



## 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:**

14 May 2021

### **SUBJECT PERSON:**

Merkanti Bank Limited

### **RELEVANT ACTIVITY CARRIED OUT:**

Credit Institution

### **SUPERVISORY ACTION:**

On-site Compliance Review carried out in 2020

### **DETAILS OF THE ADMINISTRATIVE MEASURE IMPOSED:**

Administrative Penalty of €259, 927 and Follow-Up Directive in terms of Regulation 21 of the Prevention of Money Laundering and Funding of Terrorism Regulations (PMLFTR).

### **LEGAL PROVISIONS BREACHED:**

- Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5, 3.5.1 and 3.5.2 of the Implementing Procedures Part I (IPs);
- Regulation 7(1)(b) and Section 4.3.2.1(v) of the IPs;
- Regulation 7(1)(c) of the PMLFTR and Section 4.4 of the IPs;
- Regulation 7(2)(b) of the PMLFTR and Section 4.5.1 of the IPs;
- Regulation 7(2)(a) of the PMLFTR and Section 4.5.1(a) of the IPs; and
- Regulation 15(1)(a) of the PMLFTR and Section 5.1.2 of the IPs.

### **REASONS LEADING TO THE IMPOSITION OF THE ADMINISTRATIVE MEASURE:**

Customer Risk Assessment

Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5, 3.5.1 and 3.5.2 of the IPs

The deficiencies in relation to the Customer Risk Assessment Procedures of the Bank varied between two different time periods. The Committee noted that prior to 2019 although the Bank did carry out risk

assessment of its customers no rationale was ever recorded and thus only a risk rating used to be maintained on file. In 2019 however the Bank took a proactive approach, identified such deficiency and took action to remediate its internal processes in relation to the carrying out of a customer risk assessment. Nevertheless, the Committee noted that although the Bank had revamped its customer risk assessment (“CRA”) methodology, the geographical risk factor was not being adequately considered since only the nationality and residence of the beneficial owners (“BO”) and whether or not these are domiciled in countries listed by the Financial Action Task Force (“FATF”) were being taken into consideration. The Bank therefore failed to factor in jurisdiction exposure emanating from countries that are not included in the FATF lists. The Bank also did not include jurisdiction risk exposure emanating from other sources such as the main place of business of customers or where the activity generating the customer’s or beneficial owner’s wealth is carried out, and the jurisdictions with which the customer has especially strong trading or financial connections.

#### Finding 1: Deficiencies in the pre-2019 risk rating procedure

The Committee considered the Bank’s explanations that the former risk rating was defined in the Bank’s Manual together with having in place a Risk Matrix explaining how the scoring for different elements was derived. The Bank however acknowledge that such Risk Matrix was never provided to the officials conducting the compliance review since the process had been discontinued and replaced with a new methodology. Although positively acknowledging that this had been rectified when a new MLRO joined the Bank, the Committee could not ignore that for quite a considerable time, the Bank’s CRA methodology was not sufficiently robust to detect ML/FT risks associated with its customers.

#### Finding 2: Findings relating to the revised version of the CRA – Assessment of jurisdiction

Following the improvement of the customer risk assessment methodology adopted by the Bank, it was noted that this risk factor was not being assessed adequately. Even though the Bank maintains a list of jurisdictions outlining a risk weighting per country, the jurisdiction risk analysis did not cater for the inclusion of additional jurisdictions possibly connected with the respective business relationships such targeted geographical areas of business and any other jurisdiction connected to the customer were not included.

The Committee considered that since the compliance review, the Bank has addressed the findings identified and amended its methodology to include a comprehensive assessment of the geographical risk factor. Nevertheless, the Bank’s deficiencies in its adherence to customer risk assessment obligations could not be disregarded.

The Committee therefore determined that the Bank is in breach of Regulation 5(5)(a)(ii) of the PMLFTR and Section 3.5, 3.5.1 and 3.5.2 of the Implementing Procedures Part I.

### Customer Due Diligence

#### Verification of the permanent residential address of the ultimate beneficial owner (UBOs)

##### Regulation 7(1)(b) and Section 4.3.2.1(v) of the IPs

The residential address of the ultimate beneficial owners of two of the files reviewed was not verified since the document obtained by the Bank was not adequate (being a mobile utility bill). The Committee noted that since the compliance review this had deficiency had been rectified and although still considering this as a breach, the fact that it was in only two of the files reviewed and that it only related



to the residential address of the UBO and that no other identification detail was left unverified, the Committee considered this to be a minor breach.

However, the Bank was still found in breach of Regulation 7(1)(b) and Section 4.3.2.1(v) of the Implementing Procedures – Part I.

#### Information on the purpose and intended nature of the business relationship

##### Regulation 7(1)(c) of the PMLFTR and Section 4.4 of the IPs

The Committee noted that 50% of the customer files reviewed held generic information about the corporate customer's business activities, with information being limited to descriptions like 'investment in stocks' 'investments in the medical industry', 'merchant banking' and 'litigation finance deals'. In 50% of the customer files reviewed there was no information held in relation to the anticipated level and nature of transactions. Furthermore, in 60% of the files there was no or insufficient information held on the expected source and origin of funds to be used in course of the business relationship.

The Committee considered all the information provided in the Bank's representations, together with the documentation submitted to corroborate the information. However, the information and documentation provided by the Bank in its representations were not present on file during the compliance review and neither was it provided to the officials conducting the compliance review upon their request. The Committee noted that during the on-site examination Bank representatives had acknowledged that the information in relation to the purpose and intended nature of the business relationship in the customer files mentioned in this section was not provided by the Bank. Although submitted with the representations, the Committee expressed its concerns on the fact that the Bank was not even able to locate such information during the compliance review. This raises serious doubts on how the Bank could therefore conduct proper ongoing monitoring of the business relationship on the basis of the information and documentation held, since if this information was available at the Bank, representatives could not even locate it let alone make effective use of such information.

The Committee reiterated that establishing a comprehensive customer profile is an essential obligation for all subject persons, especially for those who process transactions which may involve substantial amounts, as is the case with credit institutions. Not obtaining the necessary information would inevitably expose the Bank to an increased and unmitigated ML/FT risk. Particularly since transactions are carried out without the ability to compare them with the expected behaviour of the customer based on the profile built. Due to this deficiency unusual or anomalous transactions could very well go undetected.

The Committee therefore decided that the Bank is in breach of Regulation 7(1)(c) of the PMLFTR and Section 4.4.2 of the Implementing Procedures Part I.

#### Ongoing Monitoring

##### Updating of Documentation/Information

##### Regulation 7(2)(b) of the PMLFTR and Section 4.5.1 of the IPs

In three of the files reviewed, the Bank held documentation that was not updated with information and documentation to verify the updated corporate structures of customers. In one of these client files, the customer was acquired by new shareholders, while the current corporate shareholder was being dissolved however documentation to verify the dissolution of the former shareholder and the share



transfer were not found on file. The Committee considered that this finding has since the compliance review been rectified.

In another file discrepancies were noted between the ownership structure outlined at on-boarding and the structure chart held on file dated three years following the on-boarding. Although the Bank was aware of the reason behind such discrepancy at the time of the compliance review it was still awaiting the client to provide updated documentation. Therefore although the Bank in its representations attested that this has now been rectified, the Bank was at the time not adhering to its ongoing monitoring obligations.

The Committee therefore decided that the Bank is in breach of Regulation 7(2)(b) of the PMLFTR and Section 4.5.1(b) of the Implementing Procedures Part I.

#### Scrutiny of Transactions

##### Regulation 7(2)(a) of the PMLFTR and Section 4.5.1(a) of the Implementing Procedures Part I

The Committee noted that the Bank has no automated transaction monitoring system in place. The Bank justified this in view of the limited size of its customer portfolio and their activity. However at the time of the compliance review it was in the process of implementing an automated tool in order to enhance its AML/CFT processes and that the system would also incorporate the information collected from clients with their transaction activity.

The Committee remarked that, even if one were to consider a manual system as being sufficient to review the volume of transactions processed by the Bank, the system as applied would still present a major issue. This because it was not considering any information that the Bank may have with respect to customers' business profile. Instead, the Bank's system limited itself to comparing transactions against past transactional activities. The Bank was therefore unable to detect whether any one transaction, or even the whole transactional activity of the customer, was one that would fit within the context of customers' declared business and activities. This therefore meant that even if the past transactional activity was never in line with the profile and should have been queried, this would not have been questioned by the Bank but rather such activity was used to determine whether new transactions were similar to past ones. For instance, in one of the customer files an incoming payment of USD116, 000 was noted however the Bank only relied on a customer's SWIFT message that only outlined the sender's information. Given the lack of information provided at on-boarding and throughout the business relationship, the Bank was unable to establish whether this transaction was in line with the profile of the client.

Moreover, it was also observed that where the Bank's compliance team was trying to scrutinise transactions alerted from its manual approach, this proved to be ineffective and incomplete. The following are only a few individual examples from those identified by the Committee.

- In one of the customer files, an incoming transaction of Eur 2,750,000 was supported with a loan agreement. The agreement indicated that the Bank's holding company was lending funds to an intra-group customer. However the agreement was solely signed by one of the Bank's senior management official who was acting as a representative of both companies. It was further noted that a month later, Eur 2,749,877 were transferred to a third party. Although the Bank's Compliance Team did attempt to scrutinise this transaction and asked for supporting documentation, none was provided and at the time of the compliance review the rationale for this transaction was still unknown. The Committee also considered that although loan agreements and power of attorney documentation were submitted with the representations,

these showed how the Bank's own senior management official had signed the loan agreement on behalf of both parties, the Bank should have exercised additional caution in this case and obtained supporting documentation on the overall nature of the transfer out to the third party and its purpose. While documentation was made available to justify the transfer, this was only made available at representations stage and not during the compliance examination. This again raises questions as to whether the Bank's monitoring system was effectively working or otherwise;

- In another file, an outgoing transaction of CAD 894, 572 was carried out as a onetime transaction and further outgoing transactions amounting to CAD 2,323,572 took place over an ensuing 4 month period, each time to the same recipient – a consultancy firm. From email correspondence found on file, it was evident that the Bank's Compliance Team did in fact carry out its function and attempted to scrutinise the transactions by requesting supporting documentation however another Bank senior management official advised that the client held previous relationships with the Bank's group and insisted that the fees paid by the client were within the client's business profile. The Compliance team accepted such explanation without additional scrutiny. The Committee noted the Bank's representations in which it stated that the recipient mentioned was a firm with a long history with the parent group of the Bank and following thorough checks no suspicious activities were found and no indication of any potential illicit activities were observed. The Committee, still could not accept the representations as sufficient justification to have let such significant transactions through without obtaining any documentation that would justify the transfers.

In this same file, a number of outgoing transactions amounting to CAD335,222 were noted. However, even in this case the Compliance Team had to rely on information provided by the Bank's senior management official to understand the rationale behind the underlying payments and no further documentation was obtained. The Bank's representations explained that the payments related to a law firm, since the client was subject to a current ongoing lawsuit. No supporting documentation was provided since all correspondence between the law firm and the client is subject to client/attorney privilege. The Committee reiterated that albeit the customer/lawyer privilege, this in no way impinges on the Bank's rights as well as obligations to obtain the necessary documentation to substantiate any transaction and that invoices or any other documentation that would substantiate such transfers were necessary. This especially in view that these transactions were not even in line with the customer's profile.

- In another file, three incoming payments were noted one amounting to Eur 50,000 and two of Eur 49,995. Once again attempts to scrutinise these transactions were made by the Compliance Team of the Bank by requesting additional documentation and requesting clarifications to one of the Directors of the customer. The explanation provided was that the payments related to a repayment schedule of a loan agreement with a balance of Eur300, 000. A senior management official of the Bank's Group of Companies and the Bank's senior management official refrained from providing the loan agreement as they were claiming that the loan was considered classified, confidential and the request *per se* inappropriate. The Committee noted the Bank's representations in relation to the transactions carried out by this customer, wherein it provided an explanation for the same together with supporting documentation. However, the Committee highlighted that neither the explanations nor the supporting documentation were provided at the time of the compliance review even though Bank officials had been queried multiple times for this information. Moreover, from the correspondence found on file ,it was evident that transaction scrutiny, although attempted, was not completely carried out since the documentation was not provided ; and

- In another file, an outgoing payment of Eur400, 000 was debited from the account. On the same day the customer received an incoming payment of the same amount from a third party. The same pattern was observed for another transaction with a value of Eur200, 000 which was credited from the same third party and debited again on the same day. The Committee in this case noted how the Compliance Team attempted to scrutinise these transactions and asked information from the Bank's former senior management official. In the correspondence exchanged with him, he stated that the transactions were within the ordinary course of the business. However, neither the reason why these were considered as such nor any supporting documentation were provided to corroborate this statement. With its representations the Bank submitted the email correspondence which was reviewed by the officials conducting the compliance review showing that the Bank requested additional information to support the transaction. The Committee did not dispute the fact that the Bank's Compliance Team did try to scrutinise this and other transactions, but rather that they go ahead of the Bank's senior management officials could not in itself justify in any way the processing of any such transactions, since the purpose to scrutinise a transaction is to obtain sufficient information and documentation to understand the purpose behind the same. The loan documents provided with the letter of representations were never provided during the compliance review.

The ineffective nature of the Bank's systems and procedures was evident throughout – the manual system was only taking into consideration past transactional activity while what transactions were being escalated with the Compliance Team were not being scrutinised properly. At times this was also due to pressure from the Bank's senior management to proceed with a transaction even if no satisfactory explanation was obtained. In addition, reliance on information known only to particular individuals undermines the transaction monitoring system as this is usually difficult to trace, not supported by documentation and may eventually be lost once the individual concerned is no longer in office or in employment with the Bank.

In view of the abovementioned reasons therefore, the Committee decided that the Bank is in breach of Regulation 7(2)(a) of the PMLFTR and Section 4.5.1(a) of the Implementing Procedures Part I.

#### The Money Laundering Reporting Officer (MLRO)

#### Regulation 15(1)(a) of the PMLFTR and Section 5.1.2 of the IPs.

Although the Bank did have a knowledgeable MLRO who was also cooperative during the compliance review, his ability to act independently and effectively was significantly limited. This finding arose from the multiple meetings held between the officers conducting the review and the Bank's own Compliance Team as well as the correspondence that was found in the files reviewed. This was further confirmed by the findings which emanated from the transaction scrutiny checks carried out during the examination. All of these reflected how the MLRO's function was being hindered by interference from the Bank's senior management. While the Committee positively acknowledges the intention of the Bank to remediate its shortcomings, the Committee highlighted that the Bank is required to ensure that the MLRO is given sufficient independence to be able to exert effective influence on the Bank's AML/CFT matters including particularly the ability to enquire for supporting documentation and to decide on the basis of the internal alerts generated and the information at hand whether or not there is the need to submit an STR to the FIAU.

The Committee therefore decided that the Bank is in breach of Regulation 15(1)(a) of the PMLFTR and Section 5.1.2 of the IPs.

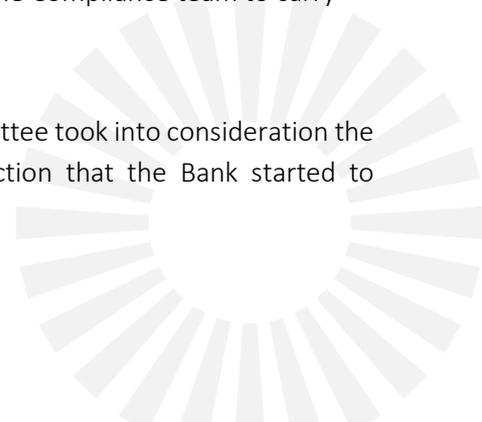
## **ADMINISTRATIVE MEASURES TAKEN BY THE FIAU'S COMPLIANCE MONITORING COMMITTEE (CMC):**

The failures identified, as listed above, necessitated the imposition of an administrative penalty that is appropriate in view of the nature of the breaches identified. In view of the above-mentioned reasons, an administrative penalty of €259, 927 has been imposed upon the Bank. In accordance with Article 13A of the PMLA. This penalty can be appealed by the Bank.

In addition to this penalty and in terms of its powers under Article 21(4)(c) of the PMLFTR, the FIAU also served the Bank with a Follow-Up Directive. The aim of this administrative measure is to direct the Bank in implementing several requirements in order to ensure that it understands the risks surrounding its operations and that the Bank has implemented sufficient controls to mitigate such identified risks. To ensure that the Bank is effectively addressing the breaches set out above, the Committee directed the Bank to provide it with an Action Plan setting out the actions already taken by the Bank, what actions it still has to implement and how these resolve the issues with the Bank's AML/CFT policies, procedures and measures set out here above. The Action Plan is to cover amongst others the following:

- 1) To provide updated documentation illustrating the remedial action undertaken pertaining to Customer Risk Assessment Methodology. The FIAU shall evaluate the new documented procedures and shall assess the Bank's knowledge of such methodology during the follow-up action.
- 2) The Bank's plan to ensure that for its active customers, the Customer Risk Assessments are updated in order to have a comprehensive understanding of the customer risks, this in line with the applicable AML/CFT obligations.
- 3) The Bank's plan to ensure that going forward ensure that verification documentation obtained is always in line with what is required in terms of the IPs and the PMLFTR.
- 4) The Bank's plan to ensure that, for its active customers, it holds adequate information pertaining to the purpose and intended nature of the business relationship and which is required to build a comprehensive risk profile is in line with the applicable AML/CFT obligations. The Bank is to also provide the latest versions of the on-boarding forms being utilized.
- 5) Provide documentation and revised transaction monitoring policies and procedures and explain how the Bank is to ensure that the transaction monitoring obligations are adequately adhered to. The Bank is also expected to provide updates in relation to transaction monitoring measures it has or shall be implementing including any details as to transaction monitoring systems. The enhancements to the Bank's transaction monitoring obligations shall also ensure that the Bank is in a position to generate internal alerts for review and determination as to whether STRs should be reported to the FIAU. The Bank should also ensure that it has the human resources necessary to monitor both the transactions and alerts generated about them are adequate.
- 6) To demonstrate how it will ensure that the function of the MLRO is safeguarded by means of the implementation of additional measures that will allow the MLRO and the Compliance team to carry out their work effectively.

In deciding the appropriate administrative measures to impose the Committee took into consideration the representations submitted by the Bank together with the remedial action that the Bank started to



implement following the compliance review, the nature and size of the Bank's operations, the overall impact, actual and potential, of the AML/CFT shortcomings identified vis-à-vis the Bank's own operations and also the local jurisdiction. The seriousness of the breaches identified together with their occurrence were also taken into consideration by the Committee in determining the administrative measures imposed.

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

**14 May 2021**

