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 measures established by the Board of Governors of the FIAU. This Notice provides select information from the FIAU's decision imposing the respective administrative measures and is not a full reproduction of the actual decision.

DATE OF IMPOSITION OF THE ADMINISTRATIVE MEASURE:
31 August 2021

SUBJECT PERSON:
Pilatus Bank Plc

RELEVANT FINANCIAL BUSINESS CARRIED OUT:
Credit Institution

SUPERVISORY ACTION:
Extensive Compliance Review carried out in 2018.

DETAILS OF THE ADMINISTRATIVE MEASURES IMPOSED:
Administrative Penalty of €4,975,500 in terms of Regulation 21 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR).

LEGAL PROVISIONS BREACHED[1]:

- Regulation 7(1)(c) of the PMLFTR;
- Regulation 7(1)(d) of the PMLFTR;
- Regulation 7(2)(a) of the PMLFTR;
- Regulation 7(2)(b) of the PMLFTR;
- Regulation 11(1) of the PMLFTR;
- Regulation 11(6)(b) of the PMLFTR ;
- Regulation 11(6)(c) of the PMLFTR ;
- Regulation 15(1) of the PMLFTR;
- Regulation 15(4) of the PMLFTR;

[1] It is being clarified that the Committee's decision in relation to this case have been taken in line with Legal Notice 180 of 2008 (as amended by Legal Notices 328 of 2009, 202 of 2012, 464 of 2014 and 78 of 2015) and with the FIAU's Implementing Procedures Part I as applicable at the time when the event referred to took place. In the case of an on-going situation, the Committee referred to the law in force at the end December 2017 (being the cut-ff date for the files reviewed during the supervisory examination, at the point in time when the relationship was terminated or the situation remedied, whichever occurred the earliest.

- Regulation 15(6) of the PMLFTR;
- Regulation 15(8) of the PMLFTR;
- Section 3.1.4 of the Implementing Procedures Part I;
- Section 3.1.5 of the Implementing Procedures Part I;
- Section 3.5 of the Implementing Procedures Part I;
- Section 3.5.3.2 of the Implementing Procedures Part I;
- Section 6.3 of the Implementing Procedures Part; and
- Section 6.4 of the Implementing Procedures Part.

REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURES:

Purpose and intended nature of the business relationship - Regulation 7(1)(c), 11(1), 11(6)(b) of the PMLFTR and Section 3.1.4, 3.5, 3.5.3.2 of the Implementing Procedures Part I.

The Committee observed how for all the files sampled for review, the Bank did not obtain the necessary information and documentation to understand the purpose and intended nature of the business relation and to build a comprehensive customer business and risk profile. Despite the Bank having adopted a form to obtain the information necessary to establish the purpose and intended nature of the business relationship, it was observed that the Bank did not implement effective measures to ensure that it had a clear and unequivocal understanding as to the purpose and intended nature of the business relationships it was establishing with its customers. Indeed, the compliance review revealed how the Bank's measures for obtaining information on the activities of the customers, their source of wealth and expected source of funds and estimated account activity were overall lacking.

The Bank relied heavily on generic information provided by its customers, which was not even considered to be sufficient to establish the customer profile for normal risk customers. Indeed, while the Bank held information on the purpose why customers opened accounts with it, such as to hold, manage and invest the wealth of their beneficial owners, it did not substantiate this with more detailed information and documentary evidence. In other instances, the Bank obtained CVs of customers and BOs without considering that these were not a reliable nor independent source of information. In other instances, the Bank held information on the customer's operations and expected turnover that were exceptionally high in value, without obtaining documentary evidence to substantiate the same.

Indeed, documentary evidence was found by the Committee to be indispensable for the Bank. This in view of the type of customers it was onboarding: PEP customers, high net worth customers and in view that the companies it was onboarding were at times dealing in high-risk jurisdictions and projecting to transact millions of Euro annually.

The Committee also observed that the Bank was heavily relying on visits Bank officials carried out at the customer's premises, this to build an understanding of the customer's operations and risk profile. The Committee did observe that while customer visits are a good initiative to get to know the customer better, such visits are far from being considered as sufficient in particular to manage the heightened risk the Bank was exposed to from the customers it was onboarding and to meet its EDD obligations triggered by such high-risk situations.

The below are few of the examples observed and for which the Committee decided the Bank breached its legal obligations:

- In 15 files the SOW and the expected SOF was indicated as being in part or in full being generated from the operations of the same business operation. Yet, the Bank did not ascertain whether it would make economic sense to have the same activity funding all 15 customers, nor did the Bank question the links between the individual customers and the said business operation. The Bank in its representations made available financial statements for the specific business operation mentioned above, as well as for other business operations that were also to fund in part some of the 15 customers. However, it was observed that were one to combine the expected annual turnover of the 15 customers abovementioned, this would amount to a total of circa €390 million. However, the financial statements in question referred to comprehensive income of €23.5 million – the shortfall between the two amounts had to be considered as too significant to ignore.

- In relation to another instance, the Bank did not adequately comprehend the SOW and expected SOF of the customer. The Bank in its representations provided documentation that includes information that the account turnover for this customer will be €5 million and that the customer is a well-known entrepreneur in the UAE and Azerbaijan, being involved in various industries including agriculture, food and beverage, retail, and construction. However, there were no details of the customer's own assets (apart from names of corporate entities owned by the customer) and evidence of the business earnings obtained from the same.

  In another instance, the Bank only held information that the customer's income would be generated from future investments, mostly from the UK residential real estate market and that the BO would be injecting the initial capital. The Bank provided a copy of the KYC Form which also made reference to the BO's source of wealth as being his salary and savings/career as a private banker. It also provided a copy of the BO's CV. The Committee however observed that no evidence confirming this was obtained and also remarked that the BO's CV which, having been compiled by the BO himself, could not be considered as sufficiently reliable to corroborate his own statements. The Bank was also required to gather more detail as to the kind of residential real estate being targeted and the areas within the UK were the investments would be targeted. Such information would have aided the Bank in understanding the nature of the transactions it could expect the customer to process but also as to the financing required by the customer to carry out such an activity.

- In another instance, the Bank failed to obtain the necessary documentary evidence to substantiate the SOW of the customer, particularly in view of his wealth estimated to be in the region of Eur 100 million.

- In another instance. the Bank failed to obtain evidence to substantiate an expected account turnover of Eur 20 million.

- In another instance the Bank failed to query a substantial discrepancy between an estimated turnover of Eur 10 million (as per the KYC Form) and a management account identifying a total income of approximately Eur 190,000.

- In a separate instance involving a trust, the Bank held information as to the trust set up. However, it did not gather the necessary documentation to substantiate the source of the assets settled on trust.

- In relation to another customer, the Bank failed to even obtain the KYC Form as well as to obtain important information relative to the customer, such as the financial size, expected business and provenance of funds information. In addition, the Bank felt no need to query why the BO of this customer created around the same time an identical entity carrying out the same activities as the one of this customer.

- In another instance, the Bank obtained information on the business operations of the customer. However, this was obtained through the collection of the relative KYC Form, 7 months after the start of the business relationship and after having allowed over Eur 16 million to pass through the customer's bank accounts. It was also observed that not only was the information obtained late, but no documentation to substantiate this information was collected. The Bank relied on there being no regulatory requirement for companies incorporated in the particular jurisdiction to prepare audited financial statements. While this may indeed have been the case, the Committee did not understand why the Bank had not asked for other forms of accounts, such as the company's management accounts or its budget.

The Bank has therefore been found to be in systemic breach of its obligation to obtain information and documentation in relation to the purpose and intended nature of the relationships and commensurate to the risks it was exposed to in terms of Regulation 7(1)(c), 11(1), 11(6)(b) of the PMLFTR and Section 3.1.4, 3.5, 3.5.3.2 of the Implementing Procedures Part I.

Ongoing Monitoring of the Business Relationship:

1. Keeping data, documentation and information up to date - Regulation 7(1)(d), 7(2)(b), 11(1), 11(6)(c) of the PMLFTR and Sections 3.1.5, 3.5, 3.5.3.2 of the Implementing Procedures Part I.

The Committee identified failures as to the Bank's obligations to ensure it keeps customer information, data and documentation up to date in 96.5% of the customer files reviewed. The Committee indeed identified that the Bank had an overall lax approach towards its ongoing monitoring obligations. The Bank failed to have robust measures in place to ensure that customer information and documentation is kept up to date. It was also observed that, where it did carry out a review, such review was more intended to simply reflect account activity in the Bank's records rather than ascertaining the reasons for any divergence in activity from what had initially been declared by the customer and, where necessary, update the information and documentation held on file. The Committee also remarked that given the high risk customers onboarded by the Bank, ongoing monitoring of the activities taking place was crucial and documentary evidence to verify the discrepancies noted was indispensable.

The below are a few examples of the cases observed during the Supervisory Examination:

- The Supervisory Examination Report identified that while the Bank held KYC ongoing review forms that were at times completed for customers, the review was merely to check whether the necessary KYC for the client under review was carried out and, in some instances, whether the

account activity was in line with the expected activity. Therefore, the Bank failed to ensure that through the ongoing reviews it determines whether the KYC information held was up to date and appropriate, and to take the action necessary when this is not the case, including obtaining updated information as well as documentary evidence substantiating this.

- In relation to two corporate customers, the Bank obtained information and documentation on another two corporations which were to fund the Bank's customers but did not have any understanding as to how these corporations were related to its customers nor how they were to provide the said funding. Ultimately, it also resulted that these corporations did not provide any funding at all as financing was provided from another of the Bank's customers.

- Another customer of the Bank involved in the textiles industry, transferred over Eur 6 million and GBP 2 million to another company owned by the same beneficial owner, outlining that the funds were intended as corporate financing on behalf of its shareholder. The Bank failed to query why a trading company would transfer most of its funds to another company rather than keeping the same to fund its own operations.

- In another instance a substantial increase in a customer's account turnover was noticed. This went from Eur 750,000 to Eur 150 million. The Bank provided an email outlining a general description of customer's business diversification. However, no explanation was provided as to how this diversification had contributed to such an exponential increase in account turnover, confirming the importance of obtaining evidence to back up any such change.

- In a number of instances, it was noticed that the customer would provide estimates of its account activity which would then be exceeded in the early days of the account's operations. Thus, in one instance, the customer received more than four times the initially anticipated amount of Eur 80 million. In another, a customer received the equivalent of Eur 7 million through a first transaction when it had indicated that the account activity was expected to be Eur 3 million. In neither of these instances, nor other similar cases, did the Bank question such exponential divergence from the customer's expected account activity and simply allowed the funds to pass through without any checks.

2. <u>Transaction Scrutiny - Regulation 7(1)(d), 7(2)(a), 11(1), 11(6)(c), and 15(1) of the PMLFTR and Sections 3.1.5, 3.5, 3.5.3.2 of the Implementing Procedures Part I</u>

   The compliance review revealed how in 86% of the customer files reviewed, the Bank allowed transactions to pass through its customers' accounts without the proper level of scrutiny being carried out. Indeed, the Committee has found that the Bank has repeatedly and systemically failed to scrutinise transactions that were either not in line with the information available to it on the customer, or that were otherwise large, anomalous, dubious, or suspicious. The Committee's concern on such failures stems from the overall disregard and lax approach the Bank had towards such an important obligation. Indeed, albeit the customers were using sketchy loan agreements and invoices to transfer money to and from each other, the Bank failed to enquire further with its customers to ascertain the veracity of the rationale behind the transfers taking place. Moreover, internal transfers between Bank customers were simply cleared off by the Bank without the necessary checks being carried out.

The Bank's relaxed approach towards scrutinising the transactions taking place is further aggravated by the high-risk nature of the customers serviced by the Banks. This in view of their political involvement, their connection with high-risk jurisdictions and the large value of transactions passing through the accounts, at times also in extremely short period of time and without any economic or commercial sense being noticeable. EDD measures in such circumstances were paramount. Yet the Bank proceeded to allow millions to pass through the said accounts without proper due diligence (let alone of an enhanced nature) being carried out. The following are some examples of these instances:

- One of the Bank's customers transferred over USD 3 million to an external company by way of a loan. The only document available was a letter confirming that the external company had been appointed by the customer to act as its agent in the UAE but which made no reference to the said loan. Therefore, the Bank failed to obtain any evidence to substantiate such loan transfers.

- Another customer received over EUR 1.9 million from an ulterior Bank customer pursuant to a loan agreement which described its purpose in very vague and generic language, ie: *"to support the Company and its Subsidiary or Group Companies with all costs, liabilities and advances".* No more questions were raised by the Bank in relation to such transfers.

- Another customer of the Bank received EUR 800,000 from another Bank customer and subsequently transferred the same amount to another entity pursuant to a loan agreement for EUR 3 million. The only reassurance held by the Bank was that these entities had common beneficial ownership.

- Five of the Bank customers received a serious of transfers, all of which were cleared off as internal transfers. The Bank in its representations made available an inter-company loan agreement. However, the Committee held reservations in relation to the reliability of this agreement for numerous reasons:

    - The document provides for any company within the group to provide a loan to another without giving details as to the purpose behind such loan;
    - The repayment terms are extremely short which leads one to question the rationale for such loans in the first place;
    - There is no interest or other fee to be paid; and
    - For almost all the companies involved in the agreement, the same individual was acting as director for all of the said companies. In such circumstances an independent person witnessing the veracity of such agreement would have been more adequate.

  Moreover, and independently of the Committee's reservation, this agreement could not be considered as sufficient to justify the transfers since, as outlined in the agreement itself, loans given should have been separately recorded. The Bank did not obtain any such documentation and therefore the loan agreement on its own could not provide a reasonable justification for all the transfers taking place.

- Another customer received around AED 239 million from one of its BOs. In turn, this customer transferred EUR 68.5 million to another customer of the Bank with the declared purpose of the said transfer being a loan repayment to the beneficial owners of this other customer. This was just the first in a series of transfers to other companies, allegedly intended to ultimately purchase a

shareholding in a Russian registered company. Such transfers were not queried by the Bank, and the purpose not substantiated with the necessary evidence.

- Another customer of the Bank received over GBP 1.5 million with the details of the transaction listed as loan repayment. However, the Bank did not obtain supporting documentation to substantiate this.

- One of the Bank's customers was provided with a loan of USD 6.5 million from the Bank secured with its own funds. The Bank did not question what could be the reason for requesting such a loan rather than making use of one's own funds. When one considers that the customer was to incur interest on the funds borrowed and could not make use of its own funds, the economic rationale behind such the transaction becomes even more doubtful.

- One of the Bank's customers transferred Eur 650,000 to another customer of the Bank, without any supporting documents being obtained to justify such internal transfers.

- One of the Bank customers received approximately USD 1 million from another entity. While the supervisory examination did highlight that the Bank tried to obtain information from the customer, it was also identified that the Bank still allowed the transfers to take place even if its requests for clarifications had gone unanswered. More worryingly, the Bank misled another local credit institution as it made it believe that it had all the necessary supporting documentation at hand when this was not the case.

- One of the customers of the Bank received over EUR 11.9 million and USD 5.45 million from its BOs and then remitted approximately EUR 6.6 million back to its BOs. Such transfers between the corporate entity and the BOs were not substantiated with any form of documentary evidence, not even an explanation as to the rationale behind these transfers.

- Another customer received funds from various entities, totalling to over USD 10.7 million and over Eur 3.5 million respectively, through a series of transactions for which the Bank did not deem it necessary to obtain any additional information or supporting documentation in relation thereto.

- Another customer of the Bank was involved in repeated transfers with a trading company. The document provided by the Bank explained that the transfers to the trading company related to capitalisation by the common beneficial owner. However, this document did not provide an explanation for the monies flowing in the opposite direction and, more importantly, did not come with any documentation attesting to the actual use being made of the funds transferred from the customer of the Bank.

The Bank has been found to have systemically breached its AML/CFT obligations in terms of Regulation 7(1)(d), 7(2)(a), 7(2)(b), 11(1), 11(6)(c), and 15(1) of the PMLFTR and Sections 3.1.5, 3.5, 3.5.3.2 of the Implementing Procedures Part I. Such failures were also deemed by the Committee to be of a serious nature which determination stems from the type of customers serviced by the Bank, the transactions being processed and the total disregard the Bank had towards an such important and onerous obligation. The Committee found the Bank to be careless and irresponsible towards its obligations to monitor customer activities and transactions

Internal/External Reporting - Regulation 15(4), 15(6), 15(8) of the PMLFTR and Section 6.3, 6.4 of the Implementing Procedures Part I

The Committee observed extensive failures in 86% of the customer files in relation to the Bank's obligation to carry out internal reviews of anomalous customer activities and transactions, and to subsequently submit an STR to the FIAU in relation to any such internal reviews where the MLRO would have established that there was a suspicion to suspect that funds and transactions may be related to money laundering.

The Committee highlighted that the compliance examination revealed a number of important red flags that should have raised the Bank's suspicion on the activities of the customers and the transactions taking place through the accounts held with the Bank:

- The information available to the Bank at onboarding significantly diverged from the customer's actual activity;
- Substantial amounts of funds passed through various (in numerous cases related) entities, at times within a short period of time, without a valid rational;
- Internal transfers within the Bank between various entities having the same beneficial ownership and monies transferred on behalf of the entities' owners without a justification for such transfers, all cleared off by the Bank simply as internal transfers;
- Where documentary evidence was obtained by the Bank, no consideration was given as to whether such evidence was sufficient or whether it made sense in the first place. Indeed, various generic and sketchy invoices, loan and other agreements were obtained by the Bank without the Bank questioning their authenticity and truthfulness;
- Various loans between entities with very generic and all-encompassing reasons, at times repaid within an exceptional short period of time, without any interest being requested or, where this was requested, without the same being paid;
- At times the Bank itself offered loans secured against cash held at the Bank without a clear rationale and without the Bank considering whether the loan granted would make economic sense;
- Loans offered by the Bank without an economic rationale even for the Bank itself (in view of interest never being paid) and used to conceal the true source of the funds.
- Conflicting explanations relative to the movement and channelling of funds through various entities and legal arrangements as well as contradictory information as to the source of funds;
- The Bank itself preparing documentation for its customers in order to justify accepting an exceptional high amount of funds on the premise that these related to dividend distribution, even though it knew that these had not been paid out or that they could only provide a justification for (expected) account activity only in part;
- Customers pressuring the Bank to process funds without questioning the rationale for the same and the Bank acceding to such pressure; and
- The Bank clearing off transactions reviewed as not anomalous on the basis that the total value of transactions received and remitted between the same two companies do not tally to the same amount without yet considering in the first place why these transactions were actually taking place.

The Committee determined that the Bank completely disregarded the most onerous and important of its obligations, i.e. to ensure that transactions that were anomalous and for which there was no explanation or that were otherwise suspicious be escalated internally for consideration by the Bank's Money Laundering Reporting Officer and reported to the FIAU where there was a suspicion that these transactions were actually linked to proceeds of criminal activity, money laundering or the funding of

terrorism. The Committee has therefore found the Bank to be in systemic breach of its obligations in terms of Regulation 15(4), 15(6), 15(8) of the PMLFTR and Section 6.3, 6.4 of the Implementing Procedures Part I for 25 of the 29 customer files reviewed.

ADMINISTRATIVE PENALTY IMPOSED BY THE FIAU'S COMPLIANCE MONITORING COMMITTEE:

In the taking of its decision, the Committee considered that the Supervisory Examination has identified very serious and systemic concerns with respect to the Bank's ability to implement measures aimed at satisfying its AML/CFT legal obligations and in safeguarding its operations and the jurisdictions from possible ML/FT threats. Such robust measures, including the need to carry out enhanced due dligence measures, were indispensable for the Bank as it held banking relationships with PEPs and high net worth individuals, and was exposed to a series of other high risk factors such as high risk jurisdictions, complex corporate structures, complex transactions, transactions of extreme high value, money movements atypical of any business or trade and an unusual high number of loans for significant amounts between Bank customers, third parties or the Bank itself.

Of particular concern for the Committee was the Bank's lax approach towards both its due diligence and enhanced due diligence obligations albeit being established to purely provide banking services to high-risk customers. It must be remarked that the Committee could not in any way ignore the Bank's direct or indirect exposure to a series of connections with figures from the Caucasus region considered to present extreme risks of money laundering. The Committee also acceded to the concerns raised in the FIAU Supervisory Examination Report that the Bank's dependence on these connections for its viability made it impossible for the Bank to ever take concrete action actions in respect of any transaction, activity or relationship deemed to be suspicious and to report the same to the FIAU.

The Committee affirmed that throughout its operations, the Bank has exposed itself, and the Maltese jurisdiction to egregious ML risks that were not being mitigated in any manner. The Bank's total disregard towards necessary AML/CFT safeguards, led to it allowing millions to pass through the Maltese economy without any consideration of possible money laundering taking place. The Committee ascertained that the Bank's systemic failures in the implementation of AML/CFT controls, measures and processes has greatly exacerbated the risks of its being used and abused by money launderers to process illicit proceeds through the Bank.

The seriousness and systemic nature of the failures determined following the supervisory examination on the Bank, exacerbated by the considerations set out hereabove has led the Committee to impose an administrative penalty of four million nine hundred seventy-five thousand and five hundred euro (Eur 4,975,500).

31 August 2021

APPEAL:

On 27 September 2021, the FIAU was served with a copy of the appeal application filed by Pilatus Bank plc ("the Bank") in front of the Court of Appeal (Inferior Jurisdiction) from the decision of the FIAU. Through the said appeal the Bank is seeking to reduce the administrative penalty imposed on it by the FIAU as per hereabove. The Bank is of the view that (a) the FIAU applied incorrectly the law in force at the time that the breaches with respect to source of wealth took place as it argues that certain requirements were only introduced at a later stage; (b) the Bank had met its on-going monitoring obligations as it had duly obtained documentation with respect to the transactions queried by the FIAU

and it did not consider that it was within its remit to delve further into certain transactions; and (c) the FIAU incorrectly applied its sanctioning powers, opting to adopt an approach that was less favourable to the Bank and which did not take into account, or only minimally, relevant factors like the severity and duration of the breach, the latest available turnover figures etc. In addition, the Bank did not consider that the FIAU had sufficiently explained the reasons for particular breaches while there were instances where the Bank perceived that the breaches seemed to reflect one another.

The administrative penalty of four million nine hundred seventy-five thousand and five hundred euro (Eur 4,975,500) has been appealed by Pilatus Bank Plc before the Court of Appeal (Inferior Jurisdiction), in line with what is provided for in terms of Article 13A of the Prevention of Money Laundering Act. 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.

11 October 2021