The definition of unusual and unjustified transactions from the perspective of the risk of money laundering and terrorist financing

Regulation

- Act No. 253/2008 Coll., on Certain Measures Against Legitimisation of Proceeds of Crime and Financing of Terrorism, as amended (**AML Act**)
- Decree No. 67/2018 Coll., on Selected Requirements for the System of Internal Rules, Procedures and Control Measures against Legitimisation of Proceeds of Crime and Financing of Terrorism (**AML Decree**)

Provisions

- **Articles 6, 8, 9, 18, 21 and 21a of the AML Act**
- **Articles 5, 7, 9, 10 and 11 of the AML Decree**

Question

The AML Act and the AML Decree stipulate, i.a., an obligation to pay attention to unusual transactions, unusual customer behaviour in a business relationship and transactions that have no obvious economic or lawful purpose. What requirements apply to obliged entities in this regard? How can unusual or unjustified transactions be identified?

I. Unusual and unjustified transactions in general

An unusual transaction or an absence of obvious reasons for making a transaction may indicate efforts to abuse the obliged entity's product or service for money laundering or terrorist financing. Such situations are, therefore, listed as potential circumstances suggesting a suspicion of money laundering or terrorist financing in Article 6(1)(a) to (f) of the AML Act. For the same reason, also Article 9(4)(c) of the AML Decree associates these transactions with higher risk.

To identify potential suspicions, Article 9(2)(c) of the AML Act also stipulates an obligation to monitor business relationships on an ongoing basis to determine whether the transactions undertaken are consistent with the obliged entity's knowledge of the customer and its business and risk profile, i.e. to establish whether these transactions are unusual (and consequently whether they are suspicious). The obliged entity complies with this obligation within the limits set out in Article 9(3) of the AML Act, i.e. to the extent necessary to determine the potential risk of money laundering and terrorist financing.

II. Identification of unusual and unjustified transactions

The obliged entity must establish procedures to comply with AML/CFT measures in its system of internal rules (Article 21(5) of the AML Act). These procedures must include processes to identify suspicious transactions, including, i.a., a definition of the unusual and unjustified transactions which the obliged entity may encounter in its specific business activities (Article 9(5) of the AML Decree) and to which, if they are identified, the obliged entity must apply enhanced customer due diligence (Article 9(4) of the AML Decree) with the view of evaluating potential suspicions.

When defining unusual and unjustified transactions and customer behaviour, the obliged entity should take into account the following two aspects:

1. unusual or unjustified nature of customer´s behaviour in general with regard to the nature of the product or service offered or the type of customer, and
2. unusual or unjustified nature of a behaviour by a specific customer given the information the obliged entity has about that customer.

<u>1. Unusual transactions with regard to the nature of the product offered</u>

To establish procedures to identify unusual transactions with regard to the nature of the product offered, it is crucial to know and understand the nature of the obliged entity's business activities, products, its usual customers and business relationships. The obliged entity should evaluate its business activities as part of its internal risk assessment pursuant to Article 21a of the AML

Act and on this basis define what customer behaviour it expects or, conversely, considers unusual in relation to the services it offers. In simplified terms, the obliged entity establishes the expected standard behaviour of most usual customers and compares it with the behaviour of the specific customer (unusual behaviour may include for example a trading method that has no economic purpose, for example the purchase and immediate resale of a financial instrument of a sort that can only be expected to generate a return after it has been held for some time).

2. Unusual transactions with regard to a specific customer

Another important element in the assessment of unusual transactions is an evaluation of whether a specific transaction or customer behaviour is consistent with the information that the obliged entity has about that customer. For this reason, the obliged entity must have sufficient information about its customer and its activities (and this information must always be up to date) so that it can assess whether the customer's specific behaviour in the business relationship, or outside its scope, is unusual, i.e. whether it is different from what the obliged entity might expect given the customer's risk profile or previous/usual behaviour (Article 8(7) of the AML Act and Articles 7(3), 10(1) and 11(1) of the AML Decree).

Specific examples of both aspects are given in section IV of this Opinion.

III. Follow-up measures

The obliged entity is also required to set out follow-up measures in its system of internal rules and apply those measures if it identifies an unusual or unjustified transaction or customer behaviour. In such a situation, the obliged entity must, in particular, determine whether or not there is reliable information that can explain such unusual behaviour, and thus evaluate whether the transaction is suspicious.

Pursuant to Article 9(4) of the AML Decree, an unusually complex or large transaction, an unusual method of conducting business, or a transaction whose economic and legal purpose is unclear is a factor of higher risk. In such a situation, the obliged entity must always perform enhanced customer due diligence. This means adopting appropriate measures pursuant to Article 9(2) of the AML Decree, but always at least obtaining and substantiating additional information, particularly about the background and purpose of such transactions and methods of conducting business (Article 9(6) of the AML Decree).[1] Other potential additional measures include enhanced monitoring of the business relationship following the identification of an unusual transaction (for example more frequent monitoring or decreasing the limits for transaction monitoring).

The type of measures adopted (except for the aforementioned requirement to obtain more information) is left to the discretion of the obliged entity. These measures must be such that they ensure the mitigation of risks associated with the given situation and, in particular, make it possible for the obliged entity to assess whether the transaction is suspicious or not.

It should be emphasised that unusual and unjustified transactions do not automatically constitute suspicious transactions as defined in Article 6 of the AML Act. During the customer due diligence process, the obliged entity may ascertain that there is a rational and legally sound reason for the unusual behaviour. For example, in the case of transactions that are unusual with regard to the nature of the product offered, a transaction may be justified when the business activities or other characteristics of the specific customer are taken into account. However, the obliged entity should use the follow-up measures to verify whether or not an unusual transaction is suspicious and, when appropriate, proceed in accordance with Article 18 (or, where relevant, also Article 20) of the AML Act.

[1] The obligation to provide additional information should applied in a reasonable (proportionate) manner. Where the obliged entity has already sufficient information at its disposal based on which it can justify why a transaction has been conducted, it is not required to obtain additional information.

IV. Illustrative features of unusual or unjustified transactions

Unusual or unjustified transactions with regard to the nature of the product offered

- The customer uses the product on a scale that is significantly higher/lower than is usual for the given product type.
- The customer conducts transactions in lower amounts than would seem economically justifiable (for example in a manner giving rise to a suspicion that the customer is trying to circumvent the legal limits for customer identification or customer due diligence).
- The customer conducts transactions or business at a different frequency than is usual and economically justifiable for the given product type (for example the purchase and immediate subsequent resale of financial instruments of a sort that can only be expected to generate a return after they have been held for some time, or the establishment and immediate termination of a business relationship in respect of products for which such behaviour is not common).
- The customer uses a non-standard distribution channel (for example the use of a foreign intermediary for no clear reason).
- The customer conducts a transaction through several intermediaries even though such action is unnecessary or intermediaries are not usually used for that sort of transaction.
- The customer conducts transactions through a series of unjustified steps (for example using several of the customer's own accounts, via several legal entities or legal arrangements connected with the customer).
- The customer uses a more complex transaction structure than is necessary and cost-effective.
- The customer conducts or shows interest in conducting transactions that seem disadvantageous to him/her, i.e. the customer does not demand or receive commensurate consideration for the payments or, conversely, sustains a loss (for example by buying and reselling financial instruments without any gain in value in the meantime, or, conversely, at a loss due to entry and exit fees).
- The customer makes or receives payments for goods in an unusual manner (for example using cash, cheques issued abroad or precious metals, even though direct payment transfers are the norm in the sector).
- The customer makes or receives payments through payment institutions in jurisdictions that allow anonymous payments even though the payments could be made through domestic payment institutions, possibly even at lower cost.

Unusual or unjustified transactions with regard to the nature of a specific customer

- The customer – a natural person with a single declared source of employment income – deposits a large amount of cash (equal, for example, to a multiple of their monthly income) on their account, or a large amount of money is transferred directly to their account.
- The customer – an entrepreneur – with declared line of business other than trading in securities, makes an order to buy securities that is disproportionately large relative to the customer's total assets.
- The customer applies for a loan the monthly repayments of which exceed the customer's disposable income known to the financial institution, or makes extraordinary repayments that do not correspond to any known sources of income of the customer.

- Repayments are made by a third party instead of the customer and the obliged entity has no reliable information about the origin of the funds.
- The customer conducts a transaction the amount (value) of which is clearly higher than would be consistent with the customer's business activity or wealth.
- The customer conducts transactions connected with foreign jurisdictions which are unjustified with regard to the information about the customer known to the obliged entity.
- The customer conducts transactions which are inconsistent with the information about the customer's business activity known to the obliged entity.
- The customer gives or receives a significant gift with no legitimate justification.
- Significant gifts or aid to/from non-profit organisations.

Nature of the Opinion	This answer expresses the opinion of the Czech National Bank staff members. The court and, as the case may be, the Bank Board of the Czech National Bank may be of a different opinion.
Contact person	Kateřina Pscherová, katerina.pscherova@cnb.cz
Date	8 January 2019