



## Administrative Measure Publication Notice

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The 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:**

25 January 2023

### **SUBJECT PERSON:**

APS Bank plc

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

Credit Institution

### **SUPERVISORY ACTION:**

Off-site compliance examination carried out between 2 November and 18 November 2020.

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

Administrative Penalty of €228,706 and a Follow-Up Directive.

### **LEGAL PROVISIONS BREACHED:**

- Regulation 5(1) of the PMLFTR and Sections 3.3 and 3.3.3 of the IPs
- Regulation 5(5)(a)(ii) of the PMLFTR and Sections 3.5.1, 3.5.2 and 3.5.3 of the IPs
- Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs
- Regulations 13(1) and 13(2) of the PMLFTR and Sections 9.1, 9.2(b) and 9.3 of the IPs
- Regulations 7(2)(a) and 7(2)(b) of the PMLFTR and Sections 4.5.1(a), 4.5.1(b) and 4.5.2.3 of the IPs

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

The Business Risk Assessment (BRA) – Breach of Regulation 5(1) of the PMLFTR and Sections 3.3 and 3.3.3 of the IPs

The compliance examination report revealed that the Bank's BRA was drafted in the final quarter of 2019 and approved by the Board of Directors some months later, in the first quarter of 2020.

In its representations, the Bank explained that although the draft BRA was indeed finalised in the fourth quarter in 2019, the BRA drafting process had started earlier in the first quarter of 2019. The Bank also highlighted that during 2019, it was in the process of implementing numerous improvements to its processes and procedures, as well as making internal changes to the set-up of its departments. These changes, amongst other considerations, impacted the Bank's ability to finalise its BRA in a timely manner. Moreover, the Bank submitted that it has always taken a prudent approach towards risk, which includes maintaining a conservative risk appetite and customer acceptance criteria.

The Committee emphasised that the legal obligation for subject persons to conduct a BRA has been in force since the issuance of the updated PMLFTR on 1 January 2018. Therefore, the Bank was expected to

complete the BRA within a reasonable timeframe following the introduction of such requirement. Furthermore, while acknowledging that the Bank held a good understanding of its business operations and the risks it is exposed to, this alone was not sufficient, and the Bank was required to document such understanding within a formalised BRA.

The Customer Risk Assessment (CRA) – Breach of Regulation 5(5)(a)(ii) of the PMLFTR and Sections 3.5.1, 3.5.2 and 3.5.3 of the IPs

During the compliance examination, various shortcomings were noted in relation to both the Bank's former risk assessment methodology, as well as the implementation of its new risk assessment methodology which came into effect in the second quarter of 2020. On this point, the Committee deemed it appropriate to consider the below-mentioned CRA findings together, stressing that such breaches all stem from the fact that the former risk assessment methodology was inadequate. The Committee also remarked that the seriousness of this failure is compounded as it persisted for a considerable period of time.

Notwithstanding the above, the Committee positively acknowledged that the Bank's new risk assessment methodology adequately addresses the majority of the shortcomings identified with the former risk assessment methodology. The Committee also commended the Bank for its proactive approach in identifying, from its own motion, the deficiencies related to the former CRA methodology, and in taking corrective action before being required to do so by the Committee.

The Committee's deliberations in relation to each finding pertaining to the former and the newly implemented risk assessment methodologies are being relayed below:

i.) Former Risk Assessment Methodology

*The former risk assessment methodology was inadequate*

The Committee noted that the Bank's former risk assessment methodology was rules-based and did not comprehensively establish the risks emanating from the business relationships with its customers. The mechanism applied:

- Was not rigorous or aligned with the risk-based approach;
- Failed to consider a holistic view of the four risk factors as specified in the IPs (i.e., customer risk, geographical risk, product/service/transaction risk and interface/delivery channels risk); and
- Did not take into account any adverse media searches performed on the customers and other related parties.

Therefore, the customer's AML risk score was not based on a composite score which exhaustively covers the four risk pillars, but only considered a set of limited factors.

In addition, for customers onboarded on the basis of the former risk assessment methodology, the CRAs undertaken and risk ratings assigned were not documented in any manner. In fact, for 58% of the customer files reviewed, the Officials could not establish the risk rating assigned by the Bank at onboarding and throughout the business relationship. For the remaining customers files, the Committee observed that although a CRA was carried out, such assessment was conducted late in a number of instances.

It was also observed that no evidence was held on file to indicate that the risk ratings assigned to existing customers were reviewed and/or updated to reflect any changes during the business relationship.

*The jurisdiction risk analysis was not comprehensive*

The Committee was informed that the former risk assessment methodology only took into consideration whether customers reside in Malta and/or are associated with non-reputable countries. In the case of connections to non-reputable jurisdictions, it could not be established to what extent a jurisdiction was considered and the respective weighting assigned. Hence, the Bank was not comprehensively accounting for the geographical risk arising from any other possible links with other jurisdictions, and did not exhaustively establish all elements and exposures from the various jurisdictions.

ii.) Newly Implemented Risk Assessment Methodology

*The majority of the customer relationships were not risk assessed with the newly introduced methodology*

At the time of the compliance examination, very few customers (both retail and corporate customers) had been risk-assessed with the new risk assessment methodology. However, the Committee was aware of the limited timeframes between the implementation of the new methodology and the compliance examination. The extent of the effectiveness of the implementation of the new CRA methodology will therefore be covered during the follow-up process.

*Findings relating to the CRAs held on file*

It was noted that for 5 customer files, the Bank had carried out the CRA following the establishment of the business relationship. Nevertheless, the Committee acknowledged that the Bank established a remediation plan to rectify the gaps pertaining to the CRA processes and risk assess existing business relationships.

Customer Due Diligence (CDD): Information on the Purpose and Intended Nature of the Business Relationship – Breach of Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs

The customer file review carried out during the compliance examination identified numerous deficiencies in the procedures which the Bank had in place to obtain and assess information on the purpose and intended nature of the business relationship. Information and/or documentation was either not collected, or inadequately obtained, as outlined through some examples below:

- For one customer file, shortcomings were noted in relation to the compilation of the beneficial owners' source of wealth (SOW). Following a review of the customer's financial statements, it was observed that: (i.) substantial shareholders' loans were reported; and (ii.) the company registered consistent losses over the years. The Committee thus held that there is clear evidence that the customer was not entirely self-sufficient, and to an extent, relies on shareholders to finance its operations. Consequently, in this specific situation, the Bank was expected to obtain SOW information on the customer's beneficial owners.
- For another file, the Bank did not collect sufficient information to establish the expected source of funds (SOF) to be used in the business relationship, whether at onboarding or during ongoing monitoring. With regard to this customer, the Committee noted that the account application form held on file prior to the compliance examination provided information regarding the customer's employment and net monthly remuneration. However, the declared net monthly remuneration of approximately €5,000 was insufficient to substantiate the estimated annual deposits of over €5 million.

This inconsistency should have raised concerns about the validity of the customer's declarations and merited further investigation by the Bank.

In its deliberations, the Committee positively acknowledged that following the compliance examination, the Bank proactively rectified almost all of the file specific deficiencies identified. The Committee also commended the fact that in 2019 (i.e. prior to the compliance examination taking place), the Bank's customer onboarding forms were revised to ensure that the customer data collected is in line with local AML/CFT requirements. Nonetheless, the Committee could not disregard the fact that at the time of the compliance examination, the Bank had failed to obtain sufficient information/documentation regarding its customers' anticipated level and nature of transactions, SOW and expected SOF.

#### Record Keeping – Breach of Regulations 13(1) and 13(2) of the PMLFTR and Sections 9.1, 9.2(b) and 9.3 of the IPs

During the compliance examination, it was established that the Bank did not have a centralised data management system, which may have impinged on the Bank's ability to implement an efficient record keeping system. However, the Committee acknowledged that at the time of the compliance examination, a records management and digitisation project was underway, which project had been initiated prior to the commencement of the compliance examination. The Committee also positively noted the fact that the Bank was able to provide all the information/documentation requested by the Officials, save for two customer files.

#### Ongoing Monitoring – Breach of Regulations 7(2)(a) and 7(2)(b) of the PMLFTR and Sections 4.5.1(a), 4.5.1(b) and 4.5.2.3 of the IPs

##### i.) Updating of Documentation/Information

###### *Periodic reviews were not adequately conducted*

As highlighted in the compliance examination report, some customer files were not subject to periodic reviews in line with the Bank's policies and procedures. For other customer files, it was observed that the information/documentation obtained for identification or verification purposes was either found to be expired or updated after a considerable period of time.

##### ii.) Scrutiny of Transactions

###### *Ineffective and inadequate processes for transaction monitoring*

The Committee positively acknowledged the automated transaction monitoring system implemented by the Bank in 2021. This transaction monitoring system was deemed as having the potential to be robust and highly effective; however, the Committee stated that such system will need to be tested as part of the follow-up process.

The Committee asserted that the Bank should not have waited so long to implement an automated transaction monitoring system. In this case, solely relying on manual monitoring for such a long period of time and not adopting an automated system at an earlier stage meant that the Bank had in place inefficient control measures to prevent/combat ML/FT risks.

The observations/findings relating to the Bank's post-transaction monitoring process which was in place at the time of the compliance examination are outlined below:

- The Committee noted that most of the post-transaction reports were not issued on a consistent basis due to a lack of resources. The Bank submitted that following the restructuring of the Compliance Function and investment in additional resources, the Bank had decided to revise the type of reports generated, and now issues three reports on a routine basis. While acknowledging the enhancements made, the Committee emphasised that the Bank's failure to issue its previously extracted post-transaction reports in line with their pre-determined frequency is indicative of an ineffective and deficient post-transaction monitoring system at the time of the compliance examination. Having consistent access to all reports would have allowed the Bank to have a more holistic view of its customers' transactional patterns and be in a better position to detect unusual and suspicious transactions.
- It was also observed that the handling and follow-up of the transactions flagged in the post-transaction reports were not of the standard expected, as can be seen through the below examples:
  - In one report, the Officials noted that for four customer files (each of which had multiple transactions featuring in the report), the Bank officials outlined that a declaration by each customer was held on file as a form of supporting evidence. However, the declarations were not included within the report or as part of the feedback received from the respective branch. In its discussions, the Committee emphasised that the Bank was not only expected to maintain a copy of the declarations on file, but also obtain further documentary evidence from the customers (such as tax declarations) if necessary.
  - In relation to another report, there were several transactions pertaining to six customer files which warranted further explanations and/or supporting documentation. For these customer files, the branch only provided a brief explanation for the transactions delineated in the report and did not collect supporting documentation to verify the customers' claims. Additionally, the activity of the customers often referred to generic terms such as "international money transfers". In this regard, the Committee stressed that the Bank needed to obtain relevant supporting documentation to substantiate the transactions undertaken and verify the customers' claims, as well as clearly document the rationale on the basis of which these transactions were deemed to be justified.
  - Similarly, the review of another report revealed that the Bank had failed to provide information and/or supporting documentation to substantiate the funds deposited by various customers. It also transpired that the explanations outlined within such report were in most instances generic, and not backed-up by sufficient supporting documentation. This was confirmed in 10 customer files, where the description to support the transactional activity was not detailed and made reference to generic terms. By way of example, for one of the customer files, an alerted transaction exceeding €19,000,000 was discounted through a note which simply stated "Bank's online platform".

In its concluding remarks, the Committee stressed that the Bank should have included valid justifications to substantiate all transactions outlined in the post-transaction reports and ensured that these explanations were backed-up by sufficient supporting documentation, which in this case, should have been included or at least referenced within these reports. This is especially important when taking into consideration the fact that the value of several transactions included in the reports were quite significant.

Notwithstanding the above, the Committee positively acknowledged the fact that following the compliance examination, the Bank took the necessary actions to remediate some of the shortcomings identified.

The Committee also commended the guidance and instructions being provided by the Bank to its staff on a continuous basis to ensure that the explanations and supporting documentation obtained are sufficient to justify the specific transactions. Consideration was also given to the fact that in 2021, the Bank launched its “APS Check-In” campaign, inviting its customer base to update their data.

#### *Findings in relation to the transactions for the customer files reviewed*

The Officials reviewed a sample of transactions and noted that in two instances, the information held on file pertaining to certain transactions which were executed in 2018/early 2019 was considered insufficient. The Committee’s deliberations in relation to these two sub-findings are delineated below:

- Customer file 1 – The Committee noted that the customer deposited over €100,000 on the same day by affecting a total of six distinct transactions. Based on the information and documentation held on file, these transactions did not reflect the customer’s profile. The customer’s gross salary had started off as being slightly over €1,000 a month and only gradually increased to over €3,000 a month after years of working experience. The pattern and value of the transactions undertaken were significantly above the average value of other transactions passing through the customer’s account. The customer had explained that the funds comprised of savings held at home and provided supporting documentation such as the employment contract and payslips. However, the documentation provided did not substantiate these transactions. In this situation, the Committee contended that the Bank was expected to question the customer’s deposit spike, as well as request further explanations and supporting documentation to justify the rationale behind these transactions.
- Customer file 2 – A total of three transactions pertaining to this customer were reviewed. The value of two of these transactions was equivalent to circa €2.7 million, while the other transaction was equal to roughly €200,000. With specific reference to the first two transactions, the Bank provided evidence that it had attempted to schedule a meeting with the customer to understand the rationale behind these transactions and request supporting documentation. However, no further updates were provided to confirm that the meeting took place, and that the requested explanations and supporting documentation were indeed obtained. In relation to the other transaction, the Bank provided a screenshot containing the basic payment details of the sender and the beneficiary, which is insufficient. In its discussions, the Committee emphasised that considering the high value of the transactions involved, the Bank was obliged to obtain further information and supporting documentation in order to validate the transactions and ensure that these make economic and lawful sense.

#### **ADMINISTRATIVE MEASURES TAKEN BY THE FIAU’S COMPLIANCE MONITORING COMMITTEE:**

After taking into consideration the aforementioned findings, the Committee decided to impose an administrative penalty of €228,706 with regard to the breaches identified in relation to:

- Regulation 5(1) of the PMLFTR and Sections 3.3 and 3.3.3 of the IPs
- Regulation 5(5)(a)(ii) of the PMLFTR and Sections 3.5.1, 3.5.2 and 3.5.3 of the IPs
- Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs
- Regulations 7(2)(a) and 7(2)(b) of the PMLFTR and Sections 4.5.1(a), 4.5.1(b) and 4.5.2.3 of the IPs

In addition, in terms of its powers under Regulation 21(4)(c) of the PMLFTR, the FIAU served the Bank with a Follow-up Directive. The aim of the Follow-up Directive is for the FIAU to ensure that the Bank has implemented the improvements and enhancements as explained in its representations, as well as

undertaken any other necessary remedial actions to ensure that it is in full compliance with its AML/CFT obligations as stipulated in the PMLFTR and the FIAU's IPs.

In virtue of this Directive, the Bank is required to make available an Action Plan indicating the remedial actions that it has carried out and implemented since the compliance examination, together with the remedial actions which are expected to be carried out to address the identified breaches, this including but not limited to:

- Providing a documented explanation of the remediation undertaken/planned to be undertaken to rectify the failures outlined above in relation to the CRA, which includes a progress update on the status of the risk assessment and scoring exercise of the Bank's existing customer relationships using the new risk assessment methodology.
- Ensuring that going forward, the necessary information/documentation regarding the purpose and intended nature of each business relationship is duly collected with the aim of establishing a comprehensive customer business and risk profile which is in line with the applicable regulations. The Bank is to furnish copies of the latest version of the customer onboarding forms being utilised, as well as its plan for the updating of active customer relationships (if applicable).
- A documented explanation of any remediation undertaken/planned to be undertaken regarding its record-keeping procedures, in particular, the progress made vis-à-vis the implementation of a centralised data management system.
- Ascertaining that the ongoing monitoring deficiencies in relation to the updating of information/documentation noted in the specific customer files have been rectified. Moreover, the Bank should ensure that all future periodic reviews are conducted in a timely and adequate manner.
- With regard to the scrutiny of transactions, the Bank is to provide a status play of its enhanced transaction monitoring processes, both from a pre-transaction monitoring perspective, as well as from a post-transaction monitoring point of view. It is important that this explanation makes reference to the detection scenarios which are currently established, the different segments in which retail and corporate customers are categorised, and the specific rules/thresholds implemented for each respective customer segment.
- An update regarding the human resources situation within the Bank's Compliance Function.

Throughout the remediation process, the Bank may be requested to provide live demonstrations of the systems it uses to comply with its AML/CFT obligations, as well as furnish a sample of customer files and transactions to ensure that the necessary remedial actions have been undertaken.

In the event that the requested information and/or documentation is not made available within the stipulated timeframes, the Bank's default will be communicated to the Committee for possible action. This could include the potential imposition of an administrative penalty in terms of the FIAU's powers under Regulation 21 of the PMLFTR.

In arriving at the final amount of the administrative penalty to impose, the Committee took into consideration the following:

- The importance of the obligations breached;
- The seriousness of the findings identified and their material impact;
- Whether these failures could have led to the unintentional facilitation of ML/FT;
- The impact that the shortcomings may have had on the Bank's operations, as well as on the local banking sector, jurisdiction and financial system at large;
- The size and operations of the Bank, and it being a core banking institution in Malta;
- That the Bank is a retail credit institution, and that most of its customers are Maltese individuals;
- The overall level of cooperation exhibited by the Bank throughout the whole process; and

- The overall good regard that the Bank has towards its AML/CFT obligations.

The Committee also ensured that the administrative sanction imposed is effective, dissuasive, and proportionate to both the failures identified, as well as with the ML/FT risks that were perceived during the compliance examination.

In its deliberations, the Committee acknowledged the Bank's ongoing commitment towards enhancing and updating its AML/CFT systems and processes, and praised the dedication displayed by the Bank's top management in their fight against ML/FT. The Committee also commended the remedial actions that the Bank has started to implement/has already implemented, stressing that in most cases, the Bank not only proactively identified the weaknesses and shortcomings in its AML/CFT framework, but also sought to take the required remedial actions without waiting for a Directive to be imposed. In fact, certain remedial actions were taken before the compliance review had commenced. Finally, the Committee noted the fact that the Bank kept the FIAU abreast of its remediation process, providing frequent progress updates of the improvements and enhancements being made, both prior to the compliance examination taking place, as well as following its completion.

**The administrative penalty hereby imposed is not yet final and may be appealed before the Court of Appeal (Inferior Jurisdiction) within the period prescribed by the applicable law. It shall become final upon the lapse of the appeal period or upon final determination by the Court.**

#### **Key take-aways**

- To carry out an adequate CRA, the subject person needs to take into consideration a holistic approach of the four risk pillars as stipulated in the IPs. Based on the CRA, the subject person will then be able to determine the level of CDD to be applied, as well as the degree and extent of ongoing monitoring required. This is why the CRA must be undertaken prior to the establishment of a business relationship or carrying out an occasional transaction. Any decisions relative to the CRA and changes thereto need to be documented to evidence that appropriate assessment has taken place.
- Obtaining relevant information and/or documentation pertaining to the purpose and intended nature of the business relationship is imperative to enable subject persons to formulate a comprehensive customer business and risk profile. By collecting information/documentation on the customer's business/occupation/employment, SOW, expected SOF, and the anticipated level and nature of activity, the subject person will be able to manage the ML/FT risks present within the business relationship in a more effective manner.
- Subject persons should also pay careful attention to circumstances where the customer's beneficial owner(s) would be financing the operations of the underlying legal arrangement. In cases where there is evidence that a customer entity is not self-sufficient, receives substantial capital injections from its beneficial owners or is being regularly funded by its beneficial owners through other means, the subject person is expected to request the customer to provide SOW information on its beneficial owners to determine the activities from which their wealth is derived.
- Subject persons are required to maintain efficient record keeping procedures which enable them to retrieve and/or grant access to information in a timely manner. Through the establishment of an effective data management system, subject persons will be in a better position to respond to any enquiries made by the FIAU, supervisory authorities or law enforcement efficiently, adequately, promptly, and comprehensively.
- As part of its ongoing monitoring obligations, the subject person needs to ensure that during the business relationship, information, documents, or data related to the customer remain up-to-date and relevant. This is achieved by the performance of regular periodic reviews or updating prompted by certain trigger events.

- The decision to implement a manual or automated transaction monitoring system is dependent on various factors such as the size of the subject person's set-up, the number of clients and transactions involved, and the level of risk to which it is exposed. In view of this, if the subject person has a voluminous customer base and processes a substantial number of transactions on a regular basis, it is expected that an automated system is adopted. This is because in this situation, not only does a manual system create inefficiencies in the process, but there is also a higher risk that unusual transactions or transactions inconsistent with the customer's business and risk profile are not adequately captured, reviewed, and reported on if necessary.
- Post-transaction monitoring is essential as it empowers subject persons to identify patterns of transactions that raise suspicion and/or are not in line with the customer's profile. As part of the post-transaction process, subject persons can opt to issue reports based on a pre-determined frequency. Each individual report will contain transactions of a similar nature which are grouped and examined together depending on the nature of the transactions and customers involved, as well as certain established rules/thresholds. Having access to a wide variety of post-transaction reports which cover several different transaction types and customer segments allows subject persons to have a more holistic view of its customers' transactional patterns and facilitates the detection of unusual and suspicious transactions. The implementation of effective post-transaction monitoring controls also enables the identification of sudden deposit spikes or deviations from the information available on the customer and its transaction history.
- Carrying out effective transaction monitoring requires subject persons to ensure that, on a risk sensitive basis, the transactions being affected by their customers are duly substantiated, and that the rationale of the transactions is known. If during the transaction monitoring process, the subject person detects transactions which are unusual, suspicious or diverge from the customer's expected or known transactional pattern, the subject person must collect adequate supporting documentation to justify the transactions executed. The assessment of whether further supporting documentation is required needs to be refreshed on an ongoing basis to ascertain that any changes in the customer's profile are accounted for.
- When there is a spike in deposits which is not reflective of the customer's risk profile, the subject person should establish the purpose of the transactions and the source of the incoming funds. Furthermore, the transactions must be backed-up by the appropriate documentary evidence.
- Enhanced transaction scrutiny, including the implementation of effective pre-transaction monitoring measures, is particularly important in cases involving heightened risks such as those involving unusually large or anomalous transactions.

**1 February 2023**

