Administrative Measure Publication Notice

This Notice is being published by the Financial Intelligence Analysis Unit (FIAU) in terms of Article 13C of the Prevention of Money Laundering Act (PMLA) and in accordance with the policies and procedures on the publication of AML/CFT penalties established by the Board of Governors of the FIAU.

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

DATE OF IMPOSITION OF THE ADMINISTRATIVE MEASURE:

31 December 2021

SUBJECT PERSON:

Southern Cross SICAV plc

RELEVANT ACTIVITY CARRIED OUT:

Collective Investment Scheme

SUPERVISORY ACTION:

Off-site Compliance Review carried out in 2021.

DETAILS OF THE ADMINISTRATIVE MEASURE IMPOSED:

Administrative Penalty of €303,710 in terms of Regulation 21 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR).

LEGAL PROVISIONS BREACHED:

- Regulation 5(5)(a) and 5(5)(f) of the PMLFTR and Section 3.4 of the IPs;
- Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the IPs;
- Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3.1.1 of the IPs;
- Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs;

REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURE:

<u>Policies and Procedures – Breach of Regulations 5(5)(a) and 5(5)(f) of the PMLFTR and Section 3.4 of the IPs:</u>

The first shortcoming in this regard was namely that the AML/CFT Procedures Manual produced by the Company was a rather generic document detailing its obligations at law but providing insufficient guidance on the ways these would be met in practice. By means of an example, the Manual indicated that after the identification and verification process is completed on the prospective customer, the Company is required to obtain information to establish the customer's business and risk profile. However, it did not provide any further explanation as to how this information would be obtained, documented and what documents would be required in specific instances.

Apart from not being sufficiently detailed, the Manual was also found to be outdated at the time of the examination. In fact, an update to the timeframe for the submission of STRs (i.e., to promptly disclose the same) was not reflected in the manual, which still referred to the previous timeframes. In addition, despite the Company's policies and procedures referring to external reporting procedures, the Manual did not indicate what actions were to be taken following the decision that the internal STR did not merit reporting it to the FIAU.

Furthermore, the Company's policies and procedures did not detail the customer acceptance policy (CAP) and only referred to it and the need to onboard customers in line with its risk appetite. The CAP was not provided during the compliance review nor was any detailed reference made to it in its manual. Furthermore, confirmation of its non-existence was provided by the MLRO during the interview. However, with its representations the Company provided a copy of the CAP. Nevertheless, upon reviewing it, the Committee observed that the Board of Directors' resolution approving the AML/CFT Manual, which contained the CAP which was inadvertently omitted, was dated 11th April 2019. Therefore, because the Company had been operating since the 15 June 2015, the Committee determined that this was compiled relatively late.

After taking all the facts into consideration, the Committee proceeded to find the Company in breach of its obligations to have the necessary policies and procedures in place, including a customer acceptance policy, in line with its obligations in terms of Regulation 5(5)(a) and 5(5)(f) of the PMLFTR as well as Section 3.4 of the IPs.

Customer Risk Assessment (CRA) – Breach of Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the IPs:

The Company provided a template of the CRA methodology and risk calculation tool that was compiled by the Administrator, including classification of foreign jurisdictions, that were not specific to the Company's circumstances. It was observed that the interface factor was not considered in the CRA sheets found on file, despite the Company carrying out most of its business on a non-face to face basis or else through reliance. There were also situations where the Company engaged in the acceptance of subscriptions in kind, and although this was listed as a parameter, it may not have been adequately considered or reflected.

For instance, in three files, the CRA sheet indicated that the funds would be coming from the bank account in the customer's name, however, no cash was ever invested by these customers with the subscription happening in kind. Therefore, apart from the fact that the CRA matrix did not consider the necessary risk indicators to carry out an adequate CRA to establish customer's risk profile, the risk matrices were also completed incorrectly due to selecting the improper option in the drop-down choices or leaving certain fields empty.

It also emerged that in conducting the CRA, the estimated transaction profile (value and volume) as well as the customer's activities are not taken into consideration when formulating the risk rating of the customer.

The Committee also learnt that in six out of 13 files reviewed, the CRA's had been conducted after the start of the business relationship, therefore the Company had embarked on these business relationships without first identifying and assessing the ML/FT risks they could pose. This was considered by the Committee to be of serious concern in view of the large value of subscriptions in the sub-funds made by

these customers, and that were allowed to take place notwithstanding the fact that the risks posed by these customers had not yet been established.

Consequently, in view of the above considerations the Committee found the Company to have breached Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the IPs.

Identification and Verification – Breach of Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3 of the IPs:

The compliance examination revealed shortcomings by the Company in terms of its obligations which require the identification and verification of natural persons, legal entities and where applicable the Beneficial Owner (BO). From the file review, several shortcomings were noted in five customer files:

- In an additional file, the customer was a university and therefore had no BO's, in view of this the controlling parties had to be identified and verified. The documentation provided identified a rector and vice rector as the persons in control. While the vice rector was identified and verified, the rector's details were neither identified nor verified (except for indication of his name).

- In another file, the information on the residential address for one of the BOs was not obtained. In addition, no documentation was obtained to confirm the residential address specified in the ''BO declaration'' form for another two customer files reviewed.

- There was also no documentation obtained to confirm the residential address for both BOs in one other file. Additionally, the passport of one of the BOs was already expired at onboarding. The passport expired on 9 May 2014, while the customer was onboarded on 2 October 2015.

In view of the abovementioned shortcomings, the Committee deemed the Company to have breached Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3.1.1 of the IPs for multiple failures to obtain the necessary identification and verification of natural persons as required.

Purpose and Intended Nature – Breach of Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs:

The compliance examination revealed that the information concerning the customer's anticipated level and nature of the activity was not obtained for all files reviewed. The Committee recognised the fact that investors may not be fully cognisant of their investment prospects after an initial subscription. However, the Company should still have obtained a general understanding of the investment appetite of the customer, this to ensure that it can have a basic understanding of what to expect and be able to monitor in line with these expectations.

Failures were also observed in the Company's measures to obtain the source of wealth (SoW) and expected source of funds (SoF) of its customers. For instance, the Company did not obtain information in relation to the source wealth/investment capabilities of the customers, for eight of the files reviewed. Furthermore, no details demonstrating the understanding from which activities these funds were generated were found. Moreover, despite the Company's Manual requiring that the client is to complete the relative ''Source of Funds Declaration' (and provide evidence prior to the submission of the relative funds), the proceeds earned from previous investments were not verified in any manner in an additional two customer relationships.

Furthermore, in an additional two customer files, where a nominee was investing on behalf of its customers, the information on file was limited to the activities of the nominee. Here, the Committee

agreed that the nominee investor would be the only entity entitled to give directions to the Company. However, the application of Simplified Due Diligence (SDD) is not an exemption from carrying out Customer Due Diligence (CDD) but rather a variation of the extent and timing of CDD to be applied in view of the lower risk of ML/FT that the customer presents. Likewise, when these situations arise, this would be conditional on the Company obtaining an undertaking from the regulated entity that CDD information and documentation on the underlying customers would be made immediately available to the Company's upon request.

From the review, it also emerged that as opposed to the regular course of business, on three occasions the Company invested its own funds in the business of its customers. This happened through payments of approximately €1 million to each of the investors, as well as being issued with units in fund. In view of this, there was no clear rationale as to why the Company was investing in the business of its customers and whether this was in line with the prospectus and the customary business of the Company.

Additionally, the Committee found the investment rationales provided by the Company in the File Notes rather difficult to understand. For instance:

- In three files, it was detailed that the investors of the Fund were looking for a solution to maximize the value of their property and to find investors interested to develop it. However, details on the developments that had to take place, and which would justify an investor investing in the fund were not provided. Moreover, some of the valuations of the property had been carried out more than three years before the subscriptions took place, undermining the reliability and validity of the valuations. Further concerns arose since as stated within the File Note itself, despite the intention of the promoter to raise cash subscriptions, due to the difficulty to raise these, the promoter decided to close the fund after a few months. This was indicative that not even potential subscribers were quite sure as to the rationale for the fund and the purpose and possible return on the investment.

- In a separate file, there was no explanation as to why a university was involved in the activity of leasing aircrafts. Moreover, on a risk sensitive basis, the Company was expected to gather additional information and/or documentation, which was more thorough and detailed to mitigate the higher risk of ML/FT (having itself identified high risks within the relationship). This would include evidence to confirm that the university could in fact afford such involvement, that the source of wealth of the university is backed with the necessary evidence and that the rationale for the university investing its returns from tuition fees in aircraft leasing made economic sense for it. The Committee noted that the excerpt financial statements obtained by the Company were for a period after the subscriptions had taken place. Therefore, the Company had entered a business relationship with this entity without having the necessary basic information, let alone having a comprehensive understanding of the source of wealth and expected source of funds of the university.

Therefore, after taking all the facts into consideration, the Committee determined that the Company was not in a position to build a comprehensive business and risk profile on its customers. A profile which would subsequently allow the Company to carry out the necessary level of ongoing monitoring. For these reasons, the Committee found the Company to have failed from adhering to Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the Implementing Procedures.

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

After taking into consideration the abovementioned breaches by the Company, the Committee decided to impose an administrative penalty of three hundred and three thousand, seven hundred and ten Euro (€303,710) with regards to the breaches identified in relation to:

- Regulations 5(5)(a) and 5(5)(f) of the PMLFTR and Sections 3.4 and 3.5 of the Implementing Procedures (IPs);
- Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Section 4.3.1.1(i) of the IPs; and
- Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the IPs.

After going into the merits of each finding as expressed above, the Committee expressed its concerns at the Company's disregard to its AML/CFT obligations. In determining the administrative penalty, the Committee also considered that the Company had started the process of surrendering its Collective Investment Scheme License with the MFSA. If this process had not been initiated, a follow up directive would have been initiated by the Committee. Furthermore, due consideration was given to the nature of the services and products offered by the Company and the size of its business operations, including the closure of its business. The Committee also considered the fact that the requirements breached are important obligations and that the failures are serious in nature, given that the Company was servicing professional investors, therefore allowing millions to be invested through the SICAV, without robust controls in place. The Company's lack of regard towards its AML/CFT obligations, could have had an impact not only on its own operations but also had repercussions towards the local jurisdiction.

5 January 2022

APPEAL: On 25th January 2022, the FIAU was served with a copy of the appeal application filed by Southern Cross Sicav plc ("the Company") before the Court of Appeal (Inferior Jurisdiction) from the decision of the FIAU. Through the said appeal, the Company is requesting the Court to revoke or annul the FIAU's decision as hereabove described.

The Company states, inter alia, that the functions and the administrative powers of the FIAU need to be scrutinized, and that the process leading to said decision breaches its right to a fair hearing. Moreover, it submits that the Unit failed to be transparent in its decision-making process. The Company also claims that the Unit's conclusions were arbitrary, and that the Company did not fall short of its regulatory obligations.

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.

25 January 2022