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COMMISSION OPINION

of 8.11.2018

**addressed to the Financial Intelligence Analysis Unit of Malta, based on Article 17(4) of
Regulation (EU) No 1093/2010, on the action necessary to comply with Union law**

(Only the English and Maltese texts are authentic.)

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1. LEGAL BACKGROUND

- (1) Directive 2005/60/EC of the European Parliament and of the Council¹ provided the Union's legal framework on the prevention of the use of the financial system for money laundering and terrorist financing until 25 June 2017. Directive 2005/60/EC was repealed and replaced by Directive (EU) 2015/849 of the European Parliament and of the Council² with effect from 26 June 2017. While breaches of Union law are assessed under Directive 2005/60/EC for facts and practices that occurred before 26 June 2017, actions to remedy the breach of Union law should be taken in accordance with Directive (EU) 2015/849 which is the currently applicable law.
- (2) Article 34 of Directive 2005/60/EC required Member States to ensure that the institutions and persons covered by that Directive establish adequate and appropriate policies and procedures of customer due diligence, reporting, record keeping, internal control, risk assessment, risk management, compliance management and communication in order to forestall and prevent operations related to money laundering or terrorist financing.
- (3) Article 37 of Directive 2005/60/EC required Member States to ensure that competent authorities at least effectively monitor and take the necessary measures with a view to ensuring compliance with the requirements of that Directive by all the institutions and persons covered by it. The same article required Member States to ensure that the competent authorities have adequate powers, including the power to compel the production of any information that is relevant to monitor compliance and perform checks and have adequate resources to perform their functions. In the case of credit and financial institutions the competent authorities were required to have enhanced supervisory powers, notably the possibility to conduct on-site inspections.
- (4) Article 39 of Directive 2005/60/EC required Member States to ensure that natural and legal persons covered by that Directive can be held liable for infringements of the national provisions adopted pursuant to that Directive and that the penalties must be effective, proportionate and dissuasive. It also required Member States to ensure that the appropriate administrative effective, proportionate and dissuasive measures

¹ Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (OJ L309, 25.11.2005, p. 15).

² Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p. 73).

could be taken against or administrative sanctions imposed on credit and financial institutions for infringements of the national provisions adopted pursuant to that Directive.

- (5) Article 17 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council³ provides that the European Banking Authority (EBA), upon a request from one or more competent authorities, the European Parliament, the Council, the Commission or the Banking Stakeholder Group, or on its own initiative, and after having informed the competent authority concerned, may investigate an alleged breach or non-application of Union law and issue a Recommendation to the competent authority in case it discovers a breach or non-application of Union law.
- (6) According to Article 17(4) of Regulation (EU) No 1093/2010, where the competent authority has not complied with Union law within a month from receipt of the EBA Recommendation, the Commission may, after having been informed by the EBA, or on its own initiative issue a formal opinion requiring the competent authority to take the action necessary to comply with Union law. The Commission's formal opinion shall take into account the Authority's recommendation.

2. FACTUAL BACKGROUND

- (7) Pilatus Bank was a credit institution established in Malta and authorised by the Maltese Financial Service Authority (MFSA) on 3 January 2014. In light of concerns surrounding Pilatus Bank and following a request by the Commission in October 2017, and exercising its powers under Article 17 of Regulation (EU) No 1093/2010, EBA investigated whether the competent authorities of Malta breached Union law or failed to apply it.
- (8) EBA carried out preliminary enquiries between October 2017 and June 2018 on the basis of both written exchanges and on-site investigations and opened a breach of Union law investigation on 23 May 2018. The investigation covered the period from September 2015 to September 2016. It focused on the Financial Intelligence Analysis Unit (FIAU) of Malta, which is the competent authority responsible for effectively monitoring the compliance of credit institutions with Directive 2005/60/EC and imposing sanctions. The FIAU is also a competent authority for the purposes of Regulation No (EU) 1093/2010.
- (9) On 11 July 2018, the Board of Supervisors of the EBA found that the FIAU had breached Union law, notably Articles 34, 37 and 39 of Directive 2005/60/EC⁴.
- (10) More specifically, EBA found that the FIAU had breached its obligations under Article 37 of Directive 2005/60/EC. Indeed, notwithstanding the fact that Pilatus Bank was a risk sensitive institution of a type that was new to the jurisdiction of Malta and should therefore have been subject to enhanced supervision, the FIAU had neither planned nor carried out an on-site inspection of the institution until asked to do so by the MFSA, two years after the institution had started its activities. No risk-based justification had been given by the FIAU for its inaction. Pilatus Bank should have been considered and supervised as a risk sensitive credit institution on the basis of its private bank business model, the fact that its customer base comprised predominantly non-resident high-net worth individuals and, in accordance with

³ 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/EC (OJ L 331, 15.12.2010, p. 12).

⁴ Malta transposed the provisions of Directive 2005/60/EC into its national law.

Commission Directive 2006/70/EC⁵, on the basis of the fact that some of its customers were politically exposed persons.

- (11) EBA also found that the FIAU had breached its obligations under Article 37 of Directive 2005/60/EC, in relation to Pilatus Bank, as it did not maintain sufficient records of the specific files and documents examined during the first on-site inspection 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 Pilatus Bank did not provide. Furthermore, during the second on-site inspection, the FIAU had not established a detailed list of the documents examined by reference to the first visit.
- (12) EBA found that the FIAU had also breached its obligations under Articles 34 and 37 of Directive 2005/60/EC by not having ensured that Pilatus Bank had in place the required policies and procedures of customer due diligence, reporting, record keeping, internal control, risk assessment, compliance management and communication in order to forestall and prevent operations related to money laundering and terrorist financing. More specifically, having made initial findings in this area, in its second on-site inspection the FIAU had wrongly focused its monitoring primarily on the existence of customer due diligence documentation confirming the source of funds and had failed to investigate whether Pilatus Bank had such policies and procedures, thereby narrowing its scope of investigation.
- (13) EBA found that the FIAU had breached its obligations under Article 39 of Directive 2005/60/EC because, although the FIAU uncovered some shortcomings, it had failed to impose effective, proportionate and dissuasive penalties and administrative sanctions or take administrative measures to correct those shortcomings. Notwithstanding the serious nature of its initial findings, the FIAU had not documented, or otherwise provided reasons and compelling arguments why it considered it appropriate not to impose any penalties or sanctions or take administrative measures. That was in particular the case for those initial findings by the FIAU that were not exclusively related to the institution's failure to provide the required customer diligence documentation, including: i) the failure to mitigate the very high risks of money laundering to which the institution was exposed; and ii) the lack of sound policies established by the institution's board of directors for customers classified as politically exposed persons. Discussions in meetings of the Compliance Monitoring Committee, the FIAU's decision-making body on supervisory matters, were not adequately reasoned or documented. It was therefore not possible to understand what led the FIAU to close the investigation without further penalties or sanctions or without administrative measures.
- (14) EBA also found that the FIAU had breached its obligations under Articles 37 and 39 of Directive (EU) 2005/60/EC because the FIAU, after having decided to close the investigation, without imposing any penalty or sanction or taking any other administrative measure, had not developed any other supervisory engagement plan with the institution despite the FIAU's documented concerns regarding unavailability of documentation at its first inspection.

⁵ Commission Directive 2006/70/EC of 1 August 2006 laying down implementing measures for Directive 2005/60/EC of the European Parliament and of the Council as regards the definition of politically exposed person and the technical criteria for simplified customer due diligence procedures and for exemption on grounds of a financial activity conducted on an occasional or very limited basis. (OJ L 214, 4.8.2006, p. 29–34)

- (15) EBA concluded that its findings point to general and systematic shortcomings by the FIAU in the application of national rules transposing Directive 2005/60/EC. Although the preliminary enquiry under Article 17 Regulation (EU) No 1093/2010 was initiated by EBA to address the concerns raised by the FIAU's supervision of Pilatus Bank, the information requested and provided to EBA was not limited to the procedures and policies applied to Pilatus Bank but extended to all the procedures and policies of the FIAU. Therefore, EBA's investigation concluded that this was a general practice of the FIAU at the time of the case at issue and not only a failure in the particular case relating to Pilatus Bank.
- (16) On 6 June 2018, the FIAU informed EBA of general actions that it had undertaken as part of an Action Plan, or which were under development, to strengthen its anti-money laundering supervisory practices and procedures. However, EBA considered that those general actions were not sufficient to remedy the deficiencies that had led to a breach of Union law.
- (17) As part of its finding that the FIAU had breached Union law for the reasons mentioned in Recitals (9) to (15), EBA issued on 11 July 2018 a Recommendation to the FIAU, in accordance with Article 17(3) of Regulation (EU) No 1093/2010, on action necessary to comply with Directive 2015/849/EU, which repealed and replaced Directive 2005/60/EC. The EBA Recommendation aimed at enabling the FIAU to remedy the particular failures that EBA had identified and which had contributed to the finding of a breach of Union law.
- (18) On 25 July 2018, the FIAU, in accordance with Article 17(3) of Regulation (EU) No 1093/2010, informed EBA in writing of the steps it had taken or intended to take to ensure compliance with Union law. From this information it appears that the FIAU has taken steps to enhance and improve its approach to risk-based supervision and its procedures, notably:
- (a) the FIAU has issued guidance documents on some subjects of risk-based supervision in relation to certain obliged entities⁶, for example on payee accounts, on identifying missing information in transfer of funds, on terrorist financing and on risk assessment, based on Directive (EU) 2015/849⁷;
 - (b) the FIAU has reviewed its risk assessment data collection questionnaire in 2017;
 - (c) in 2017 the FIAU has begun to move towards a risk-based approach to resourcing and structuring of its monitoring tasks;
 - (d) the FIAU has increased the human resources of its supervision division from five full time employees at the end of 2015 to 13 full time employees and has intensified training of staff;
 - (e) the Supervisory Procedures Manual of the FIAU for on-site inspections was revised in January 2018;

⁶ Obligated entities are those listed in Article 2 of Directive (EU) 2015/849

⁷ As Malta did not notify any transposition measure on time, the Commission opened infringement proceedings for non-communication of transposition measures and sent a Letter of Formal Notice to Malta on 19 July 2017 and a reasoned opinion on 8 December 2017. On 20 December 2017, Malta notified the transposition of Directive (EU) 2015/849. However, the Commission assessed these Maltese notifications and concluded that they did not represent a complete transposition of the Directive. On 19 July 2018 the Commission adopted an Additional Reasoned Opinion due to Malta's incomplete transposition. Malta provided additional information on transposition measures, which are currently being assessed by the Commission.

- (f) the FIAU introduced new templates to record the decision-making process of the Compliance Monitoring Committee.
- (19) On the same date, the FIAU stated its intention to take further steps to fully comply with other elements of the EBA Recommendation progressively by June 2019.
- (20) On 30 June 2018, the MFSA put forward to the European Central Bank a draft proposal for withdrawing the banking licence of Pilatus Bank, following the indictment of its owner in the United States because of allegations of financial criminal offences. On 5 November 2018, the MFSA confirmed the withdrawal of the licence by the European Central Bank.
- (21) According to the preliminary assessment provided to the Commission by EBA on 25 September 2018 at the Commission's request⁸, whilst actions taken by the FIAU as described in point (18) were a welcome progress, the FIAU had still not fully complied with the EBA Recommendation. For example, actions in the EBA Recommendation relating to ensuring an effective sanctioning policy, enhancement of the FIAU's methodology for the assessment of the money laundering and terrorist financing risks, and ensuring robust record-keeping for off-site investigations were not yet fully complied with.
- (22) By letter dated 9 October 2018, the Commission invited the FIAU to meet and to provide the Commission with any additional information. During a meeting on 18 October 2018 and thereafter, the FIAU provided the Commission with further information on the state of play of the implementation of the Recommendation of EBA, in line with its legal obligation to provide all necessary information to the Commission according to Article 17(4) of Regulation (EU) No 1093/2010.

3. ASSESSMENT

- (23) The Commission considers that the Maltese FIAU breached its obligations under Articles 34, 37 and 39 of Directive 2005/60/EC as transposed in national law. More specifically, the FIAU did not effectively monitor and take the necessary measures to ensure that Pilatus Bank complied with the requirements of Directive 2005/60/EC as required by Article 37 of that Directive. The FIAU failed to ensure that Pilatus Bank put in place adequate and appropriate policies and procedures to prevent money laundering and counter terrorist financing, as required by Article 34 of Directive 2005/60/EC. The FIAU did not impose effective, proportionate and dissuasive penalties or administrative sanctions, nor did it establish any other administrative measures to correct the shortcomings it had identified contrary to its obligation under Article 39 of Directive 2005/60/EC.
- (24) Since Directive 2005/60/EC has been replaced by Directive (EU) 2015/849 as of 26 June 2017, actions to remedy the breach of Union law should be taken in accordance with Directive (EU) 2015/849. The provisions of Articles 34, 37 and 39 of Directive 2005/60/EC were replaced by Articles 38, 45, 48, 58, 59, 60 and 61 of Directive (EU) 2015/849.
- (25) The provisions of Directive (EU) 2015/849 which are relevant for this Opinion are Articles 48 and 58. Therefore, the FIAU should take all appropriate measures to comply with Articles 48 and 58 of Directive (EU) 2015/849. The FIAU should also make every effort to comply with the European Supervisory Authorities' Joint

⁸ This assessment was communicated by EBA to the FIAU on 16 October 2018.

Guidelines on the characteristics of a risk-based approach to money laundering supervision ('the risk-based supervision guidelines')⁹.

- (26) The Commission considers that the policies and procedures to prevent money laundering and counter terrorist financing and the procedures to ensure that the FIAU could impose proportionate and dissuasive penalties or administrative sanctions are neither adequate nor appropriate and point to a general practice of the FIAU and not only a failure in the particular case relating to Pilatus Bank.
- (27) The FIAU has not yet fully implemented the EBA Recommendation on action necessary to comply with the Anti-Money Laundering and Countering Terrorist Financing Directive. Given this lack of full implementation of the EBA Recommendation, the Commission considers that the FIAU does not yet fully ensure that it is able to effectively monitor the compliance of obliged entities with their anti-money laundering and counter-terrorist financing obligations and to have an effective sanctioning policy as required by Articles 48 and 58 of Directive (EU) 2015/849.

4. CONCLUSIONS

- (28) For those reasons, the Commission, taking into account the EBA Recommendation, the actions of the FIAU, the assessment of the EBA of such actions, and the further information provided by the FIAU, considers that, in order to comply with applicable Union law, the following requirements should be met by action of the FIAU to fully ensure that it is able to effectively monitor and take the measures necessary to ensure the compliance of obliged entities with their anti-money laundering obligations and to have an effective sanctioning policy as required in Articles 48 and 58 of Directive (EU) 2015/849.
- (29) The FIAU should:
 - (a) further enhance in a holistic and comprehensive way its methodology for the assessment of the money laundering and terrorist financing risks associated with the financial sector with the help of adequate sources and ensure there is a procedure to amend its assessment without undue delay where necessary and depending on risks;
 - (b) include in its annual compliance report key information to understand the level of compliance of a certain institution with its anti-money laundering and counter-terrorist financing obligations and the level or risk of money laundering associated with that institution;
 - (c) further enhance its monitoring and supervisory strategy to allocate to each obliged entity supervisory resources in accordance with its money laundering and terrorist financing risk profile and in this respect, should ensure that institutions associated with a higher risk of money laundering and terrorist financing are subject to enhanced monitoring;
 - (d) further revise its supervisory procedures manual to ensure a consistent and effective approach to monitoring and to ensure that obliged entities comply with their anti-money laundering obligations;

⁹ ESAs 2016 72, 16.11.2016

- (e) further revise its guidelines for offsite inspections to ensure robust record-keeping processes which should be sufficiently detailed to enable the FIAU to substantiate its findings;
 - (f) revise its internal procedures to ensure that the composition of the Compliance Monitoring Committee and its procedures ensure that the discussions at the Compliance and Monitoring Committee and the decision making and voting are properly reasoned and documented including in relation to an effective, proportionate and dissuasive sanctioning policy;
 - (g) ensure that where it has concerns regarding the adequacy of an obliged entity's approach to anti-money laundering, it adopts within a reasonable period appropriate administrative measures or a supervisory plan designed to monitor the institution's approach for tackling the identified shortcomings in order to guarantee that the institution is subject to effective supervision including through an effective, proportionate and dissuasive sanctioning policy.
- (30) The Commission calls on the FIAU to inform the Commission and the European Banking Authority within 10 working days of receipt of this formal opinion of the steps it has taken or intends to take to comply with this formal opinion, as required by Article 17(5) of Regulation (EU) No 1093/2010.

Done at Brussels, 8.11.2018

For the Commission
Věra JOUROVÁ
Member of the Commission

