



## 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:**

17 August 2022

### **SUBJECT PERSON:**

Novum Bank Limited

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

Credit Institution

### **SUPERVISORY ACTION:**

Onsite Compliance Review carried out in 2019.

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

Administrative Penalty of **€89,516**, a Reprimand and a Remediation Directive in terms of Regulation 21 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR).

### **LEGAL PROVISIONS BREACHED:**

- Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.2 of the Implementing Procedures (IPs)
- Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3.2.1 of the IPs
- Regulation 7(1)(c) of the PMLFTR and Section 4.4 of the IPs
- Regulation 7(2)(a) of the PMLFTR and Section 4.5.2 of the IPs

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

Customer Risk Assessment (CRA) - Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.2 of the IPs

During a review of the CRAs and the CRA methodology applied by the Bank, it was noted that while the Bank had implemented a methodology to risk assess customers, this was not considered to be comprehensive enough, since although all the four risk pillars were being covered at times not all the risk factors were being taken into consideration. This in turn could have led the Bank to apply inadequate levels of CDD such as by classifying customers as low risk while another risk classification may have been more appropriate.

For example, it was noted that the geographical risk being taken into consideration by the Bank, was limited to the residence of a customer without consideration to any connection customers might have with other jurisdictions. Therefore, it was not possible for the Bank to identify the customer risk exposure deriving from the jurisdiction level. While it is positive that the Bank understood the importance of obtaining the residential details of the customer, it was equally important for the exposure to be assessed, beyond the geographical area (i.e., EU, Non EU – Reputable, etc.) but at country specific levels.

Upon reviewing the CRA and its methodology, the Committee concluded that there were deficiencies which were to be addressed by the Bank to reduce its ML/FT exposure, as the documents provided either lacked adequate detail on the risk factors, or the risk factors were not being considered by the Bank in the final risk scoring determination.

As a result, the Committee found the Bank to be in breach of Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.2 of the IPs.

#### Customer Due Diligence - Identification and Verification of Legal Persons - Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3.2.1 of the IPs

It was observed that in one file, the link between the corporate entity and the parent company had not been verified by independent sources. In their representations, the Bank confirmed the shortcoming. However, argued that this was one instance out of many review files, whilst also confirming that this information would be publicly available on online domains.

The Committee acknowledged that since this shortcoming was only present in one file it was more of an oversight and that good measures for identifying and verifying corporate customers were in place. However, it could not overlook that this information had not been gathered by the Bank. As a result, in view of this shortcoming, the Bank was found in breach of its obligations in terms of Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3.2.1 of the IPs.

#### Customer Due Diligence – Purpose and Intended Nature of the Business Relationship - Regulation 7(1)(c) and Section 4.4 of the IPs

The Compliance review highlighted several files where the Bank did not gather enough information on the purpose and intended nature of business relationships it engaged in. From the reviewed files, Officials observed that in three relationships involving individual lenders, the information held on file for them was deemed to be either generic or was not available on file.

In one instance, the information held on the file was that the customer worked ‘full time in craft and related trades’, whereas in another instant the customer information on file only referred to the customer being ‘self-employed’. On one other occasion, Officials took note of one file whereby no information had been obtained by the Bank on the origin of funds. The Bank considered that, in each case, they had either obtained adequate information on the customer’s employment or had enough information on the customer’s proof of income. However, the Committee concluded that the Bank did not collect enough information to fully understand the customer’s employment, and therefore to understand the source of income of the customer.

In addition, there were three other files where the Source of Funds of the corporate customers was considered also to be generic, with information on file relating to ‘business activities’, ‘share capital’ or ‘income from suppliers’. The Bank attempted to further clarify the rationale behind the information held,

but the Committee could not consider the Bank's representations as sufficient, as these only described the trail of the funds and mostly focused on explaining the share capital of the corporate customer. The Committee insisted that the Bank should have gained further understanding on the customer's activities and how the customers generated income, as well as understood the purpose and nature of the corporate customer. Obtaining vague information does not give the reassurance that the customer is known and that its expected source of funds is understood.

Consequently, the Bank was found to have breached its legal obligations in terms of Regulation 7(1)(c) of the PMLFTR and Section 4.4 of the IPs.

#### Ongoing Monitoring - Scrutiny of Transactions - Regulation 7(2)(a) of the PMLFTR and Section 4.5.2 of the IPs

Whilst reviewing these corporate files, Officials took note of two corporate files, in which there was no underlying rationale behind the transactions conducted between the corporate entities and the respective third parties.

In the first file, various transactions ranging between €400,000 and €2 million between the customer and another party were carried out. Reference to loan agreements were noted, however, in the contract agreement between the two parties, there was no rationale behind the purpose of the loan. Meanwhile, in the second file, an outward payment of €16 million was once again not supported documentation which explains the parties' motive behind the transaction.

The Bank determined that because of the limited volume of transactions which are conducted by corporate customers, it had sufficient knowledge for every single transaction which would be carried out. The Bank further confirmed that since these transactions are scrutinised manually by Bank employees, this increases the level of monitoring and understanding of the corporate customer transactions. However, independently of the volume of transactions processed, it is always important to monitor complex and large transactions to ensure that there is a business, economic and lawful purpose for the same.

When provided with documents to back up the Bank's comments, the loan agreements provided did not contain a rationale explaining why the loans had been taken out, nor did they refer to the transactions previously mentioned in this finding. Transactions of these amounts need to be thoroughly understood and backed by evidence. Obtaining loan agreements without understanding the rationale behind taking the loan and without establishing a link between the transactions and the loan agreements, is not sufficient for AML/CFT monitoring.

Whilst, the Bank was not expected to review and document each outward transaction, (since the flow of funds into the Bank should have already been understood and evidenced as necessary), when it was a case of high value outward transactions as demonstrated by the €16 million transfer, the Bank had to obtain the rationale and obtain the necessary evidence to ascertain a legitimate purpose.

As a result of the inconclusive documents, the Committee found the Bank to be in breach of Regulation 7(2)(a) of the PMLFTR and Section 4.5.2.



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

After taking into consideration the breaches committed, the Committee concluded that the Subject Person had breached the below mentioned obligations:

- Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.2 of the Implementing Procedures (IPs)
- Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3.2.1 of the IPs
- Regulation 7(1)(c) of the PMLFTR and Section 4.4 of the IPs
- Regulation 7(2)(a) of the PMLFTR and Section 4.5.2 of the IPs

Since the breaches of Regulation 7(1)(a) and Regulation 7(1)(b) of the PMLFTR and Section 4.3.2.1 of the IPs were considered minor and not serious in nature, the Committee concluded that a reprimand shall be served.

Regarding the remaining shortcomings in relation to Regulation 7(1)(c) of the PMLFTR and Section 4.4 of the IPs and Regulation 7(2)(a) of the PMLFTR and Section 4.5.2 of the IPs, the Committee decided that, in view of the seriousness of the failures identified, the imposition of an administrative penalty in terms of Regulation 21 of the PMLFTR is warranted. While noting that during the review only two customer files were identified as having transaction monitoring issues, the Committee also observed that the value of the flow of funds passing through was substantial and such risks could therefore not be overlooked. Moreover, with regards to customer profiling, the Committee took into consideration that there were approximately 20% of the relationships reviewed, where the information obtained was either too generic or not obtained at all. Furthermore, the information which was not obtained or deemed insufficient was important information necessary to understand the customer. In reaching its decision, the Committee took into consideration:

- The level of cooperation exhibited by the Subject Person during the review.
- The overall good understanding which the Bank had of its customers.
- The size of the subject person.

In view of the above, the Committee decided to impose an administrative penalty of **eighty-nine thousand five hundred sixteen euro (€89,516)** for the failure to adhere to Regulation 7(1)(c) of the PMLFTR and Section 4.4 of the IPs and Regulation 7(2)(a) of the PMLFTR and Section 4.5.2 of the IPs.

In addition to the penalty and in terms of its powers under Article 21(4)(c) of the PMLFTR, the FIAU also served the Subject Person with a Follow-Up Directive. The aim of this administrative measure is to direct the Subject Person into implementing several requirements to ensure that they understand the risks surrounding their operations and that sufficient controls have been implemented to mitigate the identified risks. The subject person is therefore required to provide to the FIAU:

- Updates on the enhancements implemented to the Customer Risk Assessment as per Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.2 of the IPs, particularly:
  - o By articulating and adopting a CRA methodology which is applied to all customers, and that factors into the overall assessment all the risk factors of the customer. The Bank must ensure that the risk factors considered within each risk pillar are sufficient to carry out a comprehensive assessment of the customer.
  - o Updating any tools, systems or measures which may be used to help achieve the Bank's obligation to risk assess the Bank's customers in terms of its AML/CFT obligations,

- Ensure that the Bank both understands and can explain the risk factors being considered, as well as their importance and how the risk factors drive the risk rating of the customer.
- Obtaining an independent verification of the ownership structure of the file found in breach in terms of Regulation 7 (1)(a) and (7)(1)(b) of the PMLFTR and Section 4.3.2.1 of the IPs.
- To ensure that the Bank holds adequate information pertaining to the purpose and intended nature of the business, as is required to build a comprehensive risk profile which is in line with the applicable AML/CFT obligations, as per Regulation 7(1)(c) of the PMLFTR and Section 4.4 of the IPs.
- Provide documentation and revised transaction monitoring policies and procedures and explain how the Bank is to ensure that the transaction monitoring obligations are adhered to.
- The Bank is also expected to provide updates in relation to transaction monitoring measures it has or will be implementing including any details as to transaction monitoring systems as per Regulation 7(2)(a) of the PMLFTR and Section 4.5.2 of the IPs. The enhancements to the Bank's transaction monitoring obligations must ensure that the Bank is able to provide documented explanations with the rationale behind the specific transaction.

**Key Take aways:**

- Understanding the risks (actual or potential) posed by customers is crucial to determine the level of controls necessary. Implementing a comprehensive customer risk assessment methodology that factors in all the risk parameters necessary and which goes into the necessary details on each risk pillar is indispensable.
- Customer profiling is at the core of understanding the customer and being able to ensure that transactions can be monitored against the profile is a critical obligation. Generic statements such as "related trades" and "self-employment" add little value to understanding the customer and its source of income/source of profit. Moreover, referring to only the share capital as a Company's source of wealth and expected source of funds is not sufficient. Trading companies have businesses and customers that fund their income which need to be understood. On the other hand, holding companies, usually hold trading customers and therefore the activities and source of wealth of those trading customer also needs to be understood to gain a comprehensive understanding of the customer.
- Transaction monitoring enables an understanding of the transactions taking place and in ascertaining that there is a business, economic and lawful purpose for the transactions being carried out. For this reason, documentation should not only be obtained but also verified to ensure that all the information necessary to understand the legitimate intent of a transactions is found.
- Not all outward transactions need to be reviewed and documented, since the subject person should have gathered the necessary information and documentation as to when funds would be flowing in,

the monitoring should also be done on a risk sensitive basis. However, high value transactions that flow out of the accounts of a customer need to be monitored. In such cases, one is expected to both have an understanding of the transaction and gather supporting evidence to ensure that there is a lawful purpose for the funds flowing out of the customer's accounts.

- One should be careful in accepting loan agreements as evidence of transactions flowing in/out of a relationship. It is important to ensure that there is a valid rationale for the loan and that it makes sense for the customer to take/provide this loan. It is also important to ensure that there are sufficient details in the loan agreements with regards to purpose, parties involved, repayment terms, duration, interest payable and other factors. It is also equally important to ensure that there is a link between the transactions taking place and the loan agreements provided.

18 August 2022

