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Mrs Tiina Astola
Director General
Directorate-General Justice and Consumers
European Commission
Rue Montoyer 59 (MO59 08/014)
1049 Brussels
Belgium

24 September 2018

Re: Request to investigate a possible breach of Union law under Article 17 of Regulation (EU) No 1093/2010

~~Dear Mrs Astola,~~

Dear Tiina,

I am writing you in relation to your letter of 23 October 2017 (Ref. Ares(2017)5170820) concerning the request to investigate a possible breach or non-application of Union law by the Maltese competent authorities in relation to Pilatus Bank.

As I communicated to you, the EBA opened a preliminary enquiry in relation to the Maltese Financial Intelligence Analysis Unit (FIAU) and another in relation to the Maltese Financial Services Authority (MFSA). I informed you of the outcome of the investigation into the FIAU by my letter of 11 July 2018.

Concerning the MFSA, the preliminary enquiry has focused on the authorisation process, the prudential supervision of Pilatus Bank, and the recent supervisory measures taken by the MSFA.

As regards the latter issue, on 30 June 2018 MFSA announced that it has formally filed with the European Central Bank (ECB) a recommendation for the withdrawal of Pilatus Bank's banking license, on the following grounds: Indictment of the Ultimate Beneficial Owner (UBO) and liquidity.

In our opinion this is an appropriate step to take to comply with Article 14 (2) of Directive 2013/36/EU, of 26 June 2013, on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ("CRD") given the current circumstances of the bank's ultimate beneficial owner.

The EBA's preliminary enquiries have raised significant concerns concerning the MFSA's authorisation and supervisory practices in relation to Pilatus Bank. However, in the light of the requirements set out in Union law for prudential supervisors which make it difficult to conclude that there have been breaches of clear and unconditional obligations established in Union law, and especially in light of the significant supervisory actions taken by the MFSA in relation to Pilatus Bank, I have decided to close the case without opening a breach of Union law investigation.

Notwithstanding the decision not to open an investigation, there are a number of areas where we believe the MFSA's practices should be improved. The MFSA has informed us of a number of measures which it is implementing to improve its authorisation and supervisory processes and the EBA intends to monitor this, including through an on-site visit which we currently propose to carry out in mid-2019.

In particular, as a result of our enquiries I have expressed concerns to the MFSA about its supervisory practices in four key areas:

- Engagement between the MFSA and the Financial Intelligence Analysis Unit during the authorisation process.
- Robustness of due diligence checks conducted as part of the authorisation process.
- Prudential supervisory response to concerns about effectiveness of AML/CFT systems and controls.
- Resources and risk prioritisation given to credit institutions pursuing a private banking business model with predominantly non-resident customers.

I have therefore asked the MFSA to update the EBA on a quarterly basis on the measures adopted to strengthen its supervision and the state of play of its implementation in these areas.

EBA staff will also carry out a further on-site visit to the MFSA which is currently scheduled for mid-2019 to assess progress in the implementation of these measures and the EBA will then review what, if any, further measures it considers need to be taken.

It will also be important to tackle the deficiencies which we have identified in current Union law in order to help address perceived shortcomings in conduct and prudential supervision of AML/CFT issues which have been discussed in the high-level joint working group on AML/CFT which you co-chaired and in which we participated. I therefore hope that the joint working group will be able to consider how best the following issues which we have identified can be addressed.

Authorisation of credit institutions

The requirements for authorisation of credit institutions are laid down by Member States under Article 8(1) CRD. While CRD contains some specific requirements, these are limited in nature or require information to be provided without setting out how it is to be assessed. This leaves considerable discretion in the assessment of authorisation requirements. RTS and ITS submitted by the EBA to the Commission in June 2017 on information to be provided in authorisation applications and the procedures for providing that information will help ensure that authorisation is not given in the absence of information on AML/CFT systems and controls being provided. However, these RTS and ITS are still awaiting endorsement by the Commission and the EBA's empowerment does not extend to harmonising the assessment of the information.

While Articles 16 and 24 CRD impose the obligation to consult and to cooperate among competent authorities of different Member States during the authorisation process, CRD does not provide for specific engagement between different competent authorities within the Member State. Given that Union law has established a requirement for AML supervisors, it may be useful to ensure that AML supervisors are required to contribute their expertise to authorisation assessments.

Assessment of qualifying holdings

The assessment of qualifying holdings in credit institutions is more fully harmonised than some other areas of prudential supervision. However, there are still limits on the extent of harmonisation achieved. In particular, the extent to which competent authorities should verify the accuracy of information provided and actively investigate and challenge that information is not harmonized.

Joint ESA guidelines have sought to develop common standards in this area, in particular making clear the wide range of information that should be taken into account. Competent authorities making suitability assessments of individuals face significant difficulties under some national legal regimes because of constraints in taking into account negative elements other than definitive judicial and administrative findings in the assessment of the fitness and propriety of qualifying holders and managers. The EBA sought to address this through guidelines but we consider that directly applicable Union law requirements are needed to address issues arising from different implementation in national legal systems, rather than from supervisory practices.

Competent authorities can also face difficulties in conducting in-depth investigations within the time limits for taking decisions on qualifying holdings and authorisations. Establishing evidence that will withstand judicial scrutiny in complex, multi-jurisdiction cases can take a significant amount of time. Establishing targeted measures that may be applied by competent authorities to limit the influence of qualifying holders where failings are, for justifiable reasons, identified after approval for an acquisition has been granted may be useful to deal with such situations.

Finally, there is a concern about the assessment criterion in Article 23(1)(e) CRD regarding how competent authorities establish reasonable grounds to suspect that an acquisition of a qualifying holding could increase the risk of AML/CFT. Without clear assessment criteria set out in Union law there is a risk that such a hypothetical assessment proves difficult to defend and so is not relied on by competent authorities.

Prudential supervision of AML/CFT

There is a need to integrate consideration of ML/TF risks as an essential part of the supervision of operational risk by the prudential authorities.

Article 74 CRD contains a broad requirement to have robust governance arrangements including adequate internal control mechanisms, and Article 85 CRD requires competent authorities to ensure that institutions implement policies and processes to evaluate and manage the exposure to operational risk. However, CRD does not specifically set out the risk of financial crime as a risk to

be assessed by institutions and by their prudential supervisors. Indeed, Article 67 CRD in setting out the administrative measures available to prudential supervisors refers to reliance on the existing findings of the AML/CFT supervisor, since paragraph 1 (o) make reference to “*an institution is found liable for a serious breach of the national provisions adopted pursuant to Directive 2005/60/EC*”.

This is a minimum list of powers, and does not preclude Member States from providing wider powers, or competent authorities from using other supervisory tools to address risks. Article 104(1) CRD makes clear that prudential supervisors’ supervisory powers should be available for the purpose of addressing risks identified in the supervisory review and evaluation process carried out under Article 97 CRD. While ML/TF risk forms part of operational risk in Article 85 CRD, the existence of separate AML/CFT supervisors and the provision in Article 67(1)(o) CRD may mean that it would be helpful to specifically include an article on ML/TF risk in Section II of Chapter 2 of Title VII of CRD to ensure clarity over the role of prudential supervisors.

The EBA could address this issue in part through further development of its SREP guidelines, but it would be useful to look at whether changes should also be made in CRD itself.

Cooperation between supervisors

The interaction between prudential and AML supervision is left to national implementation. The level of cooperation and of information exchanged can therefore vary between Member States, and there are no specific triggers for such information exchange or particular forms of supervisory action. AMLD5 assists in removing barriers to information exchange, but it does not establish positive obligations regarding cooperation. While EBA or joint ESA guidelines could assist here, there are likely to be limits on what can be achieved without a more specific framework in Union legislation.

I would like to reiterate that the EBA continues to take ML/TF issues very seriously as I hope is shown by our enquiries into the MFSA’s activities regarding Pilatus Bank and the measures we are taking. We remain committed to working with you towards a more robust and effective European AML/CFT regime.

Yours sincerely,

[signed]

Andrea Enria

CC: Olivier Guersent, Director General of DG FISMA