



AML/CFT OBLIGATIONS IN RELATION TO INVESTMENT SERVICES PROVIDERS

Q&A

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Introduction

In terms of Regulation 2(1) of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR) “investment services carried on by a person or institution licensed or required to be licensed under the provisions of the Investment Services Act” constitute “relevant financial businesses”. Therefore, any person or institution providing these services is a subject person and has therefore to comply with the anti-money laundering and countering funding of terrorism (AML/CFT) requirements emanating from the Prevention of Money Laundering Act, PMLFTR and the FIAU’s Implementing Procedures.

Representatives from the Maltese Investment Sector submitted a request to the FIAU for guidance and clarifications with respect to specific aspects of their AML/CFT obligations. Therefore, through this Question and Answer (Q&A) document, the FIAU is providing this guidance to persons or institutions offering investment services that are licensed or required to be licensed under the Investment Services Act (hereinafter referred to in this Q&A document as “Investment Services Providers” or “Subject Persons”).

By means of this publication, the FIAU, is taking the opportunity to provide examples on how the risk-based approach should be applied. Although this document covers questions submitted by the Investment Services Providers’ Sector, all AML/CFT subject persons are encouraged to read and apply it in any similar circumstances they may experience.

Therefore, the publication of this document is also an opportunity for the FIAU to provide examples on how the risk-based approach should be applied in the different scenarios that subject persons may encounter in adhering to their AML/CFT obligations.

This Q&A document includes guidance about specific scenarios and is intended to be read within the context of the Implementing Procedures Part I and any other sector specific document issued by the FIAU and addressed to Investment Service Providers.



Section 1

The subjective element in applying the source of funds requirements.

Question 1

A customer (or potential customer) wishes to deposit new funds or open a new account with an Investment Services Provider. They explain that the source of the funds being invested is inheritance. The customer provides documentary evidence showing the transfer/release of the estate to them as rightful heir.

Do subject persons also need to make verifications and enquiries on the deceased person and the deceased person's own source of funds?

Answer 1

In terms of Regulation 7(1)(c) of the PMLFTR, subject persons should assess and, as appropriate, obtain information on the purpose and intended nature of the business relationship and establish the business and risk profile of the customer. To this end, a subject person must collect information and, whenever necessary, verify it with documentation such as the expected source and origin of the funds to be used throughout the business relationship. Subject to what is stated hereunder, the general rule is therefore that subject persons do not have any obligations to consider how the deceased may have generated the funds/ assets which would have been transmitted to the customer in their capacity as the deceased's heir. Whilst it is true that the customer is now proposing to invest these same funds/ assets with the assistance of the subject person, the deceased would not themselves have a connection with the subject person, and it would therefore follow that Regulation 7(1)(c) is generally not applicable in relation the deceased.

However, even though the view mentioned above is the general rule, subject persons are nonetheless expected to evaluate the risk factors surrounding the specific business relationship. As a consequence, in the light of the risk-based approach, in scenarios involving significant amount of funds, subject persons should apply the mitigating measure of the screening for publicly available adverse information about the deceased, to exclude that they were criminals involved in financial crime. Any evidence of the adverse media searches should be kept on file, including any discounting of potential hits.

An amount is to be determined as being significant or otherwise objectively and not based on what the subject person usually handles. One has to consider the overall general economic circumstances. 10,000 Euro would not be considered as significant as the amount is one that anyone may generate over years and/or inherited. On the other hand, 100,000 Euro would be significant as it is not an amount that may be so easily generated by way of savings and therefore to be inherited.

As previously explained, the level of the ML/FT risk assessed by the subject person, would here again guide the Investment Services Providers to determine whether and in which measure to apply the measure of obtaining information on how the funds/assets inherited have been generated by the deceased.

Please find below some examples on when and how this measure should be applied in practice:

Example 1

The customer wishes to deposit a relatively small amount of funds and explains that the source is inheritance. The amount is well within the customer's known profile. After carrying out the customer risk assessment (CRA), the case is deemed to be of low ML/FT risk by the subject person.

An explanation from the customer confirming that the source is inheritance, together with a copy of the will would suffice in such a scenario. No further enquiries are required. Naturally, the risk would need to be re-assessed if the same customer deposits further funds and provides the same explanation about the origin of the funds (i.e., a series of deposits that in aggregate may add up to a more material amount).



Example 2

The customer wishes to deposit a moderate amount of funds and explains that the source is inheritance. The deceased person was also a customer of the subject person. The amount being transferred to the subject person as inheritance is within the deceased person's profile, since this information was known to the subject person during their customer relationship. After carrying out the CRA, the case is deemed to be of low/moderate ML/FT risk by the subject person.

An explanation from the customer confirming that the source is inheritance, together with supporting documentation, such as a copy of the death certificate and the latest will of the deceased demonstrating the customer is the rightful heir of the deceased, would suffice in this scenario. No further enquiries are required.



Example 3

The customer wishes to deposit a significant amount of funds and explains that the source is inheritance. The deceased person was not a customer of the subject person. After carrying out the CRA, the case is deemed to be of moderate/high ML/FT risk.

In this case, the subject person would be expected to obtain an explanation from the customer, together with documentary evidence surrounding the inheritance, such as:

- death certificate of the deceased
- copy of the latest will of the deceased, confirming that the customer is a rightful heir
- evidence of transfer of the estate of the deceased to the customer
- evidence on the value inherited by the customer, by means of bank statements
- evidence of transfer of portfolio, notary declarations confirming the assets allocated to the customer as heir of the deceased
- evidence that the amount being transferred is actually coming from the inheritance and has not been used for other unexplained activities (e.g., a bank statement showing the inward transfer of funds from the inheritance and that the balance on account as at today is composed to a large extent of that inherited amount)
- evidence of the value of the assets inherited, i.e., the actual monetary amount may be necessary for comparison with the amount being deposited for investment.

The subject person should also perform an open-source search on the deceased person to ascertain whether they were associated with any criminal activity during their lifetime, and therefore whether the estate transferred to the heirs may have represented proceeds of crime.

For the purposes of the above example 3, non-satisfactory conclusion of the above procedures may include any one or a combination of the following:

- The customer is unable to demonstrate that they are the rightful heir.
- There is no justifiable connection between the deceased and the customer (i.e., for example, the customer is not a close relative of the deceased), and no reasonable explanation is provided for this fact.
- The customer is unable to provide evidence that the estate of the deceased was transferred to him.
- The customer is unable to provide evidence that amount being invested is truly the proceeds of inheritance (i.e., they may have already used the proceeds of inheritance in another transaction, possibly using other subject persons, and is now falsely using inheritance once again, as the source of funds being invested this time round).
- The value inherited by the customer is significantly lower than the amount being invested by them.
- The value of the inheritance is not corroborated by documentary evidence.
- The open searches on the deceased's identity, as part of the onboarding or ongoing monitoring process, lead to results that indicate that the deceased was associated with criminal activities during their lifetime.
- The customer is unable to clearly explain and demonstrate how the deceased had accumulated their wealth during their lifetime in a legitimate manner.

Question 2

A customer (or potential customer) wishes to deposit new funds with a subject person, for a high amount of money (i.e., 1 million Euro), and they explain that the source of funds is the sale of property. The customer provides documentary evidence (i.e., the contract of sale) which confirms that the customer sold a property approximately six months ago for an amount greater than the 1 million Euro which is the amount being invested.

Would the contract of sale suffice as source of funds evidence? Or would the subject person require additional evidence to show that the funds being invested are the actual proceeds from the sale of property, i.e., a bank statement that shows that the amount deposited six months ago has remained substantially untouched, as indicated by the current balance on account?

When the source of funds is from the sale of property, would the subject person need to go into the merits of how the property was originally bought and apply source of funds verifications on the historical purchase?

Answer 2

The value and/or volume of the amounts invested is a key risk consideration. In terms of section 3.2.3 of the FIAU's Implementing Procedures – Part I, subject persons have to consider the risk associated with the value and volume of transactions that are to be carried out. The higher the amount to be invested, the higher the product, service and transaction risk, and the higher the likelihood that the relationship will be classified as high risk.

Even in the context of an on-going business relationship, there is an obligation on subject persons to scrutinise transactions that are not in line with the subject person's expectations and known customer activity. In either case, information, and documentation on the (expected) source of funds will be necessary to mitigate the heightened ML/FT risk.

In the case mentioned above, the deposit of 1 million Euro involves a large sum which increases the level of risk of that transaction (transaction risk). An effective mitigating measure in any such case is for the subject person to collect further information and supporting documentation. These help the subject person understand and verify the source of funds used to finance the unusual/large transaction. Obtaining the contract of sale on its own in these cases would not suffice, as it would only show that the customer had the said amount at their disposal at a given moment in time. Therefore, further verification is required. Subject persons should supplement the contract of sale with bank statements. These need to show the deposit of these sale proceeds into the customer's bank account and, very importantly, that those funds from the sale are still at the customer's disposal. The collection of these further documents will help subject persons to clarify the source of wealth of the 1 million Euro deposit. Furthermore, any other documentation that may provide the same type and level of corroboration as those already mentioned, would effectively address the ML/FT risk associated with the said transaction.

When the source of funds is the sale of a property, the Investment Services Provider does not need to go into the merits of how the property was originally bought and therefore, there would be no need to apply source of funds verifications on the historical purchase. This is because it would go beyond what is required to ascertain that the source of funds is legitimate.



Section 2

Issues on collecting information on source of wealth and expected source of funds in the case of long-established customer relationships and the extent of documentation deemed acceptable in these cases.

Question 3

A 70-year-old person has been a customer of the subject person for 40 years and had most of their existing portfolio transferred to the subject person 30 years ago. A common issue in such cases is that long-existing customers find difficulties in providing source of funds documentation today, relating to their activities 30 years ago, given the time that has elapsed. This is a common problem for long standing relationships, since the requirements for accepting new funds at the time were different. Document retention by customers and by their service providers typically does not extend beyond 10 years, and customers could not have foreseen 30 years ago the AML/CFT requirements that apply today.

What are the subject person's obligations in such a case?

How would the subject person need to act if this same scenario was presented to it by a potential new customer rather than a long-established customer? Would the Investment Services Provider need to reject the onboarding of similar cases because of the limited documentation that can be provided by the potential customer?

Answer 3

The obligation under the current AML/CFT framework is to obtain information, supplemented by documentation where necessary, on the customers' source of wealth and (expected) source of funds commensurate to the ML/FT risk presented by servicing them. Subject persons will need then to assess whether the explanations, information, documentation provided are exhaustive and reasonable, or otherwise. While the FIAU acknowledges that this may not always be an easy exercise, especially in the context of someone who has been accumulating savings over a lifetime, it is also true that no exception is possible in this regard.

Having said that, a distinction needs to be drawn between the two scenarios described, i.e., between a long-standing customer who the Investment Services Provider has been servicing over the years and one who, though of the same age, is only now approaching the Investment Services Provider for their services.

In the former scenario we need consider that the subject person should have aligned themselves to the different AML/CFT requirements gradually, as they came into force over the years. In fact, the subject person may not initially have been required to fulfil the same obligations as if the customer was onboarded today. However, they should have gradually collected the necessary information/documentation over the years. Therefore, today (30 years after having started to service the customer) they would have been in a better position to assess and understand the risks presented by the customer.

For instance, the gradual application of the CDD measures over the years would have helped to better understand the customer`s activity. Just an example to clarify this point: if a long-established customer, at some point of the business relationship, had requested the investment services provider to invest a major amount of money and declared that the source of these funds was an inheritance, the subject person could have requested a copy of the will. Moreover, through the ongoing monitoring of transactions, the subject person would have been able to notice any major amounts of money invested for which the origin was not legitimately explained. This would have triggered some suspicions.

Differently, if the source of funds declared by a long-established customer was a business activity, the customer would have been expected to probably earn and invest a given amount of money over the years. In this different scenario, the major amounts of money invested by the customer would have made economic sense. These examples are to explain how the gradual application of AML/CFT measures over the years, would have helped the subject person build an understanding of the customer and the AML/CFT risks connected with their business relationship.

If the same scenario of the 70-year-old person wanting to invest was presented by a potential new customer rather than a long-established one, the Investment Services Providers would not need to necessarily reject them based on limited documentation. The FIAU would expect the Investment Services Provider to first draw up a CRA based on the information collected and determine the level of ML/FT risk the customer presents. Upon assessing the specific risks subject persons will be exposed to by providing their services to a particular customer, one should be able to determine the level of Customer Due Diligence (CDD) required, including the level of information and documentation on source of wealth and source of funds that the customer should provide.

In situations which do not involve significant amounts being invested, and there are no red flags, the subject person can rely on the explanations provided by the prospective customer, after assessing whether it is reasonable for someone of that age to on average have a similar portfolio. This reasoning would need to be corroborated by the subject person by obtaining information on earlier and current investments held by the prospective customer. Subject persons would then need, on a risk sensitive basis, to obtain any supporting documentation that the prospective customer can further provide to assist them verify their statements depending on the level of ML/FT risk assessed.

On the other hand, in higher risk scenarios, including situations where the amounts to be invested are significant, the subject person would need a deeper and better understanding of the circumstances which led the prospective customer to accumulate the portfolio in question. In such cases, the explanations provided by the prospective customer would have to be supplemented by any documents. This may include statistical data and public records, that could corroborate the prospective customer's statements as to how they gradually accumulated the portfolio. Statistical data and public records documentation include data on average salaries which may be published by government authorities or other reliable sources, public deeds showing the acquisition or sale of immovable property, records from the Malta Business Registry that may show that someone previously held shares in a company, etc.

Moreover, documents such as bank statements could, for example, go to show any initial income invested as a result of employment or there could be public documentation, such as reports in the media, which may corroborate the prospective customer's statement. What is important is that all of this is recorded. It is also key to bear in mind that this is not an exercise akin to a tax audit and therefore it is not necessary for the customer to account for all the income and wealth accumulated over their lifetime. What needs to be assessed is whether the explanations given, and checks carried out provide a reasonable justification.

While the above would be applicable in the context of onboarding prospective customers, it can be a means to identify the source of funds of established customers, where they are unable to provide the necessary information and/or documentation. This can be done if there are no ML/FT red flags. This is a general provision generally applicable to all categories of AML/CFT subject persons.

Another interesting example could be the one of the same long-established 70-year-old customer who for many years deposited 10,000 Euro annually for investment and suddenly, starts depositing 10,000 Euro monthly for the same purpose. In such a case, subject persons should understand how the customer has substantially increased the amount of funds being invested. It is crucial to distinguish whether there are new streams of funds or otherwise.

In fact, when there is a re-investment of earnings, and this is a consequence of one or more previous investments, the source of funds is that, and subject persons do not need to ask for further documentation/information.

If we assume that the 70-year-old customer, suddenly decided to change their investment strategy and divest themselves of specific investments to reinvest in others, the subject person would only need to ensure that the amount reinvested tallies or does not greatly exceed the amount gained from the original investments. On the other hand, if there is a significant divergence between the two and it cannot be explained in any way, the subject person needs to establish how the customer is deriving the additional funds.

These examples aim to explain that the CDD measures to be applied by the subject person should always be based on the information they acquired and on whether it tallies with the actual customer`s activity.



Question 4

A potential customer asks the Investment Services Provider to open a broker account to permit them to sell Malta Government Stocks (MGS) they already own. The potential customer explains that they had applied for these MGS via their bankers or a different Investment Services Provider many years ago. The customer is not depositing the funds to invest but is asking the subject person to sell investments they already own. Following the sale, the subject person would remit the proceeds to the customer's bank account.

Apart from the standard source of wealth enquiries and verifications as required, would source of funds verifications also need to be applied, to verify how the MGSs were purchased in the first place, or would this be unnecessary since no funds are being remitted to the subject person?

Answer 4

The main ML risk in investing in Government stocks is usually when the customer is initially investing money in them. Placing money in such stocks/bonds could potentially facilitate the conversion of the proceeds of criminal activity into another form. The money would usually already be in the financial system, but the creation of an additional layer of financial transactions would facilitate concealment of the original source of the funds invested. The risk would be even greater if the customer is allowed to introduce funds into the financial system through the Investment Services Provider.

At this point, the risk of ML lies in the possible completion of the laundering cycle or the further layering of tainted funds through the re-investment of the funds generated by the sale of the MGS. It is in this context that the CRA comes into play as it would indicate the level of enquiries that the subject person needs to carry out with respect to the transaction.

A key factor in any such assessment would be the value of the MGS at the time they were acquired, as the higher the value, the higher the likelihood that the transaction should be considered as presenting a high risk of ML/FT.

In a scenario involving MGS, with an initial investment value that corresponds to what an employee with an average salary could afford, there would be no need to establish how these were obtained. In this case the risk of ML would be low, unless there are additional transactions of a similar nature requested by the same customer. What the Investment Services Provider needs to document is that the money to be invested stems from the MGS. A receipt/copy/print out showing the name of the owner of the MGS and their value is sufficient. In this scenario there would be no need to confirm the source of funds.

On the other hand, in scenarios involving MGS of significant value, the associated risk of ML/FT would be higher. Therefore, apart from documenting the ownership and value of the MGS as explained above, the subject person is required to understand the nature of the transaction and how the customer acquired the MGS. One would need to ask what prompted the sale of the MGS and how they could afford them. In addition, one would need to query why the customer used a different Investment Services Provider.

The following are possible red flags that potentially could lead to the submission of an STR to the FIAU when an Investment Services Provider is approached to sell a well performing investment:

- It is the only investment ever carried out and the total sum originally invested was much higher than what would be expected given their financial status/salary at the time of purchase.**
- The customer approached a different Investment Services Provider to sell off their investment.**
- They did not provide a legitimate reason when asked why they wanted to dispose of the MGS.**

A combination of the above potential red flags in a transaction, for which no reasonable explanation is provided, may result in the Investment Services Provider not onboarding the customer.

Supporting documents would be required to verify how the customer was able to acquire the MGS and justify the transaction in question.

Further enquiry by the Investment Services Providers would then potentially lead to the submission of a report to the FIAU.



Section 3

Third party payments particularly in the case of married persons, or persons who fully own companies.

Question 5

In the case of married couples, it is historically common for one spouse to be the main income earner and the main decision maker both in the case of their personal portfolio, as well as that of their spouse. It is also common for the main earner to seek to split the portfolio between both spouses to ensure that each one has assets registered in their names. This is beneficial if one of the spouses passes away. This is generally seen as a normal market practice locally and the reasons for it are generally clear and understandable.

To what extent and level of detail should subject persons question their customers as to why this is being done? To what extent should these practices be treated as a “third party” transaction when the funds and investments are being used interchangeably between spouses?

Answer 5

Strictly speaking, if there is a transfer of funds from a person to another person with a different account, this is deemed to be a “third party payment”. However, the AML/CFT mitigating measures that subject persons should apply depend on the risk that these couples present. What subject persons should assess is if the transfer makes sense in the light of the reasons behind it and the different characteristics of the parties involved. These situations require a case-by-case assessment, and the level of accuracy of information and documentation should be based on the specific risk that subject person has assessed.

It is understandable that, at times, spouses hold separate rather than joint investment accounts or portfolios to avoid the difficulties encountered if one of them passes away and until all succession aspects are in order. However, other reasons may be provided including a possible change in the regime governing the couple's patrimony from community of acquests to separation of assets. This would then raise the question as to why there are repeated transfers between one account and the other, if the couple opted that each one is to be individually responsible for their respective assets and liabilities.

The FIAU also understands that it is possible that one of the spouses, as the main breadwinner, provides the necessary funding for investment purposes, but the wealth and income of both partners will need to be taken into consideration to assess whether such an arrangement makes sense. In low-risk situations, this can be done by just obtaining information from the customer. Supporting documentation should be then requested where the information provided does not match with the transactions carried out during the business relationship.

If subject persons become aware of new information indicating reasons for these transactions, subject persons would need to assess it in the light of what is known about the customers both at outset of the relationship and, gradually, as it develops.

The subject person needs to assess different elements to understand the scenario, such as those indicated below.

- Is there adverse media on one of the spouses?
- Is it possible that there is an attempt to conceal proceeds of criminal activity by having assets registered under the other spouse's name?
- Did the transactions between the accounts intensify just before the issue of an attachment or freezing order?
- Is one of the spouses a PEP and the transfers are somehow a means to mask the proceeds of bribery and/or corruption?

- To what extent are the transactions being carried out comparable with transactions carried out by couples having similar arrangements and presenting similar financial circumstances?

Thus, where the accounts of spouses are utilised in a manner consistent with the activity of other low and normal ML/FT risk spouses and no red flags such as the examples listed above are present, then subject persons need not question their customers further or treat any interchanging of funds as third-party transfers.

However, attention should be paid to detect any change in transaction patterns or situations where funds and investments are being used interchangeably in a way which, in the experience of subject persons, is not in line with that of other couples in similar circumstances. In the latter case, further explanations, information and, if necessary, documentation would need to be obtained to make sure that any possible red flags are being explained by the documentation provided.

Transactions involving closely connected persons for which the customer provides inconsistent or irrational explanations, or is unwilling or unable to explain by reference to legal, tax, business, economic or other legitimate reasons for them, are always deemed to be ML/FT red flags. In such cases, further explanations, information and, if necessary, documentation would need to be obtained by the subject person.



Question 6

The following questions refer to three scenarios:

Case 1.

One natural person transferring portfolios and/or funds to their fully owned holding companies;

Case 2.

One natural person owning a holding company that transfers portfolios and/or funds from this fully owned holding company to their personal account;

Case 3.

One natural person wanting to transfer investments from one holding company to another holding company, both ultimately owned by the same natural person.

In these cases, to what extent and level of detail are subject persons expected to question their customers as to why this is being done?

What are subject persons expected to retain on file in this respect?

Should such transfers be declined altogether by subject persons?

Answer 6

The scenarios being described bear a certain degree of inherent ML/FT risks, although some higher than others. The existence of a red flag is not an automatic indicator that ML/FT is taking place, but it should attract the subject person's attention to assess the situation more fully and gather more information to either justify the unusual behaviour or determine the suspicion of ML/FT. Therefore, such transfers should not be automatically declined by subject persons, but they should seek more information to understand the legitimacy of the transfer.

The common element of the three different scenarios listed above is that they involve the movement of money from a natural person to a legal entity and vice versa or between legal entities which are all ultimately owned by the same natural person. The funds are transiting through the financial system by means of different transactions. From a general perspective, engaging in a series of conversions or movements of funds which are already in the financial system can represent part of the layering stage of ML. Often, money launderers channel such funds through the purchase and sales of investment instruments. What is unusual about the above behaviours is that the money ultimately is remaining at the disposal of the original owner. However, this happens after a transaction, or a series of transactions have been carried out. These movements increase the level of ML risk because they would make it more difficult to track the transactions and would help to disguise potentially dirty money.

The reasons behind the transactions indicate the difference between legitimate actions vs behaviours meant to create extra transactions to disguise the illegitimate origin of the funds. If the subject person is reasonably satisfied that the explanation and the supporting documentation provided by the customer are legitimate, and make sense in the specific context, then there is no reason to refuse to carry out the transactions. **This is why it is important for the subject person to assess the purpose and intended nature of the business relationship, and to get accurate source of wealth and source of funds information which will help to understand the situation and consequently apply mitigating measures accordingly.**

With respect to **Case 1** when a natural person is using the services of an Investment Services Provider to transfer a portfolio of investments currently held in their name to a Maltese holding company ultimately owned by themselves, this bears a certain degree of ML risk. For example, when the explanation provided by the customer is that this is being done to centralise the customer's lifetime investments in a holding company for better management and centralisation of assets, subject persons should carry out various checks to make sure that the transaction makes economic sense. The Investment Services Providers should start off by ensuring that the company is owned by the customer. One would then need to assess how

reasonable the explanation provided by the customer is or whether there could be an easier and more logical means to achieve the same end.

The subject persons need to confirm the reasons for the transaction by way of assessing whether, amongst others, it is:

- a question of estate planning
- a question of expenses
- a decision that allows the individual to retain overall control over the assets
- possible that there may be tax implications, especially if the customer is not resident in Malta
- some form of shareholders' loan or it will take place through a capitalisation in kind etc.

Another question may be how will the transfer take place?

All of these questions and checks help the subject persons understand more clearly if the transaction is legitimate or otherwise. All these measures taken should be duly documented. For example, if the reason of the assets transfer is to reduce the expenses due to diversification of assets management, subject persons may get a reliable prospectus which illustrates how the fees will be reduced after the transfer.

Case 2 is the case of a natural person moving money from their holding company to their personal account. It is quite normal and legitimate that at some point a beneficial owner would want to get back the funds invested in their company, maybe to spend them or to invest further. Subject persons should, on a risk sensitive basis, understand the source of funds, for example by getting information from the financial statements of the holding company, to make sure that the amounts to be transferred are, from a

general perspective, justified and in line with the financial profile of the holding company. This exercise helps the subject person ensure that the funds sent to the personal portfolio account are legitimate and that the transaction makes economic sense.

Case 3 refers to the scenario of money transiting from a holding company to another holding company, both ultimately owned by the same individual. This case has a higher level of risk than the previous ones. Subject persons are required to assess carefully whether the transactions make economic sense and fit in with the specific business context. In either case, one would have to consider how reasonable the justification provided by the customer is for any such transfer.

The following are some key factors to consider when assessing the justification provided by the customer:

- Is it possible that, for example, this is an exercise in asset stripping, so that creditors are unable to enforce their rights on any of the assets?
- Are there any tax implications, especially if the companies are not located in Malta?

These are the kind of questions that one should ask to determine if the transfers are genuine or intended to provide a veneer of legitimacy to otherwise questionable, if not suspicious, transactions. For example, if the subject person has doubts about the possibility of asset stripping, audited financial statements of the company could help to better assess the status of the company.

In all the above 3 cases, if the level of ML/FT risk involved is assessed from moderate to high, the explanations provided by the customer should be then verified through documentation. Subject persons may also verify the explanation provided by the customer by asking for a copy of any professional advice provided by a reputable accountant, auditor, tax advisor or other professional consultant. In a low-risk scenario, where the amounts involved are limited to a few thousand Euro, such an enquiry of documentation is not deemed necessary if no other red flags are present.

The experience of the Investment Service Provider involving similar transactions from the same customers can also, to some extent, be a mitigating measure if:

(i) the transactions present the same characteristics and take place within similar conditions; and

(ii) the legitimacy and economic rationale of the earlier transaction were duly justified.

However, if the subject person still has ML/FT concerns, they would need to consider reporting to the FIAU. Examples of red flags include:

- A high volume or frequency of movement of funds made with no apparent legitimate reason;
- In/out transactions for significant amounts on a short-term basis;
- Excessive transfer of funds between related or unrelated accounts without any business purpose.

From a record keeping perspective, records detailing the transactions carried out for the customers will need to be kept. These records include the information on the purpose of the transactions. Furthermore, whenever it was necessary to collect supporting documentation, records need to be kept.

Question 7

Another scenario could be a natural person transferring money to an Investment Services Provider to purchase investments in the name of their fully owned Maltese holding company. For example, a customer that sold property held in their name and wishes to use part of the proceeds to invest in listed securities and to hold those investments within their holding company with their other investments.

To what extent and level of detail are subject persons expected to question their customers as to why this is being done? What are subject persons expected to retain on file in this respect? Should such transfers be declined altogether by subject persons?

Answer 7

When a natural person is transferring money to purchase investments in the name of their fully owned Maltese holding company, Investment Services Providers, need to understand the reason why the transfer of portfolios is taking place. This understanding will help them to determine whether there is a legitimate reason to carry out the transaction.

The extent and level of detail and documentation would depend on the level of risk presented by the customer. Subject persons need to be aware of certain indicators and based on their experience, question any movement of funds that are not in line with the customer's expected behaviour, or which seem suspicious.

To this purpose, any of the questions listed in the previous answer (answer 6) and suggested mitigating measures could easily find application here too.



Section 4

**Limited information provided
by banks in respect of
payments received and
payments effected.**

Question 8

A customer deposits 100,000 Euro into the bank account of their Investment Services Provider via internet banking.

The bank statement made available by the bank shows the 100,000 Euro deposit, but does not indicate the name of the bank nor the name and number of the account from which the payment was made.

This is a common problem with all banks as their bank statements do not display this information.

What are subject persons expected to do in these cases?

Answer 8

The FIAU understands that the information requested in the above situation is not to confirm the source of funds, but is required to ensure that, in the case of significant amounts or higher levels of ML/FT risks, the following points are verified:

- (i) The funds remitted were the customer's own and not those of a third party.
- (ii) There are no other elements that could increase the risk of ML/FT associated with the customer concerned.
- (iii) That there are no additional facts in relation to the business relationship maintained and/or any transaction to be processed on the customer's behalf, which would increase ML/FT risks.

In the example provided, the amount involved would justify the need for further details, especially if it is not in keeping with the customer's known investing activity. In this case it would be necessary to obtain information and documentation on the source of these funds.

However, even in situations where the customer regularly invests significant amounts, the Investment Services Provider should from time to time, as part of its on-going monitoring obligations, ask the customer about the source of the funds being invested and from where the funds are being remitted. As indicated, this is not required with respect to every transaction carried out. This needs to be done from time to time to address the higher risks of ML/FT associated with any such relationship and to ensure that the information provided by the customer when the business relationship was established is still current.

In the case of a lack of visibility of the transaction arising from the scenario in question, a copy of the instructions given by the customer to the bank to transfer money to the Investment Services Provider may be provided to the latter. This can be in the form of a screenshot of the internet banking interface, a printout of the bank transfer's instructions etc.





Section 5

Jurisdictional risk assessments

Question 9

A customer is based in jurisdiction X and their primary income is derived from jurisdictions X and Y. They also occasionally have exposure to jurisdiction Z. However, from the explanations and documentation provided, it appears that the funds being invested by the customer are linked to jurisdictions X and Y, but not Z.

Is a jurisdiction risk assessment required in the case of jurisdictions X, Y and Z, or solely those directly applicable to the customer's relationship with the subject person?

Answer 9

The jurisdictional risk assessment's purpose is to understand how a link with a particular country renders the subject person more vulnerable to ML/FT. Subject persons' exposure to geographical risk is not limited to the jurisdictions directly linked to their customer, but also arises from the main jurisdictions from where funds received on behalf of their customer are being generated and remitted. To this end, another aspect to take into consideration is the country where the customer is resident or established. This information should be included in the CRA.

The outcome of the jurisdictional risk assessment also depends on the nature of the connection of the customer with country Z. A lower weighting should be given if country Z is not the country where the major source of funds is generated. In general, if the connection with country Z does not come into play in the business relationship or only has a negligible impact on it, there is no need for a jurisdictional assessment on jurisdiction Z.

For example, if the connection of the customer with jurisdiction Z is because this is the nationality or place of birth of the customer, subject persons should ascertain whether the customer still has any links to that jurisdiction. If not, no further assessment of such jurisdiction will need to be carried out. However, the above explained reason i.e., the inexistence of any further connection of the customer with said jurisdiction will need to be recorded so that subject person is able to explain the reason to the FIAU in case of an examination.

If during ongoing monitoring, the subject person notes that the jurisdictional connection becomes more relevant, for instance, funds start being generated and/or remitted from/to that jurisdiction, then the subject person would need to assess whether a jurisdictional risk assessment needs to be carried out and, also, to update the CRA to reflect this new information.



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