

EBA/REC/2018/02

11 July 2018

Recommendation to the Maltese Financial Intelligence Analysis Unit (FIAU) on action necessary to comply with the Anti-Money Laundering and Countering Terrorism Financing Directive

The Board of Supervisors of the European Banking Authority

Having regard to Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC¹ (the ‘Regulation’ and ‘the EBA’), in particular Article 17(3) thereof,

Having regard to Decision EBA/DC/2016/174 of 23 December 2016 of the European Banking Authority adopting Rules of Procedure for Investigation of Breach of Union Law,

Whereas

Relevant factual background

- (1) Pilatus Bank Limited (the “institution”) is a credit institution, which was authorised by the Maltese Financial Service Authority (MFSA) on 3 January 2014. The institution was set up as a private bank with a customer base comprising predominantly non-resident high net worth individuals, a significant number of whom were subsequently found to be linked to countries deemed high risk for money laundering purposes.
- (2) In September and October 2015, the Banking Supervision Unit of the MFSA carried out an on-site inspection at the institution. As part of this review, the MFSA looked at the bank’s anti-money laundering and countering the financing of terrorism (AML/CFT) measures. As an outcome of this inspection, the MFSA recommended to the FIAU that it “considers utilising its expertise and intelligence to undertake an independent exercise specifically focused on these particular customers” (politically exposed persons, PEPs).

¹ OJ L 331, 15.12.2010, p. 1.

- (3) On 15 January 2016, the FIAU communicated to the institution that it was assessing the MFSA's findings, requested some information and announced a possible on-site visit. In March 2016, the FIAU carried out an on-site inspection. The focus of the on-site inspection was the institution's treatment of PEPs.
- (4) On 17 May 2016, the FIAU issued a letter to the institution setting out its findings, which pointed to serious breaches of AML/CFT requirements (the initial inspection report), giving the institution a chance to respond. In their response, the institution rejected the FIAU's findings and advised that it had commissioned two external reviews which in its view showed that relevant Customer Due Diligence documentation had been obtained, but had not been shared with the FIAU during the on-site visit. The then Director of the FIAU met with representatives of the institution, who asked that a follow-up visit be carried out. The FIAU agreed and carried out a follow-up visit between 8 and 10 August 2016. This visit was focused solely on the previously missing customer due diligence documentation. During the follow up visit, the FIAU staff found documentation on customer files that had not been available during the first visit. The FIAU could only provide the EBA with notes from the second on-site visit to the institution.
- (5) Subsequent to the follow-up visit, the FIAU communicated to the institution, by a letter dated 26 September 2016, that "the issues raised in our letter of the 17 May 2016 are now closed. However, the FIAU has taken note of the fact that the Bank only provided information and documentation during the follow up on-site visit and is disappointed and concerned at this course of action. The matter will be kept on record."
- (6) On 23 October 2017, the European Commission's Director General for Justice and Consumers asked the EBA to investigate a possible breach of Union law. This related to the apparent failure of the FIAU and the MFSA to apply effective, proportionate and dissuasive sanctions for alleged infringements by the institution of Malta's AML/CFT provisions in line with Article 39 of Directive 2005/60/EC, of 26 October 2005, on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (AMLD3).
- (7) Most of facts of the case took place during 2016 when AMLD3 applied. However, actions to be taken to remedy the breach of Union Law should be in accordance with Directive 2015/849, of 20 May 2015, on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (AMLD4), which is the currently applicable Union Law.
- (8) The EBA conducted a preliminary enquiry, including an on-site visit to the Maltese competent authorities. The EBA's preliminary enquiry focused on the extent to which the FIAU's approach to AML/CFT supervision and enforcement in relation to Pilatus Bank Limited has been effective and in line with Union law.
- (9) On 23 May 2018, the EBA Chairperson, having consulted with the Alternate Chairperson, opened a Breach of Union Law investigation pursuant to Article 17 of EBA founding Regulation, on the basis that the FIAU appeared to have failed to apply Union law or had applied it in a way which appeared to breach Union law.

- (10) The FIAU replied to this communication by a letter of 6 June 2018 in which, after expressing its disagreement, it set out the initiatives taken to strengthen AML/CFT supervision, in terms of resources, internal processes, internal governance and supervision of financial institutions.
- (11) The BUL Panel met on 20 June 2018 and decided to send to the FIAU a draft recommendation for its opinion, before submitting a proposal to the Board of Supervisors (“BoS”).
- (12) The FIAU replied by a letter of 28 June 2018, denying the existence of a breach of Union Law and arguing that the EBA's conclusion is based on a single case and that the Action Plan already adopted by the FIAU have remediated that breach. The FIAU’s written submission has been provided to the Members and Observers of the BoS. In addition, the FIAU has had the opportunity to present its views during the BoS meeting held on 3 July 2018.

EBA Findings

- (13) The FIAU does not have sufficient records of the specific files and documents examined during the first on-site visit, to make it possible to identify which customer files were examined and which due diligence documentation was available or not available at the time. In particular, no record was made of any request for documents that the institution did not provide. Furthermore, during the second on-site visit, the FIAU did not establish a detailed list of the documents examined by reference to the first visit. This lack of records contributed to the FIAU’s inability to defend itself against the institution’s challenges.
- (14) Discussions in the Compliance Monitoring Committee Meetings, the FIAU’s decision-making body on supervisory matters (CMC), are not adequately reasoned or documented with the result that it is not possible to understand what led to the closure of the case without further supervisory measures or sanctions. It is not possible to establish whether the decision was well founded.
- (15) The institution and its advisers sought to narrow down the scope of the investigation to focus primarily on the existence of customer due diligence documentation confirming the source of funds. The FIAU seems to have agreed to this narrowed scope unquestioningly. As a consequence, it appears that in the second on-site visit the FIAU only paid attention to the availability of source of funds documentation without a deeper analysis of it but it did not pay any attention to some of the more serious findings listed in the letter of 17 May 2016. The CMC also did not take into consideration these remaining deficiencies when deciding on next steps.
- (16) Notwithstanding the serious nature of its initial findings, the FIAU has not documented, or otherwise provided clear reasons and compelling arguments why it considered it appropriate not to impose any sanctions or other supervisory measures. This applies, in particular in relation to those initial findings that are not related exclusively to the institution’s failure to provide the required customer diligence documentation, including: i) the very high risks of ML/TF to which the institution is exposed not being mitigated adequately; and ii) the lack of sound AML/CFT policies established by the institution’s board of directors for customers classified as PEPs.

- (17) Notwithstanding it was a high-risk institution of a type which was new to the jurisdiction, the FIAU neither planned nor carried out an on-site inspection to the institution until asked to do so by the MFSA, two years after the institution started its activities and no risk-based justification has been given for this inaction.
- (18) After deciding to close the case, without imposing any sanction or considering any other supervisory measure, and despite the stated concerns of the FIAU as to how documentation became available in the second on-site visit although it was not available at the first inspection, the FIAU did not develop any other supervisory engagement plan with the institution. The documents provided by the FIAU to the EBA and interviews held with FIAU staff confirm that, after the 26 September 2016 communication to the institution closing the case, despite the documented concern regarding the documentation that was not available until after its first inspection, the FIAU considered the need for additional supervisory measures only in April 2017, when the allegations were made public against the institution.

Conclusions

- (19) These findings point to general and systematic shortcomings in the FIAU's application of AMLD3. Although the preliminary enquiry was initiated to address the concerns raised by the FIAU's supervision of Pilatus Bank, the findings from the EBA's investigation reveal a general practice of the FIAU at the time of the case at issue and not only, as argued by the FIAU, a failure in this particular case. The information requested and provided to the EBA has not been limited to the procedures and policies applied to Pilatus Bank. The FIAU has also challenged the issuing of a Recommendation because an Action Plan had been already adopted by the FIAU to address the same concerns set out in the draft Recommendation. The EBA welcomes the actions that the FIAU has taken, and is in the process of taking, to strengthen its activities and functioning, and recognises that organisations can always improve their effectiveness. However, in the EBA's view the need identified by the FIAU for such a wide-ranging nature Action Plan provides support for its findings that the procedures and policies applied at the time of the case at issue were not appropriate and effective.
- (20) The FIAU did not effectively monitor and take the necessary measures with a view to ensuring compliance with the requirements of the Directive by the institution as required under Article 37 of AMLD3; the FIAU failed to ensure that the institution put in place adequate and appropriate AML/CFT policies and procedures, as required under Article 34 of AMLD3; and the FIAU neither imposed effective, proportionate and dissuasive sanctions nor any other supervisory measures to correct the shortcomings it had identified to ensure the institution's compliance with AMLD3's requirements, pursuant to Article 39 of this Directive.
- (21) The FIAU has informed the EBA of general actions that, as an Action Plan, it has undertaken, or which are in train, to strengthen its supervision. While a move in the right direction, these measures are not enough to be satisfied that the deficiencies that led to a breach of Union law

have been resolved, and therefore the EBA should adopt recommendations aimed at remedying the particular failings that it has identified which contributed to the breach of Union law. The FIAU's response should reflect how those actions will ensure compliance with Union law, having regard to the EBA's recommendations. This will ensure that the actions currently in train are appropriately taken into account in the EBA's assessment of compliance with Union law pursuant to Article 17(4) of Regulation (EU) No 1093/2010.

Has adopted this recommendation:

I – Recommendations

1. The FIAU should, in accordance with their duty under Article 4(3) of the Treaty on European Union, take all appropriate measures to ensure they fulfil their obligations under Articles 48 and 58 of AMLD4, including by interpreting national law, as far as possible, in line with those Union law obligations.
2. The FIAU should enhance its assessment of ML/TF risk associated with its financial sector to ensure it is comprehensive and relevant, and to enable it to (i) allow the identification of ML/TF risk factors both domestic and foreign affecting the Maltese financial sector; (ii) take a holistic view of the level of ML/TF risk to which each type of credit and financial institution is exposed, taking into account product, services, customer, geographic and distribution channel risks in line with the ESAs' Joint Guidelines on the characteristics of a risk-based approach to AML/CFT supervision ('the risk-based supervision guidelines', ESAs 2016 71). In particular,
 - when assessing the ML/TF risk associated with its financial sector, the FIAU should use a sufficiently broad range of sources of information, including those listed in paragraphs 17-19 of the risk-based supervision guidelines;
 - concerning the tools currently used, the FIAU should:
 - i. establish and maintain a clear process to ensure this ML/TF risk assessment remains up to date, and can be amended without undue delay where necessary;
 - ii. review the FIAU's (existing) AML controls questionnaire in order to ensure that responses to this questionnaire enable the FIAU better to understand the level of risk to which institutions in its sector are exposed. The FIAU should ensure in particular that the questionnaire contains qualitative questions that will provide it with important information the level of ML/TF risk to which an institution is exposed as a result of its business, and the adequacy and effectiveness of its AML/CFT policies and controls;
 - iii. enhance its annual compliance report by including key information that will support the use of this report for supervisory purposes. For example, the report should distinguish between different types of credit institutions (e.g. by

sub-sector or risk profile), and consider product/services/customer/distribution channel risk. It should also aligning the assessment of country risk with the ESAs' Risk Factors Guidelines and not limit the assessment to FATF blacklists, EU/UN sanctions, Transparency International CPI or being an 'international financial centre'.

3. The FIAU should establish a clear supervisory strategy in line with Step 3 of the Risk-based Supervision Guidelines, whereby it allocates supervisory resources based on the categorisation of institutions by level of ML/TF risk and to each obliged entity in line with its ML/TF risk profile. In line with these Guidelines, the FIAU should ensure that institutions associated with higher ML/TF risk, such as institutions with a business model focused on international clients and PEPs, are subject to more frequent and intrusive AML/CFT supervision.
4. Recommendations number 2 and 3 should be implemented applying the ESAs' Joint Guidelines on the characteristics of a Risk-based approach to AML/CFT supervision (ESAs 2016 72, of 16 November 2016) and the ESA's Joint Risk Factors Guidelines (JC 2017 37 of 26 June 2017).
5. The FIAU should ensure that there are sufficient resources at its disposal in the light of its tasks, the size and complexity of its sector, and the ML/TF risk level of obliged entities. The FIAU should take steps to ensure that its supervisory staff is equipped to implement and carry out risk-based supervision in an effective and consistent manner, including by providing staff with adequate training in line with paragraphs 50-53 of the risk-based supervision Guidelines.
6. The FIAU should implement robust internal procedures to conduct AML/CFT supervision, including in particular:
 - a supervisory manual to guide its onsite visits and ensure a consistent approach to monitoring and ensuring institutions' compliance with applicable AML/CFT obligations. This should set out both the procedures to be followed and the type of questions supervisors should consider when assessing the adequacy of institutions' AML/CFT policies and procedures (relevant questions are listed in the ESAs' Risk Factor Guidelines and could be used by the FIAU as a basis for its own assessments);
 - robust record-keeping processes, including:
 - i. Records of the requests for information addressed to obliged entities ;
 - ii. Records of obliged entities' responses to those requests, including records of incorrect or incomplete responses, or failure to respond;
 - iii. Records of both offsite and onsite inspections. These records should contain sufficient detail to enable the FIAU to substantiate its findings, including:
 - a) which information supervisors reviewed, and records of this information, including records of any customer files;

- b) who supervisors interviewed, and the relevant information obtained from those interviews;
 - c) supervisors' assessment of those findings.
7. The FIAU should ensure that the composition of the CMC is designed to ensure the appropriate challenge to supervisory proposals decisions and that are properly documented. In particular, the minutes of the meetings of the CMC, or any other body with the same task, should provide information about the documents examined, the discussions held and the reasons behind the conclusion reached.
8. The FIAU should ensure that where it concludes that it does not have evidence of an infringement or a clear-cut breach of applicable legislation, but maintains concerns regarding the adequacy of the an obliged entity's approach to AML/CFT, it adopts within a reasonable period appropriate supervisory measures or a supervisory plan designed to address the risk identified.

II – Implementation and monitoring

1. The FIAU shall, in accordance with the second paragraph of Article 17(3) of Regulation (EU) No 1093/2010, inform the EBA within 10 working days of receipt of this recommendation of the steps it has taken or intends to take to ensure compliance with Union law.
2. The information referred to in paragraph 1 should be set out in a report explaining the measures taken or to be taken and clearly setting out when the FIAU expects to comply with Union law, together with evidence of the actions taken and planned.
3. This recommendation shall be published on the EBA website in accordance with Article 39(5) of Regulation (EU) No 1093/2010.

Done at London, 11 July 2018

Andrea Enria
Chairperson
For the Board of Supervisors