); and its currency is the Hungarian Forint (HUF).

36. Hungary has made the transition from a centrally planned to a market economy and held its first multiparty elections in 1990 and initiated a free market economy. It joined NATO in 1999 and the European Union (EU) in 2004.

37. The form of government is Republic (parliamentary democracy). The head of state elected by the National Assembly for a five-year term is Ferenc MÁDL (since August 4, 2000), the head of government elected by the National Assembly on the recommendation of the head of state is Prime Minister Ferenc GYURCSÁNY (since September 29, 2004). The unicameral National Assembly or Országgyűles is the legislative organ (386 seats), members are elected by popular vote under a system of proportional and direct representation to serve four-year terms.

38. The legal system is based on Civil Law principles and its basic legal instrument is the Constitution (August 18, 1949, effective August 20, 1949, revised April 19, 1972; a revision of October 18, 1989 ensured legal rights for individuals and constitutional checks on the authority of the prime minister and also established the principle of parliamentary oversight; a 1997 amendment streamlined the judicial system; it was amended again in 2004 due to the requirements of EU membership).

39. Hungary joined the EU on May 1, 2004. As a member state, Hungary has harmonized its legal system with the EU law and participates in the EU decision making procedures as an active member.

40. Cash plays a relatively large role in the Hungarian economy. According to the NBH, the ratio of average cash in circulation in 2004 is about 7 percent compared to the GDP on current prices.

General Situation of Money Laundering and Financing of Terrorism

41. The Hungarian authorities only report seven prosecutions for money laundering in the last four years with the predominant predicate offenses being fraud, misappropriation,

and illegitimate financial service activity. Hungarian criminal statistics and reports of international organizations indicate that other profit-making crimes (e.g., drug-related offenses) take place and additionally testify to the presence of organized crime families in Hungary.[12] It would seem reasonable to expect that there should be more money-laundering prosecutions on the basis of such profit-making crimes.

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

Overview of the Financial Sector and DNFBP

43. *Financial institutions:* As of September 2004, the Hungarian financial system was composed of 32 banks, 5 specialized credit institutions, 178 cooperatives, 199 financial enterprises, 18 investment enterprises, 24 investment funds, 65 insurance companies and 168 pension/health related funds. They are all supervised by the HFSA. The financial system is characterized by foreign ownership and in most segments of the financial sector, the majority of financial institutions are subsidiaries of major foreign financial groups. The banks remain the dominant institutions, with 69 percent of financial system assets.

44. Banks, specialized credit institutions, cooperatives and financial enterprises are licensed by the HFSA under the Act CXII of 1996 on Credit Institutions and Financial Enterprises (Banking Act). Money transfer services are defined as financial services and required to be licensed by the HFSA. Currency exchange activities are defined as activities auxiliary to financial services and can only be performed under HFSA licensed by banks or their contracted agents. Cash processing activities, which are also defined as services auxiliary to financial services, are subject to license and supervision by the NBH. The only branches/subsidiaries of the Hungarian financial institutions are in Slovakia, Croatia, Romania, and Bulgaria.

45. The HFSA was established on April 1, 2000 as a single supervisor of the financial sector by a merger of the previous sectoral supervisors (banking and capital markets, pension funds and insurance companies). The responsibility for the legal framework governing the financial sector resides with the Ministry of Finance (MoF) under the oversight of the government. The HFSA does not have the power to issue legally-binding rules and regulations to the financial sector. However, the HFSA has the power to issue guidelines, recommendations, and model rules for the financial institutions to comply,

---

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

supported by its power to invoke sanctions.[13] The HFSA also plays an important role along with the NBH in drafting legally-binding decrees issued by the Ministry of Finance (MOF). The HFSA has full autonomy in granting and withdrawing licenses for nonbanking financial institutions, while for commercial banks, the HFSA needs the NBH's consent for granting a license, and of the NBH and the MoF for withdrawing a license. The HFSA is given operational and budgetary independence by law.

Main indicators of financial sectors in September of 2004

		Number of firms	**Total assets**	**Clients assets managed by firms**	**Reserves**	**Total intermediated assets**
			billion HUF	billion HUF	billion HUF	billion HUF
	Total	**689**	–	–	–	**30.733**
1.	***Credit institutions***	***215***	**15.017**	**11.850**	–	**26.868**
1.1	Banks	32	13.582	11.850	–	25.432
1.2	specialized credit institutions	5	1.435	–	–	1.435
1.3	Cooperatives	178	994	–	–	994
	of which saving cooperatives	173	980	–	–	980
	of which credit cooperatives	5	14	–	–	14
1.4	financial enterprises	199	1.479	–	–	1.479
2.	***Investment enterprises***	***18***		**758**	–	**758**
3.	***Investment funds***	***24***		**870**	–	**870**
4.	***Insurance companies***	***65***		–	**978**	**978**
5.	***Funds***	***168***		**1.259**	–	**1.259**
	private pension funds	18		759	–	759
	voluntary pension funds	77		481	–	481
	voluntary health funds	42		17	–	17
	income replacement funds	31		2	–	2

Source: HFSA

46. *Casinos and Gaming:* Only six Hungarian establishments are considered to be casinos, although that far from describes the full extent of gaming activity in the country. The six, which are owned by the state, operated by private licensees, and supervised by

[13] Under the AML Act, the HFSA is specifically empowered to issue model rules for financial institutions to establish their internal rules/procedures for AML compliance that are enforceable by the supervisory oversight by the HFSA.

the Hungarian Gaming Board (HGB), are the only ones allowed to operate live games and are covered by the AML Law. The Law on Gambling also recognizes two classes of "gaming houses" that can operate slot machines, electronic roulette, and other unstaffed games and are not subject to the provisions of the AML Law. 1500 of these establishments operate two or more games and some—which can also call themselves casinos—can be quite extensive. There are also 18,500 establishments with one or two low-stakes machines. In 2004, the net gaming income of the six casinos was HUF 10.1 billion (US$46 million), while that of all 20,000 gaming houses was HUF 70 billion (US$318 million). All payouts from both casinos and gaming houses are exclusively in cash and the majority of the nonstaffed games also use coins or banknotes, reducing the practice of exchanging money for tokens in gaming houses.

47. *Dealers in precious metals and stones*: There are 3,000 registered enterprises involved in the jewelry business, of which some 600 are retail shops and 90 wholesalers. The three biggest retail chains operate about 90 of the shops. There are two professional organizations in the jewelry business: one unites the 30 largest (mainly retail/wholesale) and the other is compose of 200 smaller enterprises, including producers. According to the authorities, there is no diamond cutting or polishing industry in Hungary and very little importation of polished stones.

48. *Real-estate agents*: Real estate transactions in Hungary do not necessarily involve an agent, although a lawyer or notary must be involved at closing to ensure that the title is registered to the new owner. The Ministry of Justice (MoJ) is preparing a Resolution to strengthen the verification procedure by allowing lawyers and notaries to have access to the Ministry of Interior's register of identity documents. Real estate agents are licensed through the Ministry of the Interior, which certifies third party companies that conduct training and licensing for agents. Over 20,000 licenses have been issued, but it is estimated that only 4,000 people are currently operating. Of those, 480 are members of a professional association, which conducts enhanced training for its members and requires re-training every five years. Mortgages are playing an increasingly large role in Hungarian real-estate transactions, but it is estimated that roughly two-thirds of the 375,000 annual transactions are in cash.

49. *Lawyers and Notaries:* There are approximately 9000 lawyers in Hungary, who are organized into 20 regional (county-level) Chambers of Attorneys (Bar Associations). The regional structure is capped by a National Chamber. According to the National Chamber, approximately 65 percent of its members are solo practitioners, and approximately 5 percent of its members work in the 50 or so offices with more than 10 lawyers. The notary in Hungary, as in other European jurisdictions, plays the role of a court official empowered to certify the validity of key documents, including contractual ones. There are 304 notaries in Hungary, organized into 5 regional chambers.

50. *Accountants, auditors, tax advisors:* There are approximately 40,000 registered accountants in Hungary, under 1,000 of whom are members of the Hungarian Association of Accountants. An equal or larger number of individuals practice the accounting profession in Hungary, but are not registered with the Ministry of Finance and therefore

do not have the right to certify annual company reports. There are 5,900 auditors, who are members of the Chamber of Auditors. All financial institutions, publicly listed companies and other companies with an annual turnover of HUF 50 million or more are required to have their annual company reports audited.

51. *Tax consultants and tax advisors* (who do not fall into the FATF definition of DNFBPs) are covered by the AML Act independently, even though the majority of them are also accountants.

52. *Nonprofit organizations:* Over 49,000 nonprofit organizations have been registered in Hungary under existing legislation, but this number may include a great many currently inactive groups. NPOs can take a wide variety of organizational forms, but the most important for the purposes of this review are foundations. Act CLVI of 1997 established two categories of "public-benefit" NPO ("*kozhasznu szervezet"* hereafter PBO), which perform a broad range of social service and civic functions that could generally be conceived as outsourced state, local, or municipal government responsibilities. Regular PBOs and their donors are entitled to a measure of tax relief from the state but must report on their public-benefit activities, including annual financial reports. "Priority" PBOs ("*kiemelten kozhasznu szervezet")*, which perform functions that have been explicitly assigned to state agencies or local governments, have greater tax benefits**.** It is estimated that roughly 50 percent of NPOs register in one or another of these tax-privileged statuses. While it is theoretically possible for a private foundation to register as a PBO, authorities report that this status is more commonly held by public foundations. In addition to these categories of "pure" NPOs, the company registry law of 1997 recognizes a status of "public benefit corporation(*kozhasznu tarsashag)*," which can solicit funds from the public and can also register as a PBO. For donors to receive a tax deduction, they must be able to present a receipt that specifies that the money was spent by the PBO on one of the appropriate public-benefit functions.

53. In 2003, Hungarians NPOs reported income of HUF 731 billion (US$3.26 billion in 2003 dollars). The distinguishing characteristic is the high level of state-directed support to the sector. Forty-one percent of income (HUF 302 billion/US$1.35 billion) came from state payments or tax refunds. A further 28.8 percent (HUF 210 billion/US$940 million) from membership fees and income derived from their primary activities and 15 percent (HUF 110 billion/US$493 million) was derived from various secondary business activities. Donations—both foreign and domestic—accounted for only 13 percent of income (HUF 95 billion/US$424 million). In addition, Hungarian taxpayers can designate 1 percent of their income tax payments to be paid to a specific NPO. Such "1 percent" payments amounted to 0.9 percent of NPO revenues (HUF 6.6 billion/US$30 million). Of donations, HUF 30 billion (US$134 million) came from abroad, HUF 15 billion (US$67 million) from other NPOs, leaving HUF 37 billion (US$164 million) from Hungarian corporate and HUF 20 billion (US$89 million) from Hungarian individual donations (both direct and through directed income-tax donations). Summing up Hungarian-source donation and membership-fee based income gives a total of HUF 89 billion (US$400 million) raised from Hungarian private-sector sources, excluding various forms of business-related income.

54. There is no unified supervision of NPOs in the Hungarian system. All NPOs must register, like any other enterprise, either with their County or Metropolitan Court and in that process present—in addition to the basic information required of all legal persons (see above)—declarations about the nature of its nonprofit activities. Their annual reports, including revenues and expenses and utilization of budgetary subsidies, must be published and available to the public, but are not placed in any central registry. State budget money is allocated on a contractual basis, and the relevant laws and regulations on financial control ensure that those funds are spent on the contracted activities. Recipients of "1 percent" payments must further report on how they spent those funds and are responsible to the tax authorities in the place where they are registered for false reporting.

55. Prosecutors within the Civil/Administrative Division of each county prosecutors' office are responsible for ensuring that local NPOs are operating in conformity with their charters and with their declared public welfare functions. They receive notification of all new applications, and have 15 days to challenge a registration they find inappropriate. These prosecutors also conduct ongoing supervision of the NPOs through targeted on-site examinations. However, this supervision is conducted on the basis of the general provisions of the 1972 law on Prosecutors, which was enacted before NPOs were established in Hungary, and is far from comprehensive, reaching about 1,000 NPOs annually.

Overview of commercial laws and mechanisms governing legal persons and arrangements

56. The general rules concerning the setting up and the operation of companies are set forth in Act IV of 1959 on the Civil Code and Act CXLV of 1997 on the Register of Companies, Public Company Information and Court Registration Proceedings. Act CXLV provides for registration for 16 different types of entities (Article 13).
The main types of for profit companies are the Corporation Limited by Shares; Company with Limited liability; Joint Enterprise; General and Limited Partnerships.

57. Nonprofit companies may be established for serving public purposes and interests as limited liability company with legal entity, associations and foundations. Foundations may be formed for any long-term public interest, charitable, or religious purpose by charter of foundation, executed by founder(s).

58. Any legal entity, if required by the law, may be registered under the conditions prescribed by Act CXLV in the Company Register. The Company Registers are held and maintained by Company Courts which are organized within County Courts and by a Metropolitan Court.

59. Registration is not only of declarative, but also of constitutive nature i.e., the company comes into being not by the simple deed of foundations, but by the decision of Court ordering its incorporation.

60. According to Act CXLV 'Company' means an economic organization [Paragraph (c) of Section 685 of the Civil Code], or other economic entity which, unless otherwise provided for by law or government decree, is brought into existence when entered into the Register of Companies for the purpose of engaging in some business or trade operations.

61. Since 1994, Hungary has offered offshore corporate services, i.e., registered international business companies owned by foreigners and conducting business activities outside the jurisdiction of Hungary could apply for a supplemental offshore registration, with attendant tax privileges. The possibility to register as an offshore company has been terminated by December 21, 2002. Six hundred eighty offshore companies submitted a tax declaration in 2003. They cannot carry out service activities in Hungary and financing outside the group is prohibited. All offshore companies will have to cease operations by the end of 2005.

Overview of strategy to prevent money laundering and terrorist financing

a. AML/CFT Strategies and Priorities

62. Though there is no policy paper or official program in existence regarding AML/CFT strategies and priorities, the Anti-money Laundering Interministerial Committee regularly discusses and oversees the effectiveness of the current regime. The general approach to AML/CFT is driven by progress on the development of the Third EU Directive, a process in which the Hungarian Authorities are taking an active part as an EU member state. The authorities indicated on several occasions that they would prefer to wait until the Third Directive enters into force before making any changes to the current regime, in order to avoid confusion and waste of staff resources.

63. Within this approach, certain substantive areas are seen as priorities, and some work is being done even in advance of the finalization of the Third Directive. For example, the authorities have already begun a review of the current legal and institutional framework in light of the current draft of the Directive to prepare for the changes that would be necessary to come into compliance.

64. The authorities are already focusing on strengthening the supervision of DNFBPs to improve compliance with the requirements under the AML Act. The MoF plans to organize special training sessions for DNFBP without state or professional supervision (i.e., accountants, real estate agents and dealers/traders in precious stones, articles and jewelry) in order to encourage their compliance with the AML Act. The FIU, which is responsible for supervision of this latter group also indicated that education, awareness raising, and outreach were essential priorities.

65. Another priority is improving the effective implementation of the investigation phase of criminal procedures concerning money laundering and terrorist financing. A Coordination Center for organized crime has been set up, and the exchange of data with the FIU allowed by Cabinet decision. The judicial authorities on their part recognize the need to build up practical experience and to bring more cases before the courts in order to

develop jurisprudence. Different training programs have been organized for magistrates, as well as for police officers, in order to create specialized knowledge, which now should be turned into operational use.

66. The enhancement of the FIU's technical capacity and the FIU's international cooperation are also regarded as important. Specialized software has been developed and is still under further improvement. It is intended to be able to receive and process the STRs in electronic format. The full implementation of the FIU-net is envisaged, but some technical issues need to be solved.

67. During the discussions with the assessment team, the authorities agreed that developing an effective regime for CFT, including the legislative framework for freezing assets of terrorists that are not included in the lists of the United Nations Security Council (UNSC) and the EU, is an issue with high priority.

b. The institutional framework for combating money laundering and terrorist financing

68. The MoF has the main responsibility for the regulatory framework concerning the fight against ML. The Ministry of Foreign Affairs (MoFA) is responsible for monitoring compliance with the counter terrorism resolutions and regulations and for coordinating the implementation of sanctions imposed by the EU and the UNSC. The FIU, which has been placed within the NPHQ, is responsible for the receipt, preliminary analysis, and coordination of the investigations regarding the STs of ML reported by the SPs. The FIU also supervises those DNFBPs that have neither a State nor professional supervisor, such as accountants and tax advisors, real estate agents, and dealers in precious stones and metals.

69. Other AML supervisory authorities are the HSFA for the financial sector; the Hungarian Gaming Board (HGB) for casinos; the Chamber of Attorneys (Bar Association) for lawyers, the Chamber of Notaries for Notaries, and the Chamber of Auditors for Auditors.

70. The investigation of ML falls within the competence of the NPHQ. However, if ML is committed by persons having legal immunity based on public legal status (MP's, judges of the Constitutional Court, ombudsmen, president and the deputies of the State Audit Office, judges, prosecutors), or international legal status, or by a clerk or secretary or executive of the court or the prosecutor's office, an inspector at the prosecutor's office, an independent bailiff, a county court bailiff or their respective deputies, a notary public, or a sworn member of the police or the civil national security services, or the customs authorities, or financial investigator, the investigation falls within the competence of the Prosecutorial Office for Criminal Investigation.

71. The HCFG is vested with AML functions with regard to cross border transportation of currency and other financial instruments exceeding HUF 1 million (approximately EUR 4,000) that has to be declared upon entry/exit. Under the AML Act, the HCFG has identification, record keeping, and STR requirements.

72. In order to enhance the coordination among the different authorities involved in the fight against money laundering, the Anti-Money Laundering Interministerial Committee has been set up (by the Government Resolution No. 2298/2001. (X.19.) Korm.), with representatives of the following Institutions: MoJ, MoF, NBH, HFSA, HGB, MoI, NPHQ, MoFA, political undersecretary responsible for the civilian national security services. After its establishment, representatives of the General Prosecutor's Office (GPO), the National Judicial Council, the Tax and Financial Control Administration (APEH), the Government Control Office, the National Security Bureau, and the Banking Association have joined the Committee.

73. Regarding CFT issues, Government Resolution 2112/2004 adopted a National Action Plan against terrorism and set up an Interministerial Working Group Against Terrorism under the direction of the Minister of Interior to implement the EU policy in the fight against terrorism and other related international obligations. A new action plan for 2005 is expected to be adopted by the Government.

74. The competence to investigate FT lies with the Police and the Prosecution. The National Security Office—as it is defined in the Act on the National Security Services of the Republic of Hungary (Act No. CXXV of 1995)—has a general competence to detect and ward off any concealed endeavors threatening the economic and financial security of the Republic of Hungary. Furthermore, it also plays a role in the fight against terrorism.

c. Approach concerning risk

75. The AML Act 2003 covers all the financial sectors that are supervised by the HFSA, including money transfer and money exchange services. It also expanded the AML obligations to the DNFBP, i.e., lawyers, auditors, tax accountants and advisors, real estate agents, casino, dealers in precious metals and jewelry, following the Second EU Directive on Money Laundering.

76. The authorities do not allow service providers (either financial institutions or DNFBPs) to adopt a risk-based approach in relation to their CDD requirements under the AML legislation, except to the extent that the HUF 2 million (US$11,000) threshold for occasional transaction customer due diligence (CDD) represents an implicit risk-based prioritization. In addition, the AML Act allows for exemption of CDD for certain insurance transactions as well as the customers which are financial institutions under the supervision by the HFSA, financial institutions in non-EU countries which have the equivalent AML regime, as permitted by the FATF Recommendations. The authorities indicated to the assessment team that they need more experience in implementing the current AML regime under the AML Act 2003 before deciding how to address issues of risk.

77. The HFSA, which is responsible for the supervisory oversight for AML/CFT compliance by the financial sector, has adopted a risk-based approach for overall supervision. The HFSA reviews the effectiveness of AML/CFT internal control at financial institutions, taking into account the size and nature of the risks of individual institutions.

78. Supervision of the DNFBPs is not explicitly risk based. The FIU conducts on-site inspections of randomly-selected SPs without state or professional supervision. Prosecutorial inspections of NPOs are conducted according to a work-plan that is based on sectors where problems have been previously identified.

d. Progress since the last IMF/WB assessment or mutual evaluation

79. The last IMF assessment of the Hungarian AML/CFT system took place during the Financial Sector Assessment Program (FSAP) follow-up in late 2001. MONEYVAL conducted a Mutual Evaluation of Hungary in December 2001, which was published in December 2002. Both assessments preceded the revision of the FATF 40 Recommendations and were conducted according to methodologies then current. Neither addressed CFT issues.

80. The critical modifications of the international standards, assessment methodologies, and practices since those two efforts make direct comparison with this assessment difficult. However, three critical changes in the Hungarian situation should be noted. In June 2002, the Financial Action Task Force (FATF) removed Hungary from its list of Non-Cooperative Countries and Territories (NCCT), acknowledging the significant improvements in the AML regime. On February 23, 2003, the Hungarian Parliament adopted Act XV on the Preventing and Impeding of Money Laundering (AML Act 2003), which entered into force on June 16, 2003. In May 2004, Hungary became a member of the EU, which created an obligation to implement the provisions of the EU Second Money Laundering Directive and made EU regulations directly applicable in Hungary and has involved Hungary in the deliberations on future EU AML/CFT policy.

IV. DETAILED ASSESSMENT

Table 1: Detailed Assessment

Legal System and Related Institutional Measures

Criminalization of Money Laundering (R.1 & 2)
Description and analysis
Hungary has criminalized ML through article 303 (established by article 23 of Act IX of 1994 and then amended by article 60 of Act CXXI of 2001) and article 303/A (established by article 61 of Act CXXI of 2001) of the HCC. The scope of predicate offenses for ML in the HCC is a very extensive "all crime approach" that covers all criminal activities punishable by imprisonment. Therefore only those offences which are punishable exclusively by fines or non-custodial penalties would be excluded from the scope of ML. According to the statistics made available, during the last 4 years there were 7 prosecutions for ML which have lead to 2 convictions. The offense of ML applies also to persons who commit predicate offences; in the case of ML of proceeds obtained from criminal activities committed by others (art. 303/A) it is possible to proceed against the person if "negligently unaware of the true origin of the item". ML is defined by art. 303 as the case of "*Any person who uses items obtained by the commission of criminal activities punishable by imprisonment in his business activities and/or performs any financial or bank transaction in connection with the item in order to conceal its true origin.*" Art. 303/A refers to negligent ML committed by third parties and applies to the case of: "*Any person who uses an item obtained from criminal activities committed by others* *a) in his business activities, and/or* *b) performs any financial or bank transaction in connection with the item,* *and is negligently unaware of the true origin of the item*" The definition of ML in art. 303 and 303/A is not fully in accordance with the provisions of the Vienna and Palermo Conventions (respectively by article 3, section 1 *b*, i and ii and section 1 *c*, i and iv; by article 6, section 1 *a* and *b*). In fact articles 303 and 303/A limit the scope of ML offence only if the person "*uses items obtained by the commission of activities punishable by imprisonment in his business activities and/or performs any financial or bank transaction in connection with the item in order to conceal its true origin.*" The case of the transfer of the proceeds to a third party carried out through a non-banking or non-financial transaction would not be covered under 303 or 303/A, nor would the concealment or disguise of the true origin of the proceeds and the use of the proceeds throughout acts carried outside the business activity of the perpetrator. Art. 244 of the HCC – which provides for a misdemeanor punishable with imprisonment of up to one year in the case of a person who "cooperates in securing the advantage resulting from the crime (sec. 1, c) – would not cover these cases either nor could it be considered sufficient to meet the requirements set forth in the Vienna and Palermo conventions. In fact art. 244 is too restrictive on the one hand, as it only applies when no agreement had taken place between the perpetrator and the person who would cooperate and, too lenient on the other, as the punishment is only imprisonment up to one year. All authorities that were consulted believe that the term "items obtained by the commission of activities punishable by imprisonment" would cover all proceeds directly or indirectly obtained from crimes. Art. 303, sec. 5, specifically describes the term "item" as covering "instruments embodying rights to some financial means and dematerialized securities, that allow access to the value stored in such instrument in itself to the bearer, or to the holder of the securities account in respect of dematerialized securities". However, such a definition is not

explicitly mentioned in art. 303/A, in the case of money laundering of proceeds deriving from crimes committed by third parties. The authorities indicated that this was probably due to a material error in the drafting of art. 303/A (which has been inserted in the CC after the initial provision of art. 303) and that the definition of item contained in art. 303 can be applied also for the proceeds taken into consideration by art. 303A.

The authorities have informed the team that there is no need of a conviction for the predicate offence to prosecute for ML. In this respect, the reference in art. 303 and 303/A to "criminal activities punishable by imprisonment" would enable prosecution for ML even if the perpetrator of the predicate offence is actually not punishable for circumstances which would exclude his/her culpability, for example when the perpetrator passed away, or is found mentally unfit to stand trial. However, the prosecution will have to demonstrate that the proceeds are connected to a specific predicate offence.

According to the general practice of the Hungarian courts, the mens rea for any crime is as such that knowledge may be inferred from objective factual circumstances.

There is no provision specifically addressing the case where the predicate offence of ML is committed abroad. However according to art. 3 of the HCC Hungarian law is applicable to acts committed by Hungarian citizens abroad, which are crimes in accordance with Hungarian law while art. 4 of the HCC states that Hungarian law is also applicable to acts committed by non-Hungarian citizens abroad, if they are criminal acts in accordance with Hungarian law and are also punishable in accordance with the law of the place of perpetration. Therefore in both cases, it is possible to proceed for ML also if the predicate offence has been committed abroad, though in the case of non Hungarian citizens this is possible to the extent dual criminality exists for the predicate offence.

Art. 303 is considered as a felony and the perpetrator is punishable by imprisonment not to exceed five years. In serious circumstances the punishment is imprisonment between two to eight years. Art. 303/A (negligent ML of proceeds obtained from criminal activities committed by others) is considered as a misdemeanor and the perpetrator is punishable by imprisonment not to exceed two years, work in community service or a fine. In serious circumstances the punishment is imprisonment not exceeding three years.

Ancillary offences are provided under provisions in the General Part of the HCC Article 16 of the CC makes attempts punishable for all crimes, where a person commences the perpetration of an intentional crime but does not finish it. The general rule is that the punishment for the attempt is the same as for the committed offence, but in particular circumstances set forth in Article 17, sub sect. 2 and 3, the punishment may be mitigated or the defendant discharged.

Art. 303, 3 provides a misdemeanor punishable by imprisonment in the case of a person who collaborates in the commission of ML. Article 21 regarding accomplices supplements the current scheme of ML. Accomplices – either abettor, who intentionally persuades another person to commit a crime, or accessory, who intentionally grant assistance for the perpetration of a crime – are punishable with the same penalty established for the perpetrator of the crime. The accomplice's level of responsibility would be determined by the courts, depending on the level of involvement.

On December 11, 2001, the Hungarian Parliament adopted Act CIV of 2001 on Measures Applicable to Legal Persons under Criminal Law. The Act has entered into force on the date of accession to the EU, i.e. on the 1st of May 2004 and provides for the following criminal sanctions against legal persons: winding up the legal entity; limiting the activity of the legal entity, imposing of a fine. The conditions for the applicability of these measures are the commission of a criminal act as defined by the HCC, that was aimed at or that resulted in a gaining of a financial advantage for the legal entity, committed either by a manager or a supervisory board member of the legal person acting within the legal person's scope of activity or, in the same conditions, by one of its members or employees, if the perpetration of the criminal act could have been prevented by the legal person's management. The measures are also applicable in any case of financial gain obtained by the perpetration of a criminal act of which the management of the legal person was aware of.

The number of final convictions for ML (only 2) is extremely low. While this could be also related to the circumstance that only in 2003 self laundering was introduced as a crime; the limited scope of the ML offence and, especially the need to prove the predicate offence could be also among the reasons underlying these low

figures. These factors might negatively affect the efficiency of the system.

Recommendations and comments

- Enlarge the scope of the ML offence so that it covers all the circumstances set forth by the Vienna and Palermo Convention

- Harmonize art. 303 and 303A so that the same definition of "item" will be applicable to both provisions

Compliance with FATF Recommendations

R.1	Largely compliant	ML scope is not fully consistent with Vienna and Palermo Convention. Relatively low number of prosecutions and convictions.
R.2	Compliant	

Criminalization of terrorist financing (SR.II)

Description and analysis

Article 261 of the CC, as amended by article 15 of Act II of 2003, criminalizes both terrorist acts and the provision of material assets for the commission of these acts by a terrorist group.

Art. 261, subsections 1 and 2, provides for a felony punishable by imprisonment from ten years to fifteen years or life imprisonment the case of:

- any person who commits a crime with violence against a person, or a crime that endangers the public or involves the use of a firearm – as stipulated in subsection 9 *in order to*

- *a) force a government agency, another state or an international body into doing, not doing or enduring something,*

  b) intimidate the people,
  c) change or disturb the constitutional, economic or social order of another state, or to disturb the operation of an international organization,"

- any person who seizes considerable assets or property and makes demands to government agencies or non-governmental organizations in exchange for refraining from harming or injuring said assets and property or for returning them.

According to subsection 9, par. a of art. 261 «'crime with violence against a person, crime that endangers the public or crime that involves the use of a firearm' shall mean homicide [Subsections (1) and (2) of Section 166], battery [Subsections (1)-(5) of Section 170], willful malpractice [Subsection (3) of Section 171], violation of personal freedom (Section 175), kidnapping (Section 175/A), crime against the safety of traffic [Subsections (1) and (2) of Section 184], endangering railway, air or water traffic [Subsections (1) and (2) of Section 185], violence against public officials (Section 229), violence against persons performing public duties (Section 230), violence against a supporter of a public official (Section 231), violence against a person under international protection (Section 232), public endangerment [Subsections (1)-(3) of Section 259], interference with public utilities [Subsections (1) and (2) of Section 260], seizure of an aircraft, any means of railway, water or road transport or any means of freight transport (Section 262), criminal misuse of explosives or explosive devices (Section 263), criminal misuse of firearms or ammunition [Subsections (1)-(3) of Section 263/A], arms smuggling (Section 263/B), criminal misuse of radioactive materials [Subsections (1)-(3) of Section 264], criminal misuse of weapons prohibited by treaty [Subsections (1)-(3) of Section 264/C], crimes against computer systems and computer data (Section 300/C), vandalism (Section 324) and robbery (Section 321)».

The provision of material assets for the commission of the acts stipulated in subsections 1 and 2 of art. 261 is regulated by subsection 5 of art. 261, that provides for a felony, punishable by imprisonment from five years to fifteen years, in the case of «*any person who invites, offers for, undertakes its perpetration, or agrees on the joint commission of any of the offences defined under subsections (1) and (2) in a terrorist group, or any person who in order to facilitate the commission of it, provides any of the means necessary or helpful in such activities, or provides or raises funds to finance the activities, or support the terrorist group in any other form*».

Article 261 is not fully in accordance with the International Convention for the Suppression of the Financing of Terrorism in the case of the provision/collection of funds for the benefit of an individual terrorist.

In fact, subsection 5 of article 261 criminalizes only the provision or the collection of funds and any other means necessary or helpful to support the activities of a terrorist group, excluding the financing or any other assistance provided to individual terrorists.

Considering that, according to subsection 9, par. *b*, the 'terrorist group' is defined as a «*group consisting of three or more persons operating in accord for an extended period of time, whose aim is to commit the crimes defined in subsections (1) and (2)*», the raising/collection of funds and any other support directed to one or two people who intend to commit a terrorist act would not be punishable under subsection 5 of art. 261. Therefore the scope of the criminal conduct provided by art. 261, subsection 5 appears to be limited only to the financing of terrorist organizations.

There is no autonomous criminalization of the financing of individual terrorists except on the basis of "preparation" of a terrorist act or complicity in a terrorist act.

The authorities have indicated that the case of financing/supporting an individual terrorist can be covered and punished under the general principle of "preparation", provided by article 18 of the CC which states, in subsection 1, that «*if the law orders especially, that who provides for the perpetration of a crime the conditions required therefore or facilitating that, who invites, offers for, undertakes its perpetration, or agrees on joint perpetration, shall be punishable for preparation*».
Subsection 4 of art. 261 states, accordingly, that «*Any person engaged in preparation for any of the offences defined under subsections (1) and (2) is guilty of a felony and shall be punished by five to ten years' imprisonment*».

No judicial case corroborating this interpretation has been brought to the attention of the Team.

The authorities also informed the Team that the provision/collection of funds for one or two individual terrorists would only be punishable as preparation if the terrorist act does not take place. This is because the principle of "preparation" only applies to a preparatory act, which cannot considered neither as an attempt (as the criminal conduct hasn't started yet) nor yet as an accomplished crime. But if funds are collected/raised for an individual terrorist and the terrorist act does take place those who provided/raised the funds can only be punished as accomplices.

Criminalization of FT should not be on the solely basis of aiding and abetting, attempt or conspiracy, so in this regard, Hungarian legislation cannot be considered fully compliant. However, it should be noted that in the HCC the suggested penalty for accomplices is the same as the one established for the perpetrators, according to the principles of article 21. Therefore, this gap in the legislation would not appear to have a practical impact from the standpoint of applicable penalties, since the perpetrator - the individual terrorist - and the accomplice - the person(s) who provided/raised the funds for the terrorist act carried out by the individual could both be subject to the same punishment.

Given the "all crimes approach" of the HCC in criminalizing ML the conduct constituting FT as defined by art. 261 constitutes a predicate offence for ML. Attempt is covered by the general provision contained in art. 16 of the HCC.

Recommendations and comments
The financing of terrorist acts which are not committed or intended to be committed by a terrorist group should be criminalized

Compliance with FATF Recommendations		
SR.II	Partially compliant	There is no autonomous criminalization for FT of individual terrorists.

Confiscation, freezing and seizing of proceeds of crime (R.3)

Description and analysis

I. The pre-investigative stage

If a financial service provider defined in Section 1 of Act XV of 2003 on the prevention of money laundering has any suspicion of money laundering, it may suspend the execution of the suspicious transactions and immediately notify the FIU-NPHQ. The transaction can be completed if the FIU does not notify the service provider in writing within 24 hours concerning its actions taken in accordance with the Criminal procedure code.

This system means that an administrative system of freezing is essentially only in effect for the 24 hours the service provider can suspend the execution of a transaction. Moreover, the "administrative" element of the system takes place at the initiative of the private sector service provider. The authorities—in the person of the FIU—have 24 hours to respond to this initiative. However, if it does, it will not act as an FIU anymore, but as an investigating authority using its police powers under the Criminal procedure code, which automatically implies that a criminal investigation must be started. If it does not, the "administrative" freeze is lifted.

II. The investigative stage

The rules relating to the provisional measures on freezing and seizing assets are contained in the Criminal Procedure Code (Act XXIX of 1998 on criminal proceedings). These rules apply to the stage where a criminal investigation has been launched (cf. description of the procedure under R. 27 e.a.).

1. The seizure

Seizure (Sections 151 – 158 HCPC) shall be ordered if the objects to be seized
- either constitute a means of evidence
- or may be subject to confiscation or forfeiture

The authorities competent to order seizure are the investigative authorities (basically the police) and the public prosecutor.

The objects subject to seizure are property, computer systems and media containing data recorded by such systems.

The use of the word "property", linked to the referral of confiscation and forfeiture, implies that all the objects subject to confiscation and forfeiture, as described in detail in the Criminal Code (cf. infra) can also be seized during the investigation. The notion of property therefore is very general, and can include objects that have replaced the original objects of the crime, like the proceeds of investments made after the original illicit money already has been laundered. This broad interpretation of the possibilities of seizure has been confirmed during the discussions with the General Prosecutor's Office.

The actual execution of the seizure may be performed by the police.

The seizure in Hungarian criminal investigation implies physically taking the property and consequently, depriving the owner of his right of disposal, That property shall be deposited unless other safe-keeping arrangements can be justified. Accordingly, the authorities would appear to be able, for example, to deposit large amounts of money in a bank account, or securities or shares in a financial institution, in order to ensure their proper management, avoid damage to the owner or third parties, and/or ensure the greatest possible effect of confiscation or forfeiture for the government.

The investigative authorities, the prosecutor or the court can end seizure for the purpose of investigation if there is no longer any interest in the objects for evidentiary purposes. Seizure shall automatically end when the criminal investigation ends or when the period of investigation has expired. The prosecutor is even entitled to end a court-ordered seizure prior to filing an indictment. This rule is one of the mechanisms in place to protect the defendants or third parties.

Upon terminating the seizure, the property shall be returned to the appropriate private person (owner/custodian, defendant, other claimant, depending on the circumstances). If no appropriate private party can be identified, a

court can transfer the seized property to the state, although claims may still be made later.

According to Section 157 HCPC property normally to be returned to the defendant may be retained to ensure coverage for a fine, forfeiture of property or costs of criminal proceedings.

The criminal code also covers the effective execution of the seizure, providing forced measures and penalties (Sections 158.3 and 161 HCPC).

2. Custody

In order to prevent the property from disappearing, the police or the prosecutor, in cases where these authorities are not entitled to seize, can take property into custody if immediate action is required (Section 151.6). The seizing order must hereafter be obtained as soon as possible.

3. Sequestration

Where physical dispossession is not possible like the freezing of bank accounts or blocking the transfer of property rights on real estate, a defendant's property may be sequestered (Section 159 HCPC) (as far as real estate itself is concerned, Section 159.6 provides explicitly that the seizure of a real estate shall be executed according to the rules of sequestration). Such measure implies the suspension of the right of disposal over the sequestered objects. However, in order to sequestrate, a court order is necessary as this measure is considered to be more intrusive than seizure. This sequestration can be seen as a freezing measure.

Interestingly, Section 159 (2) HCPC allows for sequestration not only of a part of the property or assets of the defendant, but even his entire property in order to cover the possible forfeiture, if reasonable grounds exist to suspect that the execution of forfeiture order would be frustrated. Although the text of Section 159 does not mention the entire "assets" of the defendant, this seems to be included in the general notion of "property". Sequestration may be ordered if the property or asset is not in the possession of the defendant.

As in the case of seizure, mechanisms have been put in place to protect ownership rights. These include ending the sequestration if the cause for it has ceased to exist, if the investigation has been ended, the time limitation has expended, or if the proceedings have been concluded without a decision granting forfeiture.

4. Precautionary measures

Parallel to the custodian measures applicable to seizure, precautionary measures can be taken in order to effectively guarantee the sequestration order (Section 160 HCPC).

The precautionary measures aim to prevent the defendant or any other party from exercising a right of disposal over movable or real property, securities representing property rights, funds managed by a financial institution under a contract or due share or ownership interest in a business organization. Precautionary measures are applicable if probable cause exists to justify sequestration and the defendant, or any of the party, attempts or can reasonably be believed to attempt to conceal the property specified above, or to transfer, alienate, or encumber the rights of disposal thereover.

Logically, as a precautionary measure requires a swift action, competence is given to the investigative authorities and the prosecutor;

Following the precautionary measure, a sequestration order shall be filed.

5. Confiscation

The confiscation mechanism is described in Section 77 of the HCC. Confiscation is mandatory for:

- actually used or intended to be used as an instrument for the commission of a criminal act
- the possession of which is dangerous or illegal

- which are created by way of a criminal act
- for which the criminal act was committed

In the first and last cases mentioned above, the confiscation can not be ordered if the object is not owned by the perpetrator, unless the owner was aware of the perpetration of the criminal act, or unless confiscation is prescribed mandatory by international convention.

Confiscation shall not be ordered if it is included in a forfeiture of assets.

Confiscated assets become state property.

6. Forfeiture

Section 77/B of the HCPC allows for the forfeiture of goods.

It has to be remarked, however, that according to the discussions in the General Prosecutor's Office, "confiscation" and of "forfeiture" are actually the same word in Hungarian, so the difference seems to be mainly in the objects.

The following objects can be forfeited:

- any financial gain or advantage resulting from criminal activities obtained by the offender in the course of or in connection with a criminal act
- any financial gain or advantage obtained by an offender in connection with crimes committed in affiliation with organized crime
- any financial gain or advantage that was used to replace the financial gain or advantage obtained by the offender in the course of or in connection with a criminal act
- any property that was supplied or intended to be used to finance the means used for the commission of a crime
- any property embodying the subject of financial gain

Any financial gain or advantage resulting from criminal activities, obtained by the offender in the course of or in connection with a criminal act, shall also be forfeited if it served the enrichment of another natural or legal person.

The provision that the property embodying the subject of financial gain can also be forfeited was introduced to clarify that the proceeds of an unlawful advantage should be subject to forfeit, i.e. in the case of active briber.

In the case of organized crime (any financial gain or advantage obtained by an offender in connection with crimes committed in affiliation with organized crime as defined in S. 137.8 HCC), all assets obtained by the perpetrator during his involvement in organized crime shall be subject to forfeiture until proven otherwise. The burden of proving that the property is legitimate falls on the defendant. The mechanism created here effectively introduces the reversal of the burden of proof for the first time in the Hungarian criminal procedure. The provision has not yet been used, and the Supreme Court stated it was a very new rule, the scope of which is not yet clear.

Section 77/B HCC also affords some protection to third parties operating in good faith. If property that would otherwise be subject to forfeiture is obtained in good faith and for a normal price, it cannot be forfeited. However, this does not exclude the forfeiture of a determined sum of money, related to the value of the property, vis-à-vis the defendant, instead of the forfeiture of the property itself which can remain in the hands of the third party.

A third party can only invoke its good faith if the transaction can be considered to be normal. If the prosecutor can prove that the property was not obtained in a bona fide manner and under normal economic circumstances, then the property can be forfeited.

Forfeiture of a determined sum is also possible in case the property is no longer accessible or if it cannot, or only with unreasonable difficulties, be distinguished from other assets.

Forfeited assets shall become property of the state.
The above mentioned notions of "assets" include any profits, intangible assets, claims of any monetary value and any financial gain or advantage.

7. Civil forfeiture / confiscation and forfeiture as measures

There is no system of civil forfeiture in the Hungarian criminal procedure.

8. Third party rights

Apart from the above mentioned protection, several mechanisms exist to protect the rights of bona fide third parties.

A specific position is afforded to the victim. As the victim is considered the party whose right or lawful interest has been violated or jeopardized by the criminal offence, it is entitled to file for legal remedy (Section 51 HCPC).

Complementing the rights of the victims, Section 55 HCPC states that anyone whose right or lawful interest may be directly affected by the decision made in the course of criminal proceedings may make objections. In proceedings involving a criminal offense subject to confiscation or forfeiture of property, other interested parties whose property may be confiscated or forfeited shall enjoy similar rights as do victims. In this case, if the court ordered confiscation or forfeiture of property, other interested parties may enforce their ownership claim by other legal means after the order has become final.

As a general rule, anyone affected by the decisions or measures taken by the police or the prosecutor may protest or object (Sections 195-196 HCPC).

9. Identification / tracing of assets

There are no specific orders to identify and trace assets. The normal provisions of the criminal procedure apply (cf. R. 27 e.a.), granting the competent authorities all necessary powers.

10. Forfeiture vs. contracts

A judgment ordering forfeiture will render a contract and the ensuing property rights void, as it is executable and takes priority on all contractually established rights. This applies as well to third parties not acting in good faith.

Recommendations and comments

- Consideration should be given to providing the FIU with statutory authorization to freeze assets and suspend transactions.
- Consideration should be given to creating a system of administrative freezing, granting the FIU / Police / Prosecutor a reasonable period of time to check the facts of the case in detail, without immediately having to open a criminal investigation.
- Much more consideration should be given to the taking away of the proceeds of crime. The number and amounts of seizures and confiscations should increase noticeably having regard to the high number of prosecutions for economic crime. Operational practice should more consistently and systematically link seizure/confiscation with investigations.

Compliance with FATF Recommendations

R.3	Largely Compliant	Very limited number and amount of seizures and confiscations

Freezing of funds used for terrorist financing (SR.III)

Description and analysis

The rules mentioned under Recommendation 3 equally apply to terrorist financing.

In case of such offences (Sections 18-21 and 261 HCC), the normal provisions of the criminal procedure are applicable (i.e. cash money or other financial valuables in physical form can be seized and bank accounts or property rights can be sequestered, if necessary preceded by a precautionary measure).

In case financial means used for terrorist acts are directly related to the commission of the offence, they may be considered as an instrument used or intended to be used for the perpetration of the offence, in which case confiscation would be possible. This could be the case in relation to the offence of financing of terrorism.

In case the offence would be the terrorism offences as such, the financial means used to perpetrate that offence, can be forfeited, as Section 77/B allows for the forfeiture of any property used to finance the means used for the perpetration of the offence (e.g. to buy weapons or explosives).

Especially with regard to the UN resolutions and lists a distinction has to be made.

Resolution 1267 is implemented through the EU-lists, thereby providing the necessary mechanisms to freeze, as well as procedures to un-list or de-freeze (cf. infra).

Resolution 1373 requires that regulation for the freezing without delay of assets of persons committing or trying to commit terrorist offences be provided. There is no specific legislation in Hungarian law specifically implementing the Resolution. It has to be noted however that all the applicable EU provisions requiring immediate freezing are in force, thereby covering part of the problem. As far as the criminal investigation is concerned, the necessary procedures are also in place. However, the Resolution requires freezing "without delay." The freezing possibility provided by Section 9 of the Act on prevention of ML does not seem applicable to terrorist financing. As the freezing of accounts can be seen as a sequestration measure according to Section 159 HCPC, a court order is necessary, non withstanding precautionary measures (Section 160 HCPC). This procedure can be time-consuming.

Another potential weakness in the freezing regime concerns how the authorities become aware of the assets. Financial institutions are especially well placed to notice suspicious transactions, including those related to terrorism. However, there exists no general obligation to file STR's in case of suspicion of terrorist financing operations. The specific obligation - based on Section 261 HCC – that requires reporting upon "reliable information" and not upon a mere suspicion, may be too high a threshold.

The Hungarian authorities consistently maintained, in their AML policy plan, the 2005 Questionnaire and during discussions with the team, that the freezing of terrorist assets does not require special powers, In our opinion, this point of view is not backed up by the legislative texts. The preamble of the Act on prevention of money laundering ("The objective of this Act….to potential money laundering operations as well as to help combat the flow of funds financing terrorism"), which the authorities repeatedly cited during the discussions with the team, is not sufficient legal ground to freeze assets in terrorist financing cases. The authorities were not able to maintain a freeze in the one court case related to terrorist financing that was referred to by the authorities. According to some interlocutors, the court specifically rejected this legal ground for freezing and according to others, the funds were released for lack of evidence. The text of the judgment was requested but not yet received. The Bar Association also expressed the opinion that the duty to report suspicion of terrorist financing would have to be based on Section 261 HCC (thereby requiring "reliable information"), and not on the AML prevention act. The same opinion is expressed in the Model rules for financial service providers.

Thus, the legal basis for quick action on freezing assets related to terrorist financing is weak, which risks leaving a gap in the structures needed to combat terrorist financing. Measures should be envisaged to close this gap.

As far as the protection of third parties is concerned, the provisions explained under Recommendation 3 apply during the criminal investigation stage.

For the measures ordered on the basis of EU-provisions, Government Decree 306/2004 allows granting exemptions at the request of the person concerned or ex officio. The National Police Headquarters is the deciding authority in first instance, with appeals going to the Ministry of Interior.

Recommendations and comments

- Create legal authority for freezing possibilities for the financial institutions upon suspicion of terrorist financing
- Provide the FIU / Police / Prosecutor with an autonomous competence to freeze in cases of suspicious transactions possibly linked to FT
- Provide a sufficient period of freezing in order to do serious checks before having to start criminal investigations
- Provide clear procedures for de-listing and un-freezing also for the UNSCR

Compliance with FATF Recommendations

SR.III	Partially compliant	No generally applicable immediate action for freezing is possible under Hungarian law

The Financial Intelligence Unit and its functions (R.26, 30 & 32)

Description and analysis

The AML law designates the NPHQ as the competent institution to receive reports of "*any data, facts or circumstances indicating ML*" (article 2, sect. 1 par. d), pursuant to Act XXIV of 1994 that had placed the FIU functions of receiving, analyzing and disseminating the STRs received by the SPs within the NPHQ.

The NPHQ as an FIU has been a member of the Egmont Group since 1998.

Following a reorganization of the NPHQ of July 2004 the FIU is currently placed in the ML Department, within the Economic Crime Division of the National Bureau of Investigations. Its functions are set forth in the "Internal Regulation no. 17 of June 1st of the Chief Commissioner on the Police Measures Related to the Prevention and Impeding of Money Laundering" and "Internal Regulation no. 5 of June 16th 2004 of the General Director for Criminal Investigation of the National Police".

According to these rules the FIU is solely responsible for AML issues and not for CFT. The authorities indicated that CFT issues would be dealt by the Counter Terrorism and Extremism Department, within another Division of the National Bureau of Investigation. However, there appears to be no legal provision in the Hungarian legislative framework requiring SPs to report transactions suspected to be aimed at FT. The matter will be discussed in more detail with respect to SR IV.

The ML Department is formed of 3 units: one is in charge of receiving the STRs and conducting searching/screening tasks on the reports received; another unit is in charge of open and secret investigations and a third has been recently established to carry out the supervisory functions assigned by the AML act over the SPs that have no State or professional supervision..

The FIU carries out its activities with sufficient operational independence and conducts specialized activities in relationship with other Police units: it receives (on hard copy) the STRs related to ML from the SPs, processes the requests of suspension of transactions in the circumstances set forth in article 9 ("*where there is any suspicion of money laundering and if prompt action by the police is deemed appropriate to examine certain corresponding information, data or circumstance*") and conducts an analysis of the STRs received carrying out "screening-searching activities". Such activities include searching the criminal record database and other databases (such as the Companies Register, querying , for example, about management and members of companies, scope of activity, balance sheets); requesting additional information from the service provider that has filed the report and (since 2005, as the authorities have indicated) also from any other service provider subject to the AML law; requests to other public institutions (among others Tax and Financial Audit Authorities, Customs and Finance Guard and the Internal Security Services); requesting checks to be carried out by the regional and local branch of the Police and requesting information to foreign counterparts.
If further fact-finding is deemed necessary, the FIU may request "secret information gathering" to be carried out by the territorial competent Police branch.

In the cases where suspicion of ML is confirmed by preliminary screening and by covert information gathering an open investigation/criminal procedure will be started according to the CPC provisions.

In the case of ML conducted by third parties that took no part in the predicate offence the competence for investigation is with the ML Department, while in the case of self laundering the competence is of the department investigating over the predicate offence.

However, according to the "Internal Regulation no. 5 of June 16th 2004 of the General Director for Criminal Investigation of the National Police" the ML Department has the responsibility to coordinate all secret information gathering activities and the criminal proceedings initiated.

In compliance with article 10, section 2 of AML law, the FIU may use information received from SPs solely for purposes of the fight against money laundering. The data obtained under AML law cannot therefore be used during the detection and investigation of other criminal acts, said data shall be obtained according to the appropriate rules of procedure and authority.

The information held by the FIU is stored in a secure computerized database accessible only to FIU staff.

Besides the typical FIU core functions, the AML department is also responsible for AML/CFT supervision over SPs without State or professional supervision, such as real estate agents or brokers; accountants and tax advisors and dealers of precious metals, precious stones, articles, ornaments and jewelry made of precious metals and/or stones; dealers of cultural assets and works of art, as well as any person selling the abovementioned items at auctions or on consignment . The FIU must approve internal regulations adopted by the SPs pursuant to the AML law – a task which has proved to be very time-consuming, given the number of such service providers and the human resources available – and carries out on-site inspections to check whether such SPs operate in compliance with the requirements regarding identification, reporting, record keeping and training of employees. As of February 2005 the AML Department carried out 254 inspections (148 in Budapest and 106 in other regions), and found 21 cases of violation of AML requirements.

Since the 1st of January 2005 the NPHQ have also the responsibility to approve any request of conversion of the remaining anonymous account into personal ones.

According to article 11 the agencies exercising state and professional supervision over SPs should provide - in cooperation with the NPHQ and in agreement with the Ministry of Finance - guidelines and models to the SPs for drawing up internal Regulations that, among others, would contain guidelines to detect ST of ML, rules for handling and protecting data obtained through the identification procedures and the procedures for reporting STRs.

According to the authorities, the number of staff assigned to the AML Department has constantly been increased. After the re-organization of the 1st of July 2004 the ML Department has now 42 posts (19 sworn officers, 16 civil servants, 7 public employees), of which 36 have been filled.

Staff has a high decree of educational study background (18 out of 19 officers have degrees) mainly related to the policing, legal and economic professional fields. The AML Department is planning to acquire professional expertise also in other domains. Staff participated to various training initiatives, including abroad, and the FIU has benefited of an institutional building and training project financed by the EC.

The Department is conveniently housed and IT equipment and workstations widely available for staff.

According to the questionnaire "*the IT infrastructure of the FIU is at present unable to sort reports and provide data on them to tell which of the reports relate to foreign or domestic transactions, to electronic or manual transactions, to tell which transactions were cross-border or domestic transactions. Also, the system cannot query the total money value of the transactions reported, or the money value of transactions sorted according to various criteria*".

However the mission has been informed by the authorities that in 2005 an enhanced software programme will be installed in the ML Department that will allow the FIU to receive STRs in an electronic format and will make possible to establish various links and interconnections and to prepare various statistics.

While the FIU doesn't publicly release periodic reports, statistics on STRs are produced.

Statistics

The authorities have stated that during 2004, the FIU has received and processed 14120 STRs. The figures related to STRs received from 2001 to 2004 can be broken into the following:

	2001	2002	2003	2004
Financial institutions	1512	5032	10764	12170
Cooperative (savings) banks	48	876	905	1167
Accountants	-	2	7	174
Notaries	1	0	51	35
Casinos	0	1	1	-
Bureaux des changes	13	169	369	456
Insurance companies	2	53	41	83
Securities companies	n.a.	28	66	86
Post		7	15	3
Individuals	-	5	13	-
Brand dealers	42	36	86	-
Tax consultants	-	2	1	1
Auditors	-	2	5	1
Pawnbrokers	-	-	4	17
State Treasury	-	4	3	13
Customs and Finance Guards	5	3	6	-
HFSA	1	4	5	-
Others	4	75	88	-
Total:	1628	6271	12364	14120

Note: FIU received 1186 identification forms + 18 other requests from the Customs and Finance Guard above STRs in 2004.

According to the information provided in the questionnaire the typical money laundering typologies would consist of transferring money to companies in return for false invoices drawn for fictitious services; depositing large amounts of cash in banks declaring that money is coming from currency exchange activities, then drawing them out in a different currency; depositing small amounts of cash which are not falling under the rules of reporting.

Regarding the exchange of information with foreign FIUs, this is permitted directly by art.8/A of the AML law;. The FIU indicated that they have a limited number of Memorandum of Understanding in place, since the law directly allows the exchange of information. The statistics indicated by the authorities show a constant increase of request of legal assistance from/to the FIU and its foreign counterparts (requests made by the FIU: in 2001 2, 103 in 2004; requests received by foreign counterparts: 23 in 2001: 76 in 2004).

Recommendations and comments

- Placing responsibility for CFT matters with the FIU; establishing a clear obligation to report to FIU STRs related to FT.

Consideration should be given to:

- Given the Police nature of the FIU and number of staff, placing the supervisory function over DNFBPS outside the FIU;
- The FIU continuing to upgrade its software;
- The analysis of STRs by the FIU identifying as much as possible underlying predicate offences; and
- Having the statistics of STRs compiled by the FIU provided in greater detail and containing references to predicate offence where possible.

Compliance with FATF Recommendations		
R.26	Largely Compliant[14]	CFT is not covered by the FIU; no legal obligation to report to FIU STRs related to FT
R.30	Compliant	
R.32	Compliant	

Law enforcement, prosecution and other competent authorities–the framework for the investigation and prosecution of offences, and for confiscation and freezing (R.27, 28, 30 & 32)

Description and analysis

1. Procedural issues

I. <u>The pre-investigative stage</u>

The police exercise the general powers of an investigating authority (Section 1 Act XXXIV of 1994 on the Police).

The police have the normal powers to stop and question persons and search them and their belongings to ensure public order and prevent and detect offences (Sections 29 and following).

The police can request information from the tax authorities if necessary for starting a criminal investigation with the permission of the prosecutor (Section 79 HCPC).

Before starting a criminal investigation, the police may conduct a covert intelligence gathering operation for the purposes of preventing, investigating or stopping a criminal act, to locate and capture offenders, to obtain evidence or to protect persons participating in the criminal proceedings (Sections 63 and following). The measures can be taken against natural persons, but also against legal entities, and shall not be disclosed to them.

In relation to this covert intelligence gathering, a distinction has to be made.

Some operations are not subject to a court order. As such, the police may, for example, employ informants, establish maintain cover organizations ("front stores"), observe persons, premises, etc. and use undercover-agents to make purchases or infiltrate in a criminal organization (this however being subjected to the permission of the prosecutor)

[14] See also the discussion and compliance rating in respect of SR IV below.

Other operations aimed at attaining the criminal investigation objective are subject to court order, in case of serious criminal acts: secret search of a private home, observation in a private home using technical devices, access to mail, telecommunications, e-mail and computers.

The police may also make an agreement with an offender, terminating an investigation if information is offered that is considered more important. The prosecutor however may overrule this decision on the basis of his general competencies, as confirmed by the General Prosecutor's Office.

Subject to the authorization of the prosecutor, the police can request information from the tax authority, telecommunications service providers and institutions handling data qualified as bank, securities, treasurer's or business secrets, relating to an offence punishable with at least two years. As an emergency measure, the data can be requested without the prosecutor's permission if any delay would cause serious harm and the case is connected with drug trafficking, terrorism, money laundering or organized crime. The prosecutor's permission shall be asked while filing the request to the provider (Section 68).

II. The criminal investigation

1. General rules of criminal investigation and procedure

a) General principles

Criminal proceedings begin with an investigation, the aim of which is to conduct an inquiry into the offence, identify the offender and locate and secure the means of evidence (Section 164 HCPC). Such proceedings may only be initiated upon suspicion of a criminal offence and only against the person reasonably suspected of having committed a criminal offence (Section 6 HCPC). Immediate investigative action needed to ensure the means of evidence, prevent the suspect from fleeing or for other high priority-reasons is possible (Section 170 HCPC).

b) The investigation

An investigation may be launched by the investigative authority, which is typically the police. In addition, investigations may be launched by the Customs and Finance Guards, which have certain competences for example in cases of smuggling, tax fraud or other types of fraud if involving taxes or subsidies falling within the customs and excises scope (Section 36.2 HCPC).

The police will conduct the investigation or perform certain investigative acts independently if the offence was detected by its services, if a complaint was filed to it, or if the offence came to its knowledge in any other way (Section 35 HCPC). When conducting an investigation independently, the prosecutor shall supervise compliance with the provisions of the criminal procedure and the investigation shall be conducted according to the orders of the prosecutor. He may amend or repeal the decision of the police, can order the police to terminate the investigation or terminate the investigation himself and he may take over the investigation himself.

The prosecutor can also order an investigation and assign the investigative authority that is to carry out the proceedings.

Finally, the prosecutor can also conduct his own investigation, but even in this case he may instruct any investigative authority to carry out investigative acts. He also has his own special prosecutorial investigative units to assist him.

c) Decision on the investigation

The prosecutor may dispense with further investigation. He, and in certain cases the police, can also suspend the investigation if for example the identity of the suspect can not be established, if decisions on preliminary issues must be obtained, if foreign legal assistance is required (Sections 187-188 HCPC). The prosecutor can terminate the investigation i.a. if there is no criminal offence established or if insufficient charges exist towards the suspect (Sections 190-191 HCPC).

Upon the existence of sufficient grounds to prosecute, the prosecutor can decide to file an indictment (Sections 216 and following HCPC).

d) Complaints

Anyone may file a complaint concerning a criminal offence. If it is obligatory to do so, failure constitutes a criminal offence (cf. f. ex. Section 261.5 HCC). Members of the authority and official persons shall be obliged to file a complaint relating to a criminal offence coming to their knowledge within their competence. The complaint shall be made to the police or the prosecutor (Sections 171-172 HCPC)

2. Evidence

Evidence is defined as the facts which are relevant to the application of criminal law and procedure. The objective of gathering evidence shall be the thorough and complete elucidation of the true facts (Section 75 HCPC)

As means of evidence, Section 76 HCPC considers the testimony of witnesses, the expert opinion, physical evidence, documents and the pleadings of the defendant. Documents and physical evidence produced or obtained by the authorities may be utilized in the criminal proceedings. Physical evidence can be all things suitable for proving the facts, including documents. The notion of documents includes all evidence prepared and suitable for proving that a fact or data is true (Sections 115-116 HCPC).

Evidence shall be traced, gathered, secured and used in compliance with the criminal procedure provisions. In the course of criminal proceedings, all means of evidence specified by law and all evidentiary procedures may be used without restriction, if legally obtained. The prosecutor and the court shall freely weigh each piece of evidence separately and collectively and establish the conclusion of evidence based on their belief thus formed (Sections 76-78 HCPC).

3. Documents

According to Act XV of 2003 on the prevention and combating of money laundering, service providers must retain data and documents related to their obligations under this act for ten years (Section 10).

The Act C of 2000 on accounting requires the retention of annual reports and registers for minimum ten years. Accounting documents for (in)direct support of bookkeeping records must be kept for minimum eight years. These provisions also apply to non-profit organizations (Act CLVI of 1997 on non-profit organizations).

4. Data

After the beginning of a criminal investigation the police may collect data in order to establish the existence and location of means of evidence. It may use the law enforcement databases, request documents, data and information from any third party, request an investigation from the head of any government or public body, business organization or foundation, inspect the scene and employ advisors. It may also perform data collection (Section 178 HCPC).

The police, the prosecutor and the court may contact central and local government authorities and agencies, authorities and public organizations, as well as business organizations to request data or documents. Encrypted data must be restored in their original form. If the requested organization fails to comply in a timely manner, or unlawfully refuses to fulfill the request, a disciplinary penalty may be imposed. Forced measures may also be ordered in addition to the penalty (Section 71 HCPC)

5. Subpoenas

The police, the prosecutor and the court can serve subpoenas on persons whose presence is statutory for the procedural action, and on persons whose presence is not mandatory but permitted. The person summoned by subpoena is obliged to appear before the issuing authority. The person summoned may be requested to bring

documentation or evidence regarding the case (Section 67 HCPC)

6. Body search

A body search may be ordered by the police or the prosecutor if it is reasonably believed that the person is in possession of means of evidence or of property subject to confiscation or forfeiture, or in order to find such means or property.

7. Search warrants

Search warrants can be issued, in order to search houses, vehicles or computer systems or other computer media containing data. A search may be ordered when there is reasonable cause to believe that it will result in apprehending a person having committed an offence, uncover traces of an offence, finding means of evidence or locate property subject to confiscation and seizure. The search may be ordered by the prosecutor or the court, as well as by the police unless the prosecutor decides otherwise. Inasmuch as possible, the warrant shall indicate the means of evidence or the property subject to confiscation and seizure intended to be found during the search.

8. Search and inspections

The police, the prosecutor or the court may order a search for an object with an unknown location, if it may be seized by law, or if it as ordered to be seized or sequestrated (Section 73.7 HCPC).

If the facts to be proven require the examination of a person, an object or site, or the observation of an object or site, the prosecutor or the court may order such a measure (Section 119 HCPC).

9. Physical coercive measures and custody

If the attendance of a person before the investigating authority, the prosecutor or the court is necessary, these authorities can issue a bench warrant, restricting the personal freedom. The person concerned can be arrested and brought before the competent service (Section 162 HCPC)

As a coercive measure, a custody of maximum 72 hours may be ordered, upon reasonable suspicion that he has committed an offence subject to imprisonment, on condition that a probable cause exists to believe that a pre-trial detention will follow. The custody can be ordered by the investigating authority, the prosecutor or the court. If the custody is ordered by the police however, it has to notify the prosecutor within twenty-four hours. The custody can be prolonged by a pre-trial detention, ordered by the court. (Sections 126, 127 and 131 HCPC).

10. Witnesses

Unless an exemption is provided, anyone summoned as a witness shall be obliged to give testimony (Section 79 HCPC). Exemptions include the self-incrimination or secrecy obligations if no authorization has been given, and if no other legal provision allows or obliges to give information despite a secrecy rule (Sections 8-82 HCPC). However, Section 82.4 specifically stipulates that no one may refuse to testify as a witness against whom the investigation or the criminal proceedings were terminated by the court on the basis of Section 332.1.e HCPC, if their response would be self-incriminating in respect of criminal offences which ceased to be indictable for reasons stipulated in, i.a., Section 303.4 HCC. Witnesses illegitimately refusing to testify or co-operate despite being warned of the consequences, are subject to a disciplinary penalty (Section 93 HCPC).

Special measures for the protection of witnesses are also put in place. If the witness is in a condition directly jeopardizing his life, he may be heard at the court before the trial has started (Section 87 HCPC)

In order to protect the physical integrity of the witness different forms of protection can be provided (cf. Sections 95-98/A HCPC).

11. Special investigative techniques

The prosecutor and the police are entitled to conduct covert data gathering operations, in order to establish the identity and locate the suspect and to find evidence. This covert data gathering is not to be confused with the covert intelligence gathering conducted in the pre-investigative stage (cf. supra). Covert data gathering is subject to the use of other means that would reasonably appear unlikely to succeed or would involve unreasonable difficulties (Section 202 HCPC).

The covert data gathering is allowed upon suspicion of an offence, i.a.

which has been committed intentionally and punishable by five years or more
is related to trans-boundary crime
has been committed in an repeated or organized manner
is related to narcotics
is related to counterfeiting of money or securities

If the investigation is conducted by the prosecutor covert data gathering is not limited to the above mentioned list of offences (Sections 200-201 HCPC).

During the investigation the police may use covert investigators, this however being subject to permission of the prosecutor.

A judicial permit however has to be obtained, after a motion filed by the prosecutor to the court (Section 203 HCPC) to keep a home under surveillance, to learn contents of letters, mail or communications and to learn data transmitted or stored in a computer system.

The gathering can take place for ninety days, but can be extended for a further ninety days (Section 203 HCPC).

If obtaining a judicial permission would jeopardize the success of the operation, the prosecutor may issue an order authorizing covert data gathering for a period of seventy-two hours (Section 203 HCPC)

Organizations forwarding, processing and managing communications services, mail or computer data shall be obliged to provide the conditions and to co-operate (Section 204 HCPC)

The results of covert data gathering, or of covert intelligence gathering during the pre-investigative stage, may only be used in other criminal proceedings, if the conditions for the covert data gathering also apply to the other proceedings and the purpose corresponds to the original objective of the gathering (Section 206 HCPC).

12. Disciplinary penalties

In specific cases, disciplinary penalties may be imposed, ranging from 1.000 to 200.000 HUF, or, in serious or repeated cases, up to 500.000 HUF. The decision falls in the competence of the prosecutor or the court. Such penalties can i.a. be imposed in relation to subpoenas, witnesses and seizure (Section 161 HCPC)

13. Secrecy provisions

If during the investigation it seems necessary to obtain information from the tax authorities, organizations providing communication services, as well as from organizations managing data classified as bank secret, securities secret, fund secret or business secret, the prosecutor or the police, with the consent of the prosecutor, may make such requests. The disclosure of data can not be refused (Section 178/A HCPC)

Different acts stipulate that the obligations to keep different business, bank, securities, tax or other secrets is not applicable in respect of investigating authorities, the prosecutor or the court acting within the scope of criminal procedures (f. ex. Act CXII of 1996 on credit institutions and financial enterprises, Act LX of 2003 on insurance institutions and the insurance business, Act CXI of 1996 on securities offerings, investment services and the stock exchange and Act XCII of 2003 on the rules of taxation). As far as the pre-investigative stage is concerned, different acts, like the mentioned Acts CXI and CXII of 1996, contain more restrictive provisions. The requests for information must only be answered if the offences relate to drug trafficking, terrorism, arms trafficking, money laundering and organized crime.

There is no offence of breach of business, bank or securities secrecy if the transmission of information is regulated by law or is prescribed in the Act on the prevention of money laundering (Sections 300/B and 300/DHCC)

2. Designated law enforcement authorities

1. The police and the Customs and Finance Guards

The central unit of the Police having national competence is the National Police Headquarters (NPHQ). The regional units are chief departments, subordinate to the NPHQ. The local units are departments subordinate to the chief departments (Section 3). The police has a nationwide strength of about 42.000.

Within the NPHQ there is a Criminal investigation department (C.I.D.) general directorate, comprising i.a. an intelligence division, a crime analysis department, the international law enforcement cooperation centre and the national bureau of investigation.

This National Bureau of Investigation in its turn comprises an organized crime division (with a criminal organizations department), an economic crime division (with an economic crime department and the money laundering department), a CID division (with a transnational crimes department and a counter-terrorism department) and a financial crime investigation division.

According to the authorities, the estimated personnel strength of the economic crimes division totals about 92, divided as follows: economic crimes department 38, anti-corruption department 20, money laundering department 43 (on paper, 36 in practice). The financial crimes division has about 300 personnel, including personnel at the county level. The criminal organizations department contains about 20-30 staff.

The money laundering department of the NBI has exclusive competence in cases where the perpetrator of the predicate offence and of the money laundering offence are different persons or entities. In other cases (cases of self-laundering) the county police units handle the investigations.

The financial crimes division handles the tax fraud cases, the economic crime division all other kinds of economic offences. The transnational crimes department handles different kinds of cases, especially if the perpetrator is Hungarian.

The money laundering department also provides assistance to local levels, although this is limited by staffing levels. .

According to the authorities, the Customs and Finance Guard have a strength of 6, 666.

Act CXXVI of 2000 created a Co-ordination centre for fighting organized crime. The Centre is an independent central office responsible for supporting and coordinating law enforcement activities. The Centre is also supposed to help governmental decision-making by supplying statistical data and analysis. A Cabinet decision of 2002 authorized the exchange of data between the FIU and the Centre. According to the Hungarian Progress Report 2003 – Questionnaire such exchange has effectively taken place. Although the team repeatedly requested a meeting with this Centre, no one in the Centre seemed available to receive us, even briefly. This is remarkable, as the authorities in their answer on the questionnaire mentioned that different organized crime groups had been identified. It would therefore have been of importance to have more information on this issue and the possible links with money laundering. The requested law on this Centre was requested but not yet received.

Detecting terrorist acts (Section 261 HCC) shall be the competence of the police if the relevant report is submitted to it or the fact became known to the police (Section 69).

2. The public prosecution office

According to Chapter XI of Act XX of 1949 containing the Constitution, the Prosecutor General heads the Office

of the public prosecutor. The prosecution service ensures the rights of persons and organizations and prosecutes any act violating the security of the country. It shall exercise the rights specified in the law relating to investigations, shall represent the prosecution in court proceedings and shall be responsible for the supervision of the legality of penal measures. The prosecution shall also ensure that everybody complies with the law (Section 51). The Prosecutor General is elected by Parliament (cf. on the relationship of the control of the Parliament the decision of the Constitutional Court 03/2004 of February 17, 2004, stating that the Parliamentary right of questioning him may not endanger the Prosecution service as an independent constitutional body), other public prosecutors are appointed by him (Sections 52-53).

The prosecution service is headed by the General Prosecutor's Office. The other levels are the regional appellate prosecutors, the county prosecutors and the local prosecutors. Within the General Prosecutor's Office, a Deputy Prosecutor General is responsible for the criminal law division. This division counts amongst others a department for supervision of investigations and a department for special cases. This Department was set up on July 1, 2001. It supervises economic crimes, including money laundering. By decision of the General Prosecutor certain cases can be closely watched and monitored by this department, like for example terrorist cases. The county prosecution offices have an office for criminal investigations, a division for supervising investigations and a division for court proceedings. The total number of prosecutors is about 2,500.

3. The courts

Only the county courts have competence to deal with terrorism (Section 261 HCC) and money laundering (Section 303 HCC) offences (Section 16 HCPC). As was explained by the General Prosecutor's Office, the local courts were excluded in an effort to centralize these types of crimes in the county courts, creating more expertise in the courts. It has to be noted however that this centralization only applies to intentional money laundering. The negligent laundering can also be dealt with at local level.

3. Training

Hungarian officials have received various kinds of training, amongst which can be mentioned the training of prosecutors by US Treasury staff, the development of a training CD for judges, a FinCen course for the FIU, a series of Phare-sponsored seminars, an extensive AML training for prosecutors and judges in the Hungarian prosecutor's training centre, training for prosecutors by the U.S. DOJ and ILEA and the training of designated investigators at each of the county police headquarters in financial background investigations.

The investigators in the money laundering department are specialized. Most graduated from a police college, where great emphasis is placed on economic crime and money laundering. Several of the staff are lawyers, and there are some who have more than one degree, in economics, banking or related subjects.

In the training sessions for the Department, other services also attend, like county level investigators, the Border Guards and the Customs and Finance Guard.
Information on the money laundering legislation is also available on the intranet website of the Supreme Court. Documentation of this has been provided, but has not yet been translated.
The General Prosecutor's Office stated that in the yearly training plan of the Office, special priority is given to EU-priority areas, i.a. money laundering and economic crime. A state organized training on economic crime, given at the university, is also available. This is a 3 year course (one day / week), leading to the degree of "legal expert on economic crime". About 30 % of the prosecutors have obtained this degree. The General Prosecutor personally recommends and supports this program, also making available the necessary budgets and the working conditions for the magistrates to attend this training. The program documents have been requested but not yet received.

4. International co-operative actions

In case of competing competencies between different investigative authorities, the responsible authority shall be designated by the prosecutor. The investigating authorities are entitled to set up joint task forces (Section 37 HCPC).

Pursuant to international treaties, members of foreign investigative authorities are allowed to attend investigatory actions (Section 184 HCPC).

5. Reviews of techniques

Circumstances giving rise to suspicion of money laundering are explained in different documents of financial service providers, like for example in the sample regulations of the Chamber of Hungarian auditors.

Until June 2004, the FIU sent specific feedback about the STR's received. Since then, only general letters to the financial institutions are sent. The FIU also provides training sessions, but in order to avoid difficulties afterwards by institutions mentioning the training they received by the same investigators which later maybe will have to investigate on them, the emphasis is placed on "training the trainer"-sessions.

The Customs and Finance Guard is ready to further elaborate risk assessment profiles, paying special attention to the surveillance of cross-border traffic in regards of cash-transfer.

6. Statistics

1. General crime statistics

The crime statistics provided by the Hungarian authorities show, i.a., the following numbers of investigations. For each category mentioned below the figures respectively contain the investigations started, decisions to cease the investigation and suggestions to prosecute, for the years 2001-2004.

Trafficking in human beings	14 / 56 / 68
Acts of terrorism	10 / 6 / 4
Participation on criminal organization	4 / 0 / 4
Misuse of narcotic drugs	4.198 / 872 / 1.925
Unauthorized financial services	315 / 131 /132
Unauthorized investment services	10 / 4 / 4
Money laundering	25 / 7 / 7
Tax and social security fraud	1.732 / 421 / 2.198
Smuggling	20 / 2 / 16
Embezzlement	5.242 / 2.243 / 2.254
Fraud	18.766 / 4.130 / 10.206
Fraudulent breach of trust	606 / 275 / 169
Total economic crimes	10.121 / 3.290 / 4.160
Total crimes against property	131.219 / 62.747 / 31.666
Total crimes that became known	206.468 / 85.168 / 64.697

The Hungarian Progress Report 2003 mentions an annual figure of 300-350.000 crimes against property and economic crimes, totaling a loss of 100-150 billion HUF (0,37 – 0,50 billion EUR). It seems that these figures take into account complaints that have immediately been dropped, since the number of investigations mentioned in other statistics is much lower.

According to other statistics provided in the 2005 Questionnaire, in the period between 2002 and November 2004, the following procedures were conducted under the Police Act:

Criminal investigations on charges of money laundering: 3, 12 and 17
Criminal investigations on charges of money laundering in a case referred by other police units: 10, 3, 2
Information gathering operations: 12, 9, 11
Information gathering operations pursuant to reports from other police units: 50, 22, 38

2. Suspicious transaction reports

The evolution of the submission of STR's shows the following:

2001	1.628
2002	6.271
2003	12.364
2004	14.120

The reports filed by bureaux de change numbered 13, 169, 369 and 456 respectively
The STR's originating from the customs totaled 5, 3, 6 and 0.

According to the Questionnaire transmitted by the Hungarian authorities, the STR's so far have not triggered a single overt investigation by the police. Money laundering investigations were only conducted based on a denouncement of another type, or on the outcome of covert intelligence gathering. The FIU reported to the team however that of the approximately 15.000 STR's received in 2004, 20 open investigations have been launched, 9 covert investigations and a number of investigations handled by other police services than the Money laundering department.

3. Prosecution statistics

The number of incoming files at the prosecution office totals about 650.000 per year, which is a steady figure since 2001, slightly rising however in 2003. The number of criminal cases since 1994 (100 %) has risen to about 145 % in 2003, the number of prosecutors to about 128 %. The criminal cases brought before the courts totaled 108.474 in 2002 and 105.406 in 2003. The success rate of cases brought before court was 96,5 % in 2002, 96,4 % in 2003. The economic crimes total about 15.000, rising every year since 2000. Tax and social insurance fraud cases follow this trend.

The data from the prosecution office mentioned in the January 2005 Questionnaire show 7 cases of prosecution related to money laundering. Two judgments of conviction were obtained, and one acquittal. The predicate offences were fraud, misappropriation and illegitimate financial service activities. In one case the sentence was a fine and forfeiture of 500.000 HUF, in the second case the sentence was 1 year and 8 months of imprisonment, 2 years ban from public affairs and a fine of 200.00 HUF.

During the meeting of the team with the Supreme Court, it was mentioned that a conviction on money laundering charges had been obtained against 10 persons, all based on Section 303/B HCC (failure to report), Against 5 persons charges were filed for Section 303, but they were acquitted due to the lack of evidence.

4. The predicate offences

The Questionnaire states that "typically" the predicate offences relate to crimes against property and financial / economic crime, like fraud, embezzlement, tax and social security fraud and fraudulent breach of trust. Typical ways of money laundering would involve transferring money to companies in return for false invoices, depositing large amounts of cash in banks declaring their origin from currency exchange, or depositing small amounts of cash not falling under the rules of reporting.

The 2005 Questionnaire argues that no specific information is available about crime groups involved, but that it seems "reasonable" to pay special attention to money exchange services. The small number of cases is not enough to draw any conclusions about the pattern of money laundering, the Questionnaire states. This argument is contrary to the above mentioned statement about money laundering cases being "typically" related to certain predicate offences. Moreover, it reverses the problem. Because there are so few cases being investigated and prosecuted, no patterns can be established, rendering the build-up of know-how and experience difficult.

5. Seizure and confiscation / forfeiture

As far as the money laundering investigations are concerned, 5 seizures were made, 33 sequestrations and 1

forfeiture were ordered. The total amount of seizure would amount to 6 billion HUF.

According to the Hungarian progress report 2003 in two different money laundering cases the equivalent of 5 million EUR was frozen.

6. Terrorism (related) cases

As far as terrorism cases are concerned, the Hungarian authorities report two convictions linked to sending / receiving funds related to internationally listed Islamic funds by foreigners residing in Hungary. In one case 1 year and 5 months of imprisonment was imposed, in the second 5 years for each defendant. The 2005 Questionnaire however also mentions 16 investigations of terrorism between 2002 and 2004, resulting in 5 indictments and 2 convictions, the rest of the investigations either terminated or suspended. This number of investigations launched (16) does not match with the tables of crime statistics the authorities provided, which only show 8 investigations launched between 2002 and 2004. In yet another paragraph of the Questionnaire it is stated that during the last 4 years only 2 offences have been registered in relation to terrorism. These probably refer to the two court convictions mentioned above.

In one terrorist case 450.000 EUR was seized, but released afterwards as the case was dropped.

According to a meeting with the Banking Association, there might have been two cases of asset freezing related to terrorist financing, but no further details were known.

According to the answers given to the team by the FIU, there have been no cases of freezing as a result of the EU-lists, suspension of transactions as a result of other types of lists have taken place, but no further details could be obtained.

Up until the assessment, the FIU also reported that no STR's related to terrorist financing have been received, nor any notification of freezing of accounts. However, after the visit by the assessment team, 2 STR's related to terrorist financing have been received.

According to the Financial Supervisory Authority there has been one case of freezing the funds being released afterwards for lack of evidence.

7. Interpretation of the statistics

As a general remark, the different statistics provided are very difficult to match. It is hardly possible to link the various elements, and to follow money laundering cases from the beginning to the end. It is not clear if the figures given on seizure and forfeiture are accurately held and updated. Even in the questionnaire the answers provided do not seem to match, although specific technical reasons might be involved, statistical material always needing to be handled and interpreted with great care.

Recommendations and comments

- Strengthening the HCFG competences in AML/CFT, specifically placing more emphasis on the financial angle of the investigations.
- The investigations on organized crime should focus more on potential ML offences and be more closely coordinated with ML investigations. Despite a specialized police department and a Co-ordination centre on organized crime, this effort and knowledge is not reflected in the results on ML.
- Law Enforcement officials must gain more practical experience in ML investigation and prosecution through a more generalized and aggressive prosecution policy. A more innovative and daring use of the existing tools is necessary.

Compliance with FATF Recommendations

R.27	Largely Compliant	Insufficient focus on potential ML offenses and relatively low number of prosecutions and convictions
R.28	Compliant	
R.30	Compliant	

R.32	Largely Compliant	Statistics for investigations and prosecutions are inconsistent. Figures for seizures and confiscations are not accurate

Cash couriers (SR.IX)

Description and analysis

Article 7 of the AML law requires any person who crosses the frontier of Hungary carrying cash in HUF or any other currency, traveler's checks, international money order, transferable securities or money market instruments worth one million HUF (appr. 5.500 USD) or more to declare it to the customs authority in writing. The declaration will have to indicate the amount of cash and the type of currency carried by the person in question, or the issuer, the serial number and the face value of the securities or money market instruments where applicable, as well as the information required Paragraph a) of Subsection (1) of article 5 for the identification of natural persons (that is given name, surname and, where applicable, married name; address; date and place of birth; nationality; mother's maiden name; number and type of identification document).
It is unclear whether the obligation of declaration captures also bearer shares (the reference both in the law and in the declaration form is to "transferable securities")

The Authority responsible for the enforcement of such obligation is the HCFG (total staff 6666). HCFH has been recently reorganized pursuant to Act XIX of 2004.

Failure to provide such declaration or a false declaration is punished with an administrative fine of 50.000 HUF (appr. 250 USD). Such sanction is not effective or dissuasive given the relatively small amount (especially in the case where large amount of valuables are be brought in/out of the Country without being declared) and considering that there is no power to seize/freeze such valuables in the case of suspicion of ML or FT, as will be discussed later on.

The authorities indicated that the obligation of declaration applies not only in the case of physical transportation by a natural person, but also in the case of shipment and mailing. A specific Office within HCFG is assigned the task to check the declaration related to shipment and mailing of valuables.
In 2003 there were 1443 in-bound reports, 1146 out-bound reports and 1196 transit cases, and 24 cases detected of failure to declare. In 2004 there were 925 in-bound reports, 410 out-bound reports and 506 transit cases and 24 cases of failure to report (22 of them referring to shipment/mailing of valuables detected at Budapest airport).

In each case when the threshold is met (whether declared or not declared) the relevant information is transmitted to the General Directorate of HCFG, which would store it in a hard copy archive for 10 years. There are plans for establishing a computerized database. The authorities informed the team that, according to the Law on Data Protection, personal data can be stored only in the cases of false/failure of declaration.

According to article 36 of the CPC, HCFG is empowered to conduct investigation and is vested with all relevant law-enforcement powers available in a series of crimes (such as, among others, smuggling, social security or tax fraud, drug related offences and forgery), but not specifically for ML or FT. While HCFG would be vested with limited functions as regard to ML no competences are provided for nor restrictive measures are at disposal of HCFG in the case of FT.

Therefore HCFG has no authority to freeze/seize any of the valuables which are subject to the declaration obligation provided by art. 7 in the case of a suspicion of ML/FT nor has the power to restrain/stop the currency in order to ascertain whether evidence of ML or FT may be found. As described in more details below, if there is a suspicion of ML (but not in the case of FT) HCFG has the obligation to register relevant data and to file an STR to the FIU.
HCFG can ask questions about the origin of the valuables (asking for a bank statement, for instance to justify the cash carried), but if the declaration has been properly fulfilled and supporting documents are given for the valuables carried, there is no possibility for Customs to stop or retain the valuables. In the case of failure to declare or false declaration the only available sanction is the above mentioned fine, again without any further possibility to refrain, stop or freeze the valuables, even if there is a suspicion of FT. The authorities indicated that in such a case the Police will be informed; however seizure powers would be available only within the course of a criminal investigation, whereas not in a case of simple suspicion.

Under art. 7, sect. 3 of the AML law the HCFG has to establish the identity of any person crossing the border if there is any suspicion of ML. There is no such an obligation in the case of suspicion of FT.
Section 4 provides the obligation to report to the FIU any suspicion of ML that HCFG might detect in accomplishing its tasks related to the declaration obligation for in-bound out-bound transportation of valuables as well as a record keeping requirement for 10 years. There is no reference to FT, neither in the case of mandatory obligation, nor in the case of reporting. HCFG informed the team that, so far, no case of in-bound out-bound transportation of valuables suspected of being related to FT has been detected.

Statistics regarding STRs that HCFG has reported to the FIU are confusing.
The breakdown of the questionnaire indicates the following figures:

	2001	**2002**	**2003**
Customs and Finance Guards	**5**	**3**	**6**

However the authorities indicated that, until 2004 they would report to the FIU all declarations, and that they had subsequently reached an agreement with the FIU so that only in the case of effective suspicion of ML an STR would be filed. Therefore the numbers of reports prior to 2004 are deceptively low. In 2004 HCFG has submitted 364 STRs to the FIU.

HCFG is also responsible for the control of the traffic of precious metals and stones.
HCFG has agreements for co-operation with all neighboring Countries except Romania.

Recommendations and comments

- Identification, record keeping and reporting requirements should apply also in the case of FT.
- HCFG should be given the authority to stop/restrain cash to ascertain whether evidence may be found for ML/FT.
- Sanctions should be more effective and dissuasive.
- Immediate seizure should be available in the case of cash related to ML/FT.

Compliance with FATF Recommendations

SR.IX	Partially compliant	No possibility to stop/restrain or seize in the case of ML/FT

Preventive Measures–Financial Institutions

Risk of money laundering or terrorist financing

Description and analysis

All the financial institutions are covered by the AML Act. The Section 1 of AML Act determines the range of financial institutions, who fall under the scope of AML Act:

1. financial services or activities auxiliary to financial intermediation (i.e.; currency exchange activities, clearing operations, money processing activities and financial broking on the interbank market);
2. investment services, activities auxiliary to investment services or investment fund management services;
3. insurance underwriting, insurance agency or insurance consulting services;
4. commodity exchange services;
5. postal financial intermediation services, postal money transfer, accepting and delivering domestic and international postal money orders; and
6. providing services of a voluntary mutual insurance fund.

However, the following exemptions for customer due diligence (CDD) requirements are laid down in the Section 3 (6)-(15) and 3/A of the AML Act;

1. insurance transactions

- Life insurance policies where the annual premium is no more than 240,000 HUF, or a single premium of no more than 600, 000 HUF (Section 3(6)b);
- Insurance policies for pension schemes if there is no surrender clause and the policy cannot be used as collateral and if they provide retirement benefits to employees where the contracting party of the insurance policy is the employer (Section 3(6)c)

2. financial institutions in Hungary that are supervised by the Hungarian Financial Supervisory Authority (HFSA) (Section 3(12));
3. financial institutions that are registered in a country whose legal system is compatible with the Council Directive 91/308/EEC on AML (Section 3/A (3)).

These exemptions for CDD requirements are acceptable under the risk based concept adopted by the Recommendation 5. In addition, some of these are actually specifically authorized in the relevant Recommendations of the FATF as well as interpretative notes to the Recommendations regarding simplified or reduced CDD measures.

Customer due diligence, including enhanced or reduced measures (R.5 to 8)

Description and analysis

R.5

(Anonymous deposits)

Since the amendment of Law-Decree No.II of 1989 on Saving Deposits in December 2001, all savings deposits accounts must be registered by identifying the depositor's (and the beneficiary's) given name and surname (maiden name), address, date and place of birth, nationality, mother's maiden name, and number and type of identification documents (Section 1 of the Law-Decree). Those anonymous deposits that were already in existence need to be converted into registered forms and this must take place at the time of the first presentation of the savings deposit book at banks. According to the Section 15/A of the Law-Decree, the phasing out process of the anonymous deposits were set at three phases;

1. First phase (until June 30, 2002); only suspicious transformation from anonymous to registered deposits had to be reported to the FIU
2. Second phase (after July 1, 2002 until Dec 31, 2004); deposit holders and/or beneficiary of the transformed deposits with 2 million HUF or more needed to be reported to the FIU.
3. Third phase (after January 1, 2005); the remaining non-identified anonymous deposits are frozen in a way that any transformation requires a written request of the holder/beneficiary and must be reported to the FIU for permission. The transaction may be executed only following the permission of the FIU.

In addition, under Section 3 of the AML Act that requires customer due diligence (see details below) and the Section 16(9) together with the Section 5(6) of the AML Act, financial institutions are required to reidentify all the existing customers by March 31, 2004 in a way that customers appear in person or by way of a representative at the premises of the financial institutions and identification of the information required by the AML Act are complete. Financial institutions are required to refuse transactions with customers after April 1, 2004 who are not reidentified by March 31, 2004.

Therefore, financial institutions are not allowed to keep anonymous accounts or accounts in fictitious names or numbered accounts.

Also in practice, through these transformation processes of anonymous deposits, according to the authorities, more than 95% of previous anonymous deposits (in terms of value) were transformed into registered one. The number of anonymous deposits declined at a slower pace, from 5.2 million accounts in January 2002 to 2.4 million accounts in February 2005, i.e., by 54%; however the average value of a remaining anonymous deposits diminished more significantly from 86 thousand HUF to 6 thousand HUF during the same period.

The HFSA receives the data regarding the transformation of anonymous deposits (number of accounts, amount and etc) on quarterly basis and monitors the progress in transformation. Also the HFSA reviews the effectiveness of internal control for transformation of anonymous deposits through on-site inspections.

(Customer due diligence)

- *Occasion for CDD*

Under the Section 3 of the AML Act, financial institutions have to undertake CDD

1. when establishing a business relationship with a customer;
2. carrying out an occasional transactions over 2 million HUF (around USD 10,000);
3. in the event of noticing any data, facts or circumstances that may suggest money laundering and the identification according to the previous points has not been completed, including when financial institutions have doubts about the veracity of previous CDD;

Also under the Section 5(8) of the AML Act, cross-border wire transfers should be accompanied by information on the name, address and the account number of originator

- *Required CDD measures*

For natural persons, financial institutions have to identify by their name (additionally maiden name, previous name if applicable) mother's name, place and date of birth, address, nationality, type and number of ID (Section 5(1) of the AML Act). Acceptable documents of natural persons are national identity cards, passports, address cards, student cards, and driver's license attesting the above data.

For legal persons, CDD requires the name, legal seat, principal activity, number of deed of foundation, procuration, and legal representative. Representatives of legal persons have to produce their own IDs the deed of foundation and the authenticated copy of the court of registry entry of the company or organization they represent (Section 4 and 5(1) of the AML Act)

For beneficial owner, the Section 6 provides that the customer is required to provide a written statement to the financial institutions as to whether he is acting in his own name or in the name and on behalf of the actual holder (beneficial owner). If the statement indicates that he is acting in the name and on behalf of the actual holder, it shall contain the information of name and address of the actual holder. If any doubt arises concerning the identify of the actual holder, the financial institutions shall request the customer to reconfirm the identify of the actual holder. In addition, financial institutions are required under the Section 6(4) of the AML Act to take all reasonable and appropriate measures in order to establish the identify of the actual holder.

However, Section 6(2) of the AML Act requires only name and address of the beneficial owners, as opposed to a natural or legal person who comes directly to the financial institutions for whom more detailed information are required for the identification under Section 5(1) of the AML Act. This would appear to be a weakness in the legislation, without reasons to justify such difference in the kind and amount of information for customer identification.

For customers that are legal persons, Section 6 of the Capital Markets Act provides that securities offered to the public must be registered ones and no share can be transferred to a new owner without clear paper trail. Nominees have to be registered together with the beneficial owner. The stock ledger is available for both the authorities and the interested parties, including financial institutions. Unless the identity of the beneficial owner is proven and well documented, new business relationship should not be established. The beneficial owner has to be identified by the financial institution by its name and address.

Though there is no clear requirement in the AML Act, the Recommendation of the President of the HFSA No.1/2004 on the prevention and impeding of terrorism and money laundering provides that financial institutions obtain information on the purpose and intended nature of the business relationship.

The Section 5(3) of the AML Act requires that, during the life of the business relation, customers shall notify financial institutions any change in the data and information supplied for CDD or those concerning the beneficiary owner within 5 business days of the day when such change is first noticed. Also financial institutions shall advise customers concerning their obligations to report to financial institutions any and call changes (Section 5(4) of the AML Act). In addition, the Recommendation of the President of the HFSA No.1/2004 provides that financial institutions develop customer profile based on the CDD process and conduct on-going due diligence during the whole business relationship.

The Recommendation of the President of the HFSA No.1/2004 provides increased attention should be paid to certain categories of customers, including customers represented by a nominee, customers who change from one bank to another for the same or similar services, customers represented by independent lawyers.

Under the AML Act, CDD measures are not required for certain customers/transactions (see the Section on "Risk of money laundering or terrorist financing")

However, under the Section 3(4) of the AML Act, whenever suspicion of money laundering emerges, CDD is required.

- *Timing of verifications*

Under the Section 3 of the AML Act, financial institutions have to verify the identity of the customer and the beneficial owner with documents required by the AML Act, when establishing a business relationship or conducting transactions on an occasional basis. The only case when identification may follow the establishment of business relationship is the indemnity payment for the beneficiaries of certain types of insurances, but identification and verification must precede disbursement (Section 3(9) of the AML Act).

- *Failure to satisfactorily complete CDD*

The Section 5(6) of the AML Act provides that if CDD of customers and beneficial owner is not possible, financial institutions shall not enter into a business relationship and shall refuse to carry out current transactions. Also the Recommendation of the President of the HFSA No.1/2004 provides that incomplete identification data provision is a reason for suspicion to be reported to the FIU.

- *Existing customers*

Under the Section 16(9) together with the Section 5(6) of the AML Act, financial institutions are required to reidentify all the existing customers by March 31, 2004 in a way that customers appear in person or by way of a representative at the premises of the financial institutions and identification of the information required by the AML Act are complete. Financial institutions are required to refuse transactions with customers after April 1, 2004 who are not reidentified by March 31, 2004.

For CDD of anonymous deposit holders and beneficiary, see the section above on "Anonymous deposits.

For CDD measures, all the financial institutions are required by the Section 11(3) and (5) of the AML Act to establish their internal procedure/regulations for AML, including procedures for CDD, to be approved by the HFSA. Following the Section 11(4) of the AML Act, the HFSA issued Model Rules for financial institutions to prepare for internal procedures/regulations for AML, and has approved more than 2000 internal procedures/regulations. The HFSA receives the data on annual basis through off-site monitoring of financial institutions, including the number of internal audits for AML/CFT internal control, anonymous deposits that have been transformed into registered one, and the number of beneficial owners. The HFSA also reviews the effectiveness of internal control for CDD through on-site inspections of financial institutions that are conducted at least every two years (see more details in the Section on "The supervisory oversight system").

According to discussions with the private banks, securities firm and the insurance association together with some insurance companies met during the assessment , it appears that they have established internal controls for CDD, following the AML Act, the Recommendation of the President of the HFSA No.1/2004 as well as the Model Rules issued by the HFSA (some of the banks showed the assessor a copy of their internal policies and procedures for CDD). It has been confirmed that the internal controls for CDD of these institutions have been reviewed by the HFSA through its off-site monitoring and on-site inspections.

R.6

The Recommendation of the President of the HFSA No.1/2004 requires that enhanced attention be paid to politically exposed persons (PEPs) whose eventual irregular financial transactions represent a reputational risk for the institution (there is no distinction between domestic and foreign PEPs), and that the establishment of business relations with PEPs should be the responsibility of a top manager. However, there is no separate provision regarding approval by senior management of continuing business relations with persons becoming PEPs after the establishment of a business relationship. The Recommendation of the President of the HFSA No.1/2004 provides that financial institutions shall demand clarification of source of funds for all customers. Business relation with PEPs is also referred in the Recommendation of the President of the HFSA No.1/2004 as one of aspects to be monitored for possible suspicious transaction to which special attention needs to be paid.

The 2003 UN Convention against Corruption has been ratified in September 2004 by the Decision of the Parliament 73/2004.

R.7
There is no requirement in the AML Act on enhanced due diligence measures for cross-border correspondent banking relationship. The Recommendation of the President of the HFSA No.1/2004 had no reference to the issue at the time of the on-site visit by the assessment team.

Correspondent banking relationships are approved traditionally by senior management of banks, because under the past Foreign Exchange Control regime, the opening of any new correspondent bank account abroad needed the approval of the National Bank of Hungary that was issued upon a well-documented request of the senior management of banks. Payable-through accounts are not in use in Hungarian banks. The authorities also indicated to the assessment team that during the period of the re-identification of all the customers required by the AML Act 2003, all the correspondent banks of Hungarian banks had to re-identify themselves with the provision of all data and documents regarding the owners, business lines, business practices requested by the Hungarian partner banks.

In addition, in order to make clearer the importance of enhanced due diligence measures for cross-border correspondent banking relationship, the HFSA updated in April 2005, immediately after the on-site visit by the assessment team, the Recommendation of the President of the HFSA No. 1/2004 and added the details requirements for correspondent banking relationship based on those included in the CDD paper by the Basel Committee.

R.8
The Recommendation of the President of the HFSA No.1/2004 provides that financial institutions should pay special attention to risks potentially inherent in new or developing technologies that favor anonymity and take all necessary actions to prevent the use of such techniques in money laundering schemes, and stresses that financial institutions should have adequate policies and procedures for managing potential specific risks related to business relations and transactions that do not require a personal contact.

The HFSA reviews through its off-site monitoring and on-site inspection the effectiveness of internal control among financial institutions relating to the Recommendations above, including the relevant policies and procedures as well as their implementation (see more details in the Section on "Supervisory and oversight system") . Also, according to the discussions with the private banks, securities firm and the insurance association together with some insurance companies met during the assessment , it appears that they have established internal controls relating to the Recommendations above, following the Recommendation of the President of the HFSA No.1/2004 (some of the banks showed the assessor a copy of their internal policies and procedures).

Recommendations and comments

- Measures to be taken to require full information for the identification of beneficial owners, for example by the AML Act and the supervisory rules by the HFSA.
- There should be explicit requirements regarding approval by senior management of continuing business relations with persons becoming PEPs after the establishment of a business relationship.

Compliance with FATF Recommendations

R.5	Largely Compliant	Information required for the identification of beneficial owners are less than those for direct customers, without justifiable reasons.
R.6	Largely Compliant	A lack of explicit requirement regarding approval by senior management of continuing business relations with persons becoming PEPs after the establishment of a business relationship
R.7	Compliant	
R.8	Compliant	

Third parties and introduced business (R.9)

Description and analysis

In Hungary, it is not allowed for any financial institution or other third party to introduce business since under

Section 16(9) together with Section 5(6) of the AML Act, financial institutions are required to reidentify all the existing customers in person or through a representative at the premises of the financial institutions by March 31, 2004 and verify all the information required by the AML Act.

Independent insurance brokers are an exception. They can introduce business to insurance companies, but they are supervised by HFSA and have to comply with all CDD measures as any other type of financial institution. The Section 3(8) of the AML Act allows that in this case insurance companies accept the full identification data from the brokers as credible. Full copy of CDD data has to be given to insurance company, while one copy remains at the broker. Both have to keep them for 10 years after business relationship has ended.

Recommendations and comments

--

Compliance with FATF Recommendations

R.9	Compliant	

Financial institution secrecy or confidentiality (R.4)

Description and analysis

There is no obstacle for the competent authorities to have access to information at financial institutions and implement AML/CFT measures.

(Banking sector)
Section 51(2) of the Act CXII of 1996 on Credit Institutions and Financial Enterprises ("Banking Act") provides that the obligation to keep bank secrets shall not apply in respect of the HFSA , investigating authorities, and the public prosecutor's office.

In addition Section 52 of the Banking Act provides that banks shall satisfy the written request for investigating authorities, the national security service and the public prosecutor's office without delay concerning its customer's bank account and the transactions on such account if it is alleged that the bank account or the transactions is associated with

1. trafficking of narcotic drugs;
2. terrorism;
3. illegal trafficking in arms;
4. money laundering; or
5. organized crime.

Under Section 146 of the Banking Act, the HFSA is empowered to conduct on-site inspections of banks, and is able to access to any data and information at banks.

(Insurance sector)
Section 157(1) of the Act LX of 2003 on Insurance Institutions and the Insurance Business ("Insurance Act") provides that the obligation to keep insurance secrets shall not apply to the HFSA, investigating authorities and the public prosecutor's office. Also Section 157(5) of the Insurance Act provides that insurance companies shall supply information to investigative authorities and to the national security service if there is any suspicion that tan insurance transaction is associated with

1. drug trafficking;
2. terrorism;
3. illegal arms trafficking; or
4. money laundering.

Under Section 170 of the Insurance Act, the HFSA is empowered to conduct on-site inspections of insurance companies, and is able to access to any data and information at insurance companies.

(Securities sector)
Section 370(2) of the Act CXX of 2001 on the Capital Market ("Capital Market Act") provides that the requirement of confidentiality concerning securities secrets shall not apply to the HFSA, investigating authorities and the public prosecutor. Also Section 372 of the Capital Market Act provides that investment service providers, commodities brokers, investment fund managers, the exchange and clearing corporations must satisfy

the written request of investigating authorities, the national security service and the public prosecutor's office concerning any transaction in which they are involved and any account they operate if it is alleged that the transaction or the account can be linked to

1. trafficking of narcotic drugs;
2. terrorism;
3. illegal trafficking in arms;
4. money laundering; or
5. organized crime.

Under the Section 396 of the Capital Market Act, the HFSA is empowered to conduct on-site inspections of investment service providers, commodities brokers, investment fund managers, and the exchange and clearing corporations, and is able to access to any data and information these institutions.

(Criminal Procedure Code)
If during the investigation it seems necessary to obtain information from the tax authorities, organizations providing communication services, as well as from organizations managing data classified as bank secret, securities secret, fund secret or business secret, the prosecutor or the police, but with the consent of the prosecutor, may make such requests. The supply of data can not be refused (Section 178/A HCPC).

Different acts stipulate that the obligations to keep different business, bank, securities, tax or other secrets is not applicable in respect of investigating authorities, the prosecutor or the court acting within the scope of criminal procedures (for example, Act CXII of 1996 on Credit Institutions and Financial Enterprises, Act LX of 2003 on Insurance Institutions and the Insurance Business, Act CXI of 1996 on Securities Offerings, Investment Services and the Stock Exchange and Act XCII of 2003 on the Rules of Taxation). As far as the pre-investigative stage is concerned, different acts, like the mentioned Acts CXI and CXII of 1996, contain more restrictive provisions. The requests for information must only be answered if the offences relate to drug trafficking, terrorism, arms trafficking, money laundering and organized crime.

Recommendations and comments

--

Compliance with FATF Recommendations

R.4	Compliant	

Record keeping and wire transfer rules (R.10 & SR.VII)

Description and analysis

R.10

For transactions records, all the financial institutions are required by Section 169(2) the Act C of 2000 on Accounting ("Accounting Act") to keep all transaction records for 8 years. Also the financial institutions are required to keep all the transaction records for a minimum of 5 years by the Section 13/B(6)f) of the Banking Act, the Section 160(1) of the Insurance Act and the Section 101/A(6)f) of the Capital Market Act.

For records of customer identification, all the financial institutions are required by the Section 10(1) of the AML Act to retain the data and documents obtained through the CDD process as well as the copies of identification documents (such as ID cards and passports) for a minimum of 10 years after the business relationship has ended. The Model Rules issued by the HFSA for banking, insurance and securities sector respectively to prepare for their internal rules and procedures for AML, including record keeping, to be approved by the HFSA, also include the obligations to keep records of customer identification and their copies for a minimum of 10 years.

In addition, the Section 10(4) of the AML Act requires all the financial institutions to keep records of all cash transactions of the equivalent of 2 million HUF or more (around USD 10,000) including the identification of the customers.

All the financial institutions are required to satisfy written requests from investigating authorities, the national security service and the public prosecutor's office concerning their customer's accounts and transactions without delay if it is alleged that the accounts or the transactions are associated with crimes including trafficking of narcotic drugs, terrorism, illegal trafficking in arms and money laundering (Section 52 of the Banking Act, the

Section 157(5) of the Insurance Act, and the Section 372 of the Capital Market Act)

The HFSA has approved more than 2000 internal procedures/regulations for AML, including record keeping. The HFSA receives, through off-site monitoring of financial institutions, the data, including the number of internal audits for AML/CFT internal control. The HFSA also reviews the effectiveness of internal control for AML, including record keeping, through on-site inspections of financial institutions that are conducted at least every two years.

According to the discussions with the private banks, securities firm and the insurance association together with some insurance companies met during the assessment , it appears that they have established internal controls for record keeping, following the AML Act as well as the Model Rules issued by the HFSA (some of the banks showed the assessor a copy of their internal policies and procedures for record keeping). It has been confirmed that the internal controls for record keeping of these institutions have been reviewed by the HFSA through its off-site monitoring and on-site inspections.

SR.VII

The Decree No 9/2001 of the National Bank of Hungary (NBH) on payment services, and on the rule of cash processing services, applies to payments within Hungary and to and from foreign countries. Section 8(1) of the Decree requires that, on payment orders, there must be a clear indication of the name, address and bank account number of the originator and the beneficiary. Section 8(2) of the Decree also provides that receiving banks have the right to refuse any payment order without these information and may return to the ordering bank. There is no de minimus threshold for these requirements.

Also Section 5(8) of the AML Act requires that the name, address and account number of the originating customer should be recorded in incoming cross-border wire transfer to financial institutions in Hungary.

In addition, the Recommendation of the President of the HFSA No 1/2004 on the prevention and impeding of terrorism and money laundering provides that banks and other service providers should specify the data of originator in accordance with the requirements in Decree No9/2001 of the NBH. The Recommendation also stipulates that special attention needs to be paid to payments where originator information is not complete and receiving banks should request originating bank for specified information.

The HFSA reviews banks' compliance with the requirements under the Recommendations of the President of HFSA No1/2004, through on-site inspections. Also the NBH reviews banks compliance with the requirements under Decree No. 9/2001 of the NBH through on-site inspections.

For domestic payment and settlement, two systems are currently in place in Hungary. The Interbank Clearing System (ICS)- operated by Giro, owned by commercial banks and the NBH- processes retail payments overnight, and the settlement takes place in the NBH's accounting system. The NBH operates the RTGS system for large-value payments (VIBER). On the payment form in use in domestic payments there are one space for the originator's name and residence, one for the beneficiary's name and residence, and another two spaces for their account number. In the ICS system, there is not sufficient space in the field for address in the form. The problem of the separation of the name-residence space will be addressed in few years. The NBH is actively taking part in the design of the renewal of ICS system, which will allow more space for the information including address, most probably in line with SWIFT messaging standards. For the large value same day payments, the same format as MT 103 for the SWIFT is used and there are sufficient space for filling in name, address and account number;

The banks met during the assessment responded that the name, address and account numbers are filled in all the outgoing transfer messages, and that, in case of insufficient information about originator in incoming transfer messages, they will request further information to originating banks and return the orders if complete information is not provided.

Recommendations and comments
Ensure that, for the payment form in domestic ICS system, sufficient space for information on the originator (name, address and account number) should be allowed as planned .

Compliance with FATF Recommendations		
R.10	Compliant	

SR.VII	Compliant	

Monitoring of transactions and relationships (R.11 & 21)

Description and analysis

R.11

Section 11(3) of the AML Act provides that all the financial institutions shall adopt internal procedures/regulations to be approved by the HFSA, which must contain guidelines to recognize information, facts, or circumstances that may suggest money laundering, and the procedure for carrying out the obligation to report suspicious transactions including internal control, information and data processing systems that facilitate such procedures.

Model rules issued by the HFSA for banks, insurance companies and securities firms respectively to prepare for internal procedures/regulations for AML also include internal control systems (either manually or electronically) to screen suspicious transactions. Criteria to screen such transactions in the Model rules include unusual nature of economic relations and frequency of transactions.

The Recommendation of the President of the HFSA No 1/2004 on the prevention and impeding of terrorism and money laundering also provides that financial institutions should pay increased attention to all complex and unusually large transactions as well as all transactions of an unusual character, which do not have an easily explainable economic and obvious lawful objective. The Recommendation also provides that the motives behind such transactions should be examined very thoroughly, the results must be stated in writing and made available for competent authorities and examiners.

Although there is no explicit requirement to keep records of the findings of screenings for at least five years, the Recommendation of the President of the HFSA No. 1/2004 provides that the findings must be stated in writing and made available for competent authorities and examiners. Also the financial institutions are required to keep records of all transactions for a minimum of 5 years (Section 13/B(6)f) of the Banking Act, the Section 160(1) of the Insurance Act and the Section 101/A(6)f) of the Capital Market Act). In addition, the Section 10(1) of the AML Act requires all the financial institutions to retain the documents relating to STRs for 10 years from the date when they were recorded.

The HFSA has approved internal procedures/regulations that are established by all financial institutions and reviews the effectiveness of implementation of the internal control systems through off-site monitoring and on-site inspections.

According to the discussions with the private banks, securities firm and the insurance association together with some insurance companies met during the assessment , it appears that they have established internal controls for monitoring transactions, following the Recommendation of the President of the HFSA No.1/2004 as well as the Model Rules issued by the HFSA, including the development of software for the computerized monitoring system.

R.21

The HFSA has issued letters addressed to the financial institutions to request them to pay attention to the counties and territories that are listed as Non-Cooperative Countries and Territories (NCCT) by the FATF, and also posts the NCCT lists in the web-site of the HFSA.

The Model rules issued by the HFSA for banks, insurance companies and securities firms respectively to prepare for internal regulations and rules for AML also includes internal control systems (either manually or electronically) to screen suspicious transactions. Criteria to screen such transactions in the Model rules include remittance to or from off-shore institutions and international lists published by the HFSA, EU or other bodies including the NCCT list by the FATF.

In addition, the Recommendation of the President of the HFSA No 1/2004 on the prevention and impeding of terrorism and money laundering also provides that financial institutions should pay increased attention to all complex and unusually large transactions as well as all transactions of an unusual character, which do not have an easily explainable economic and obvious lawful objective. The Recommendation also provides that the

motives behind such transactions should be examined very thoroughly, the results must be stated in writing and made available for competent authorities and examiners.

The HFSA has approved more than 2000 internal procedures/regulations that are established by all financial institutions and reviews the effectiveness of implementation of the internal control systems through off-site monitoring and on-site inspections.

Also the financial institutions visited by the assessment team indicated that they frequently refer to the web-site of the HFSA, including the NCCT list by the FATF, and pay special attention to transactions and clients in these jurisdictions.

Recommendations and comments

The authorities may consider requiring explicitly that financial institutions keep records of findings of screenings.

Compliance with FATF Recommendations

R.11	Compliant	
R.21	Compliant	

Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)

Description and analysis

R13

Pursuant to article 8 of the AML Act SPs have an obligation to report directly to the NPHQ, "*in the event of noticing any information, fact or circumstance that may suggest money laundering*".

There is no legal obligation in the AML Act for a SPs to make an STR in the case of suspicion of FT in the AML Act.

The obligation to report in a case of suspicion of ML is not automatically triggered by large size or cash transactions exceeding a designated thresholds.

The provision is structured to cover not only STs but also any other fact or circumstance that may indicate a case of ML. The report must include the details recorded during the identification of the customer and a brief description of the data facts or circumstances denoting the suspicion of money laundering.

Attempted transactions seem not to be subject to reporting.

The MoF and the HFSA have issued Guidelines for the SPs to enhance the detection of suspicious transactions.

Article 9 of the AML Law provides the possibility for the SPs to suspend a transaction where there is any suspicion of money laundering and where prompt action by the police is deemed necessary to verify, data, facts, or circumstances. In this case, the SP is required to immediately notify the NPHQ. The transaction can be executed if the NPHQ does not notify the SP in writing (fax, letter) within 24 hours.

As previously mentioned, under article 7 of the AML Law HCFG will report any suspicion of ML that might have been detected with reference to the declaration of in-bound/out-bound transportation of valuables exceeding 1 million HUF.

According to art. 8 in connection with article 1, section 1 par. *n*, the obligation to report is primarily vested in the "*directors, managers and employees of the SPs and in any family members actively engaged in such business*" (it has been explained that the latter category would cover the case of business subject to AML Law that are family-run). However, SPs of a relevant dimension (it is not clear if the reference in the text of art. 7, sect. 2 to the "*structure of the organization*" is meant to those SPs that employ 10 or more employees and that are subject, according to article 11, to internal control and training on AML) have the obligation to appoint a "liaison officer", who would "*forward the reports received*" to the NPHQ without delay.

The HCC with art. 303/B, criminalizes the failure to report under the AML Law as a felony punishable by imprisonment not to exceed three years in case of intentional failure; and as a misdemeanor punishable by imprisonment not to exceed two years, work in community service or with a fine in case of negligent failure.

It should be noted that since the introduction of this provision in the CC (by article 62 of Act CXXIU of 2001), which has entered in to force as of April the 1st 2002, the number of STRs reported to the FIU has been

exponentially growing as the chart below clearly demonstrates.

	2001	2002	2003	2004
Total:	**1628**	**6271**	**12364**	**14120**

The Team has been informed that the trend of increased reporting has also been significantly driven by a recent case where 15 cashiers of banks have been arrested for failure to report under art. 303/B.

The criminalization of the failure to report, especially in the case of negligence, appears to be not only disproportionate but also counterproductive in the detection of STs. The criminal responsibility for failure the SPs would naturally lead to a large amount of "defensive reporting," rather than attempts to identify the real suspicious ones.

Most authorities and especially representatives of the private sectors have expressed serious concerns about the utility of this provision to improve the capacity of the SPs to detect STRs.

Even though the FIU reported that the quality of STRs improved in the last year, the team sees a need for further efforts to improve the capacity of the SPs to detect STs. The low quality of the STRs appears to be confirmed in the questionnaire, where it states that "*Typically, 90 % of an STR consists of none other than data of a bank transaction, i.e. account number, amount of money transferred to the account and perhaps the title of the transfer, the details of the account holder or the account holder's agent and the description of the data, facts or circumstances indicating money laundering.*" Moreover, STRs have not produced many real results: out of 14120 STRs received in 2004 only 20 cases (as referred by the authorities) turned into investigations (but the statistics made available in the questionnaire for the investigation of ML cases for the first 11 months of 2004 – which are not necessary related to STRs - show only 9 initiatives of investigations, out of which 5 turned into a request to prosecute). Apparently no prosecution was ever started out of an investigation arising from an STR, as the authorities have informed the Team.

R14

Article 8 (5) of AML Law provides safe disclosures rules for reporting of STRs to the FIU. In particular it provides for an exemption from any violation of bank, securities, insurance, pension fund or business secrets or from the violation of restrictions on the disclosure of data or information pursuant to either a legal regulation or a contract for the individual who reports a ST to the FIU. In addition to this, in the case of bona fide reporting, par. (6) states that the individual who had filed an STR will not be held responsible if the content of the report would subsequently prove to be unfounded.

With particular regard to lawyers and notaries public, Section 15 (6) provides that fulfillment of the reporting obligation cannot be considered as a breach of the confidentiality requirements.

Pursuant to article 8 par. (4), either the individuals referred to in Paragraph n) of Subsection (1) of Section 1 ("service providers including directors, managers and employees of the SPs and in any family members actively engaged in such business") or the liaison officer appointed by the SP have the obligation not to disclose any information regarding the STR, the contents thereof, and the identity of the person filing the report to any third person or organization (with the exception of the investigative authorities), or the customer. In addition they are obliged to ensure that the filing of the report, the contents thereof, and the identity of the person filing the report remain confidential.

R19.

HCFG is planning to create a computerized database for all cross-border transportation of currencies and other financial instruments

R25

Under Section 11 (4) of the AML Act, the public bodies exercising state or professional supervision over the service provider have the power to issue – in cooperation with the NPHQ and with the approval of the Ministry of Finance - guidelines and model laws available to the service provider. Such guidelines have been issued for all SPs and provide for guidance in the detection of ML typologies and STs. The "Recommendation of the

President of the Hungarian Financial Supervisory Authority no. 1/2004 on the prevention and impeding of terrorism and money laundering" address also CFT issues, giving same typology examples.

Until June 2004 the FIU had been providing case by case feedback to the SPs with regard to the content of the STRs and if any cause for ML had been established with reference to the facts/circumstances indicated in the STR. Since then, the FIU has deemed it more appropriate to provide for an overall analytic information feedback to be used by SPs. This overall feedback, which highlight lacks and deficiencies of the STRs received, is aimed at improving the SPs' capacities to file STRs.

SR IV

Although there is a general obligation to report to law enforcement authorities upon knowledge of preparation of terrorist acts, there is no legal obligation in the Hungarian legislative framework to report a transaction on the basis of a suspicion that the funds involved may be aimed at FT.

According to the response given in the questionnaire, such a legal obligation could be inferred from the purpose of the AML Law which, as stated in the preamble, has been identified as to prevent the laundering of the proceeds of criminal activities through the financial system, the capital markets and other areas exposed to potential money laundering operations as well as to help combat the flow of funds financing terrorism.

This seems a rather weak argument and the Team is feels strongly that the lack of a specific requirement to report suspicious transactions aimed at F is a gap that needs to be filled.

Some authorities have recalled art. 261, section 8 of the HCC (which states that "*Any person who is in possession of reliable information concerning plans for a terrorist act and fails to report it to the authorities at his earliest convenience, is guilty of a felony, and punishable by imprisonment up to three years*"), as a basis for the obligation to file an STR. This does not to seem convincing either, considering that such provision, requiring "reliable information" would not cover the case of a simple suspicion of FT or a transaction simply suspected to be aimed at FT.

The Recommendation of the President of the HFSA no. 1/2004 on the prevention and impeding of terrorism and ML calls SPs to monitor the lists of organizations and persons related to terrorism and to report to the competent investigation authority "whenever there is a suspicion of a financial transaction which supports terrorism" "following the procedure used for suspected ML". However this provision, as confirmed by HFSA, is not enforceable and, moreover, would not cover the SPs that are not supervised by the HFSA.

Recommendations and comments

- A clear legal basis for the obligation to report STs related to FT should be established.
- Further measures are needed to improve the capabilities of the SPs to detect STRs related to ML and FT, and to improve the quality of STRs, for example, by conducting trainings for the SPs.
- Reporting STRs should be in electronic format.

Compliance with FATF Recommendations

R.13	Partially compliant	Need to improve quality of STRs. No coverage of FT and attempted transactions.
R.14	Compliant	
R.19	Compliant	
R.25	Compliant	
SR.IV	Non compliant	No legal obligation for reporting of STRs related to FT

Internal controls, compliance, audit and foreign branches (R.15 & 22)

Description and analysis

R.15

Section 11(3) of the AML Act provides that all financial institutions shall establish internal regulations for AML to be approved by the HFSA. The Section 11(2) of the AML Act requires financial institutions to provide training for employees to learn the legal provisions of ML, business relations and transactions that enable or constitute ML, and to be able to proceed properly in case ML is suspected.

The elements to be included in internal rules/regulations at financial institutions under the Section 11(5) of the AML Act include the followings;

1. guidelines to recognize information, facts or circumstances that may suggest money laundering;
2. procedure for CDD;
3. procedure for identifying beneficial owners
4. procedures for carrying out reporting obligations of suspicious transactions, including internal control, information and a data processing system that facilitate such procedure;
5. procedures and forms for reporting to FIU;
6. rules for training of employees; and
7. codes of procedures and conduct that are to be observed by the employees in direct contact with customers.

The HFSA issued Model rules for banks, insurance companies and securities firms respectively to prepare of internal regulations/rules for AML, which include rules and procedures on the followings;

1. record keeping;
2. CDD;
3. rules for employees in direct contacts with customers;
4. reporting of suspicious transactions, including form and contents to be included in STRs;
5. appointment of designated person in charge of forwarding STRs to FIU, training of employees and leading other efforts for AML;
6. internal audit for AML;
7. screening systems of suspicious transactions, including criteria for screening; and
8. training (at recruiting and regular training at least once a year).

The HFSA approves internal regulations/rules for AML of all financial institutions. In case any deficiencies are identified against the model rules, the HFSA requests that they be corrected before granting an approval.

In addition the Recommendation of the President of the HFSA No 1/2004 on the prevention and impeding of terrorism and money laundering includes a number of recommendations on internal control and compliance for AMLCFT as follows;

1. appointment of designated person (money laundering reporting officer: MLRO) at management level, reporting the designation and the relevant data on the MLRO to the FIU, and the task of the MLRO;
2. procedures for CDD (including enhanced due diligence for PEPs, introduced business and etc);
3. procedures for record keeping;
4. rules for dealing with wire transfer;
5. filtering system for suspicious transactions;
6. procedures for reporting to FIU;
7. responsibilities of employees;
8. Internal audit;
9. training (including regular training at least once a year, an examination for the results of training);and
10. reference to relevant national and international legislations and documents for AML

Under the Section 8(2) of the AML Act, financial institutions shall designate "liaison officer(s)" or money laundering reporting officer (MLRO) to forward STRs to the FIU and shall notify the FIU within 5 days of the appointment of the liaison officer the name and position. In addition, the Model rules of the HFSA and the Recommendation of the President of the HFSA No1/2004 provide the following:

1. The MLRO should be at management level
2. Financial institutions should inform the FIU of the appointment of the MLRO with information on the identity, position and telephone number of the MLRO;
3. The MLRO should organize a training for employees at least once a year and document the results of examination after the training;
4. The MLRO is responsible for forwarding reports to the FIU, keeping relevant records, and responding timely and accurately to the request from the Police.
5. The MLRO has unlimited access to data and information, including CDD and transaction records.
6. The MLRO should regularly inform the management, internal audit and supervisory board of financial institutions on his activities.

For internal audit function for AML/CFT at financial institutions, Model rules of the HFSA as well as the Recommendations by the President of the HFSA provide the following:

1. regular (at least once a year) internal audit to review compliance with internal regulations on AML
2. internal audit should cover CDD, declaration of beneficial owner, review of STRs, review of filtering system for suspicious transactions, review of training and examinations and other relevant issues
3. internal audit reports to the supervisory board and management of financial institutions.

Concerning screening procedures for hiring employees of the financial institutions, Section 13 (1)c) of the Act on Credit Institutions and Financial Enterprises, Section 63(2)c) of the Act on Insurance, and Section 92 (1)a) of the Act on Capital Market provides that the activities of the financial institutions may commence on condition that all personnel requirements and criteria are satisfied. The Executive Decrees No.2 of 1995 and No.20 of 1998 of the Minister of Finance provides for the basic and higher professional qualification for employees of financial institutions, including high ethical standards. The HFSA reviews, through regular on-site examinations of the financial institutions, the quality of staff as part of "Personnel Risk".

The HFSA has approved more than 2000 internal regulations/procedures of financial institutions, and reviews the effectiveness of internal controls, including implementation of the internal regulations/procedures as well as Recommendations by the HFSA, through on-site inspections. For AML/CFT, comprehensive on-site inspections are conducted at least once every two years, with targeted inspections for AML/CFT and follow up inspections to review the effectiveness of internal controls at financial institutions.

The approval by the HFSA of internal regulations/procedures of financial institutions is "pro-forma" against the Model Rules and the HFSA reviews the effectiveness of implementation the internal procedures/regulations through on-site inspections. In the letter (resolution) by the HFSA approving internal procedures, the HFSA may also require that internal rules be modified and updated following changes in legislation. Such modifications also need to be approved by the HFSA.

All the institutions the team met with during the assessment have internal procedures/regulations for AML that have been approved by the HFSA and have designated persons (MLRO) (some institutions showed the team a copy of their internal procures and manuals) . The MLRO provides regular (at least once a year) trainings on AML, sometimes inviting staff from the FIU and HFSA. Also, the internal audit function reviews the effectiveness of internal controls for AML and reports to the management and supervisory board. These institutions are inspected by the HFSA at least once every two years. The HFSA informed the assessment team that, according to their on-site inspections on AML/CFT internal control among financial institutions, internal audits put focus on auditing of AML/CFT.

R.22

Opening of branches and establishing subsidiaries in foreign countries are subject to approval by the HFSA under the relevant laws, including Sections 14(1)i) and 32/A of the Banking Act. In the approval process, the HFSA refers to foreign supervisors which host branches and subsidiaries of Hungarian institutions about the AML/CFT regime in that jurisdiction and does not allow the opening of branch or establishment in countries that do not comply with the FATF Recommendations, or where complying with the Hungarian AML rules/procedures are prohibited. Actually there are no branches nor subsidiaries of Hungarian financial institutions except subsidiaries of Hungarian banks in Slovakia, Croatia, Romania, and Bulgaria.

In addition, in the HFSA's supervision on consolidated basis, foreign branches of the Hungarian financial institutions are supervised and examined by the HFSA, including their compliance with AML/CFT requirements in Hungary. The HFSA has concluded MOUs with foreign supervisors under which the HFSA has conducted on-site examinations of the overseas subsidiaries of Hungarian institutions, including review of their compliance with the AML/CFT requirements in Hungary. The manual for on-site examiners of the HFSA has provisions relating to the review of AML/CFT, including the AML/CFT compliance by overseas branches and subsidiaries of Hungarian institutions,

Recommendations and comments

The authorities may consider introducing more explicit requirements to require financial institutions to ensure their foreign branches and subsidiaries observe AML/CFT measures in Hungary and inform the HFSA when they are unable to observe AML/CFT measures in foreign jurisdictions.

Compliance with FATF Recommendations

R.15	Compliant	
R.22	Compliant	

Shell banks (R.18)

Description and analysis

Under the Banking Act, the establishment of banks are subject to licensing by the HFSA. The HFSA reviews the mind and management of applications and does not allow such shell banks.

In the case of establishing a bank in Hungary, Section 17 of the Banking Act provides that the application for foundation shall include

1. the deed of foundation which clearly defines the type and sphere of activities to be established;
2. proof of deposit of 50% of the subscribed capital defined in the Banking Act;
3. a description of the drafts for the organizational structure, system of management, decision making and control mechanisms as well as the bylaws;
4. in the case of applicants domiciled abroad, a statement concerning the applicant's agent for service of process; such agent must be an attorney or a law firm registered in Hungary, or the applicant's bank representative office in Hungary.

In the case of foreign financial institutions establishing branches in Hungary, Section 17/A (1) of the Banking Act requires the following to be attached to the application for foundation permit to the HFSA;

1. the foreign banks' instrument of constitution
2. the foreign bank's certificate of incorporation issued within three months to date in roof of the bank being registered in the register
3. a copy of the authorization issued by the competent home country supervisory where the foreign bank is registered
4. a certificate from the competent home country supervisory that the main office directing the bank is in the country where it is registered;
5. the audited and approved balance sheet and other relevant documents
6. a detailed description of the founder's ownership structure and of the circumstances under which the founder is considered to be affiliated to a group of persons in partnership

Also Section 17/A(2) of the Banking Act provides that the HFSA should establish that there is a valid and effective international cooperation agreement (such as MOU), based on mutual recognition of the supervisory authorities, between the HFSA and the home country supervision, and that applicant's home country has legal regulations on AML that confirm to the requirements under the Hungarian laws.

Therefore, it is not allowed to establish shell banks or branches of foreign shell banks n Hungary..

With regard to correspondent banking relationship with shell banks or relation of the respondent banks with shell banks, at the time of the on-site visit by the assessment team. there was no explicit prohibition in the AML/CFT regime in Hungary, including the AML Act and the Recommendation of the President of the HFSA No 1/2004 on the prevention and impeding of terrorism and money laundering. However, immediately after the on-site visit by the assessment team in April 2005, the HFSA updated the Recommendation of the President of the HFSA No. 1/2004 and added a detailed section on correspondent banking relationship which provides that banks should only establish correspondent relationships with foreign banks that are effectively supervised by the relevant authorities, and that banks should refuse to enter into or continue a correspondent banking relationship with a bank incorporated in a jurisdiction in which it has no physical presence and which is unaffiliated with a regulated financial group (i.e. shell banks). Also it provides that banks should establish their respondent banks have customer due diligence standards and that banks should pay particular attention when continuing relationship with respondent banks located in jurisdictions that have poor CDD standards or have been identified as NCCT.

Recommendations and comments

--

Compliance with FATF Recommendations

R.18	Compliant	

The supervisory and oversight system–competent authorities and SROs: Role, functions, duties and powers (including sanctions) (R.17, 23, 29 & 30)

Description and analysis

R.17

Both criminal and administrative sanctions are available to punish non-compliance with the requirements under the AML/CFT rules.

Criminal sanctions

Section 303/B of the Hungarian Criminal Code (Act IV of 1978) provides sanctions for non–performance of Reporting Obligation in Connection with Money Laundering

(1) Any person who fails to comply with the reporting obligation by the Act on the Prevention and Combating of Money Laundering is guilty of felony punishable by imprisonment not to exceed three years.

(2) Any person who negligently fails to comply with the reporting obligation referred to in Subsection (1) is guilty of misdemeanor punishable by imprisonment not to exceed two years, work in community service or a fine. According to the authorities, in recent cases, 15 cashiers of banks were arrested for the negligence of reporting.

However, based on the discussions with the financial institutions visited (as discussed above), the current regime which imposes terms of imprisonment for intentional and negligent non-reporting of suspicious transactions may be counter-productive to the extent that it results in over-reporting by the financial institutions. This is particularly the case with respect to negligent non-reporting. In addition, the quality of STRs reported can be substantially improved as many STRs are reported merely on the basis of the size of the transaction and not pursuant to a suspicion of money laundering

Administrative sanctions

Under each sectoral laws for financial institutions, the HFSA is empowered for administrative sanctions, which include, warning, fines (both against legal persons and natural persons), resolutions to request correction of deficiencies, withdrawing, restricting and suspending licenses, request of dismissal of executive officers and other members of the management body as well as disciplinary action against employees, nomination of supervisory commissioner who takes the control of the financial institutions (the Sections 150-156 of the Banking Act, the Sections 196-198 of the Insurance Act, and the Sections of 399-400 of the Capital Market Act).

The HFSA conducted AML/CFT focused on-site inspection of financial institutions in 2003 and 2004; as a result of the inspections, the HFSA took the following sanctions;

1. resolutions to 7 insurance companies;
2. resolutions to 9 banks and fine for 1 bank;
3. resolutions to 5 financial enterprises;
4. resolutions and management letters to 6 investment firms; and
5. withdrawal of license of 2 bureau de change

In addition, the HFSA has published the resolutions in the Financial Gazette and the web-site of the HFSA.

R.23

Under the Section 1(1) and Section 2(2) of the AML Act, the HFSA is designated as responsible for supervision of financial institutions' compliance with the requirements under the AML Act. Also the Section 2(2) of the HFSA ACT provides that the HFSA shall continually monitor compliance with legal and supervisory regulations governing the operations of financial institutions, with particular emphasis on ML

The HFSA has issued Model Rules for each financial sector to develop internal procedures/regulations for AML and has approved the internal procedures/regulations for AML prepared by all the financial institutions. The HFSA has also issued the Recommendation of the President of the HFSA No.1/2004 on the prevention and impeding of terrorism and money laundering. In particular, for CFT, the Recommendation provides that financial institutions should pay increased attention to the lists of terrorists and terrorism organizations and that they should immediately report to the competent investigation authorities in case of a suspicion on FT.

The HFSA reviews the effectiveness of internal control for AML through off-site monitoring and on-site inspections, and take administrative actions/sanctions necessary to rectify any deficiencies identified, thus ensures the financial institutions to comply with the requirements for AML/CFT.

For off-site monitoring, the HFSA receives data on quarterly basis, including on anonymous deposits that have been transformed into registered ones, STRs (number, amount of transactions and etc.), and the number of beneficial owners and assets frozen based on the lists of terrorists issued by the UN and EU (number of accounts, amount of assets frozen). The HFSA also receives the number of internal audits conducted on AML/CFT, but not receive a copy of the internal audit reports, though they request for on-site inspections. However, the HFSA receives a "compliance report" from external auditors of financial institutions once a year, which covers findings relating to compliance with relevant laws, regulations and resolutions of the HFSA as well as internal control of financial institutions (Section 136 of the Banking Act, Section 151 of the Insurance Act and Section 360 of the Capital Market Act). With the data obtained as well as the compliance reports from external auditors, the HFSA establishes high risk areas to be a focus of on-site inspections.

For on-site inspections, the HFSA conducts i) a comprehensive inspection, at least once every 2 years, including the review of AML/CFT internal control; ii) follow up inspections; and iii)targeted inspections, including with focus on AML/CFT internal control. The HFSA has an on-site inspection manual, which also covers the AML/CFT issues. On-site inspections spend 2-3 weeks with 20 inspectors on average, while AML targeted inspections are conducted by 2-3 inspectors for a shorter period. The HFSA conducted inspections relating to AML/CFT internal controls for 274 institutions in 2003 and 241 institutions in 2004.

However, since there is no legal obligation of reporting STs based on suspicion of FT, the HFSA's supervisory oversight seems less robust for CFT than AML.

R.29

Section 2(2) of the Act CXXIV of 1999 on government Control of Financial Institutions (FSA ACT) provides that the HFSA shall continually monitor compliance with legal and supervisory regulations governing the operations of financial institutions, with particular emphasis on ML. The HFSA is empowered to control and oversee the compliance with and the enforcement of regulations relating to financial institutions, including the AML Act as well as other relevant requirements for AML/CFT, and to examine, analyze and evaluate their prudent operations (Section 138 of the Banking Act, Section 169 of the Insurance Act, and Section 378 of the Capital Market Act).

For that purpose, the HFSA is empowered to conduct on-site inspections of financial institutions and to request any records, data, information and documents (Section 146 of the Banking Act, Section 170 of the Insurance Act, and Section 396 of the Capital Market Act).

The HFSA has a power of administrative sanctions and has actually took actions against non-compliance with AML/CFT requirements, as described above for R.17

R.30

The HFSA is staffed with around 540 staff, and is in charge of supervision of all financial institutions (689 in total in September 2004). A staff of the HFSA is required by the Section 11 of the FSA Act to maintain confidentiality with regard to all of the secrets, information, data, and facts which they obtain in the course of discharging their duties at the HFSA, and the obligation shall remain in effect after the termini nation of the employment at the HFSA. The staff of the HFSA is subject to clean criminal records under the Code of Civil Servants, and the internal rule of the HFSA has provisions on conflicts of interests.

A supervisory staff is responsible for supervision of 2-3 financial institutions on average both for off-site monitoring and on-site inspections, including their AML/CFT compliance. The staff of the HFSA are skilled and trained, and participate in regular training relating to AML/CFT both in- and out of the country.

Recommendations and comments

- The authorities should review the effectiveness of the current regime of imposing terms of imprisonment for negligent non-reporting of suspicious transactions under the Section 303/B of the HCC.
- A clear legal basis for STR obligation relating to FT should be established to ensure effective supervisory oversight for CFT.

Compliance with FATF Recommendations		
R.17	Largely compliant	The current regime of imposing terms of imprisonment for intentional and negligent non-reporting of suspicious transactions under the Section 303/B of the HCC is not proportionate to the severity of non-reporting, especially in the case of negligent non-reporting.
R.23	Largely Compliant	Supervisory oversight for CFT is less robust due to a lack of legal basis for the STR obligation relating to FT
R.29	Compliant	
R.30	Compliant	

Financial institutions–market entry and ownership/control (R.23)

Description and analysis

(Banks)

Regarding ownership of banks, when entering to market, banks are required to get authorization (license) from the HFSA. The Section 11 of the Banking Act provides any person with qualifying participation in banks (i.e., i) controls 10 % or more of the capital, ii) has powers to appoint or remove 20% or more of the members of banks decision-making, management, supervisory and other bodies; or iii)has powers to exercise significant influence over the management of banks) must satisfy;

1. be independent of any influence which may endanger the bank's sound, diligent and reliable operation; and
2. transparency in business connections and ownership structure so as to allow the competent authority to exercise effective supervision over banks.

The Section 37 of the Banking Act provides that the HFSA's permission must be obtained before acquisition of qualifying participation (the same definition as above) in banks.

Regarding fit and properness executive officers and the members of Supervisory Board, the Section 13(4) of the Banking Act provides that any person who has been convicted for crimes cannot be appointed or elected to an executive officer, and the HFSA is entitled to check the register of convicted criminals and the register of individuals indicted under criminal charges (Section 13(5) of the Banking Act). The Section 44 (4) of the Banking Act also provide that no person having a criminal record can be elected or appointed as an executive officer. Also the Section 44 (6) of the Banking Act provides no person who has been indicted by the public prosecutor or indicted abroad for a property or economic crime that is punishable under Hungarian law can be elected or appointed as an executive officer until the conclusion of the criminal procedure. The HFSA shall reject an application for authorization for the election or appointment of a person having a criminal record or who has been indicted (Section 44(3) of the Banking Act).

(Insurance companies)

Under the Section 58 of the Insurance Act, the foundation of insurance companies are subject to license by the HFSA, and the application for a license shall include information concerning the shareholders, whether they are natural or legal persons, on persons with a qualifying holding and the extent of the qualifying holders defined in the Section 3, 5) of the Insurance Act. In addition, the Section 111 of the Insurance Act provides that, for the acquisition of an interest in a joint-stock insurance company that will provide a qualifying holding or alter an existing qualifying holdings, a prior permission by the HFSA must be obtained. The application for that must contain an official document in proof of having no criminal record for natural persons issued within 3 months to date by the authority of competent jurisdiction for the place where the applicant's permanent resident is located.

The Section 83 (1) and (3) of the Insurance Act provides that election or appointment of executive officer is subject to authorization by the HFSA, and the executive officer shall have no prior criminal records. The Section 83(5) of the Insurance Act also provide that no person who has been indicted by the public prosecutor or abroad for a property or economic crime that is punishable under Hungarian law may be appointed as executive officer until the conclusion of the criminal procedure. Similar fit and properness requirements are applied to managing director under the Section 84 of the Insurance Act.

The Section 83 (1) and (3) of the Insurance Act provides that election or appointment of executive officer is subject to authorization by the HFSA, and the executive officer shall have no prior criminal records. The Section 83(5) of the Insurance Act also provide that no person who has been indicted by the public prosecutor or abroad for a property or economic crime that is punishable under Hungarian law may be appointed as executive officer until the conclusion of the criminal procedure. Similar fit and properness requirements are applied to managing director under the Section 84 of the Insurance Act.

(Securities firms)
Section 107 of the Capital Market Act provides that , the application for acquisition of a qualifying holding in an securities firms, that is subject to authorization by the HFSA, shall include the information that the applicant, if a natural person, has no prior criminal record.

Also Section 97 of the Capital Market Act provides that investment service providers shall be managed by at least two officers with no prior criminal record.

(Money transfer services)
Under the Section 3(1) of the Banking Act, money transfer services are defined as financial services which require license from the HFSA, and are subject to the requirements under the AML Act and to supervision by the HFSA for AML compliance (Section 1(1) and (2) of the AML Act). Therefore, money transfer services without license from the HFSA is illegal. The HFSA is not aware of such illegal money transfer services or underground banking. If the HFSA notes such illegal money transfer services, it should report to the Police following the legal obligation to report criminal conduct during the course of discharging duties of the HFSA under the obligation of the Criminal Procedures Code)

(Money exchange services)
Under the Section 3(2) of the Banking Act, currency exchange activities are defined as activities auxiliary to financial services which require license from the HFSA. Under the Section 1 of the Government Decree 297/2001(XII.27.) on Money Exchange Services, only banks and persons employed by banks under agency contract to provide money exchange services ("exchange agent") may operate money exchange services.

The HFSA request the opinion of the National Police Headquarters prior to granting a license. The National Police Headquarters shall convey its opinion from point of view of criminal and public safety concerns (Section 2 of the Government Decree). When submitting application for license to the HFSA, exchange agents attach to the applications the terms of service approved by banks and must have a valid agency contract with banks (Section 3 of the Government Decree).

Also an official certificate of criminal history issued within 30 days to date for the persons to be elected or appointed as an executive officer of exchange agents need to be enclose with the application (Section 5 of the Government Decree). Under the Section 12 of the Government Decree, the following persons cannot be elected or appointed as an executive officer of exchange agents;

1. any person who has a criminal record
2. any person who has been indicted by the public prosecutor or who has been indicted for a crime against property or an economic crime that is punishable under Hungarian law may not be employed as an executive officer until the conclusion of the criminal procedure;
3. any person who has been punished for a misdemeanor offense for any fraudulent violations of financial or accounting regulations.

Under the Section 18 of the Government Decree, exchange agents shall have internal regulation, including the provision on AML, and shall keep the regulations updated at all times.

Internal control (audit) department of banks which have agency contracts with exchange agents shall examine/audit once a year whether the agents provide money exchange services in compliance with the law and the provision laid down in the contract with the banks. The banks must notify the HFSA without delay whenever the agents are engaged in violation of the law or in breach of the contract (Section 26 of the Government Decree).

The HFSA shall revoke license of exchange agents including the cases where they

1. are engaged in any unlawful activity;
2. do not comply with the legal provision on money exchange operations;
3. have repeatedly violated the legal provision on accounting, control and on the authorized activity and/or the regulations of the Commission (Section 7 of the Government Decree)

The exchange office visited by the assessment team indicated that they hare internal procedures for AML that are developed following model rules by the HFSA and that have been approved by the HFSA for obtaining a license from the HFSA, as well as internal control, including designation of money laundering reporting officer and training of employees on AML. Also the bank visited which as contract with exchange agents indicated that compliance officer of the bank provides AML training material to exchange agents, and that internal audit of the bank reviews the internal control at exchange agents once a year (there are internal auditors dedicated to internal audit of exchange agents). Interface between exchange agents and the HFSA is normally intermediated by the banks which have agents contracts with exchange agents, including submission of documents to the HFSA. The HFSA conducts on-site inspections of exchange offices, and revoked the licenses of 2 exchange agents in 2004.

(Cash processing services)
Cash processing services which are defined as auxiliary to financial services in the Section 3(2)c) of the Banking Act are subject to a license as financial enterprise and supervision by the National Bank of Hungary (NBH) (Section 3(6) of the Banking Act). Applications for licensing for cash processing service should include a certificate of no criminal record issued within 30 days to date for executive employees, for the manager in charge of cash processing operation and for all directly involved in cash processing activities, and need to be reviewed by the NBH. The NBH issued Model Rules for cash processing services to establish their own internal procedures/regulations for AML. There are currently 6 companies engaged in cash processing services.

Also the NBH has approved internal procedures/regulations of cash processing activities, and reviews their implementation through annual on-site inspection by the NBH. The NBH also organized seminars twice for the cash processing services companies, where the AML was on of the highlighted topics

Recommendations and comments
--

Compliance with FATF Recommendations		
R.23	Compliant	

AML/CFT Guidelines (R.25)

Description and analysis

The Section 11(3) of the AML Act provides that every financial institution must prepare internal rules/regulations covering the obligations laid down in the Act, to be approved by the HFSA.

The Section 11(5) of the AML Act requires the internal rules/regulations to contain at least the following elements:

1. aspects to be taken into consideration when establishing data, facts or circumstances that might be indications of money laundering;
2. the internal procedures of customer identification;
3. the internal procedures of establishing the identity of the beneficial owner and the manner of making a declaration by customers to this effect;
4. the internal procedures of the reporting requirement, including the underlying internal control, communication and data processing systems;
5. procedures and format of reporting to the FIU, the form for the report;
6. provisions concerning the handling, recording and protection of data generated in connection with the identification or reporting;
7. provisions pertaining to the training and continuous further training of employees;
8. procedural and behavioral standards applicable in individual cases to employees in direct contact with customers; and
9. description of the crime of money laundering in the HCC and of the provisions of the AML Act, as well

as of the secrecy provisions of the regulations applicable to the service provider.

Section 11 (4) of the AML Act provides that the HFSA assist supervised financial institutions in working out their Rules by publishing Guidelines and Model Rules. The Model Rules are prepared in co-operation with the FIU (who contributes to the effective operation of the anti-money-laundering system by sharing their experiences gained in the course of investigations) and in agreement with the Ministry of Finance (who was responsible for writing the text of the AML Act). The HFSA, as the agency responsible for the supervision of financial institutions, issued the Model Rules for each sector of the above mentioned financial institutions.

However, cash processing services, which are defined as auxiliary to financial services in the Section 3(2)c) of the Banking Act, are subject to a license as financial enterprise and are supervised by the National Bank of Hungary (NBH) (Section 3(6) of the Banking Act). The NBH issued Model Rules for cash processing services to establish their own internal procedures/regulations for AML.

For the case of postal financial intermediation services, postal money transfer, and postal money orders services that are subject to the requirements under the AML Act, the HFSA worked with the Hungarian Post Limited which provide such services and developed the internal procedures/regulations for the Hungarian Post Limited.

The Model Rules give a description of ML and FT techniques, methods and the typologies of the unusual transactions, as well as give additional measures the financial institutions could take to ensure that their AML/CFT measures are effective. The model rules also include internal rules/procedures for record keeping, procedures for CDD, rules and procedures for employees in direct contact with customers, provisions relating to screening suspicious transactions, procedures for reporting STRs including format and contest of reports, rules relating to designated persons to report to the FIU, rules for internal audit, provisions for training of employee and other issues required by the Section 11(5) of the AML Act.

The HFSA has approved more than 2000 internal procedures/regulations that have been prepared by each financial institution, following the Model Regulations by the HFSA. The approval by the HFSA is "pro-forma" against the Model Rules and the HFSA reviews the effectiveness of implementation the internal procedures/regulations through on-site inspections.

Also the NBH has approved internal procedures/regulations of cash processing companies, and reviews their implementation through annual on-site inspection by the NBH.

The HFSA has also issued the Recommendation of the President of the HFSA No.1/2004 on the prevention and impeding of terrorism and money laundering, which provides guidance on effective internal controls at financial institutions on AML/CFT measures.

Recommendations and comments

--

Compliance with FATF Recommendations

R.25	Compliant	

Ongoing supervision and monitoring (R.23, 29 & 32)

Description and analysis

R.23

Under the Section 1(1) and Section 2(2) of the AML Act, the HFSA is designated as responsible for supervision of financial institutions' compliance with the requirements under the AML Act. Also the Section 2(2) of the HFSA ACT provides that the HFSA shall continually monitor compliance with legal and supervisory regulations governing the operations of financial institutions, with particular emphasis on ML

The HFSA has issued Model Rules for each financial sector to develop internal procedures/regulations for AML and has approved the internal procedures/regulations for AML prepared by all the financial institutions. The HFSA has also issued the Recommendation by the President of the HFSA No.1/2004 on the prevention and impeding of terrorism and money laundering. In particular, for CFT, the Recommendation provides that financial institutions should pay increased attention to the lists of terrorists and terrorism organizations and that they should immediately report to the competent investigation authorities in case of a suspicion on FT.

The HFSA reviews the effectiveness of internal control for AML through off-site monitoring and on-site inspections, and take administrative actions/sanctions necessary to rectify any deficiencies identified, thus ensures the financial institutions to comply with the requirements for AML/CFT.

For off-site monitoring, the HFSA receives on quarterly basis the data, including those on anonymous deposits that have been transformed into registered one, STRs (number, amount of transactions and etc.), the number of beneficiary owners and assets frozen based on the lists of terrorists issued by the UN and EU (number of accounts, amount of assets frozen). The HFSA also receives the number of internal audits conducted on AML/CFT, but not receive a copy of the internal audit reports, though they request for on-site inspections. However, the HFSA receives "compliance report" from external auditors of financial institutions once a year, which covers findings relating to compliance with relevant laws, regulations and resolutions of the HFSA as well as internal control of financial institutions (Section 136 of the Banking Act, Section 151 of the Insurance Act and Section 360 of the Capital Market Act). With the data obtained as well as compliance reports from external auditors, the HFSA establishes high risk areas to be focused by on-site inspections.

For on-site inspections, the HFSA conducts i) comprehensive inspection, at least, once every 2 years, including the review of AML/CFT internal control; ii) follow up inspection; and iii)targeted inspections, including with focus on AML/CFT internal control. The HFSA has on-site inspection manual, which also covers the AML/CFT issues. On-site inspections spend 2-3 weeks with 20 inspectors on average, while AML targeted inspections are conducted by 2-3 inspectors for shorter period. The HFSA conducted inspections focusing on AML/CFT for 274 institutions in 2003 and 241 institutions in 2004. As a result of the inspections, the HFSA took the following sanctions;

1. resolutions to 7 insurance companies;
2. resolutions to 9 banks and fine for 1 bank;
3. resolutions to 5 financial enterprises;
4. resolutions and management letters to 6 investment firms; and
5. withdrawal of license of 2 bureau de change

In addition, the HFSA has published the resolutions in the Financial Gazette and the web-site of the HFSA.

However, since there is no legal obligation of reporting STs based on suspicion of FT, the HFSA's supervisory oversight seems less robust for CFT than AML.

R.29

The Section 2(2) of the Act CXXIV of 1999 on government Control of Financial Institutions (FSA ACT) provides that the HFSA shall continually monitor compliance with legal and supervisory regulations governing the operations of financial institutions, with particular emphasis on ML. The HFSA is empowered to control and oversee the compliance with and the enforcement of regulations relating to financial institutions, including the AML Act as well as other relevant requirements for AML/CFT, and to examine, analyze and evaluate their prudent operations (Section 138 of the Banking Act, Section 169 of the Insurance Act, and Section 378 of the Capital Market Act).

For that purpose, the HFSA is empowered to conduct on-site inspections of financial institutions and to request any records, data, information and documents (Section 146 of the Banking Act, Section 170 of the Insurance Act, and Section 396 of the Capital Market Act).

The HFSA has a power of administrative sanctions and has actually took actions against non-compliance with AML/CFT requirements, as described above for R. 17

R.32

As part of off-site monitoring, the HFSA receives from the financial institutions the following data on quarterly basis;

1. number and amount of registered anonymous deposits;
2. STRs (number, full and average amount of transactions for STRs, full incoming/outgoing amount of transactions for STRs)
3. assets frozen (number of accounts and amount of money frozen)

4. number of internal audits among financial institutions relating to AML/CFT (Note: internal audit reports are obtained during on-site inspections)
5. number of beneficiary owners

The HFSA also maintains data of on-site inspections focused on AML/CFT (274 in 2003 and 241 in 2004). The HFSA summarizes findings and lessons that were obtained from the on-site inspections and such findings/lessons are discussed at the Interministerial Committee for AML.

The Interministerial Committee for AML, chaired by the Ministry of Finance, reviews effectiveness of the AML system on regular basis. Also, the Interministerial Working Group for the fight against terrorism, chaired by the Ministry of Interior, discusses policies relating to combating terrorism, including CFT, and established National Plan of Action on Combat Terrorism adopted by the Government in May 2004 (see more details in the Section on "National cooperation and coordination")

Recommendations and comments

A clear legal basis for STR obligation relating to FT should be established to ensure effective supervisory oversight for CFT.

Compliance with FATF Recommendations

R.23	Largely Compliant	Supervisory oversight for CFT is less robust due to a lack of legal basis for the STR obligation relating to FT
R.29	Compliant	
R.32	Compliant	

Money or value transfer services (SR.VI)

Description and analysis

Money transfer services are defined as financial services that are subject to license and supervision by the HFSA under the Section 3 of the Banking Act, and are also subject to the requirements of AML under the Section 1 of the AML Act. Any unlicensed money transfer services would be illegal and would be subject to investigation by criminal/law enforcement authorities.

Postal money transfers are supervised by the HFSA. The Postal service does not provide account for customers, therefore money transfers by posts are only in cash and by walk-in customers. Postal money transfer is also subject to the AML Act (Section 1(1)e)) and supervised by the HFSA. Since there is just one Hungarian Post Limited, the HFSA worked together with the Post to establish its internal rules for AML (no Model Rules were issued).

Western Union money transfer services are managed by InterCash, Hungary, which is licensed by the HFSA as financial enterprises which are engaged only in money transmission services (Section 6(2) of the Banking Act). InterCash provides Western Union money transfer services through agents, including exchange offices, which are contracted agents with InterCash. The HFSA supervises InterCash through off-site monitoring and on-site inspections. The agents for InterCash have to be just notified to the HFSA (no supervision by the HFSA) and InterCash as the licensed financial enterprise should audit the agents (under Section 19 of the Banking Act). Also the HFSA reviews the contracts between the InterCash and its agents, including the InterCash's right to review the internal control of it agents.

Recommendations and comments

--

Compliance with FATF Recommendations

SR.VI	Compliant	

Preventive Measures–Designated Non-Financial Businesses and Professions

Customer due diligence and record-keeping (R.12)

Description and analysis

General: The CDD requirements of DNFBPs are the same as those for financial institutions established by Articles 3-6 of the AML Act (see the section "Customer due diligence, including enhanced or reduced measures (R.5 to 8) above). The issues noted in that section concerning CDD for beneficial owners are equally

problematic for DNFBPs.

The specific implementation of those requirements differs from profession to profession as follows.

Casinos: Hungarian casinos must fully identify all customers at entry (Article 3, Section 5), but Hungary does not impose an additional identification requirement on financial transactions above US$3000. As Hungarian casinos are state-supervised, this practice is in compliance with the 2nd EU Money Laundering Directive (Art. 2, sec.6)[15]. "Gaming houses," as they are not considered to be casinos, have no CDD requirement. According to the model regulation promulgated by the Gaming Commission, the beneficial owner requirement is considered fulfilled if the casino prominently posts a warning concerning this requirement and treats any customer who does not make a statement as gambling for themselves.

Dealers in precious stones and metals: According to Ministry of Finance Directive 7005/2003 (PK8) PM, such dealers are required to perform CDD as in the general section above. Reportedly, contractual business relations are rare in this sector, as are transactions above the threshold.

Real-estate agents: According to Ministry of Finance Directive 7002/2003 (PK8) PM, real estate agents are required to perform CDD as in the general section above. Practitioners report that Hungarian agency relationships are always conducted on a contractual basis.

Lawyers and notaries: Lawyers and notaries are required perform CDD as in the general section above on any client who engages their services for (i) the purchase of sale of equity participations in a business entity or association, (ii) the sale or purchase of real property, or (iii) the establishment, operation, or termination of a business entity or association. Failure to do so is sanctioned by the respective Chambers. Such identification requirements also apply when they accept cash or valuables from any client for safekeeping. Act XI of 1998, article 5, section 1, subsection e) authorizes lawyers to accept such valuables, and the rules governing their use of them are laid out in Article 30 of the same Act. Section 3 of that Act stipulates that "The attorney may only treat the cash and valuables he has received as deposits; the attorney may not use them, nor may he accept an agency that authorizes use of deposited items." This measure – alongside the general prohibitions against commercial activity (Art 6, Sec 1, subsection b) - would appear to militate against a lawyer managing bank, savings, or securities accounts on behalf of a client (FATF criterion 12.1.d.iii), actions which the Chamber of Attorneys reported were indeed prohibited. The Chamber of Notaries likewise informed the team that their members could not manage accounts for clients and only rarely held cash or valuables. However, Chapter XI of Act XLI of 1991 on Notaries Public stipulates an extensive series of conditions for the custody of instruments, money, and valuables. In the case of money, valuables, and securities, Article 165, section 1 presents the rules for transferring such items to a third party and does not specifically stipulate that the notary should record the identity of the third party. The Chamber of Notaries should review this procedure to ensure that the identify of the third party is taken as a matter of common practice. Otherwise, such a procedure could pose a money-laundering risk not directly captured in the AML Law.

Lawyers and notaries are exempt from this requirement (and from other requirements under the AML law) if the indications of money laundering are discovered "in connection with providing the defense in criminal proceedings or legal representation before a court - other than the court of registry - during any stage of such defense or representation or at any time thereafter," and lawyers are further exempt "while providing legal advice relating to the initiation of such proceedings." Notaries are further exempt when they are conducting a "non-trial procedure," which refers to probate action, nullifying securities, and deleting a mortgage. The beneficial owner requirements for notaries (20th directive of the National Chamber of Notaries, Article 14) involves taking full identification information for both legal and natural persons. These latter two exemptions should be reviewed to see if fall within the scope of the equity and real estate transactions meant to be included under the AML law.

[15] The question of more fully harmonizing the EU and FATF formulations on casino CDD will be raised during an upcoming FATF review.

Auditors: The sample regulations of the Chamber of Auditors, approved on 29 August 2003 and subsequently modified on 16 October 2004, require full CDD upon the signing of an auditing contract, which is the required mechanism for establishing a business relationship. As all auditors' clients would therefore be identified, no supplemental stipulations concerning occasional transactions or money-laundering indications are required.

Accountant and tax advisors: According to Ministry of Finance Directives 7003/2003 (PK8) PM and 7004/2003 (PK8) PM , these professions are also subject to the identification requirements of the AML legislation whenever they enter into a contractual relationship with a client or if they detect money laundering. No occasional transaction identification requirement is stipulated. Given the customary business practices of their professions, these requirements did not appear to be problematic for natural persons.

Recommendations and comments

The rules and practices of notaries should be reviewed to ensure that the notary collects full CDD information for any third party to whom he or she may transfer money, valuables, or securities and to see if all the exemptions for "non-trial procedure" are appropriate.

As with financial institutions, the DNFBP beneficial owner identification process should be strengthened in the AML legislation to ensure that service providers are taking full information on legal and natural persons.

Compliance with FATF Recommendations

R.12	Partially Compliant	Information required for the identification of beneficial owners are less than direct customers without justifiable reasons.

Monitoring of transactions and relationships (R.12 & 16)

Description and analysis

The model rules circulated by the Ministry of Finance, the Chambers of Notaries, Attorneys, and Auditors, and the HGB listed above all contain descriptions of potentially suspicious transactions and circumstances that are appropriate to the professions in question and generally conform to the R.11 focus on unusual or large transactions. No specific enhancements for politically exposed persons (PEPs) are either required by law or highlighted in the model rules, nor do the law or guidelines make provision for either enhanced or reduced customer due diligence procedures for DNFBPs.

DNFBPs are required to keep records for ten years, which is longer than required by R. 10. The customer is responsible for reporting any changes in their identification data to the service provider and the service provider is responsible for informing the customer of this obligation.

The law does not require special attention to transactions with countries which do not or insufficiently apply the FATF recommendations, although the model rule for Auditors does append the list of the NCCT countries current at the time it was issued.

Casinos have been instructed by the Gaming Board Model Rules to pay special attention to the veracity of any "Certificate of Winnings" that a customer may request to ensure against creating a fictitious source for possibly illegal income and to consider a request for a false certificate to be grounds for suspicion of money-laundering. Unlike casinos, Gaming Houses are not authorized to issue such certificates.

Recommendations and comments

Full compliance with the FATF recommendation would require enhanced due diligence for PEPs and wider and more systematic dissemination to DNFPBs of information about international compliance with the FATF standards.

Compliance with FATF Recommendations

R.12	Largely Compliant	Lack of provisions for PEPs.
R.16	Compliant	

Suspicious transaction reporting (R.16)

Description and analysis

General: DNFBPs – like financial institutions - are required to file STRs under the Art 8 of the AML Act, with the strengths and weaknesses (no FT requirement, no reporting of attempts) noted above (pp. 67-8). Lawyers and notaries are covered for the same kinds of transactions and subject to the same exemptions as for their CDD requirement. DNFBPs filed 1 STR in 2001, 7 in 2002, 65 in 2003, and 211 in 2004. Most of these came from

accountants and notaries. Lawyers, real estate agents, and precious goods dealers have filed none to date, while casinos and auditors have filed negligible numbers. Lawyers and Notaries file their STRs through their respective Chambers, which can add an unnecessary element of delay in reporting. All other DNFBPs file directly to the FIU.

DNFBPs are protected from liability if they report a suspicious transaction in good faith, even if that report is subsequently found to be incorrect. However, like other service providers, they are subject to criminal penalties if they fail to report a suspicious transaction , even through negligence. Informing the subject of a suspicious activity report that he/she is under suspicion ("tipping off") is prohibited.
The low numbers of reports from lawyers may reflect a tension between their reporting obligation and traditional lawyer-client privilege, or may (as they suggest) mean that the knowledge that such information is no longer privileged has kept clients from confiding in them. Lawyers have only been required to file STRs since the entry into force of the AML Act on 16 June, 2003, as were Notaries, who have filed some STRs.

Accountants were responsible for 174 of the 2004 reports, despite what one practitioner reported as a discomfort with the reporting function that the AML legislation assigned to them.. Auditors, despite their low level of reports, expressed a much greater comfort with their reporting obligations. The guidance to auditors on what constitutes a suspicious transaction are admirably thorough.

Sales-oriented DNFBPs (real estate agents, high-value goods dealers) have less contact with the supervisory authorities and less familiarity with the concept of money laundering activity in general. The indicators of suspicion given in the Ministry of Finance model rules focus on false customer identification, which would not apply to all transactions, to price disparities not always characteristic of the role asset-purchases can play in the ML process, or to future sales of items about which the dealer or agent might well have no knowledge. These factors could also help explain the absence of reports.

The FIU noted that the quality of the STRs has improved since the early period, but acknowledged that getting a significant number of high-quality STRs from these sectors requires continued outreach, education, and awareness-raising activities. The FIU has participated in workshops for DNFBPs and plan to continue to do so.

Recommendations and comments

Continued and enhanced measures should be taken to increase the quantity and quality of STR reporting from the DNFBPs. This will require systematic and continued outreach and improved guidance on suspicious transaction reporting – especially to DNFBPs that are not organized within SROs to overcome existing habits and to ensure that all service providers are aware of their responsibilities.

DNFBPs, like financial institutions, should be required to report transactions suspected of financing terrorism and should be required to report attempts to launder money.

Compliance with FATF Recommendations

R.16	Partially Compliant	Low numbers of STRs from DNFBPs, sub-optimal guidance on STRs for some DNFBPs, no FT or attempted ML reporting requirements.

Internal controls, compliance & audit (R.16)

Description and analysis

The Chambers of Attorneys, Notaries, and Auditors all circulated model rules to their members and smaller offices were allowed to adopt these without modification. The HGB circulated mandatory guidelines for internal rules to the casinos. The Ministry of Finance issued model rules for DNFBPs without SROs, who were required to submit their own rules back to the FIU. The NPHQ has received 21,000 internal rules from the DNFBPs it supervises , mainly from accountants and real estate agents. It reports that the vast majority of these rules are adequate, being closely based on the model rules disseminated by the Ministry of Finance.

All DNFBPs are required to designate a compliance officer, maintain internal AML/CFT rules, and to conduct training of staff. Training of accountants, auditors, notaries, and lawyers in their obligations under the AML legislation has been integrated into the on-going education which these groups have to attend periodically to maintain their legally recognized status. AML/CFT obligations are also a component of training for all real estate agents, both the one-time courses taught through the Ministry of the Interior and the on-going professional

training offered by the professional association to its members. Dealers in precious metals and stones that have more than 10 employees conduct their own, in-house, training, but are required to keep records of it and have them available for presentation to the authorities during on-site inspections. Casinos are also required to train their own staff and be able to document this training during inspections.

Recommendations and comments

Compliance with FATF Recommendations

R.16	Compliant	

Regulation, supervision and monitoring (R.17, 24-25)

Description and analysis

General: AML/CFT supervision of Hungarian DNFBPs falls into three categories: Casinos are directly under the supervision of the HGB, lawyers, notaries, and auditors are supervised by their respective chambers, and other professions (accountants, real estate agents, high-value goods dealers, etc) directly by the FIU. None of the model rules for DNFBPs address CFT issues.

Casinos: The HGB conducts regular close oversight of the casinos, including of their compliance with their obligations under the AML Act, in accordance with the provisions of that Act and its responsibilities under the Act XXXIV of 1991. They have conducted 26 specialized AML/CFT on-site examinations since the passage of the new AML law. They check the internal rules and training materials of the casinos and conduct spot checks of the CID procedures. The HGB has issued sanctions for failure to report a suspicious transaction and for record-keeping failures.

Article 2, Section 4 of the Act XXXIV of 1991 stipulates that no license to operate any gambling establishment, including both casinos and gaming houses if:
"b) the applicant or his senior officer has a criminal record, or committed crimes against public faith (Chapter XVI, title III of the Criminal Code), economic crimes (Chapter XVII of the Criminal Code), or crimes against property (Chapter XVIII of the Criminal Code), furthermore, the crime of organization of prohibited gambling activities within three years prior to submitting the application, and/or committed an offence against property, committed a financial offence, or the offence of violating the rules applicable to the operation of game and money-winning machines, or participation in prohibited gambling activities within two years prior to submitting the application." In practice, this largely relies on the Certificate of Clean Police Record also used by the HFSA for Financial Institutions.

Before the license is issued, applicants go through a tendering process, managed by the Ministry of Finance, which includes background checks and is reportedly able to screen out applicants with criminal associations. To avoid conflicts of interest, the HGB is not represented on the interagency body which oversees the tenders, and therefore cannot directly report on how fully and effectively this screening process protects Hungarian casinos from influence by criminal associates.

Self-Regulated DNFBPs: The professional Chambers are adapting to their AML/CFT responsibilities adequately. They have developed Model rules based on the AML law and disseminated them to their members and have incorporated AML/CFT infractions into their sanctioning policy. Those that conduct on-site examinations of their members (lawyers, auditors, notaries) report that they check compliance with AML/CFT obligations, although no sanctions have yet been issued.

Non self-regulated DNFBPs: The NPHQ is responsible for reviewing the internal rules of the non-supervised DNFBPs, conducting on-site inspections, and reviewing the training these DNFBPs conduct on their AML/CFT responsibilities. This extremely labor-intensive supervisory function would appear to be added on to the workload of an already fully committed staff. Nonetheless, the FIU has conducted 197 random on-site inspections of DNFBPs during 2003, 92 of which were outside Budapest. In 21 instances, they found deficiencies in the internal rules, record-keeping, or training activities of the supervised institution and issued a finding containing mandatory corrective measures. The authorities are considering the option of devolving the on-site inspection function to local police authorities, but this may well involve a sub-optimal blurring of the policing and supervisory function – already strained by the location of the FIU within the National Police Headquarters.

The professional chambers and the casinos report a fairly interactive process with the authorities in the development of the AML legislation and the model rules. There was some outreach to the non-supervised DNFBPs, but follow-up on questions and concerns appears to have been less than they would have liked. The Notaries reported receiving both specific and analytical feedback concerning the STRs that they had filed.

Recommendations and comments

- All of the sectors are covered by sanctions, although in some cases their effectiveness is still untested.

The authorities should review the tendering process for Gaming establishments to ensure that protections against the involvement of criminal associates is strong enough.

- Increase the resources available for supervision of non self-regulated DNFBPs.
- Improved feedback to the DNFBPs should be part of the ongoing awareness-raising and education efforts.
- Issue guidance on CFT for DNFBPs.

Compliance with FATF Recommendations

R.17	Compliant	
R.24	Largely Compliant	Supervision of DNFPBs without state or professional supervision understaffed
R.25	Largely Compliant	No guidance on CFT for DNFBPs

Other non-financial businesses and professions—Modern secure transaction techniques (R.20)

Description and analysis

The Hungarian legislation already covers a wider range of high-value goods dealers than required under the FATF recommendations and the authorities are participating in the preparation of the 3rd EU AML Directive, which is contemplating including a further extension of the group. Part of this latter work involves comparing their existing legislation with the draft Directive.

The largest Hungarian banknote in circulation is HUF 20000 (approx US$110). Hungarian authorities are aware of the large role cash plays in their economy and have mandated the use of the banking system and funds transfers for certain official transactions. In addition, the NBH has formed a working group on payments systems to develop measures to make financial institutions more accessible and attractive to potential clients.

Recommendations and comments

Compliance with FATF Recommendations

R.20	Compliant	

Legal Persons and Arrangements & Nonprofit Organizations

Legal Persons–Access to beneficial ownership and control information (R.33)

Description and analysis

The general rules concerning the setting up and the operation of companies are set forth in Act IV of 1959 on the Civil Code and Act CXLV of 1997 on the Register of Companies, Public Company Information and Court Registration Proceedings.

The main types of for-profit companies are the Corporation Limited by Shares, Company with Limited liability; Joint Enterprise; General and Limited Partnerships.

The Corporation Limited by Shares (CLS) is a separate legal entity, having separate existence from its shareholders and acting through its agents. CLS qualifies as private if its shares are not issued publicly; as public if the shares are publicly issued, either in part or in full. Regular share certificates, which are negotiable instruments, may be issued if the stated capital is fully paid in. Dematerialized shares may be issued to and must be of a "registered by name" nature. In the case of a Company with Limited Liability (CLL), the liability of the company is limited to its stated capital. Ownership rights of each member in the company are embodied in a "business quota" that is transferable unless otherwise prescribed in the articles of incorporation. Joint enterprise (JE) is a non-limited liability corporation of entities whose members are liable for its debts in proportion to their contribution. A General Partnership (GP)is an association of ten or more individuals or entities that does not constitute a separate legal entity and whose partners would jointly liable for debts while the responsibility in the case of Limited Partnership (LP) would be limited to the amount invested.

Non profit companies can be limited liability companies with legal entity, established for serving public purposes

and interests; Foundations may be formed for any long-term public interest , charitable or religious purpose by charter of foundation, executed by founder(s).

Any legal entity, if required by the law, may be registered under the conditions prescribed by Act CXLV in the Company Register. The Company Registers are held and maintained by Company Courts which are organized within County Courts and by a Metropolitan Court, (referred to as Court of Registration, which keeps the Register of Companies).
Registration is not only of declarative, but also of constitutive nature i.e. the company comes into being not by the simple deed of foundations but by the decision of Court ordering its incorporation.

Under the Act CXLV the registration system is computerized and run by the Company Registration Service of the Ministry of Justice and it is accessible to the public.

The Act CXLV provides for registration for 16 different types of entity (art. 13).

Article 12 provides for the data which is mandatory for all kind of entities: among others the company's registration number; the name and the registered office of the company; the deed of foundation; the company's principal activity; the company's subscribed capital, broken down by monetary and in-kind contributions; the name (corporate name), address (registered office) and the positions of the persons vested with the power of representation; all bank accounts of the company and the name(s) and address(es) of the financial institutions keeping such accounts.

Article 13 sets forth the specific data requested for every type of entity. These data, among others, would include the name of members and owners.

The mission has been informed that in the case of companies with legal personality a certificate from a bank that proves that the capital has been paid up would be also requested.

The Court of Registration conducts a formal control to check that all documentation has been produced and that it is complete and regular. In the case of foreign individuals or foreign companies that would be owners/members of a company, it would be sufficient to provide an authenticated copy of the same documentation that would be required for Hungarian Nationals. It would not be possible for the Court to inquire directly its foreign counterparts.

The Mission has been informed that the Law of Capital Market (Act CXX of 2001) has prohibited the issuing of bearer shares which was previously allowed. While references to bearer shares can still be found in some provisions of law (such as in art. 180 of Law no. IX of 1997 on Corporate Business Associations and in art. 13 sec. (5)of Law CXLV of 1997on the Register of Company) the Mission has been informed that these provisions would not be anymore effective.

Through art. 13 (10) a foreign company may register in Hungary a "direct commercial representative office(s)". In this case the data required is:
a) the name, type, file number from the company register (registration number) and registered office of the foreign company,
b) the name and seat of the court or authority where the foreign company is registered,
c) the name (corporate name) and home address (registered office) of the foreign company's executive officers and the first and last day of their term in office.
The Mission has been informed that a foreign company that would register a representative's office pursuant to art. 13 sec. 10 would not be allowed to conduct business activities. However the representative's office could buy properties, as well as establishing business relationship (such as opening a bank account).

As far as identification of the beneficial owner issues are concerned the Court of registry would rely on the AML identification requirements prescribed for the lawyers and notaries who are involved in the preparation of the deed of foundation of the company.

Should a change regarding the registered entity occur this must be reported to the Court: among others it should

be noted that, according to article 30, section 2 " Any amendments involving the company's registered office (business premises, branch office) or its members (owners), executive officers, supervisory board members or its auditor shall take effect upon being registered in the company register retroactively as of the effective date of the change in question".

Recommendations and comments

Compliance with FATF Recommendations

R.33	Compliant	

Legal Arrangements–Access to beneficial ownership and control information (R.34)

Description and analysis

The mission was informed that legal arrangements, other than the legal persons discussed above under Recommendation 33 do not exist in Hungary. However, according to the information provided by the Court of Registry, under article 13, section 10, of Act CXLV of 1997, a representative of a foreign trust could be registered as a "direct commercial representative office(s) of foreigners in Hungary".

Recommendations and comments

Compliance with FATF Recommendations

R.34	Not applicable	

Nonprofit organizations (SR.VIII)

Description and analysis

The Hungarian authorities have not yet undertaken a review of the vulnerabilities of their NPO sector, although the draft of 2nd National Action Plan of the Interministerial Task Force on Counterterrorism is reported to contain plans for such a review.

The registration requirements and the on-going supervision of the NPOs by dedicated staff at the Public Prosecutor's office would seem to provide a measure of protection against terrorist organizations posing as legitimate Hungarian NPOs, although the registration process is not so rigorous that such a maneuver would be impossible to perform.

The protections against the diversion of funds collected by Hungarian NPOs are strongest in the area of budgetary subsidies, which many Hungarian NPOs receive. The reporting requirements for receipt of "1%" funds (see p. 17) also allow for some level of programmatic verification, as does the specific nature of the tax receipts required for donors to PBOs to receive deductions. The general supervisory powers of the General Prosecutor's office do not include access to bank records and therefore do not currently provide a basis for tracing financial flows through the organization.

It would appear that there the controls over the NPO sector are not explicitly linked to the act of raising funds from the public, but are rather related to the high level of "outsourced" public-sector activity performed by the sector in exchange for direct and indirect subventions from the government. In other words, there would appear to be no legal basis for stopping an unregistered NPO from soliciting funds from private citizens for relief victims abroad (not one of the public benefit functions enumerated in Act CLVI/1997) and no mechanism for the Hungarian authorities to control what such an NPO did with the funds. Judging by the relatively low level of individual private donations to registered Hungarian NPOs, however, this might currently be a relatively low-level risk, however it would be an appropriate area for the NPO review to look into. .

Recommendations and comments

The authorities need to conduct a review of the sector in order to be fully compliant with the FATF recommendations. That examination should look broadly at increasing the transparency in the sector, strengthening the legal basis for supervision, and oversight over NPO fundraising. Authorities should consult widely with the sector on ways of improving transparency and reporting.

Compliance with FATF Recommendations

SR.VIII	Partially Compliant	Conduct necessary review; modernize oversight regime

National and International Cooperation

National cooperation and coordination (R.31)

Description and analysis

The **Minister of Finance** has the main responsibility of forming of the regulatory framework concerning AML and the national and international communication concerning this subject.

To facilitate the co-ordination of AML, an **Interministerial Committee** has been set up since 2001 by the Government Resolution No. 2298/2001. (X.19.) Korm., with members delegated by the following entities: Ministry of Justice, Ministry of Finance, National Bank of Hungary (NBH), Hungarian Financial Supervisory Authority (HFSA), Hungarian Gaming Board (HGB), Interior Ministry, National Police Headquarters (NPHQ), Ministry of Foreign Affairs, political undersecretary responsible for the civilian national security services. After its establishment, representatives of the Attorney General's Office, the National Judicial Council, the Tax and Financial Control Administration (APEH), the Government Control Office, the National Security Bureau and the Banking Association have been added to the Committee. It was chaired by the Government Commissioner.

On 8 January 2002, the Government appointed a Government Commissioner to co-ordinate actions against money laundering (Government Resolution No. 1003/2002. (I.21.) Korm.). His tasks include initiating and co-coordinating legislative amendments, making recommendations concerning implementation and representing Hungary in international organizations. On the basis of the Government Decree No. 2/2004. (I.5.) Korm. of 1 January 2004 the Minister of Finance took up the duties of the Government Commissioner and the Government Resolution No. 1003/2002. (I.21.) Korm. is repealed, Therefore, the Minister of Finance chairs the Anti-money laundering Interministerial Committee.

The AML Interministerial Committee, though not a decision making body, discusses issues, including legislation relevant to AML, measures necessary to address international requirements such as the FATF. Recommendations and the EU Directive, and has met 16 times between June 2001 and February 2005.

Since October 2003, there are regular (bi-weekly) meetings between the competent security and law enforcement agencies, hosted by the National Security Office (**Anti-terror Co-ordination Committee**). In this framework all the relevant information is exchanged and ongoing operations are coordinated. The FIU contacts the financial institutions and the HFSA, if necessary, based on the outcome of these meetings.

On the policy level, since April 2004, there is an **Interministerial Working Group** which has been set up by Government Resolution No. 2112/2004. (V.7.) Korm., chaired by the Minister of Interior for identifying the possible legal and/or capacity obstacles as regards the national implementation of the EU policy of fight against terrorism and the national counter-terrorism machinery in general. In this Working Group, all the relevant ministries (incl. Ministry of Finance, as well as Ministry of Economics and Transport) and agencies are represented. The Working Group established National Plan of Action to Combat Terrorism adopted by the Government in May 2004, which includes measures for CFT. The second National Plan of Action is expected to be adopted by the Government in 2005.

Recommendations and comments

--

Compliance with FATF Recommendations

R.31	Compliant	

The Conventions and UN Special Resolutions (R.35 & SR.I)

Description and analysis

The Vienna Convention was signed on August 22, 1989 and ratified on November 15, 1996; the Palermo Convention was signed on December 12, 2000 but has not yet been ratified; the FT Convention was signed on November 30, 2001 and ratified on October 14, 2002.
The Hungarian Parliament adopted Act L of 1998 for the promulgation of the Vienna Convention and Act LIX for the promulgation of the FT Convention
The Act XXXVIII of 1996 on the international legal assistance in criminal matters applies in relation to both Conventions.

Hungary has also signed (November 6, 1997) and ratified (March 2, 2000) the Council of Europe Convention on

Laundering, Search, Seizure and Confiscation of Proceeds from Crime.

As discussed above in the sections on Recommendations 1 and 2, the definitions of the ML offence in Art.303 and 303/B of the HCC do not follow, in their language and structure, the international standards set forth by the Vienna and Palermo Conventions. Both articles appear to limit the scope of the ML offence to cases where the perpetrator "*uses items obtained by the commission of activities punishable by imprisonment in his business activities and/or performs any financial or bank transaction in connection with the item in order to conceal its true origin*", so that intentional conversion or transfer, as well as concealment and disguise are not fully covered.

Even though under the current legislation the offence of FT is not criminalized as a separate offence (at least in the case of financing aimed at individual terrorists), the HCC covers the material elements of FT set forth under Article 2, paragraph 1 of the FT Convention. The case of financing of individual terrorists is based on the ancillary nature of the FT offense and it is treated either as an act of complicity or under the provision of "preparation". In certain circumstances it carries the same penalty as the main terrorism offense. In addition, the offense of FT would be applicable even in cases where the financed terrorist acts have actually not been committed nor even attempted (in the case of preparation, set forth under section 4 of article 261) .

Government Resolution 2112/2004 adopted a National Action Plan against terrorism and set up an Interministerial Working Group Against Terrorism under the direction of the Minister of Interior to implement the EU policy in the fight against terrorism and other related international obligations. Among the most significant currently unmet goals mentioned in the Plan are ratifying the Palermo Convention, improving the exchange of intelligence and co-operation among international Police forces, adopting domestic legislation to allow freezing of intangible, real and tangible assets of suspected terrorist and amending the existing provision pertaining to the freezing of financial assets.
The implementation of the UN Convention on FT and UNSCRs 1267, 1269, 1333 and 1390 appears to pose some issues.

The absence of a legal obligation for SPs to report suspicions of FT impedes their involvement in the identification and detection of funds used or allocated for the purpose of committing FT and consequently weakens the possibility for forfeiture, (see article 8 of the Convention). The AML law does not provide for such a reporting obligation nor does it provide, as in the case of ML, the possibility to suspend a transaction in the circumstances set forth in art. 9.

There is no domestic legislation implementing UNSCR 1267 nor UNSCR 1373. The authorities have informed the team that, as Hungary is a Member of the EU they would consider directly applicable the EU regulations which have been issued consequently the UNSCRs. This argument doesn't' appear to be persuasive nor seems to fully address all the legal issues related to this matter.

First, the EU Regulations require domestic legislation to determine sanctions and the authority responsible to check compliance with the obligations set forth in those regulations. The Hungarian legislative framework seems lacking in this respect[16].

Second, there are major issues concerning the freezing of real goods, (related to the practical implementation of the freezing) which seem not to be covered by domestic legislation.

The Hungarian Authorities have acknowledged these issues in the National Plan of Action to Combat Terrorism, which, under the above mentioned UN Convention and UNSCR 1373, states that "deficiencies were discovered in the course of the review". As already mentioned, the National Plan identifies as target to be achieved the adoption of a legislation that allows "freezing of intangible, real and tangible assets" as well as amendment of laws pertaining to financial assets.

[16] The Hungarian authorities informed the team that, as of the 1st of June 2005, a bill (no. 16127) on the amendment of the Criminal Code and other acts is pending before the Hungarian Parliament. According to this amendment, section 261/A of the Criminal Code will sanction with 5 years of imprisonment the breach of obligations deriving from embargoes (including the case, as the authorities have informed, of an the obligation to freeze financial means, or other values related to property, or economic resources).

Only one case has been reported to the mission in which assets belonging to individuals or entities included on the UN 1267 Sanctions Committee's consolidated list have been identified. The authorities are encouraged to proceed with the adoption of domestic acts that would enable Hungary to comply fully with UNSCRs 1267 and 1373.

Recommendations and comments

- Ratify and fully implement the Palermo Convention
- Fully implement Vienna and UN Convention on FT
- Provide for domestic legislation implementing the UN Resolutions

Compliance with FATF Recommendations

R.35	Partially Compliant	Palermo Convention not ratified and implemented; scope of the ML and FT is not fully consistent with Vienna and the UN Convention for FT
SR.I	Partially compliant	Legal framework and implementation not consistent with the UN Convention on FT and with UNSCR

Mutual Legal Assistance (R.32, 36-38, SR.V)

Description and analysis

1. Mutual legal assistance: general rules

Mutual legal assistance matters are taken care of in three ways, with partly overlapping aspects.
The first category of rules are those stipulated in different treaties.
The second set are the general legislative rules contained in Act XXXVIII of 1996 on international legal assistance in criminal matters.
The third category are the rules provided by the Act CXXX of 2003 on the co-operation with the member states of the European Union in criminal matters.

The basic rules are described in the Act of 1996 on international legal assistance. This Act shall apply unless otherwise stipulated by an international treaty.

The forms of mutual legal assistance that are possible cover a whole range, including

surrender or acceptance of criminal proceedings
surrender or acceptance of the execution of forfeiture of assets, confiscation or other measures of the same effect (this provision was added by Act CXXX of 2003)
procedural assistance

Principally, legal assistance can only be provided on the condition that the offence is punishable according to both Hungarian law and the law of the foreign State, thus requiring the dual criminality. Since both for money laundering and terrorist financing, the FATF States are obliged to criminalize these activities, this should in practice pose no problem in this field.

The fact that tax offences might be involved, or might be the predicate offence for the money laundering, presents no obstacle for legal assistance.

Legal assistance cannot be provided for political offenses, but acts where the goal of the offense, the motive and methods are of an essentially criminal nature, outweighing any political aspect, will not be considered as political. Pre-meditated murder will always be considered as criminal.

Upon execution, the Minister of Justice or the General Prosecutor may ask for a statement of reciprocity. If there is no reciprocity guaranteed, the request for legal assistance may still be executed, on the decision of these authorities, in agreement with the Minister of Foreign Affairs.

Unless otherwise provided, the execution of legal assistance will be done in accordance with the principles of the Criminal procedure code (Section 10).

Criminal proceedings transferred by foreign authorities may be accepted, if the offender is a Hungarian citizen or an immigrant living in Hungary. The General Prosecutor will decide on this issue (Sections 43-44).

After the decision of the Court, the Minister of Justice shall inform the requesting State.

Normally, requests for legal assistance shall be sent through the diplomatic channel, but the Minister of Justice and the General Prosecutor are also authorized to accept requests directly sent to them, thus minimizing the procedural requirements and allowing for a quick reaction.

2. Confiscation / forfeiture

Surrender or acceptance of the execution of forfeiture of assets or confiscation shall take place in compliance with obligations undertaken in international treaties. This exception to the general principles allow to apply the execution even without reciprocity (Section 6.3).

As far as the execution of forfeiture and confiscation is concerned, specific procedural rules were introduced.

According to Section 60/A, enforceable sentences of foreign courts related to the execution of assets or confiscation shall be executed based on an international treaty and on receiving a request. The same principle was already formulated by Section 6.3 (cf. supra). The Minister of Justice is appointed as receiving authority, and he shall forward the request to the Metropolitan Court of Budapest. The execution will not be accepted however if a Hungarian court already has passed a final judgment in the case underlying the sentence of the foreign court. This exception seems to narrow the scope of application, since a Hungarian judgment that only imposed an imprisonment or a fine could make it impossible to take away of the profits of the crime that may have been discovered by foreign judicial authorities. This is however an inevitable consequence of the non bis in idem-principle, insofar confiscation is regarded as a criminal sanction on itself and not as a measure"

The Metropolitan Court of Budapest shall examine, according to the principles of the Criminal code and the Criminal procedure code, as well as applicable international treaties, whether the conditions for execution are fulfilled, and shall decide to recognize or not recognize the foreign judgment, and decide on the execution or non-execution thereof. The recognition of foreign confiscation or forfeiture judgments is thus possible, but not automatic, unless international treaties oblige otherwise.

If the punishment or measure ordered by the foreign court is not fully compatible with the Hungarian legal regulations, the Court shall establish the measures to be taken in accordance with Hungarian law, and shall order the execution in a way ensuring that the foreign punishment or measure is complied with in the greatest possible extent. Although there are no specific provisions on civil forfeiture decisions, Section 60/B mentions “punishments or measures”, which allows for a broad scope. “Measures” could of course be limited to criminal proceedings, like the confiscation and forfeiture in Hungarian law itself, but is not necessarily limited thereto. On the other hand, the Act of 1996 deals with legal assistance in criminal matters, so it will be an interpretation of the purpose of foreign civil forfeiture measures, rather than limiting them to measures taken in criminal proceedings as such. It is not clear whether a civil forfeiture measure would be considered against Hungarian law, but the formulation used in Section 60/B does not suggest so, and the specific provision that measures shall be taken in order to execute the request to the fullest possible extent seem to point in the direction of the acceptance of such civil forfeiture execution requests. Since the provisions of the Hungarian Criminal Code on confiscation and forfeiture are themselves broad, there does not seem to be an immediate problem.

In this respect, the rules of the Criminal Code also must be mentioned.

A verdict rendered by a foreign court shall have the same effect as a verdict rendered by a Hungarian court (Section 6 HCC), if

- the foreign court proceeded on the basis of charges filed by the Hungarian authorities or upon transfer of the criminal proceeding
- the foreign court proceeded based on charges filed against the perpetrator for an act that is punishable by Hungarian law and by the law of the foreign state as well, and the proceeding conducted abroad and the sentence imposed or the measure employed is in conformity with Hungarian law

The validity of a verdict rendered by a foreign court shall not be recognized if it relates to a criminal act of political nature. An offense shall however not be considered to be of political nature if the criminal aspects outweigh the political ones, in view of all applicable circumstances, such as motive and means employed. Premeditated homicide will always be regarded upon as a criminal offence (Section 6 HCC).

3. Procedural acts

The Hungarian authorities shall provide procedural assistance upon request (Section 61 – cf. also Section 4 mentioned supra).

This assistance can include investigative activities, searches for evidence, questioning of suspects and witnesses, hearing of experts, inspection of sites, searches, frisk searches, seizure, transit, documents and objects, service of documents, provision of personal data or criminal records. (Section 61). For a description of these measures, we can refer to the other Recommendations.

Official documents may be served within the scope of international legal assistance (Section 70.1.e HCPC)

The legal assistance request can even be executed without the dual criminality normally required (Section 5), if the requesting State guarantees reciprocity (Section 62).

As mentioned above, the rules of the Criminal procedure code are normally applied (Section 10). This principle is repeated in Section 64. However, a modern provision is added, stipulating that other procedures may be employed at the request of the foreign State, if not incompatible with Hungarian law.

The receiving authority appointed for legal assistance requests is the General Prosecutor. He will forward the request to the prosecutor designated by him to execute the demand. If assistance of a court if requested by the foreign authorities, or if according to Hungarian law the request must be approve by court, the General Prosecutor shall forward the request to the Minister of Justice, who in turn will forward it to the territorially competent court (Section 70).

The foreign authorities shall be informed of the decisions, and, if needed, of the reasons making it impossible to approve the request.

4. Asset sharing

There are no provisions in Hungarian law allowing for the asset sharing at this point. The Ministry of Justice pointed out that they are waiting for an EU framework decision. Asset sharing would however be possible on a case-by-case basis, as no treaty is necessary to provide mutual legal assistance.

5. Statistics

Between 2001 and 2004, 13 rogatory letters were granted, none was denied. The 2005 Questionnaire still mentions the Act XIX of 1994 on the promulgation of the European Convention on mutual assistance in criminal matters of 1959, not the 1996 Act, so it is not entirely clear whether other figures might exist.

Other requests made by foreign counterparts numbered 4 between 2001 and 2004

There are no specific statistics kept permitting to see in how many cases money laundering or terrorist financing was involved, nor to see how many cases / what amounts of asset freezing, seizure, confiscation or forfeiture were received / sent.

6. Terrorist financing

There is no exception provided for the application of the above mentioned rules to terrorist financing. As terrorist financing is an offence under Hungarian law (cf. Sections 18-21 and 261 HCC, but cf. other Recommendations),

and has to be criminalized in the FATF states, the normal mutual legal assistance principles apply.

Recommendations and comments

- More detailed and precise statistics must be kept to track ML / FT cases.
- Consideration should be given to the adoption of asset sharing provisions

Compliance with FATF Recommendations

R.32	Largely compliant	In the mutual legal assistance statistics, no detailed statistics for ML/FT.
R.36	Compliant	
R.37	Compliant	
R.38	Compliant	
SR.V	Compliant	

Extradition (R.32, 37 & 39, & SR.V)

Description and analysis

Recommendations 32, extradition

1. General rules

The extradition rules can be provided for by international treaties, by Act XXXVIII of 1996 on international legal assistance in criminal matters, and by Act CXXX of 2003 on co-operation with the member states of the European Union.

The 1996 Act on international legal assistance shall be applied unless otherwise stated by treaties (Section 3). Extradition is one of the forms of assistance provided (Section 4).

Persons found in Hungary may be extradited for the purpose of criminal proceedings, if the offence is punishable under both Hungarian and the foreign law by imprisonment of at least one year (Section 11). Extradition could be refused, for example for *non bis in idem* reasons (Section 12).

Extradition of Hungarian national citizens is not possible in principle. It can only be allowed if the person sought is also a citizen of the foreign State (so dual nationality) and has his residence in that State (Section 13).

Extradition can only be allowed if in the requesting State no other criminal proceedings are conducted against the person sought for which extradition was not granted, and on condition that that person will not be extradited to third States for the offense (Section 16). This last issue only refers to the same offence, as specified by the Ministry of Justice during meetings with the team.

If several States ask for the extradition, the decision shall take the location of the offence, the citizenship, the gravity of offences, and other elements into account.

The requests for extradition shall be received by the Minister of Justice, which will forward it to the Metropolitan Court of Budapest. Appeals to the appellate chamber of the Court are possible, but shall have no delaying effect (Section 18).

The Court can order the apprehension of the person sought for extradition. The police can take him into custody bring him before the Court. The custody can take up to 72 hours (Section 19).

Arrest for extradition may not exceed six months, to be extended by the Court one time by another six months.

When the Court orders the provisional arrest, the person is informed that if he consents to the extradition the provisions of the international treaties shall not be applied. The Minister of Justice can then consent to the extradition even before receiving the request by official channels.

In urgent cases, the requesting State may ask for a provisional arrest before submitting an extradition demand.

Such previous demands may also be channeled through Interpol. The police shall take the necessary measures, and can take the person sought into custody for up to 72 hours, bringing him before the Court. (Section 24).

The provisional arrest shall be terminated if no extradition request was received within forty days (Section 25).

The Minister of Justice is the competent authority to decide on extradition matters (Section 26).

If extradition if refused, the Minister shall forward the case to the General Prosecutor for consideration of initiation of criminal proceedings in Hungary (Section 28). This might for instance be the case if the person sought cannot be extradited because of his Hungarian nationality.

In the course of the extradition, the Court may also authorize the transmission of property, which was used in the commission of the offence, or was acquired as a result of the offence, or which has replaced property which was acquired as a result of the offence. Such a transmission remains possible even if the extradition itself is not granted, but the provision does not affect ownership or other rights (Section 30). Although this possibility of transferal of property is very broad, and could theoretically include profits of crime or money laundered, the Ministry of Justice pointed out that this was not the purpose of the provision. In case of seizure, the other provisions on procedural assistance should be applied.

No statistics on extradition procedures were provided.

2. The extradition between EU-Member States

Act CXXX of 2003 regulates the extradition between member states of the European Union.

Unless otherwise stipulated, the 1996 Act on international legal assistance and the Criminal procedure code shall apply.

The Minister of Justice shall receive the European arrest warrant.

Following a European arrest warrant, a person staying in Hungary may be arrested and surrendered for conducting criminal proceedings or execution of a sentence in the requesting state. The requested person shall be surrendered without verifying the dual criminality, for the offences listed in the Annex I to the 2003 Act. This list contains the terrorism (Section 261) and money laundering (Sections 303 and 303/B) offences. If for the offences listed in the Annex I the punishment for the offence in the issuing member state is less than three years maximum, or for offences not mentioned in the list, the dual criminality still applies. For tax and customs offences, the extradition shall not be refused because the tax or duty is not known in the Hungarian system.

Hungarian citizens will not be extradited for execution of sentences, but in that case the execution can be taken over by Hungary. For the criminal proceedings themselves, nationals can be extradited, but the condition may be added that after the sentence they are to be returned for execution of the sentence.

The execution of the European arrest warrant may be refused if it relates to offences committed in whole or in part on Hungarian territory.

In case of conflicts between various requests, the advice of Eurojust may be asked.

The Metropolitan Court will act as judicial authority. Custody for 72 hours is possible to bring the person before the Court. Simplified proceedings are in place if the person requested consents to his surrender to the requesting State, and, if appropriate, to the specialty rule.

Provisional arrest is possible for 40 days.

At the request of the foreign authority or *ex officio*, the Court can take measures for the seizure and handing over of property which may constitute evidence, or which has been acquired by the requested person as a result of or is related to the offence, this provision however not affecting ownership or other rights.

No statistics on the application of the European arrest warrant were provided.

3. Terrorist financing

There is no exception provided for the application of the above mentioned rules to terrorist financing. As terrorist financing is an offence under Hungarian law (cf. Sections 18-21 and 261 HCC, but cf. other Recommendations), and has to be criminalized in the FATF states, the normal mutual legal assistance principles apply.

Recommendations and comments		
Statistics on extradition should be established.		
Compliance with FATF Recommendations		
R.32	Largely compliant	No detailed statistics available
R.37	Compliant	
R.39	Compliant	
SR.V	Compliant	

Other Forms of International Co-operation (R.32 & 40, & SR.V)

Description and analysis

Recommendation 40

1. International co-operation

In 2001 Hungary has concluded a co-operation agreement with Europol. It has become a full member on September 1, 2004.

Hungary has co-operation agreements with 21 EU-member states and 22 other States, including the US, Bulgaria, Russia, Romania, the Ukraine, Croatia, Turkey, Bosnia-Herzegovina, Serbia-Montenegro and China.

It also participates in the working groups of regional initiatives, like the Central European Initiative and the Wisigrad Cooperation.

The Hungarian police maintains a network of liaison officers. These comprise the Nordic countries, the UK, the Netherlands, Belgium, France, German, Austrian, Spain, Italy, Poland, the Slovak Republic, Russia, the Ukraine, Romania, the US, Canada and Israel. Most of these LO's are in the country, some cover the country from their stations abroad.
The Hungarian police has LO's at Europol, the BKA in Germany, at the SECI Centre in Bucharest, in Moscow, Kiev and Ankara, and foresees a post at IP Lyon and one for the Italian region.

2. The Police Act

Section 2 of the Police Act 1994 stipulates that on the basis of international treaties and reciprocity, the Police shall cooperate with foreign and international law enforcement organizations and fight international crime. Based on international treaties, Hungarian police officers may exercise law enforcement powers abroad and foreign police officers may exercise law enforcement powers within Hungary.

3. The Act on international co-operation of 2002

Act LIV of 2002 on the international co-operation of the law enforcement bodies, established the International law enforcement cooperation centre.(NEBEK) A directorate for international co-operation was already created by Act LIV of 1999, and set up in February 2000, following the recommendations of the high-level working group of 1998. The idea is based on a "one-stop shop"-principle. A draft to better coordinate these two legislations, which have some points of conflict, has been submitted to the Minister of the Interior.

This Centre is located within the National Police Headquarters, and has different bureaus, including the Europol desk, the Interpol national central bureau and the bilateral / EU cooperation desk. In the near future the creation

of a Sirene desk will be effectuated, due to the accession to the Schengen treaty.

Nebek provides a 24 hour service. It has a staff of 83, but due to financial restrictions only 69 are effectively employed. The service handled 51.631messages in 2002 (33.524 from abroad and 18.107 internal) and 46.350 in 2003 (31.196 from abroad and 15.154 internal). The Europol liaison office handled since 2002 719 cases, involving 2.548 real operational information exchanges. Two third of the cases is focused on currency counterfeiting, drugs, illegal immigration and terrorist activities. Money laundering represents 3 % in this Europol-related activities, financial crimes 7 %. A new IT system has been developed and is still being improved, so that in the future more detailed figures should be available. The regulation states that the requests must be answered within 30 days, or faster if the foreign authorities request so.

The Nebek is not only a central co-operation centre for the police, but also for the Customs and Finance Guards and for the Border Guards.

The Centre works on the strategic non-operational level. For urgent matters and specific operational requirements, some services are allowed to have direct contacts with their foreign counterparts, keeping the Centre informed about these contacts but without necessarily having to divulge operational information. Amongst these units are the National Bureau of Investigation and the Criminal Logistics Unit, handling undercover operations, surveillance and witness protection.

Other specialized units, as the FIU and the counter-terrorism department have their own secure channels.

4. Operational co-operation

The 2002 Act can only be applied on the basis of an international agreement that regulates the forms of cooperation. The international agreement shall be applicable if it differs from the provisions of the Act. The Hungarian law enforcement agencies may also co-operate with agencies of the EU-states on the basis of common positions, framework decisions or other decisions based on the EU Treaty.

Different forms of cooperation are made possible by the Act:

direct exchange of information
controlled delivery
joint crime detection teams
informants
undercover operations
cross-border surveillance
hot pursuit
criminal intelligence gathering
witness protection

Exchange of information can be related to criminal records, vehicle number plates, identification of persons (such as identity and address) or documents (such as driving licenses), or the identification of the subscriber of telecommunications.

If according to Hungarian law the approval of the prosecutor is required, than this approval has to be obtained prior the execution of the request.
Data and information collected during covert intelligence investigations (pre-investigative stage, i.e. before the criminal investigation) may be disclosed to international and foreign criminal investigation and judicial authorities on the basis of an international convention, treaty or agreement or, in lack thereof, on the basis of reciprocity if it is necessary for eliminating a serious and direct danger or preventing a serious criminal act, provided that the conditions for data handling are met (Section 63.5 Police Act).

Personal data may only be processed to foreign authorities according to the Hungarian legislation. Such data protection rules can f. ex. be found in Sections 71 and others of the Criminal procedure code, 76-91 of the Act on the Police and 38-52 of the Act on the national security services. Similar provisions can be found elsewhere (cf.

Section 87 Police Act: the police may disclose personal data to foreign criminal investigation and judicial authorities and international criminal organizations under an international commitment).

Under international commitment, the police may order that a marking is placed in the personal data of a suspect, during the search for that person, vehicle or object (Section 89).

According to the NEBEK, no joint investigative teams in the Eurojust-interpretation of joint team working on one case have been operational yet. In the broader Europol-interpretation of different teams working closely together, some experience exists.

5. Terrorist financing

There is no exception provided for the application of the above mentioned rules to terrorist financing. As terrorist financing is an offence under Hungarian law (cf. Sections 18-21 and 261 HCC, but cf. other Recommendations), and has to be criminalized in the FATF states, the normal mutual legal assistance principles apply.

6. Exchange of information with foreign supervisors

Under Section 5 of the Act of HFSA, the HFSA is empowered to enter into cooperation agreements and exchange of information with foreign supervisors. The HFSA may provide information to foreign supervisors for the evaluation of licensing of financial institutions and prudential supervision, as well as for developing solid grounds for resolutions against financial institutions. The HFSA has concluded MOUs for information exchange with foreign supervisors. Though the MOUs do not normally specify the AML/CFT issues, rather the MOUs cover all the supervisory relevant issues including the AML/CFT, the HFSA has exchanged information on AML/CFT matters with foreign supervisors, for example, the German financial supervisory authorities.

Recommendations and comments		
• More detailed and precise statistics must be kept to track ML / FT cases.		
Compliance with FATF Recommendations		
R.32	Largely Compliant	Statistics are not accurate
R.40	Compliant	
SR.V	Compliant	

Table 2: Ratings of Compliance with FATF Recommendations

[The rating of compliance vis-à-vis the FATF Recommendations should be made according to the four levels of compliance mentioned in the 2004 Methodology (Compliant (C), Largely Compliant (LC), Partially Compliant (PC), Non-Compliant (NC)), or could, in exceptional cases, be marked as not applicable (na).]

Forty Recommendations	Rating	Summary of factors underlying rating
Legal systems		
2. ML offence	LC	The scope of money laundering is not fully consistent with the Vienna and Palermo Conventions. Relatively low number of prosecutions and convictions
3. ML offence–mental element and corporate liability	C	
4. Confiscation and provisional measures	LC	Very limited number and amount of seizures and confiscations
Preventive measures		
5. Secrecy laws consistent with the Recommendations	C	
6. Customer due diligence	LC	Information required for the identification of beneficial owners are less than direct customers without justifiable reasons.
7. Politically exposed persons	LC	A lack of explicit requirement regarding approval by senior management of continuing business relations with persons becoming PEPs after the establishment of a business relationship
8. Correspondent banking	C	
9. New technologies & non face-to-face business	C	
10. Third parties and introducers	C	
11. Record keeping	C	
12. Unusual transactions	C	
13. DNFBP–R.5, 6, 8-11	PC	Information required for the identification of beneficial owners are less than direct customers without justifiable reasons. Lack of provisions for PEPs
14. Suspicious transaction reporting	PC	Need to improve quality of STRs. Need to cover FT and attempted transactions.
15. Protection & no tipping-off	C	
16. Internal controls, compliance & audit	C	

17. DNFBP–R.13-15 & 21	PC	Need improved outreach and guidance on suspicious transaction reporting for all DNFBPs to improve quantity and quality of reporting. Need to cover FT and attempted transactions.
18. Sanctions	LC	The current regime of imposing terms of imprisonment for intentional and negligent non-reporting of suspicious transactions under the Section 303/B of the HCC is not proportionate to the severity of non-reporting, especially in the case of negligent non-reporting.
19. Shell banks	C	
20. Other forms of reporting	C	
21. Other NFBP & secure transaction techniques	C	
22. Special attention for higher risk countries	C	
23. Foreign branches & subsidiaries	C	
24. Regulation, supervision and monitoring	LC	Supervisory oversight for CFT is less robust due to a lack of legal basis for the STR obligation relating to FT
25. DNFBP – regulation, supervision and monitoring	LC	Supervision of DNFPBs without state or professional supervision understaffed
26. Guidelines & Feedback	LC	No guidance on CFT for DNFBPs
Institutional and other measures		
27. The FIU	LC	CFT is not covered by the FIU; no legal obligation to report to FIU STRs related to FT
28. Law enforcement authorities	LC	Insufficient focus on potential ML offenses and relatively low number of prosecutions and convictions
29. Powers of competent authorities	C	
30. Supervisors	C	
31. Resources, integrity and training	C	
32. National co-operation	C	
33. Statistics	LC	Statistics for investigations and prosecutions are inconsistent. Figures for seizures and confiscations are not accurate. No detailed statistics related to mutual legal assistance.
34. Legal persons–beneficial owners	C	
35. Legal arrangements – beneficial owners	N.A.	
International Cooperation		

36. Conventions	PC	Palermo Convention not ratified and implemented; scope of the ML and FT is not fully consistent with Vienna and the UN Convention for FT
37. Mutual legal assistance (MLA)	C	
38. Dual criminality	C	
39. MLA on confiscation and freezing	C	
40. Extradition	C	
41. Other forms of co-operation	C	
Nine Special Recommendations	**Rating**	**Summary of factors underlying rating**
SR.I Implement UN instruments	PC	Legal framework and implementation not consistent with the UN Convention on FT and with UNSCR
SR.II Criminalize terrorist financing	PC	There is no autonomous criminalization for FT of individual terrorists.
SR.III Freeze and confiscate terrorist assets	PC	No generally applicable immediate action for freezing possible
SR.IV Suspicious transaction reporting	NC	No legal obligation for reporting STRs related to FT
SR.V International cooperation	C	
SR.VI AML requirements for money/value transfer services	C	
SR.VII Wire transfer rules	C	
SR.VIII Nonprofit organizations	PC	No review of the adequacy of relevant laws and regulations to prevent abuse of NPOs for FT
SR.IX Cash Couriers	PC	No possibility to stop/restrain or seize in the case of ML/FT.

Table 3: Recommended Action Plan to Improve Compliance with FATF Recommendations

FATF 40+9 Recommendations	Recommended Action (listed in order of priority)
1. General	No text required
2. Legal System and Related Institutional Measures	
Criminalization of Money Laundering (R.1 & 2)	• Enlarge the scope of the ML offense so that it covers all the circumstances set forth by the Vienna and Palermo Conventions. • Harmonize Article 303 and 303A so that the same definition of "item" will be formally applicable to both provisions.
Criminalization of Terrorist Financing (SR.II)	There should be a separate provision for FT, particularly for the case of financing terrorist acts which are not to be committed or intended to be committed by a terrorist group.
Confiscation, freezing and seizing of proceeds of crime (R.3)	• Consideration should be given to providing the FIU with statutory authorization to freeze assets and suspend transactions. • Consideration should be given to creating a system of administrative freezing, granting the FIU, Police and Prosecutor a reasonable period of time to check the facts of the case in detail, without immediately having to open a criminal investigation. • Much more consideration should be given to the taking away of the proceeds of crime. The number and amounts of seizures and confiscations should increase noticeably, given the high number of prosecutions for economic crime. Operational practice should more consistently and systematically link seizure/confiscation with investigations.
Freezing of funds used for terrorist financing (SR.III)	• Create legal authority for the financial institutions to freeze upon suspicion of terrorist financing. • Provide the FIU, Police and Prosecutor with an autonomous competence to freeze in cases of suspicious transactions possibly linked to FT. • Provide a sufficient period of freezing in order to do serious checks before having to start criminal investigations. • Provide clear procedures for de-listing and un-freezing also for the UNSCR.
The Financial Intelligence Unit and its functions (R.26, 30 & 32)	• Placing responsibility for CFT matters with the FIU and establishing a clear obligation to report to FIU STRs related to FT. Consideration should be given to: • Given the Police nature of the FIU and number of staff, placing the supervisory function over DNFBPs outside the FIU; • The FIU continuing to upgrade its software; • The analysis of STRs by the FIU identifying as much as possible underlying predicate offences; and • Having the statistics of STRs compiled by the FIU provided in greater detail and containing references to predicate offence

	where possible.
Law enforcement, prosecution and other competent authorities (R.27, 28, 30 & 32)	• Strengthening the HCFG competences in AML/CFT, specifically placing more emphasis on the financial angle of the investigations. • The investigations on organized crime should focus more on potential ML offenses and be more closely coordinated with ML investigations. • Law Enforcement officials must gain more practical experience in ML investigation and prosecution through a more generalized and aggressive prosecution policy and a more innovative and daring use of the existing tools is necessary.
Cash couriers (SR IX)	• Identification, record keeping and reporting requirements should apply also in the case of FT. • HCFG should be given the authority to stop/restrain cash to ascertain whether evidence may be found for ML/FT. • Sanctions should be more effective and dissuasive. • Immediate seizure should be available in the case of cash and valuables related to ML/FT. .
3. Preventive Measures–Financial Institutions	
Customer due diligence, including enhanced or reduced measures (R.5 to 8)	• Measures need to be taken to require full information for the identification of beneficial owners, for example by the AML Act and the supervisory rules by the HFSA. • There should be explicit requirements regarding approval by senior management of continuing business relations with persons becoming PEPs after the establishment of a business relationship.
Record keeping and wire transfer rules (R.10 & SR.VII)	Ensure that, for the payment form in domestic ICS system, sufficient space for information on the originator (name, address and account number) should be allowed as planned.
Monitoring of transactions and relationships (R.11 & 21)	The authorities may consider requiring explicitly that financial institutions keep records of findings of screenings.
Suspicious transaction reports and other reporting (R.13-14, 19, 25 & SR.IV)	• A clear legal basis for the obligation to report suspicious transactions relating to the financing of terrorism should be established. • Further efforts are needed to improve the capabilities of financial institutions to detect STRs related to ML and FT. • Reporting STRs should be in electronic format.
Internal controls, compliance, audit and foreign branches (R.15 & 22)	The authorities may consider introducing more explicit requirements to require financial institutions to ensure their foreign branches and subsidiaries observe AML/CFT measures in Hungary and inform the HFSA when they are unable to observe AML/CFT measures in foreign jurisdictions.
The supervisory and oversight system–competent authorities and SROs (R. 17, 23, 29 & 30).	• The authorities should review the effectiveness of the current regime of imposing terms of imprisonment for negligent non-reporting of suspicious transactions under the Section 303/B of the HCC.

	• A clear legal basis for STR obligation relating to FT should be established to ensure effective supervisory oversight for CFT.
Ongoing supervision and monitoring (R.23, 29 & 32)	A clear legal basis for STR obligation relating to FT should be established to ensure effective supervisory oversight for CFT.
4. Preventive Measures–Nonfinancial Businesses and Professions	
Customer due diligence and record-keeping (R.12)	• The rules and practices of notaries should be reviewed to ensure that the notary collects full CDD information for any third party to whom he or she may transfer money, valuables, or securities. • The beneficial owner identification process should be strengthened both in the AML legislation and in the various directives and guidelines, to require full information for natural and legal persons.
Monitoring of transactions and relationships (R.12 & 16)	Enhanced due diligence for PEPs and wider and more systematic dissemination to DNFPBs of information about international compliance with the FATF standards are needed.
Suspicious transaction reporting (R.16)	• Active measures should be taken to increase the quantity and quality of STR reporting from the DNFBPs. This will require systematic and continued outreach and improved guidance on suspicious transaction reporting – especially to DNFBPs that are not organized within SROs to overcome existing habits and to ensure that all service providers are aware of their responsibilities. • A clear legal basis for the obligation to report suspicious transactions relating to the financing of terrorism should be established.
Regulation, supervision and monitoring (R.17, 24-25)	• The authorities should review the tendering process for Gaming establishments to ensure that protections against the involvement of criminal associates is strong enough. • Improved feedback to the DNFBPs should be part of ongoing awareness-raising and education efforts. • Issue guidance on CFT for DNFBPs. • Increase the resources available for supervision of non self-regulated DNFBPs.
5. Legal Persons and Arrangements & Nonprofit Organizations	
Nonprofit organizations (SR.VIII)	• The authorities need to conduct a review of the sector in order to be fully compliant with the FATF recommendations. That examination should look broadly at increasing the transparency in the sector, strengthening the legal basis for supervision and oversight over NPO fundraising. • Authorities should consult widely with the sector on ways of improving transparency and reporting.
6. National and International Cooperation	

The Conventions and UN Special Resolutions (R.35 & SR.I)	• Ratify and fully implement the Palermo Convention • Fully implement Vienna and UN Convention on FT • Provide for domestic legislation implementing the UN Resolutions
Mutual Legal Assistance (R.32, 36-38, SR.V)	• More detailed and precise statistics must be kept to track ML / FT cases. • Consideration should be give to asset sharing provisions.
Other Forms of Cooperation (R.32 & 40, & SR.V)	• More detailed and precise statistics must be kept to track ML / FT cases.

V. AUTHORITIES' RESPONSE TO THE ASSESSMENT

The Hungarian Authorities thank the IMF/WB team and the expert of Moneyval for the assessment and were in broad agreement with its findings.

1. The Hungarian authorities consider that the main message of the 2005 AML/CFT assessment is that the overall AML situation in Hungary is favourable:

"*The Hungarian authorities have made significant progress in strengthening their AML regime in the four years since the last assessment… the legislative framework for AML is in place... Financial institutions' compliance with the AML requirements is well-supervised and they are well aware of their obligations under the Act."*

The Hungarian authorities appreciate the recommendations made by the IMF/WB team and the expert of MONEYVAL and they are committed to consider seriously these recommendations in addressing deficiencies in the legislative framework. This will take place as soon as the final version of the EU's new AML/CFT directive will be available for implementation, although they are ready to commence the work concerning the most important issues in the near future.

2.

2.1 The Hungarian authorities are of the opinion that the inevitably short comments in the report might be sometimes misleading as to the real level of compliance and awareness of the Hungarian society. Just to take a typical example: concerning cash couriers the assessors generally states in the report that there is no possibility to stop/restrain or seize in the case of ML/FT. In full this remark would be as follows: There is no possibility to stop/restrain or seize in the case of ML/FT, *if there is no suspicion as regards the criminal origin of the assets carried by the cash courier.* In our view it is quite logical that when the customs officers have no reason for suspicion, they do not undertake any coercive action.

2.2 The assessment of the Hungarian authorities regarding the legislative framework for CFT , especially the legal obligation to report FT suspicious transactions differs considerably from that of the assessors.

As for the implementation of the UNSCRs on CFT issues we would like to emphasize that the relevant EU regulations on restrictive measures adapted the mentioned resolutions. These EU regulations are directly enforceable and applicable in Hungary being a member state of the EU since 1st of May 2004. Thus, the general legislative framework is in place and there is a need to complete in details the related implementing measures.

With respect to suspicious transaction reporting we would like to mention that the Hungarian authorities are of the opinion, the AML Act's preamble gives the legal ground for the reporting STRs on data, facts and circumstances indicating terrorist financing. Although the preamble does not provide a solid legal basis, but the reporting system is effective in practice

and e.g. the Recommendation No.1/2004 of the HFSA defines guidelines for the service providers.

Furthermore it is well known that Hungarian financial service providers (banks, insurance companies, investment funds, etc.) have been heavily investing in FT screening software. It is also acknowledged in the assessment report that reports on FT suspicion are regularly sent to the FIU and there were two cases in 2004 when due to suspicion of FT assets were frozen. It is equally well known that the constantly updated EU terrorist list is publicly available on the homepage of the Hungarian Financial Supervisory Authority (HFSA) and all financial service providers are daily updating their screening systems accordingly. Furthermore the HFSA approves all AML/CFT internal rules of the financial service providers and without a comprehensive reporting system including FT reporting there is no chance to obtain an approval that is an essential element of a license. All on-site inspections of the HFSA focus on this subject.
However this and many more measures are summarily assessed as "No legal obligation for reporting STRs related to FT".

Our point is that in the case of a well-functioning AML/CFT system accepted as such also by the assessors the very existence and the functioning of the system should be taken into account when assessing if there was a legal basis for the establishment of the system.

Finally, the high level of compliance of the Hungarian AML/CFT system with the international standards indicates the commitment of Hungary to fight against money laundering and suppressing the financing of terrorism. The achievements of Hungary serve as a well-grounded basis for further development of the AML/CFT system in place.

ANNEX I: DETAILS OF ALL BODIES MET ON THE ON-SITE MISSION

- Inter-Ministerial Committee on ML
- Ministry of Finance
- Ministry of Justice
- Ministry of Interior
- Ministry of Foreign Affairs
- National Police Headquarters
- General Prosecutor's Office
- Supreme Court
- FIU (as part of National Police Headquarters)
- Tax and Financial Control Administration
- Hungarian Customs and Finance Guard
- Court of Registry
- National Bank of Hungary
- HFSA
- Hungarian Gaming Board
- National Communication Agency

- Hungarian Banking Association
- Investment Association
- Association of Hungarian Insurance Companies
- Association of Chartered Accountants
- Hungarian Bar Association
- Chamber of Auditors
- Chamber of Public Notaries
- National Association of Hungarian Jewelers
- Hungarian Real Estate Association
- Nonprofit Information and Training Center Foundation

- CIB Bank
- Calyon Bank
- ING Bank
- Metrum Kft. External Auditor
- Casino Varkert
- IBISZ Money Exchange
- Realszistema Securities Rt.

ANNEX II: COPIES OF KEY LAWS, REGULATIONS AND OTHER MEASURES*

- Act XV of 2003 on the Prevention and Combating of Money Laundering
- Act LXXXIII of 2001 on Combating Terrorism, on Tightening up the Provisions on the Impeding of ML and on the Ordering of Restrictive Measures
- Act LIV of 2002 on International Cooperation of Law Enforcement Agencies
- Section 303 of Act CXX of 1999 on the Criminal Code
- Act XXXVIII of 1996 on International Mutual Legal Assistance in Criminal Matters
- Act XXXIV of 1991 on the Organization of Gambling
- Recommendation of the President of the HFSA No 1/2004 on the prevention and impeding terrorism and money laundering

* Only for assessments of FATF/FSRB member countries that also constitute a mutual evaluation.

ANNEX III: LIST OF ALL LAWS, REGULATIONS AND OTHER MATERIAL RECEIVED

(Laws)

- Act XV of 2003 on the Prevention and Combating of Money Laundering
- Act LX of 2003 on Insurance Institutions and Insurance Business
- Act CXXX of 2003 On the Co-operation with the Member States of the European Union in Criminal Matters
- Act CI of 2003 on the Post
- Act LIV of 2002 on International Cooperation of Law Enforcement Agencies
- Act CXX of 2001 on the Capital Market
- Act LVIII of 2001 on the National Bank of Hungary
- Act LXXXIII of 2001 on Combating Terrorism, on Tightening up the Provisions on the Impeding of ML and on the Ordering of Restrictive Measures
- Act CIV of 2001 on criminal liability of legal persons
- Act CXXI of 2001 on self-laundering and negligent ML
- Act C of 2000 on Accounting
- Act CXXIV of 1999 on Government Control of Financial Institutions (HFSA Act)
- Act XI of 1998 on Attorneys at Law
- Act XIX of 1998 on Criminal Proceedings
- Act CXLIV of 1997 on Business Association
- Act CXLV of 1997 on the Registration of Companies, Public Company Information and Court Registration Proceedings Act CXII of 1996 on Credit Institutions and Financial Enterprises
- Act CXII of 1996 on Credit Institutions and Financial Enterprises
- Act CXI of 1996 on Securities Offerings, Investment Services and the Stock Exchange
- Act XXXVIII of 1996 on International Mutual Legal Assistance in Criminal Matters
- Act LXXXI of 1996 on Corporate and Tax and Dividend Tax

- Act CXXV of 1995 on the National Security Services of the Republic of Hungary
- Act XXXIV of 1994 on the Police
- Act XCVI of 1993 on Voluntary Mutual Insurance Funds
- Act XLI of 1991 on Notaries Public
- Act XXXIV of 1991 on the Organization of Gambling
- Criminal Procedure Code
- Act IV of 1978 on the Criminal Code
- Act IV of 1959 Civil Code; Section 29(1). 58(3), 62(2), 74/A(2)
- Act IV of 1957 on the General Rules of Administrative Procedures
- Act XX of 1949, The Constitution of the Republic of Hungary

(Decrees/Guidelines/Circulars/others)

- Government Decree 306/2004 on the tasks of the authorities granting exemptions from the asset-related restrictive measures ordered by the European Union
- Government Resolution No 2112/2004. (V.7.) Korm (on creation of Interministerial Working Group on terrorism)
- Government Decree No 2/2004 (I.5.) Korm (on the MOF's chairmanship for the Interministerial Committee on AML).
- Government Decree No 306/2004 (XI.13) (on certain administrative tasks related to exemption from restrictions imposed by the EU)
- Government Resolution No2286/2002 of 26 September on Further measures to impede ML and FT
- Government Decree 232/2001 (XII. 10.) Korm. on Monetary Circulation, Financial Transaction Services and on Electronic Payment Instruments
- Government Decree 297/2001 (XII. 27.) on Money Exchange Services
- Government Resolution No 2298/2001. (X.19.) Korm (on creation of AML Interministerial Committee)

- Government Decree 224/2000(XII. 19.) on taxation of non-profit organizations
- Law-Decree No. 2 of 1989 on Savings Deposits

(FIU)

- NPHQ Internal Regulation no. 17 of 1 June 2004 of the Chief Commissioner on the Police Measures Related to the Prevention and Impeding of Money Laundering
- Internal Regulation no. 5 of 16 June 2004 of the General Director for Criminal Investigation of the National Police
- Guidelines for accounting and tax advisory services
- Guidelines for entities trading in precious metals
- Guideline for entities trading in real estate agency
- Other regulations/rules relating to organization and operation of FIU

(HFSA)

- Recommendation of the President of HFSA No 1/2004 on the prevention and impeding terrorism and ML
- Model Rules for Providers of Financial Services and Auxiliary Financial Services for the Preparation of Rules on the Prevention of Money Laundering
- GUIDE to the Model Rules of Providers of Financial Services and Auxiliary Financial Services
- Model rules for Providers of Insurance Services for the Preparation of Rules on the Prevention of Money Laundering
- GUIDE to the Model Rules of Insurance Companies
- Annual Report 2003
- Manual/procedures of on-site examinations to review AML/CFT compliance

(Hungarian Gaming Board)

- Guideline No 1/2003 and a sample regulation for the prevention and restriction of ML

(Ministry of Interior)

- Ministry of Interior-Police Decision of June 16, 2003, regarding FIU's power to sign MOU with foreign FIU

(Ministry of Finance)

- Directive of the Minister of Finance No. 7002/2003. (PK.8.) PM on guidelines relating to the implementation of Act XV of 2003 on the Prevention and Impeding of Money Laundering (for those engaged in activities related to real estate transactions and concerning the drafting of their internal Rules)

- Directive of the Minister of Finance No. 7003/2003. (PK.8.) PM on guidelines relating to the implementation of Act XV of 2003 on the Prevention and Impeding of Money Laundering (for those engaged in accounting (book-keeping) activities and concerning the drafting of their internal Rules)

- Directive of the Minister of Finance No. 7004/2003. (PK.8.) PM on guidelines relating to the implementation of Act XV of 2003 on the Prevention and Impeding of Money Laundering (for those engaged in tax consultancy, chartered tax consultancy and tax advisory activities and concerning the drafting of their internal Rules)

- Directive of the Minister of Finance No. 7005/2003. (PK.8.) PM on guidelines relating to the implementation of Act XV of 2003 on the Prevention and Impeding of Money Laundering (for those who trade in precious metals, precious stones, goods made from either thereof, jewellery, cultural assets, works of art, or sell such assets in auctions or as commission agents, and concerning the drafting of their internal Rules)

- Directive 7001/2004 (P.K.12.) PM on the Amendment to Directive 7002/2003 (P.K.8.) PM, Directive 7003/2003(P.K.8.) PM, Directive 7004/2003 (P.K.8.) PM and Directive 7005/2003 (P.K.8.) PM concerning the guiding rules in relation to the implementation of the Act XV of 2003 on the Prevention and Combating of Money Laundering

- Directive 7002/2004 (P.K.12.) PM on the Amendment to Directive 7002/2003 (P.K.8.) PM, Directive 7003/2003(P.K.8.) PM, Directive 7004/2003 (P.K.8.) PM and Directive 7005/2003 (P.K.8.) PM concerning the guiding rules in relation to the implementation of the Act XV of 2003 on the Prevention and Combating of Money Laundering

- Communication of the Ministry of Finance of April 2, 2004 (relating to financial services for homeless persons)

(NBH)

- Decree No. 9/2001 (MK 147.) MNB on Payment Transactions, Clearing and Settlement Transactions, and on the Rules of Money Processing Operations

- Model Rules for cash processing companies as their core business activity toward amending internal policies for preventing money laundering

(Constitutional Court)

- Resolution No 24/1988

(Inter-Ministerial Committee on ML)

- Terms of reference, minutes/records of meetings, and other documents that show its activities/discussions

(DNFBP SROs)

- Model Rules for Lawyers, Notaries, and other DNFBPs
- Sample regulations for auditors on the prevention and obstruction of money laundering
- Circulars to members about AML/CFT responsibilities for Lawyers, Notaries, Auditors

Statistics

- Number of STRs with breakdown of reporting bodies, number passed to law enforcement for investigations, any information on STRs from lawyers
- Number of ML/FT investigations and prosecutions, with breakdown on those generated by STRs or not
- Number of orders for provisional measures and confiscations
- Number of on-site examinations of financial institutions by HFSA, with breakdown on categories of institutions, frequencies, those focused on AML/CFT
- Number of disbarments conducted in Hungary in the last 5 years, in general and for AML/CFT related offenses
- Number of DNFBPs that have sent in the name of their designated officer, with breakdown by type of DNFBP
- Amount of money raised from Hungarian sources by domestic or foreign NPOs, and amount sent abroad
- Number and percentage of Hungarian NPOs that have tax privileged status.

Reports

(PC-R-EV/MONEYVAL)

- Second round mutual evaluation report by PC-R-EV (Dec 2002)
- Progress report 1999-2000 on Hungary by PC-R-EV (May 2000)

(FATF)

- Self-Assessment Questionnaire for the 25 NCCT Criteria (2002 and 2003)
- Self-Assessment Questionnaire for the FATF Special Recommendations on CFT (2003)
- FATF Second Review to identify NCCT (June 2001)
- FATF Third Review to identify NCCT (June 2002)
- FATF Fourth Review to identify NCCT (June 2003)