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 administrative measures established by the Board of Governors of the FIAU.

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:

12th December 2023

RELEVANT ACTIVITY CARRIED OUT:

Investment Services

SUPERVISORY ACTION:

Off-site compliance review carried out in 2021

DETAILS OF THE ADMINISTRATIVE MEASURES IMPOSED:

Administrative Penalty of €46,681, 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(1) of the PMLFTR and Sections 3.3 and 3.3.3 of the Implementing Procedures Part I (IPs).
- Regulation 5(5)(a)(ii) of the PMLFTR and Sections 3.5.1(a) and 3.5.3 of the IPs.
- Regulation 7(1)(a) of the PMLFTR and Sections 4.3.1.1 of the IPs.
- Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs.
- Regulation 7(2)(b) of the PMLFTR and Sections 4.5.1(b) and 4.5.3 of the IPs.
- Regulation 7(2)(a) of the PMLFTR and Sections 4.5.1(a) of the IPs.
- Regulations 11(5) of the PMLFTR and Section 4.9.2.2 of the lPs.

REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURE:

Business Risk Assessment (BRA) - Regulation 5(1) of the PMLFTR and Sections 3.3 and 3.3.3 of the IPs.

The Company was found to have documented its first business risk assessment over 1.5 years from when the obligation came into force back in January 2018. Regulation 5(3) of the PMLFTR clearly requires the BRA to be properly documented and be made available to the FIAU upon demand. Hence, the Company was unable to evidence that it had adequately identified and assessed the ML/FT threats and vulnerabilities that it was being exposed to when servicing its clients. Accordingly, the Company was expected to take swifter action and ascertain that it allocated sufficient resources to duly complete the BRA in a timely manner in line with its AML/CFT obligations imposed by law.

Finally, the FIAU positively acknowledged the Company's statement that the Company's BRA has since then been reviewed regularly, kept up to date and approved by the board of directors.

Customer Risk Assessment (CRA) - Regulation 5(5)(a)(ii) of the PMLFTR and Sections 3.5.1(a) and 3.5.3 of the IPs.

The examination identified shortcomings in the Company's CRA procedure and methodology adopted by the Company at the time of the compliance examination, since it failed to:

- For all its customers, document the rationale behind the final attributed risk rating. Instead, the Company merely provided the overall rating assigned to its customers, which rating was determined on the basis of general considerations outlined in the Company's established 'template.'

- Ascertain that the CRA adequately takes into consideration the 4 risk pillars, this since the Company's established 'template' failed to:
    - With regards to customer risk, encompass crucial aspects such as the customer's economic activity, source of wealth (SoW), and source of funds (SoF). Apart from this, the Company also failed to cater for information regarding the type and complexity of the structure involved and whether the customer is a voluntary organisation, the activity the customer is associated with, etc.
    - In relation to geographical risk, failed to take into consideration links to other jurisdictions with which the customer or its BO may have had strong trading, financial and/or personal connections, as well as the jurisdictions through which funds are expected to pass.
    - With regards to product/service risk, it failed to cater for considerations such as the level of transparency or opaqueness of the product and the complexity of the product, service or transaction. Also, no reference was made to the different type of industries/sectors that the customer is expected to investment in.

In its representations the Company stated that prior to onboarding a customer, the compliance and back-office team would hold a full-scope verbal discussion, wherein the potential customer vis-à-vis the requested services would be duly assessed, to ensure that no additional risk exposure will result from the customer onboarding and ensuing relationship. The Company further emphasised that its customers are limited to trading only through a regulated stock exchange or in regulated schemes, that the majority of its clients were natural persons and did not involve complex structures. Here, the FIAU acknowledged that personally meeting customers and getting an understanding of the risk profile is in fact a good and effective control. However, this does not exonerate the Company from conducting a CRA in line with its AML/CFT Obligations. Therefore, the Company failed to outline concrete, objective and adequate considerations, thereby allowing significant room for subjectivity and inadequate identification of all the ML/FT risk exposure emanating from its customers.

Finally, the proactive approach undertaken by the Company following the examination whereby it commenced the implementation of a new CRA system was positively acknowledged. However, the FIAU was seriously concerned to note that up until the oral hearing held by the Company with the FIAU's Committee in 2023, the Company still hasn't migrated all its customer population to the new system. Hence some of its customers have still not been thoroughly risk assessed. The remediation undertaken on this regard and further required remediation is still to be attested by the FIAU.

Identification and Verification (ID&V) – Regulation 7(1)(a) of the PMLFTR and Sections 4.3.1.1 of the IPs.

The examination revealed that the Company failed to hold adequate documentation to verify the identity and/ or residential address of its customers, this in less than 25% of the files reviewed. Mainly this shortcoming related to customers either being onboarded despite providing expired documentation and/or the Company being unable to extract documentation pertaining to clients onboarded prior 2018.

Notwithstanding the above, the FIAU positively acknowledged the proactive efforts taken by the Company in 2020 (prior to the examination), this by requesting customers to send the required missing documentation, and where said customers did not comply to the request, the Company proceeded to freeze their accounts (some of which are still frozen according to the Company's statement).

Purpose and Intended Nature of the Business Relationship (P&IN) – Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs.

The examination revealed that in less than 20% of the files reviewed, the information recorded for the SoW/SoF of the clients was deemed to be of a generic nature such as 'self-employed employment', 'business activities', 'inheritance' or otherwise not found at all. Primarily, the Committee acknowledged that the Company had been servicing some of its clients for several years and that at the time the depth of the Regulations and guidance was less detailed. However, despite additional enhancements and guidance issued to explain the AML/CFT obligations pertaining to obtaining information and/or documentation on SoW/SoF, the Company still failed to collect the required information and/or documentation. Examples of which are being illustrated hereunder:

- One customer file onboarded in 2021 was rated as a 'high-risk legal entity', was incorporated in Mauritius and after onboarding was allowed to invest approximately €3million. For this file, the Company's standard form was largely incomplete and almost all the fields were left blank. Specifically, to account for SoW/SoF, the form completed by the customer indicated "dividend from subsidiary company" and 1 box was ticked which read "SoW derived from Company profits or dividends". Also, the Company collected information to show that funds derived from trust funds pertaining to the owners and corporate documentation pertaining to said trust. Also, in its submission, the Company stated to have blocked the account pending receipt of additional documentation.

  However, whilst commending the Company for eventually blocking the account, in view of the risks involved with this client (ties to Mauritius, involvement of trusts, significant amounts involved), apart from collecting the above information, the Company should have substantiated the same by collecting supporting documentation to ascertain the origin of the SoW/SoF, as well as obtain clarity between the information obtained from the customer and that declared on the form. The Company was to ensure that documentation collected pertaining to said trusts indeed provide a picture of the origin of funds behind the €3million investment.

- Another customer file concerned a Russian national which was onboarded in 2021 and rated as 'high risk' as being a resident in the Cayman Islands and requested an initial deposit of €160,000. The Company had information on file to show that the customer was "employed" with a yearly income of over €100,000. The Company argued that it did not collect supporting documentation given that the customer had been subject to CDD prior to his qualification for the Malta Residency Programme. The Committee discarded this reasoning as it runs counter to Section 4.10.2 of the IPs Part I which clearly stated that, "regardless of any reliance on another subject person or third party, subject persons always remain ultimately responsible for compliance with their CDD requirement". This coupled with the higher risk elements portrayed by this customer, required the Company to collect supporting SoW/SoF documentation to ascertain the legitimacy of the funds being invested.

Ongoing monitoring (Updating of Documentation) - Regulation 7(2)(b) of the PMLFTR and Sections 4.5.1(b) and 4.5.3 of the IPs.

The examination identified that for all the files reviewed, no evidence that periodic reviews were ever conducted was provided.

From the files reviewed, the Committee noted a significant lapse in the Company's adherence to the obligation postulated in Regulation 7(2)(b) of the PMLFTR and Sections 4.5.1 and 4.5.3 of the IPs, as well as non-adherence to its own policies and procedures which outlined that periodic reviews were to be performed every 5 years for 'Low risk' customers, every 3 years for 'Low to Medium risk' customers, every 2 years for 'Medium risk' customers and annually for 'Medium to High risk' customers. This concern is further exacerbated given that for several years prior to the 'company-wide periodic review' undertaken in 2020, the Company did not undertake any periodic reviews. This raised concerns about the effectiveness of the Company's compliance procedures.

During the time of the examination (2021), the MLRO explained that since 2020, only high-risk customers had been reviewed and no reviews were performed for Low and Medium risk customers, except if a re-investment was performed. It was explained that when an existing customer loops in a sum of money, a periodic review is conducted on the customer, however, if no changes are applicable, no record is kept of such review. However, given the Company's failure to conduct timely and comprehensive periodic reviews, coupled with inconsistent documentation practices, the Company is to ensure that going forward, periodic reviews should be undertaken on a 'periodic basis' in line with the risk based approach. Depending on the level of risk, subject persons may set up a schedule to review the information they hold on file at regular intervals, and particularly ensure that certain events such as a change in behaviour or activity leads to an updating of the customer profile and CDD information available.

Transaction Monitoring - Regulation 7(2)(a) of the PMLFTR and Sections 4.5.1(a) of the IPs.

During the examination, it was noted that the Company did not conduct sufficient transaction monitoring in one file. This since the Company failed to request any supporting documentation to account for the origin of an investment of €16,000 made by a 'housewife'. Despite the customer declaring an annual income of €4,700 and "other income" of €800 from "funds/bonds", the Company did not ascertain the veracity of such statements and question as to how a housewife has an annual income in the first place and also how the customer was able to undertaken an investment worth over 3 years of such 'declared income'.

Politically Exposed Persons (PEPs) - Regulations 11(5) of the PMLFTR and Section 4.9.2.2 of the lPs.

The examination identified non-adherence to PEP regulations with reference to a number of files related to the same PEP, this since the required EDD measures were not undertaken. Specifically, in line with Section 3.5.3.2, the Company was required to:

(i) Obtain senior management approval,
(ii) Take adequate measures to establish the SOW and SOF involved; and
(iii) Conduct enhanced on-going monitoring.

Consideration of the risk mitigants for such files were also taken into account, such as the minimal amount of investment made (less than €5k) and the eventual block of the accounts pending receipt of documentation. However, in view of the connection with the respective PEP, the Company was still required to ensure to undertake the required EDD measures as per point (i) – (iii) above.

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

When deciding on the appropriate administrative measures to impose, in addition to the specific breaches outlined above, the Committee took into consideration the importance of the obligations being breached, the level of seriousness, and at times systemic nature, of the findings identified, as well as the extent of ML/FT risk such failures could lead to. The Committee was particularly concerned with the Company's CRA shortcomings which convey the inadequacies in the Company's understanding of the ML/FT risks portrayed by its customers. Furthermore, the Company failed, for a number of customers, to obtain SoF/SoW information and/or documentation. Also in one file the Company failed to conduct inadequate scrutiny on a number of transactions.

The Committee also considered the Company's size, that this is not a large institution as well as the impact that the subject person's failures may have had on both its operations and on the local jurisdiction. The good level of cooperation portrayed by the Company throughout the supervisory process was also factored in, including the Company's commitment to remediate its failures, and its statements that it had already commenced working on some action points. This was also evidenced through documentation provided as well as explained by Company representatives during their oral hearing with the Committee. However, overall the Committee couldn't but note that, at least up until the compliance review, the failures observed confirm that the Company has not given due regard towards its AML/CFT obligations.

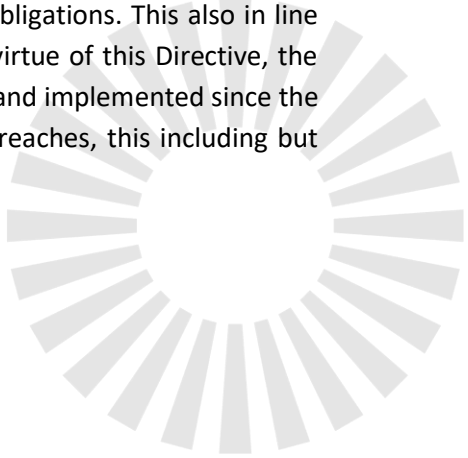
After taking into consideration the abovementioned, the Committee decided to impose an administrative penalty of € 46,681 with regards to the breaches identified in relation to:

- Regulations 5(5)(a)(ii) of the PMLFTR and Sections 3.5.1(a) and 3.5.3 of the IPs.
- Regulation 7(1)(c) of the PMLFTR and Sections 4.4.2 of the IPs.
- Regulation 7(2)(a) of the PMLFTR and Section 4.5.1 of the IPs.

In addition to the above, the Committee also issued a reprimand in relation to the below breaches:

- Regulation 7(1)(a) of the PMLFTR and Sections 4.3.1.1 of the IPs.
- Regulation 11(5) of the PMLFTR and Section 4.9.2.2 of the IPs.

In terms of Regulation 21(4)(c) of the PMLFTR, the FIAU also served the subject person with a Remediation Directive, to be able to assess the remedial actions being implemented by the subject person in view of the breaches identified. The aim of the Directive is for the FIAU to ensure that the Company enhances its AML/CFT safeguards and that it becomes fully compliant with the obligations imposed in terms of the PMLFTR and the FIAU's IPs, as well as perform any required follow-up measures in relation to the Company's adherence to its AML/CFT legal obligations. This also in line with the Company's commitment to enhance its AML/CFT measures. In virtue of this Directive, the Company is expected indicate the remedial actions that it has carried out and implemented since the compliance examination to ensure compliance following the identified breaches, this including but not limited to:



- Ensuring that the Company's current BRA in force is robust and tailored to address all the ML/FT threats and vulnerabilities that its business is and may be exposed to;

- Ensuring that new and existing customers are subject to an adequate risk assessment in line with the obligations at law.

- Ensuring that the Company has the adequate procedures in place to collect sufficient information to substantiate the activities from which the customers are deriving their SoW and/or SoF in terms of the 'Purpose and Intended Nature of the business relationship' obligation.

- Updating of the Customer's ongoing monitoring policies and procedures. Customers' information and documentation should also be updated according to adequate ongoing monitoring periodic reviews and said updates should be retained by the Company in line with its record keeping obligations. Such procedures and the updates carried out on the customers shall be performed on a risk-based approach which is sustainable and realistic for the Company to adhere to.

The Directive served on the Company shall ascertain that sufficient and tangible progress is achieved on the adoption and implementation of all the procedures and measures referred to above. In the event that the requested information and/or supporting documentation are not made available within the stipulated timeframes, or the Company falls short of its obligations in terms of this Directive, the Company's default will be communicated to the Committee for its eventual actions, including the possibility of the imposition of an administrative penalty in terms of the FIAU's powers under Regulation 21(1) of the PMLFTR.

The administrative penalty hereby imposed is not yet final and may be appealed before the Court of Appeal (Inferior Jurisdiction) within the period as 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

- The CRA should be based on the 4 risk pillars in line with Section 3.5 of the IPs, for subject persons to attain a comprehensive framework and visibility of establishing the risks associated with each of its customers. To establish a comprehensive CRA, subject persons should clearly document the rationale behind how the final risk rating was calculated and attained. Documenting the rationale behind every customer risk assessment is crucial for several reasons, especially because it provides a basis/justification for decision-making (controls to be applied) and for future ongoing monitoring.

- Knowing the customers personally is a good mitigating measure, however this does not extinguish the subject persons' obligation to collect documentation required to conduct identification and/or verification. Subject persons should ensure that the documents collected are valid and not expired and adequately retained in line with applicable regulations.

- In establishing their customers' business and risk profiles, subject persons must, *inter alia*, obtain information, and where necessary, supporting documentation, regarding the activities from which the customers derived their wealth, as well as the expected sources and origin of the funds to be used throughout the business relationship. If there is a need to collect SOW/SOF documentation, subject persons should not only seek to acquire such documents, but also scrutinise them to ensure that they adequately explain the customers' SOW/SOF and make sense in the broader context of the customers' profiles.

- Even if customers have been subject to previous CDD by third parties or even by the government by way of example of the customer mentioned above who was eligible for the Malta Residency Programme, subject persons must conduct their own diligence given that regardless of any reliance because subject persons will always remain ultimately responsible for compliance with their CDD requirement. This as envisaged in Regulation 7(1) of the PMLFTR and Section 4.10.2 of the IPs.

- Periodic reviews should be undertaken on a 'periodic basis' in line with the risk based approach. The policies and procedures adopted by subject persons should make sense and be reasonably attainable to ensure that it is feasible to stick to the timelines. Subject persons may take the following factors into consideration when it comes to deciding how frequently information needs to be updated, and to which extent (a)The customer's risk rating, (b)the kind of information to be updated (e.g., a subject person may determine that the residential address should not be updated frequently as long as the customer is transacting from within the same jurisdiction); and (c)whether there are any risks that may be mitigated through updating.

- Subject persons should apply the following EDD measures to PEPs; (i) obtaining senior management approval, (ii) taking adequate measures to establish the SOW and SOF involved and (iii) conducting enhanced on-going monitoring. This in line with Regulation 11(5) of the PMLFTR Section 3.5.3.2 of the IPs.

12th December 2023

APPEAL - On the 10th of January 2024, the FIAU was served with a copy of the appeal application filed by the Company before the Court of Appeal (Inferior Jurisdiction), from the decision of the FIAU.

The Company is, *inter alia*, contesting the FIAU's decision in relation to its Customer Risk Assessment; is contesting the FIAU's reprimand issued in relation to Customer Due Diligence – Identification and Verification; and is contesting the FIAU's decision in relation to the lack of information in relation to the Purpose and Intended Nature of certain business relationships, namely, insufficient information to substantiate the activities from which the customers derive their SOW and/or SOF and Scrutiny of Transactions.

The Company is also contesting the Constitutional validity of Article 21 of the PMLFTR.

Therefore, the Company *inter alia* asked the Court to revoke and annul the decision of the FIAU in its regard, or alternatively, to modify and reform said decision by reducing the penalty and/or reprimand imposed upon it.

Pending the outcome of the appeal, the decision of the FIAU is not to be considered final and the resulting administrative penalty cannot be considered as due, given that the Court may confirm, vary or reject in whole or in part, the decision of the FIAU. As a result, the FIAU may not take any action to enforce the administrative penalty pending judgement by the Court.

This publication notice shall be updated once the appeal is decided by the Court so as to reflect the outcome of the same.

12 January 2024