Administrative Measure Publication Notice

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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:

30 March 2022

RELEVANT ACTIVITY CARRIED OUT:

Corporate Services Provider (Class B) offering Directorship Services

CASE 1:

SUPERVISORY ACTION:

Off-site Compliance Review carried out in 2021.

DETAILS OF THE ADMINISTRATIVE MEASURE IMPOSED:

Administrative Penalty of €20,145 and a Remediation Directive in terms of Regulation 21 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR).

LEGAL PROVISIONS BREACHED:

- Regulations 5(1) of the PMLFTR and Section 3.3 of the Implementing Procedures (IPs)
- Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the IPs
- Regulations 7(2)(a) and 7(2)(b) of the PMLFTR and Section 4.5.1 of the IPs

REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURE:

The Business Risk Assessment (BRA) - Regulation 5(1) of the PMLFTR and Section 3.3 of the IPs:

Whilst reviewing the BRA, the Committee observed that in theory it highlighted the inherent ML/FT risk factors faced by the Company, but it omitted the inclusion of an analysis of the risk scenarios, the likelihood of any risk materialising and the possible impact thereof. Therefore, the BRA in place could not be considered as adequate for the Company to be able to comprehensively understand its risks and to effectively implement adequate controls. Some of the deficiencies highlighted include:

- The BRA referred to various sources that could be utilised to identify and assess its threats and vulnerabilities and the likelihood and impact of ML/FT risks arising from exposure to specific jurisdictions. Additionally, reference was made to the list of countries extracted from Transparency International, HMT Sanctions, EU Sanctions, UN Sanctions, OFAC Sanctions and FATF requirements and countries which are deemed to be EU Non-Cooperative territories or jurisdictions the EU has

identified as possessing weak AML regimes. However, the considerations taken from such statements or organizations and how these contributed to an understanding of the Company's geographical risks were neither found nor explained.

- Under product risk there was no indication of the volume of business, which limited the possibility to truly understand the exposure to each of the risks identified. The Committee remarked that products or services that inherently provide or facilitate anonymity, thus allowing the customer or the beneficial owner to remain anonymous or facilitate hiding their identity, such as in the case of a nominee are to be considered in light of the ML/FT risks they present. This observation was made due to the Company having relationships which involved ownership held in a nominee capacity.

The Committee reiterated that by not having an adequately documented BRA, the Company diminished both its ability to comprehensively identify the threats and vulnerabilities to which it was exposed and to adequately implement the necessary controls to mitigate the risks. When assessing the extent of this failure, the Committee also considered that it had lasted for at least three (3) years from when the regulatory obligation was introduced. The Company had therefore had ample time to revise its BRA so that a thorough and comprehensive understanding of its business risks could have been attained.

Hence, following the consideration of all the above factors, the Committee found the Company to be in breach of Regulation 5(1) of the PMLFTR and Section 3.3.4 of the Implementing Procedures Part I.

<u>Customer Risk Assessment (CRA) – Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the IPs:</u>

The Committee noted that the CRA adopted was not rigorous and comprehensive enough to enable the Company to understand the risks posed by customers, nor to effectively apply the risk-based approach. Consequently, the measures being applied did not include the identification and the assessment of all risks in relation to every business relationship that the Company established. The Committee concluded that the CRA's generic nature created gaps in the understanding of the risks posed by the customer profile. This especially since customer risk is the risk of ML/FT that arises from entertaining relations with a given person or entity. Therefore, when carrying out the CRA, consideration should have been given to the business or professional activity carried out by the customer or the beneficial owner, from which the funds to be used during a business relationship are expected to be derived.

It was also observed that the CRA methodology failed to include information on the weighting of the risk factors mentioned. The Committee considered that the final score was not an aggregate of the scores. To this effect, the Committee emphasised that an effective CRA is one where all the risk criteria are exhaustively considered, and an understanding of risk is obtained. Thus, the Company was expected to take into consideration all the criteria that influence the customers' risks, in a manner that drives the assessment based on the risk to which such customer exposes it to.

During the file review it was revealed that in practice, the Company had not consistently implemented its CRA and risk rating procedures, because a CRA was not performed at onboarding nor throughout the business relationship for one (1) of the files reviewed. Furthermore, in an additional five (5) files, the initial CRA's had been conducted after the start of the business relationship. This led to a situation whereby the Company embarked on business relationships without first identifying and assessing ML/FT risks emanating from the specific business relationships. This resulted in a failure to apply adequate Customer Due Diligence (CDD) measures to mitigate the risks related to such relationships.

Additionally, the Committee emphasised the importance of ensuring that the adverse media checks carried out are linked with the CRA. This since the customer's reputation also needs to be factored in, to ensure that all risks associated with a particular customer, including those obtained from screening through databases, are mitigated. The Committee identified two (2) instances in which the corporate customer was on-boarded by the Company after the incorporation date, and hence screening should have been conducted.

Consequently, in view of the above shortcomings the Company was found in breach of its obligations in terms of Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the IPs.

On-Going Monitoring – Regulations 7(2)(a) and 7(2)(b) of the PMLFTR and Section 4.5.1 of the IPs:

The CRA, as well as the initial CDD measures and any other mitigating measures carried out, would have all been based on the information obtained about the customer during the establishment of the business relationship. This information must therefore remain relevant, accurate and sufficiently timely if the Company is to have a clear understanding of the ML/FT risks it is exposed to and so that the measures it has put in place remain effective. From the file analysis it was noted that the Company had failed to carry out on-going name screening for two (2) of the files reviewed. An example is being illustrated hereunder:

- In one file, consideration was given to the Company's statement that even though the file held no evidence of on-going name screening, Know Your Customer (KYC) was monitored and updated throughout 2018 and 2019 as part of a bank account opening process. However, this monitoring had to be documented and kept on file, as well as reassessed in view of any possible additional risks.

Due to the above, the Committee concluded that the Company's failure to carry out appropriate screening on an on-going basis had resulted in its not being able to identify whether a specific customer merited a higher risk rating and therefore require enhanced measures. Consequently, the Company was found to have breached its legal obligations in terms of Regulations 7(2)(a) and 7(2)(b) of the PMLFTR and Section 4.5.1 of the IPs.

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 twenty thousand one hundred and forty-five euro (€20,145) with regards to the breaches identified in relation to:

- Regulations 5(1) of the PMLFTR and Section 3.3 of the Implementing Procedures (IPs)
- Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5 of the IPs
- Regulations 7(2)(a) and 7(2)(b) of the PMLFTR and Section 4.5 of the IPs

When making its decision, the Committee also took into consideration the level of cooperation exhibited by the Company during the compliance review. The size of the Company's operations was also considered. Furthermore, when deciding on the appropriate administrative measures to impose, the Committee took into consideration the representations submitted by the Company, together with the remedial action that the Company had already started to implement. The Committee took note of the pro-active and immediate actions taken by the Company to remediate its failures as well as the positive regard portrayed to ensuring it has the necessary safeguards to understand and manage its risks and those of its customers. However, the Committee had to take into consideration that for a number of years

the Company had an ineffective understanding of both its business risks and customer risks and that this continued at least until the compliance review. CSPs are important gatekeepers as they provide services which allow third parties access to the financial system through the legal entities they incorporate and/or administer for the benefit of the beneficial owners of these entities. Any vulnerability within their AML/CFT framework increases the likelihood that they and the financial system as a whole may be abused for ML/FT purposes.

In addition to the above-mentioned penalty and in terms of its powers under Article 21(4)(c) of the PMLFTR, the FIAU also served the Company with a Remediation Directive. The aim of this administrative measure is to direct the Company to take the necessary remedial action to ensure that it understands the risks surrounding its operations and that the Company has implemented sufficient controls to mitigate the identified risks. To ensure that the Company is effectively addressing the breaches set out above, the Committee instructed the Company to make available all documentation and/or information necessary to prove that the remedial actions have indeed been implemented in practice. The Remediation Directive also directs the Company to, on a risk sensitive basis, re-assess the CRA of existing active customers. The Company is therefore requested to provide the FIAU with the timeframes outlining the period within which all current customer relationships will be reviewed in line with the new system

Furthermore, the Remediation Directive provides for a follow-up meeting to be conducted with the Company to discuss the actions being taken to address the shortcomings highlighted and to ensure the documented policies and procedures made available, including the most recent Business Risk Assessment are well understood by the Company. The follow-up meeting is intended to provide the FIAU with more reassurance that the remedial actions are being implemented and to ensure that the Company has sufficient knowledge with regards to the AML/CFT obligations.

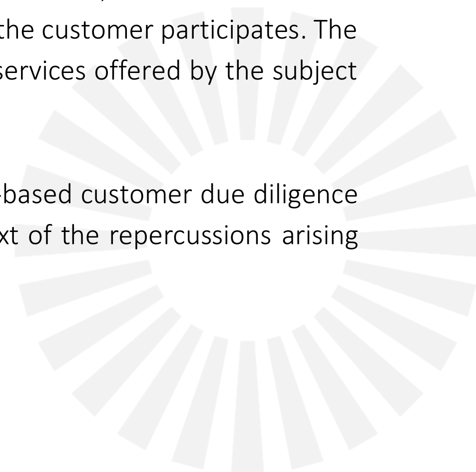
Finally, the Company has also been duly informed that in the event that the Company fails to provide the above-mentioned action plan and supporting documentation available within the specified deadline, the Company's default will be communicated to the Committee for its eventual actions, including the possibility of the imposition of an administrative penalty in terms of the FIAU's powers under Regulation 21 of the PMLFTR.

Key Take aways:

- The BRA should not be a list of risks or a list of considerations, but an actual assessment of the risks faced by the subject person, both through the consideration of experience (when available) and from an understanding of how each factor, actual or potential, could impact the risks to which the subject person is exposed to.

- Each individual risk must be understood in its totality. Customers need to be seen in the context of the different services/businesses they are involved in, or plan to be involved in, as well as the source that will fund the operations carried out by the customer or in which the customer participates. The product risk must be assessed in view of the risks that the products/services offered by the subject person may present.

- The CRA is fundamental for the effective application of effective risk-based customer due diligence and monitoring. As such, risk factors must be weighted in the context of the repercussions arising



from their possible occurrence and all risk criteria are to be exhaustively considered. It is also important to link all risk factors including the results of adverse media checks carried out.

- Risk is never static but evolves and changes with any new element or development such as a new product or the customer venturing into a new service, or new adverse information presents itself. Therefore, it is crucial that the assessments, both at the business and customer level, remain relevant, accurate and updated in a sufficiently timely manner. This ensures a clear, unambiguous and accurate understanding of the ML/FT risks the subject person is exposed to and that the measures needed to manage these risks are effectively taken and implemented.

CASE 2:

SUPERVISORY ACTION:

Thematic Off-site Compliance Review carried out in 2021.

DETAILS OF THE ADMINISTRATIVE MEASURE IMPOSED:

Administrative Penalty of €11,000 in terms of Regulation 21 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR).

LEGAL PROVISIONS BREACHED:

- Regulation 15(3) of the PMLFTR and Section 5.5 of the Implementing Procedures (IPs)
- Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Sections 4.3.1 and 4.3.2.1(v) of the IPs
- Regulations 7(1)(a) and 7(6) of the PMLFTR and Section 4.6.5 of the IPs

REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURE:

Failure to submit an STR and/or SAR – Regulation 15(3) of the PMLFTR and Section 5.5 of the IPs

In one of the files reviewed, the customer's ownership and control structure chart obtained at onboarding showed that the corporate customer was owned by another legal entity – Company A. Shares of Company A were in turn, owned by a Scheme, with the ultimate natural person on top of the Scheme being Mr B. However, from the documentation provided it was noted that during the business relationship, Mr B retired from the Scheme, with Mrs A and a Trustee being appointed in his stead. Therefore, as per the constitutive documents held by the Company, the Beneficial Owners (BO) were Mrs A and the Trustee. However, through email correspondence held, it was observed that even though Mr B had retired from the Scheme, it was possibly Mr B who owned and controlled the customer even after his resignation as trustee of the Scheme.

Committee Members noted several red flags arising from the business relationship with this customer. These red flags should have prompted the Company to suspect that another individual owned and controlled the corporate customer. This should have led the Company to suspect the true purpose behind it and to submit a suspicious report to the FIAU. Some of the red flags considered by the Committee are explained hereunder:

- An internal email which was dated after Mr B’s resignation highlighted concerns given that the company had been receiving money from the parent company and transferring it to the subsidiary. This had been happening for a few years, yet there were no formal agreements in place documenting

and justifying this flow of funds. Furthermore, it mentioned that Mr B is the ultimate BO at the top of this whole structure. However, it was not known where these payments were ultimately coming from.

- Mr B's continuous involvement through the provision of loans raised concerns that he is still actively involved and in control of the customer, the scheme and the property. The use of loans to finance corporate activities may also be a further indicator of possible misuse of corporate vehicles for committing and/or laundering the proceeds of tax evasion. This is especially possible where it results that the amounts lent to the corporate entity are not in keeping with the known customer profile and financial resources. It is also true that their repeated occurrence, particularly when the loans are offered with very favourable conditions, and may even end up unpaid, should be considered as an important red flag and that something amiss is taking place within the entity.

- Over the years, Mrs A had paid rent on a property, which had generally been sufficient to cover the running expenses. These expenses had increased and therefore additional funding was required. This increase in expenses was used as a justification for the additional quarterly loans that would be expected from Mr B. It is of concern that additional loans were resorted to, to cover the additional expenses, rather than finding more feasible means to cover the expenses, such as by increasing the rent.

- A Worldcheck screening of Mr B was performed, even though he had retired as trustee of the Scheme. This was considered as confirming that the Company was aware of Mr B's continued interest in the customer company.

- A CRA carried out during the business relationship raised further questions, due to the inclusion of Mr B and the specific reference to his source of wealth, when Mr B was no longer meant to be involved due to his retirement. This further reaffirms the group's dependence on Mr B, as also outlined through the continuous loans being provided.

The Committee therefore concluded that the Company was presented with sufficient indicators to reasonably suspect that Mr B was attempting to conceal his beneficial ownership and that he still exercised control over the corporate customer. Consequently, the Committee decided that the Company was in breach of Regulation 15(3) PMLFTR and Section 5.5 of the IPs.

<u>Customer's ownership and control structure not entirely verified through independent checks – Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Sections 4.3.1 and 4.3.2.1(v) of the IPs</u>

The structure chart provided for one of the files showed two entities Company 1, with Mr X as BO, and Company 2, with Mr Y as BO, each owning 50% of the shares of the corporate customer. Nevertheless, no documentation was provided to verify the link between Company B, and its BO Mr B. The Company should have therefore carried out appropriate checks and gathered information as to be able to understand the ownership and control structure and determine who is the customer's beneficial owner.

Moreover, the Committee noted that the FIAU officers had indeed observed the involvement of Company 3 from the MBR Register and had also asked the Company for further clarifications. Nevertheless, from the documentation provided during the compliance review, the Committee, aside from the Register of Members and Share Ledgers, could not locate any ownership and control structure charts that indicated the existence of Company 3.

Given the multi-tier structure, a comprehensive chart and documentary evidence to allow the Company to understand how the beneficial owner is linked to the customer was indispensable.

Consequently, in view of the findings identified during the Examination, and as confirmed above, the Committee determined that the Company breached its obligations in terms of Regulations 7(1)(a), 7(1)(b) and 7(6)(a) of the PMLFTR and Sections 4.2.2, 4.3 and 4.3.2.1(iv) of the IPs.

Proof that BO information was registered with a designated BO registry not obtained timely – Regulations 7(1)(a) and 7(6) of the PMLFTR and Section 4.6.5 of the IPs

This shortcoming was identified in one (1) of the files reviewed. As part of the documentation provided for the customer mentioned, the Company made available an extract of the MBR website showing the information with regards to the BO, having the same date as FIAU's request for this customer's documents. Although the correct BO forms were submitted in a timely manner to the MBR, a record of the submission had not been recorded or filed. Therefore, the issue at hand is of 'lack of evidence' for the submission, which is human error on the part of the client relationship administrator in charge of this specific customer at the time.

Nevertheless, the Committee found the Company in breach of Regulation 7(1)(a) of the PMLFTR and 7(6) of the PMLFTR and Section 4.6.5 of the IPs. However, because the Company held other documentation leading up to the BO, and that extracts of BO registers were found on the files of the other reviewed customers, the Committee concluded that a Reprimand will be imposed for this breach.

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

After taking into consideration the abovementioned breaches committed by the Company, the Committee decided to impose an administrative penalty of eleven thousand euro (€11,000) with regards to the breaches identified in relation to:

- Regulation 15(3) of the PMLFTR and Section 5.5 of the Implementing Procedures (IPs)
- Regulations 7(1)(a) and 7(1)(b) of the PMLFTR and Sections 4.3.1 and 4.3.2.1(v) of the

The Committee also served the Company with a Reprimand for breaching the below Regulations:

- Regulations 7(1)(a) and 7(6) of the PMLFTR and Section 4.6.5 of the IPs

When reaching its decision, the Committee also took into consideration the level of cooperation demonstrated by the Company during the compliance review. The size of the Company's operations was also considered. Furthermore, the Committee based its decision on the following considerations:

- The scenario where the Company failed to have a comprehensive understanding of the corporate structure of the customer it was servicing including determining with certainty the beneficial owner together with any changes to the BO.

- The circumstances surrounding the customer where it was noted that the Company held sufficient evidence to suspect that the initial beneficial owner had remained in control, albeit not remaining the BO on paper.

- The way the activity was being carried out in relation to the loans being provided was a red flag and therefore the Company should have submitted a suspicious report to the FIAU in view of possible ML risks.

- The foreign ownership of the relationship.

- The lack of appreciation of the ML risks it was exposed to by the red flags presented through the established relationship, as well as to the importance of abiding with its AML/CFT obligations, which obligations are very onerous and important.

Key Take aways:

- Beneficial ownership is not only decided through one's ownership of the shares and voting rights. One must always remain vigilant and cautious of ownership through control by other means. Funding the operations of the customer, involvement in decision making, continuous correspondence with another individual without justification, are all aspects that need to be well factored in and considered as they can be indicative of someone in control of the entity despite not officially being stated or documented.

- Tax evasion is a serious crime, the movement of funds through corporate customers not directly linked to individuals and the use of loans are red flags that need to be taken well into account and assessed.

- Suspicion of undisclosed ownership should be reported. BOs hiding their ownership is an ML risk since they could easily be utilising such structures to shift their funds without being directly linked to them.

- It is critical that ownership and control structures are understood and confirmed to truly know the customer being serviced, as well as to understand possible risks involved behind the established relationship or the transaction being processed.

- Registration on BO registers needs to be both checked and substantiated by evidence which needs to be kept on file.

TOTAL VALUE OF ADMINISTRATIVE PENALTY FOR THE TWO CASES:

Thirty-One thousand One Hundred and forty-five Euro (€31,145)

4 April 2022