



## Administrative Measure Publication Notice

This Notice is being published by the Financial Intelligence Analysis Unit (FIAU) in terms of Article 13C of the Prevention of Money Laundering Act (PMLA) and in accordance with the policies and procedures on the publication of AML/CFT penalties established by the Board of Governors of the FIAU.

This Notice provides select information from the FIAU's decision imposing the respective administrative measures, and is not a reproduction of the actual decision.

### **DATE OF IMPOSITION OF THE ADMINISTRATIVE MEASURE:**

23 October 2020

### **SUBJECT PERSON:**

Lombard Bank Malta plc

### **RELEVANT ACTIVITY CARRIED OUT:**

Credit Institution

### **SUPERVISORY ACTION:**

On-site Compliance Review carried out in 2019

### **DETAILS OF THE ADMINISTRATIVE MEASURE IMPOSED:**

Administrative Penalty of €340,058 and Follow-Up Directive in terms of Regulation 21 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR).

### **LEGAL PROVISIONS BREACHED:**

- Regulations 5(1) of the PMLFTR and Section 3.3 of the Implementing Procedures Part I (IPs);
- Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the IPs;
- Regulation 11(1)(b) of the PMLFTR and Section 4.9.1 of the IPs;
- Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs;
- Regulation 7(1)(d) and Regulation 7(2) of the PMLFTR as well as Section 4.5 of the IPs.

### **REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURE:**

Regulations 5(1) of the PMLFTR as well as Section 3.3 of the IPs

Prior to the on-site compliance examination, the Officials were provided with a copy of the Bank's Business Risk Assessment (the "BRA") dated 2018 which referenced legislation and IPs that were in force at the time of its compilation. Upon reviewing the documentation, the Committee observed that despite theoretically highlighting the inherent ML/FT risk factors faced by the Bank, the BRA omitted the inclusion of the analysis of risk scenarios, the likelihood of any risk materialising and the possible impact thereof. As a result, due to the BRA not providing a holistic understanding of the various risk factors that may arise out of the Bank's activities, the Bank was not in a position to comprehend which areas of risk required the strongest controls.

Following discussions held during the compliance examination, the Officials were informed that the BRA was in the process of being updated and were subsequently presented with an additional document. While noting that the Bank tried to implement a scoring mechanism by the introduction of a Risk Scoring Matrix, the Committee remarked that said Matrix is far from being adequate to cover an understanding of the Bank's business risks. It was also observed that although this Matrix does make reference to a number of controls, said controls are focused on addressing the possible risk of non-compliance with AML/CFT obligations rather than on the mitigating effect of the controls put in place. Therefore when carrying out a revision of the BRA, the Bank is also expected to analyze the mitigating effect of the controls put in place for the risks identified and to consequently determine the level of residual risk it is exposed to.

In view of the above-mentioned shortcomings, the Committee found the Bank to have failed to take appropriate steps, proportionate to the nature and size of its business, to assess the risks of ML/FT arising from its activities and to adequately document such assessment. The Committee therefore decided that the Bank is in breach of its obligations in terms of Regulations 5(1) of the PMLFTR and Section 3.3 of the IPs.

#### Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the Implementing Procedures

Although the Bank did have customer risk assessment procedures in place, the measures and methodology reflected within these procedures were not rigorous and comprehensive enough. Consequently the Bank was not able to understand the risks posed by customers and to effectively apply the measures required to mitigate the risk identified in line with the risk-based approach.

It was additionally noted that notwithstanding the Customer Acceptance Policy classifying various factors into different risk brackets, such division was considered to be generic and the risk ratings applied are based on minimal factors. For instance, a customer would be deemed as Medium risk if it were resident in one particular jurisdiction without taking into consideration connections to other jurisdictions. Moreover, the CRA made reference to high, medium and low risk factors, however no reference is made as to how the ultimate rating is attained. That is, the Bank did not outline how for example a customer involved in a high risk business who requested a low risk product would be ultimately risk rated. The Committee determined that while the type of product being offered is an indispensable consideration to take when conducting a CRA, this factor cannot be considered in isolation of the other three risk factors – mainly geography, customer and interface. Therefore, the Bank did not have in place an adequate methodology for the inclusion and consideration of all risk factors.

While noting that the Bank initiated actions to enhance its processes for CRA, through the implementation of a new customized software that will be used for compliance purposes, including in the compilation of customer risk assessments, the failures as determined in the preceding paragraphs of this section led the Committee to determine that the Bank has systemically breached Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the Implementing Procedures Part I.

#### Regulation 11(1)(b) of the PMLFTR and Section 4.9.1 of the IPs

The Officials' observations which were considered by the Committee involved a number of files in which the required enhanced due diligence measures (EDD) were either not carried out or deemed to be inadequate (the information gathered by the Bank deemed as inappropriate in order to mitigate the risks emanating from the business relationship).

- EDD for Higher Risk Situations:

In one particular case, the Bank had increased one of its customer's risk rating to high throughout the course of the business relationship in view of a change in circumstances which warranted an increase in this customer's risk. It was further observed that whilst the Bank maintained operation of the account, the Bank also exercised strict monitoring for the business relationship. However the Committee deemed that the satisfactory evidence the Bank referred to evidence does by no means verify the provenance of the funds and therefore even the close monitoring carried out was rendered ineffective and the Bank failed to obtain relevant evidence to justify such transactions in relation to the products/services rendered by the customer through the request of additional documentation.

- EDD for PEPs:

The file review established that in one client file involving a Politically Exposed Person, the Bank failed to apply EDD that would address the high risk emanating from PEPs. This in view that despite being aware of the customer's political involvements, the Bank failed to establish the Source of Wealth (SoW) and Source of Funds (SoF). This is required in order to be satisfied that the customer does not handle proceeds derived from corruption or other criminal activities which are increased risks known to be associated with customers who are PEPs. This in turn would have subsequently further assisted the Bank in carrying out the necessary level of ongoing monitoring, also in terms of the EDD measures necessary for PEPs.

In view of the aforementioned shortcomings the Committee determined that the Bank is in breach of Regulation 11(1)(b) of the PMLFTR and Section 4.9.1 of the Implementing Procedures for its failures to apply EDD measures on a risk-sensitive basis in those situations that, by their nature, represented a higher risk of ML/FT.

Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the Implementing Procedures

The compliance review performed revealed that the Bank had failed on a number occasions to adhere to its obligation to obtain sufficient information to establish the purpose and intended nature of the business relationships it maintained with its customers. Throughout the compliance examination, the officials carrying out the review noted that three files contained inadequate information recorded to satisfy the source(s) of wealth requirements. These files either had no information at all, or the information held on file did not provide enough detail to support the activities that generated the customer's overall accumulation of wealth.

As a result, the Bank had for the three files reviewed failed to collect the necessary information on its customers. Therefore it had not ascertained that it acquired the necessary information to comprehensively understand its customers, the risk exposed to by servicing the same, and the degree and extent of due diligence and monitoring required. In view of the above considerations, the Committee determined that the information obtained for a number of client files in relation to the purpose and intended nature of the business relationship was insufficient.

Consequently, the Bank was not in a position to build a comprehensive business and risk profile on its customers prior to entering into a business relationship which would subsequently allow the Bank to carry out effective transaction monitoring. For these reasons, the Committee found the Bank to be in breach of Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs.

## Regulation 7(1)(d) and Regulation 7(2) of the PMLFTR as well as Section 4.5 of the Implementing Procedures

### Updating of Documentation/Information:

At the time of the compliance review, the number of overdue periodic reviews as outlined in the 'On-going Monitoring Reviews' sheet provided by the Bank, amounted to 1,777 files. The list provided indicated periodic reviews which have been overdue since July 2018. As part of its deliberations, the Committee made reference to the Bank's AML Risk Assessment dated 2019 which highlighted that up until December 2018, there were a total of 2,017 customer relationships pending to be reviewed. The Committee also considered a statement found with this document, which recognized a recent recommendation by the Bank's Internal Audit to address the backlog and that in view of this recommendation, a plan to address the expired reviews in the shortest time possible was already in place. However, the Bank failed to take concrete action on the recommendation by the internal audit and only a mere 240 overdue reviews were carried out in 9 months, which was considered as ineffective by the Committee.

It was additionally noted that the periodic reviews conducted by the Bank were not being consistently documented across the board. For the files under review, the Officials established that on-going monitoring record sheets were not present in all files, hence the Officials were not in a position to confirm whether a review had been conducted by the Bank in line with the Bank's policies and procedures. This was further accentuated since the Bank in its representations stated that not all records are centralised, since the on-going monitoring sheets are kept in separate files at branch/department and not within the customer records file. It was questionable therefore how proper monitoring of the business relationship could be attained without a centralised record keeping mechanism.

It was apparent to the Committee that the Bank was not implementing its policies and procedures in practice. Doubts were also raised as to how a Bank, having such a size and customer base could update its records manually, something which as evidenced from the findings of the compliance review, was not being achieved by the Bank. In view of this shortcoming, in which the Bank failed to monitor the customer relationships and ensure that information and documentation held are up to date, the Committee found the Bank in breach of Regulations 7(1)(d) and 7(2)(b) of the PMLFTR and Section 4.5 of the Implementing Procedures.

### Scrutiny of Transactions:

Serious shortcomings were identified in relation to the Bank's obligation to scrutinise transactions taking place through the customers' accounts. It was revealed that the Bank either did not scrutinise the transactions being effected through its accounts, or it otherwise carried out inadequate monitoring of the activity carried out within the accounts held. It was put forward to the Committee that during the compliance examination, the Officials onsite noted that minimal or no supporting documentation was held on file for a number of transactions reviewed that were unusual or not in line with the information provided by the clients.

The failure to scrutinise transactions appropriately was observed specifically in transactions effected to the accounts of three files. Whilst in certain instances the volumes passing through the Bank's accounts were extremely large, in other cases the transactions did not tally with the customer profile. The Bank neither questioned such voluminous amounts nor did it attempt to obtain further information about the

payments from its customers. Instead, it proceeded to allow the transactions being effected. The details of the failures in relation to scrutiny of transactions are being relayed hereunder:

- In one of the files reviewed, although a deposit of €2,000,000 had been effected, the provenance of these funds was not substantiated in any manner. The Committee considered that the only documentation maintained on file were copies of cheques issued from bank accounts of the customer held with another bank. In addition, although there was a substantial increase in the funds deposited with the Bank from this same customer which resulted in a deposit of €4,000,000 within a span of only 10 months, such a substantial increase was not questioned by the Bank;
- In another file reviewed, although the customer received a deposit of over €400,000 the only explanation found on file was that the funds were the customer's savings inherited from her parents. However, this statement was not corroborated with sufficient evidence. In view of such explanation, the Bank was expected to obtain a copy of the will and not rely merely on an explanation made by the customer; and
- In a third file, the Bank failed to obtain supporting documentation in relation to two inward payments which accumulated to €1.5million each credited within a 15-day period. Although the Bank tried to explain the origin of these funds by presenting an increase in Share Capital (Form H) and an explanation that the funds were originating from the ultimate beneficial owner's account, it was noted that these funds, as evidenced in the bank statements provided by the Bank had originated from the UBO's two other companies. However, here again the Bank failed to question why the UBO received such funds from the other companies, only for same to be transferred to the customer's account with the Bank. Nor did the Bank try to understand why the customer necessitated such substantial increase in share capital.

After taking all of the aforementioned facts into consideration, the Committee determined that the Bank failed to carry out effective monitoring and scrutiny of the transactions that were taking place through the accounts of its customers. Therefore, the Bank was found to be in breach of Regulation 7(1)(d) and Regulation 7(2) of the PMLFTR as well as Section 4.5 of the Implementing Procedures.

#### **ADMINISTRATIVE MEASURES TAKEN BY THE FIAU'S COMPLIANCE MONITORING COMMITTEE (CMC):**

The failures identified, as has been explained above, necessitated the imposition of an administrative penalty that is appropriate in view of the nature of the breaches identified. For the reason explained above, an administrative penalty of €340,058 has been imposed upon the Bank. In accordance with Article 13A of the PMLA, this penalty can be appealed by the Bank.

In addition to the above mentioned penalty and in terms of its powers under Article 21(4)(c) of the PMLFTR, the FIAU also served the Bank with a Follow-Up Directive. The aim of this administrative measure is to direct the Bank into implementing several requirements in order to ensure that it understands the risks surrounding its operations and that the Bank has implemented sufficient controls to mitigate such identified risks. To ensure that the Bank is effectively addressing the breaches set out above, the Committee directed the Bank to provide it with an Action Plan setting out the actions already taken by the Bank, what actions it still has to implement and in both instances how these resolve the issues with the Bank's AML/CFT policies, procedures and measures set out here above., The Action Plan is to cover amongst others the following:

- The updating and implementation of an effective Business Risk Assessment, that enables the Bank to understand the AML/CFT risks it already faces or may become exposed to and to determine on the basis of such risk understanding, the controls that need to be implemented;
- A detailed explanation of the new risk assessment tool which is to be implemented and what information will be fed into the respective tool and how such tool will aid the Bank in compiling an effective CRA;
- The updating of measures used to gather more information and documentation to create a customer profile for higher risk situations; and
- The updating of the on-boarding forms to ensure that sufficient information is obtained to enable the Bank to establish a comprehensive customer business and risk profile.
- A detailed timeline explaining the different phases of the Bank's plan to update the expired customer file reviews;
- The implementation of measures to ensure that the Bank avoids becoming overdue in the review of customer relationships;
- An explanation as to how the KYC Portal System shall be utilised to carry out transaction scrutiny, together with the timeframes for implementation; and
- A timeframe for the centralisation of all customer information to enable the effective monitoring of customer relationships.

In determining the appropriate administrative measures to impose, the Committee took into consideration the representations submitted by the Bank together with the remedial action that the Bank had already started to implement, the nature and size of the Bank's operations, the overall impact, actual and potential, of the AML/CFT shortcomings identified vis-à-vis the Bank's own operations and also the local jurisdiction. The seriousness of the breaches identified, together with their occurrence were also taken into consideration by the Committee in determining the administrative measures imposed.

Finally, the Bank has also been duly informed that in the eventuality that the Bank fails to provide the above mentioned action plan and supporting documentation available within the specified deadline, the Bank's default shall be communicated to the Committee for its eventual actions, including the possibility of the imposition of an administrative penalty in terms of the FIAU's powers under Regulation 21 of the PMLFTR.

**30 October 2020**

**APPEAL:**

On Thursday 19<sup>th</sup> November 2020, the FIAU has been duly notified that Lombard Bank Malta plc has, in accordance with the provisions of Article 13A of the Prevention of Money Laundering Act (PMLA), appealed the decisions taken by the FIAU. The Bank has appealed all breaches as mentioned in this publication in relation to which the FIAU's Compliance Monitoring Committee decided to impose an administrative penalty. **The Bank also appealed on grounds of wrong evaluation of facts and raised the issue as to whether the process that led to the imposition of this administrative penalty is in line with the right to a fair hearing**

**20<sup>th</sup> November 2020**

**Pending the outcome of the appeal, the decision of the FIAU leading to the imposition of the administrative penalty is not to be considered final and the resulting administrative penalty cannot be considered as due, given that the Court may confirm, vary or revoke, in whole or in part, the decision of the FIAU. As a result, the FIAU may not take any action to enforce the administrative penalty pending judgement by the Court. This publication notice shall be updated once the appeal is decided by the Court to reflect the outcome of same.**

**4 August 2021**