



Administrative Measure Publication Notice

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DATE OF IMPOSITION OF THE ADMINISTRATIVE MEASURE:

10 June 2022

RELEVANT ACTIVITY CARRIED OUT:

Corporate Service Provider (CSP)

SUPERVISORY ACTION:

Targeted compliance review carried out in 2021

DETAILS OF THE ADMINISTRATIVE MEASURE IMPOSED:

Administrative Penalty of €20,064 in terms of Regulation 21 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR).

LEGAL PROVISIONS BREACHED:

- Regulations 7(5) and 7(3) of the PMLFTR and Section 4.3 of the Implementing Procedures (IPs);
- Regulations 7(1)(d), 7(2)(a), 7(2)(b);
- Regulations 15(1) and 15(3) of the PMLFTR and Sections 5.4 and 5.5 of the IPs.

REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURE:

Customer Due Diligence (CDD) – Identification and Verification and No Authorization to Act on behalf of the Customer obtained

At the time of customer onboarding, the Subject Person had failed to identify and verify the beneficial owner (BO) in respect of one of its corporate customers. At onboarding, the Subject Person was in possession of a Letter of Engagement which merely indicated that a local CSP was holding shares on behalf of another company. No further information as to the identity of the BO behind the latter company was provided. Subsequently, a couple of months later, the Subject Person was provided with a declaration by an intermediary company, declaring that it had the required CDD documentation on the BO behind the corporate customer. The intermediary further stated that this declaration may be relied on as fulfilment of the CDD obligations in respect of the corporate customer's BO. However, the Subject Person was inadequately applying the reliance measure. The SP is required to immediately obtain the information

required under Regulation 7(1)(a) to (c) of the PMLFTR, including the information required to establish the identity of the Bos from the entity being relied on. It was only almost two years after customer onboarding, that the intermediary company confirmed to the Subject Person the beneficial ownership of the corporate customer. However, the Committee took into consideration the fact that the Company had in the meantime identified the identity of the BOs through C6 screening, even though this was done 6 months following customer onboarding. Therefore, the Committee concluded that the Subject Person's shortcoming concerned the timeliness of the obligation to identify and verify the BO of its corporate customer.

Moreover, the Committee noted that the Subject Person had failed to obtain the authorisation required for the intermediary company to act on behalf of the corporate customer. Aggravating matters further was the fact that the Subject Person constantly received instructions on behalf of the corporate customer through the mentioned intermediary company.

Consequently, in view of the above shortcomings, the Committee decided that the Subject Person was in breach of Regulation 7(5) and 7(3) of the PMLFTR and Section 4.3 of the IPs.

Ongoing Monitoring – Inadequate Information on the Subsidiary held by the Customer and Inadequate Scrutiny of Transactions

The Committee noted that the Subject Person was aware that one of its corporate customers had incorporated a subsidiary company since the Subject Person itself, as director of this corporate customer had, through a power of attorney, granted power to all employees of another company to incorporate the mentioned subsidiary. The only information held on file in relation to this subsidiary was that its activity would be that of incorporating, managing and supervising businesses. The Subject Person failed to gather more information about the customers targeted by the subsidiary, its target markets, the detail of the managing and supervision of the businesses it would be servicing, and the prospective level of business expected. Due to this failure, the Subject Person could not have a comprehensive profile of its corporate customer. Aggravating matters further was the fact that the Subject Person also failed to obtain the required information notwithstanding the various transactions that were carried out during the business relationship. As a result, the Subject Person was servicing this corporate customer without having a clear understanding as to how its revenue was being generated, and how the resulting transactions were arising. In its representations, the Subject Person claimed that the purpose of the corporate customer's subsidiary was that of a holding company and it did not have any customers/target markets and its purpose was not to provide services but to invest in shares and Intellectual Property. Nonetheless, the Committee remarked that the fact that an entity's purpose is that of investing in Intellectual Property does not mean that it does not have customers nor that it does not have target markets. Also, the Committee considered the fact that during the targeted review the Subject Person did not provide any reference or explanation indicating that the corporate customer's subsidiary invests in Intellectual Property. The Subject Person also failed to prove this when submitting its representations, since the only document indicating the corporate customer's subsidiary's link to trademarks were the entity's financial reports for two specific years. These financial reports were unaudited due to an exemption in the country of incorporation of the corporate customer's subsidiary, which relieved the latter from compiling audited accounts. Indeed, due to these accounts being unaudited, the Auditor for the corporate customer qualified as well.

Moreover, the Subject Person held sufficient information to understand that the BO of the corporate customer also owned other companies. Nonetheless, throughout the business relationship with the

corporate customer, the Subject Person failed to question and understand the rationale behind the fact that the same BO required the setting up of four distinct companies, all incorporated in separate jurisdictions and all of which seemed to be providing similar services (to incorporate, manage and supervise businesses).

Moreover, financial statements submitted with the MBR (duly signed by the Subject Person), revealed that the corporate customer's subsidiary had itself a wholly owned subsidiary. Again, the Subject Person failed to obtain explanations and/or documentation to understand the business behind this other subsidiary and the rationale behind the establishment of the latter. A CSP providing services to a holding company is expected to understand and gather information on the trading/commercial activity carried out directly by the holding company's subsidiary or subsidiaries (where these are trading companies), or indirectly by subsidiaries of these subsidiaries in the ownership chain¹.

Furthermore, the Subject Person had failed to adequately scrutinise several transactions which occurred between its corporate customer, and three other companies, notwithstanding that, the Subject Person was aware that all mentioned companies belonged to the same BO:

- Firstly, the corporate customer's subsidiary took a loan of around five million US Dollars (\$5,000,000) from an entity, which as already stated, was also owned by the BO of the corporate customer and its subsidiary.
- Secondly, an Assignment of Debt Agreement outlined that the corporate customer's subsidiary owed the entity referred to earlier over four million US Dollars (\$4,000,000) and accrued interests.
- The same Assignment of Debt Agreement outlined that the corporate customer agreed to take on the entire debt due by the corporate customer's subsidiary and the previously mentioned entity.
- Furthermore, by virtue of a Capital Contribution Agreement, around two million US Dollars (\$2,000,000) of the balance owed to the corporate customer by its subsidiary, was capitalised as paid in share premium to the issued shares held by the corporate customer in the subsidiary.
- Additionally, according to a Debt Assumption Agreement the corporate customer assigned the debt which it took over from its subsidiary, to another company also belonging to the same BO.
- Furthermore, according to a Credit Assignment Agreement, the corporate customer's subsidiary had a claimable credit of over five million US Dollars (\$5,000,000) towards another company, also belonging to the same BO. The Agreement further stated that the mentioned credit was assigned by the corporate customer's subsidiary to the corporate customer. It was also stated that the corporate customer had a credit of over one million US Dollars (\$1,000,000), in favour of its subsidiary. This latter credit had to be compensated with a valuable consideration equal to the nominal value of the abovementioned assignment agreement. The difference had to be paid by the corporate customer to its subsidiary.

¹ Subject Persons are to take notice of the requirements of Part II of the IPs for CSPs on this matter. It is important to clarify that although these IPs were not in force during the start of the relationship with the corporate customer and the incorporation of the abovementioned subsidiaries, the Subject Person was nevertheless expected to obtain information on the subsidiaries since this was crucial and indispensable to understand the holding company (i.e. the customer), satisfy the obligations of having a good customer profile and keep the same updated. Additionally, the Subject Person was expected to take immediate action and gather the required information once the IPs Part II entered into force.

Notwithstanding being faced with all the above-mentioned loans and assignments, the Subject Person failed to ascertain the rationale behind these loans and their transfer between interrelated entities belonging to the same BO.

In view of the above, the Committee determined that the Subject Person was in breach of Regulation 7(1)(d), 7(2)(a) & 7(2)(b) of the PMLFTR for failure to effectively scrutinise transactions and conduct adequate ongoing monitoring of the business relationship.

Reporting Obligations

The Subject Person was faced with various Red Flags which should have raised ML/FT concerns on one of its corporate customers. These Red Flags constituted sufficient grounds for the Subject Person to suspect that funds could possibly be proceeds of criminal activity or that ML could have taken place, or that an attempt was made to carry out a transaction or activity related to such proceeds. The red flags identified are outlined below:

- The various providers involved in the relationship. The Subject Persons indeed failed to understand the rationale behind using a foreign intermediary to incorporate a Maltese registered entity with the aim of acting as a holding company, having another local entity holding shares in a fiduciary capacity and requiring the Subject Person (i.e., a third separate provider) to act as Director of the newly incorporated Maltese company.
- The rationale behind the fact that the newly incorporated Maltese holding company (the corporate customer) instructed another foreign entity to incorporate a subsidiary company for the Maltese corporate customer to invest its assets in it. While this on its own is not enough to submit a report to the FIAU, it should have been considered by the Subject Person, especially within the context of the other Red Flags outlined below.
- As evident from the electronic correspondence submitted by the Subject Person with the FIAU for the purposes of the targeted review, the corporate customer's intermediary entity was on various occasions irresponsive, not clear with their replies and not in time in delivering what was requested.
- Over the years, loans were being taken and assigned between four companies belonging to the same BO, without evidence of the necessity of the loans, as well as without a clear rationale for the assignments between the companies (as better explained in the preceding section). This should have triggered suspicion that the BO might be using these companies to layer funds through interparty loans. This is further substantiated through several changes of debt/credit assignments across the companies, all belonging to the same BO.
- The last available audited financial statements were for the period end 2016. These outlined that they were prepared on a break-up basis since the management intended to liquidate the corporate customer in the near future. No other financial statements have been prepared, audited and provided to the registrar of companies since then. Yet, the corporate customer was still relatively operational as clearly outlined from the loans granted, their transfers and other credit transfers that took place since 2016. These operations were not being adequately accounted and audited.

In view of the above, the Committee determined that the Company was in breach of Regulation 15(1) and 15(3) of the 2018 PMLFTR as well as Sections 5.4 and 5.5 of the IPs for failure to effectively implement internal and external reporting procedures including the failure to submit an STR to the FIAU in such circumstances.

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

After taking into consideration the abovementioned breaches by the Subject Person, the Committee decided to impose an administrative penalty of twenty thousand and sixty-four euro (**€20,064**) with regards to the breaches identified in relation to:

- Regulations 7(5) and 7(3) of the PMLFTR and Section 4.3 of the IPs for the failure to identify the BO of one of its corporate customers at onboarding and for the failure to obtain the authorisation required for the intermediary company to act on behalf of the mentioned corporate customer.
- Regulations 7(1)(d), 7(2)(a) & 7(2)(b) of the PMLFTR for the failure to effectively scrutinise transactions and conduct adequate ongoing monitoring of the business relationship.
- Regulations 15(1) and 15(3) of the PMLFTR for the failure to effectively implement internal and external reporting procedures including the failure to submit an STR to the FIAU in such circumstances.

When deciding on the appropriate administrative measures to impose, in addition to the specific breaches outlined above, the Committee took into consideration the importance of the obligations being breached, the seriousness of the findings identified, and the risk of possible ML caused by the breaches identified. The Committee also considered the Subject Person's size and the impact that the Subject Person's failure may have had on both its operations and on the local jurisdiction. The good level of cooperation portrayed by the Company and its officials throughout the supervisory process were also factored in.

Key Takeaways

- Prior to establishing a business relationship with a new corporate customer, a Subject Person is required to undertake appropriate checks and gather information to be able to establish a company's ownership and control structure including ascertaining who is the beneficial owner. Having established who is the beneficial owner, the Subject Person must ensure that the corporate customer provides it with the personal details of the beneficial owner as listed in Section 4.3.1(i) of the IPs. The Subject Person then must verify the beneficial owner's identity by applying any of the verification measures referred to in Section 4.3.1 of the IPs that may be most appropriate to the circumstances of the case.
- The Subject Person must ensure that the intermediary acting for and on behalf of the customer is duly authorised in writing to do this. Thus, the Subject Person must obtain and retain on file either the original or a copy of the authorisation granted by the customer to the intermediary.
- The information on the activity or purpose that the company or partnership/s will be carrying out or serving must involve understanding the trading/commercial activity that is to be carried out by the company. When the company is not set up to carry out a commercial/trading activity but rather to hold assets (e.g., a shareholding in another entity), it is not enough to simply determine the purpose of that company, which may be quite self-evident from the nature of the company itself (i.e., to hold shares in a subsidiary company or companies). The CSP providing services to that company is expected to understand and gather information on the trading/commercial activity carried out directly by the holding company's subsidiary or subsidiaries (where these are trading companies), or indirectly by subsidiaries of these subsidiaries in the ownership chain. It is only by doing this that the CSP can get a holistic understanding of what purpose or activity the holding company will be linked to.

- A Subject Person is required to examine the purpose and background of all complex and unusually large transactions, and unusual patterns of transactions that have no apparent or economic lawful purpose and increase the degree and nature of ongoing monitoring to determine whether the transactions are suspicious.
- An unusual transaction, as well as unusual behaviour, should serve as a red flag/trigger event for the Subject Person to assess the situation and request or obtain additional information or documentation to establish whether the transaction is suspicious and needs to be reported with the FIAU.
- The non-filing of financial statements is in fact a Red Flag, particularly when the value of loans and assignments taking place is substantial.
- The incorporation of various entities and the passage of funds through loans, assignments or other means must be thoroughly assessed and a legitimate purpose established. The layering of funds can easily take place through such means and therefore robust measures must be in place to manage such risk.

13 June 2022

