

**A CRITICAL ANALYSIS OF ANTI-MONEY LAUNDERING SUPERVISION IN
MALTA**

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ABSTRACT

Anti-money laundering and counter terrorism financing compliance ('AML/CFT) supervision is a critical component in the global fight against money laundering and terrorist financing ('ML/TF'), in ensuring that financial intermediaries are appropriately applying AML/CFT controls in line with the ML/TF risks faced by their business and ultimately preventing the misuse of the financial system for ML/TF purposes. In Malta, the AML/CFT supervision is undertaken by the Financial Intelligence Analysis Unit ('FIAU') with the help of supervisory authorities which act as agents of the FIAU, assisting it in carrying out AML/CFT supervision. The Maltese supervisory framework has recently been placed under scrutiny, with the FIAU and supervisory authorities working hand in hand to improve the current framework. Despite this, some issues remain with the current supervisory setup, including the fact that supervisory authorities are unable to take action in relation to AML/CFT breaches, this being the central argument behind the study. This dissertation therefore seeks to understand whether an alternate supervisory setup could lead to more benefits in the long run, by answering the primary research question: Can the current architectural set-up of AML/CFT supervision in Malta be improved? The dissertation therefore identifies various factors which can hamper the effectiveness of Malta's current supervisory setup and concludes that while the current supervisory model appears to work well with regard to the gaming sector, benefits could be gained if the Malta Financial Services Authority, as the single regulator for financial services, were to be assigned AML/CFT supervisory responsibilities for the financial sector. The study also takes into account various limitations and considerations relating to the introduction of an alternative model.

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LIST OF ABBREVIATIONS

AML/CFT	Anti-money laundering and counter financing of terrorism
AMLA	Anti-money laundering Authority of the EU
CASPAR	FIAU Compliance and Supervision Platform for Assessing Risk
CMC	FIAU's Compliance Monitoring Committee
DNFBPs	Designated non-financial businesses and professions
EBA	European Banking Authority
ECOLEF	Study on the economic and legal effectiveness of AML/CFT policy in the EU
ESAs	European Supervisory Authorities
FATF	Financial Action Task Force
FCA	Financial Conduct Authority (UK)
FIAU	Financial Intelligence Analysis Unit of Malta
FIU	Financial Intelligence Unit
MFSA	Malta Financial Services Authority
MGA	Malta Gaming Authority
ML/TF	Money laundering and terrorism financing
MLRO	Money Laundering Reporting Officer
MONEYVAL	Council of Europe Committee of Experts on the Evaluation of AML Measures
MoU	Memorandum of Understanding
PMLA	Prevention of Money Laundering Act
PMLFTR	Prevention of Money Laundering and Funding of Terrorism Regulations
STR	Suspicious Transaction Report

INTRODUCTION

(i) Dissertation Outline

Anti-money laundering and counter terrorism financing ('AML/CFT') compliance supervision is a critical component in the global fight against money laundering and terrorist financing ('ML/TF') in ensuring that financial intermediaries are appropriately applying AML/CFT controls in line with the ML/TF risks faced by their business. In Malta, the AML/CFT supervision is undertaken by the Financial Intelligence Analysis Unit ('FIAU') with the help of supervisory authorities which act as agents of the FIAU, assisting it in carrying out AML/CFT supervision. The Maltese supervisory framework has recently been placed under scrutiny, with the FIAU and supervisory authorities working hand in hand to improve the current framework. Despite this, some issues remain with the current supervisory setup, including the fact that supervisory authorities are unable to take action in relation to AML/CFT breaches and this dissertation therefore seeks to understand whether an alternate supervisory setup could lead to more benefits in the long run. In this regard, the governance of AML/CFT supervision in Malta is a vital component to the effectiveness of supervision, and the supervisory setup should therefore be considered in light of recent events and characteristics of the current Maltese supervisory system.

In order to assist in the global fight against ML/TF, the Financial Actions Task Force ('FATF') has established a list of 40 Recommendations which jurisdictions should apply to ensure an effective AML/CFT framework. In this regard Recommendations 26 to 28 set forth specific standards and guidelines for the carrying out of effective AML/CFT supervision. Despite this, the FATF's Recommendations set forth overarching principles, and do not recommend particular architectural models for the carrying out of such supervision. The specific supervisory architectural set up of a jurisdiction must be tailored according to the jurisdiction's resource availability, vulnerability to ML/TF and the specific risks it faces in this regard. Despite this, the AML/CFT supervision in a jurisdiction should be effective, and this is assessed through mutual evaluations undertaken by the FATF or its regional representatives.

In Malta, a recent mutual evaluation on the application of the FATF's Recommendations has resulted in the jurisdiction being placed on the FATF's grey-list and subject to enhanced

monitoring. The findings of mutual evaluations undertaken by both FATF and the Council of Europe Committee of Experts on the Evaluation of AML Measures ('MONEYVAL') in recent years indicate certain shortcomings in the supervisory model being applied in Malta, with the latest FATF assessment indicating that the jurisdiction has a low level of effectiveness when it comes to AML/CFT supervision. While improvements have been made to increase the efficiency and effectiveness of AML/CFT supervision of Subject Persons in Malta, one must consider whether the current architectural set up, wherein the FIAU is the single AML/CFT supervisor and has the support of the various supervisory authorities, the latter being agents of the FIAU, may be improved, when considering the number and nature of Malta's Subject Person population and the relevant changes being proposed to the AML/CFT framework at EU level.

The dissertation therefore seeks to critically analyse the current supervisory architecture, as well as the responsibilities of the various agencies included in this set up and amendments being proposed to the AML/CFT framework at EU level, in order to determine whether an alternative framework, wherein the supervisory authorities have a primary role in AML/CFT supervision in their respective sectors, could be more beneficial. The FATF mutual evaluation findings and the steps taken by local authorities to remediate any deficiencies to the AML/CFT framework will also be taken into account when discussing whether an alteration to Malta's AML/CFT supervisory model may be beneficial.

(ii) Aim of the Research and Research Question

The dissertation will seek to critically analyse the architectural model for AML/CFT supervision in Malta, particularly the role of the FIAU, and the Malta Financial Services Authority ('MFSA') and the Malta Gaming Authority ('MGA') as supervisory authorities which are agents of the FIAU in terms of the law and which oversee licensing and supervision in their sectoral frameworks. The study shall not address the role of other 'supervisory authorities' such as the Malta Business Registry, the Accountancy Board and or other sectoral licensing boards, since these supervisory authorities do not make up large public authorities charged with the oversight of long-established prudential sectoral frameworks as is the case for the MFSA and the MGA.

The research question selected for the purpose of this study therefore is: Can the current architectural set-up of AML/CFT supervision in Malta be improved? In attempting to answer this question, research has been conducted with respect to the international standards and EU legislation governing AML/CFT supervision and the role of FIUs, the results of AML/CFT mutual evaluations carried out on Malta in recent years and the architectural setup for AML/CFT supervision in other jurisdictions.

The central argument behind the alternative proposal revolves around supervisory authorities' abilities to take action in relation to AML/CFT breaches which they identify in the course of their supervisory work. Under the current model, the FIAU is the sole AML/CFT supervisor, and therefore it is the FIAU which takes enforcement action in relation to AML/CFT breaches. In this regard, supervisory authorities, which as agents of the FIAU carry out AML/CFT supervision on its behalf, are unable to take enforcement action in relation to AML/CFT breaches. The study will not therefore seek to analyse how improvements can be made to the existing architectural setup, since remediation is well underway with respect to MONEYVAL and FATF findings. The study will instead seek to understand whether an alternative supervisory architecture, which would make MFSA and MGA primary AML/CFT supervisors for their respective sectors, could be beneficial for Malta's AML/CFT supervision in the long run.

(iii) Methodology and Contribution to knowledge

This dissertation has been informed by extensive research into inter alia global standards for AML/CFT supervision, previous research undertaken on architectural models for supervision in the EU and their effectiveness, guidance and publications of various local and global institutions involved in the fight against ML/TF, the results of mutual evaluations undertaken by FATF or its regional bodies and cases of AML/CFT failures which occurred in Malta. In order to further contribute to the study, interviews have also been undertaken with senior members of the FIAU, the MFSA and the MGA. These interviews aimed to gain insight into the working relationship between the FIAU and the supervisory authorities, whilst also understanding whether the MFSA and the MGA's role in AML/CFT supervision with respect to the financial and gaming sectors in Malta could be enhanced by having the AML/CFT supervisory mandate shared among authorities. The knowledge and insights gained through interviews have been incorporated into the critical analysis found in Chapter 3.

Substantial academic work has been undertaken on the institutional architecture of supervision in the context of financial supervision¹, however limited academic work has been carried out locally on the AML/CFT supervisory setup. In this regard, the study is unique in critically analysing the architectural setup of AML/CFT supervision in Malta, mainly how Maltese legislation bestows the supervisory mandate on the FIAU and sets out how supervisory authorities, specifically the MFSA and the MGA, are considered agents of the FIAU in terms of its supervisory function. The study will aim to identify inherent shortcomings to this setup, and to discuss whether an alternate setup could be more beneficial in the long run, particularly in light of changes to the AML/CFT framework at EU level and Malta's recent grey-listing.

(iv) Limitations

At the time of writing, Malta has already made significant steps to address the deficiencies, particularly to the AML/CFT supervisory framework, which were identified through the mutual evaluation, showing that the FIU model for supervision as applied in Malta can be effective. Despite this, the study aims to propose a structural change to the way AML/CFT supervision is carried out in Malta, which could overcome some of the shortcomings which are inherent to the current supervisory structure.

The ever-changing legislative landscape surrounding AML/CFT, as well as changing ML/TF risks, may also be considered a limitation, given that the supervisory structure may need to be amended in other ways on the basis of such developments. Furthermore, the study is informed by publicly available information, and there may be other factors to take into consideration when establishing whether an alternate supervisory model could reap benefits in the long run.

(v) Chapter Outline

¹ See Donato Masciandaro, "Divide et Impera: financial supervision unification and the central bank fragmentation effect" [2007] *European Journal of Political Economy*, Vol. 23 No. 2, pp. 285-315; Donato Masciandaro and Quintyn Marc, "The Architecture of Securities Market Supervision before and after the Crisis." [2012] Paolo Baffi Centre Research Paper 2012-114; Marco Arnone and Alessandro Gambini, "Architecture of Financial Supervisory Authorities and the Basel Core Principles." [2006] Catholic University of Milan, Institute for Economic Policy Working Paper 48 and European Central Bank Discussion Paper, "The architecture of supervision" [2019] ECB Working Paper Series No 2287.

In order to set the context for the critical analysis, Chapter 1 of the dissertation provides an analysis of the international standards and legislation relating to the supervision of obliged persons subject to AML/CFT requirements. This analysis will address inter alia international standards on AML/CFT supervision, the role of FIUs in the context of AML/CFT frameworks and the various models of AML/CFT supervisory architectures and methodologies across jurisdictions. Both at international level and EU level, principles are set for the carrying out of effective AML/CFT supervision, however the architectural setup of such supervision is left to the discretion of the jurisdictions taking into account unique ML/TF vulnerabilities, resulting in a range of supervisory models and practices across countries.

Building on the analyses of the first chapter, Chapter 2 shall provide an initial analysis of the Maltese framework for supervising compliance with AML/CFT, with a particular focus on the roles and responsibilities of the MFSA and the MGA, as agents of the FIAU. Furthermore, Chapter 2 also analysis the enforcement process applied in cases of non-compliance with AML/CFT requirements. The Chapter will also discuss the Maltese setup in the context of international standards and the EU framework, as well as analyse recent AML/CFT supervisory failures and past mutual evaluations of Malta in order to inform the critical analyses found in Chapter 3.

The third chapter continues with an in-depth critical analysis of the current framework in Malta, drawing on evidence found through research as well interviews carried out with persons considered competent within the area of AML/CFT supervision. It aims to go beyond the MONEYVAL and FATF assessments to identify deficiencies inherent in the current supervisory setup, and to understand how such deficiencies may be overcome through the introduction of an alternate supervisory model which would involve the MFSA and MGA being the lead AML/CFT supervisors in their respective sectors in order to ensure an effective AML/CFT supervisory framework particularly in view of Malta's limited supervisory resources. The Chapter will also aim to analyse whether the proposed change would be equally appropriate for MFSA and MGA, given the specific circumstances and operating history of the respective authorities.

CHAPTER 1: ARCHITECTURAL MODELS OF AML/CFT SUPERVISION

1.1 Introduction

AML/CFT supervision is a critical component in the prevention of the misuse of the financial system for the purposes of ML/TF. In this regard, jurisdictions have sought to set up AML/CFT frameworks which include requirements for financial intermediaries to adopt certain controls in order to prevent their activities from being utilised for the purpose of ML/TF. While the requirement to safeguard the financial system lies with the intermediaries which are bound by law to adopt a comprehensive AML/CFT framework, one must ensure that the entities actually comply with their AML/CFT obligations through effective supervision. Such effective supervision is achieved through various mechanisms including sanctioning in cases of non-compliance identified through supervision, in order to further encourage firms to meet their obligations. This Chapter shall analyse the international standards and models for AML/CFT supervision, as well as the role of FIUs and other supervisors in monitoring compliance of obliged entities with their AML/CFT requirements. Furthermore, the Chapter will analyse current and upcoming EU legislation surrounding AML/CFT in order to apply these findings to the analysis of the supervisory architecture adopted in Malta as found in Chapters 2 and 3.

1.2 The Concept of AML Supervision: Analysis of FATF Recommendations

The FATF is a recognised international organisation which sets global standards for the prevention of the misuse of the financial system for ML/TF purposes. It was initially established by the G7 Summit in 1989 with a one-year mandate aimed at combatting the laundering of proceeds of illegal narcotics trade². Over time, the FATF's mandate has extended to other forms of financial crime, including terrorist financing, proliferation of weapons of mass destruction and illegal wildlife trade. The FATF has established a set of 40 Recommendations to jurisdictions which, when effectively applied, may prevent the misuse of the financial system for ML/TF. The Recommendations are considered to be soft law³, and the FATF undertakes mutual evaluations on the AML/CFT frameworks of jurisdictions and

² Mark T. Nance, "The regime that FATF built: an introduction to the Financial Action Task Force." [2018] *Crime, Law and Social Change* 69.2: 109-129.

³ Kern Alexander, "The international anti-money-laundering regime: the role of the financial action task force." [2001] *Journal of Money Laundering Control*.

rates them on the basis of the implementation of the 40 Recommendations⁴ and the overall effectiveness of the AML/CFT framework, assigning ratings to jurisdictions and placing them temporarily on a list subject to increased monitoring by the FATF (known as the grey list) in cases of strategic deficiencies in their AML/CFT framework. In cases where significant strategic AML/CFT deficiencies are identified, countries are further placed on a list of high-risk jurisdictions, externally known as a blacklist, and subsequently any persons from that jurisdiction would have to be considered high-risk, requiring enhanced due diligence and AML/CFT scrutiny⁵. Jurisdictions transacting with high-risk jurisdictions are required to limit or scrutinise transactions with the high-risk jurisdictions and residents thereof. This may cause an economic impact to the high-risk jurisdiction⁶ and therefore incentivise compliance with the FATF standards.

The FATF Recommendations therefore broadly set out principles which countries should adhere to in order to develop and maintain a robust AML/CFT framework. To this end, a section of the FATF's Recommendations is entirely dedicated to AML/CFT supervision and sets out guidelines on the powers and responsibilities of competent authorities as well as other institutional measures which may be adopted in order to ensure effective supervision of financial intermediaries subject to AML/CFT requirements⁷. In this regard, Recommendation 26 requires that countries ensure that obliged entities are subject to adequate regulation and supervision and effectively implement the FATF's recommendations. In particular, it requires national competent authorities or financial supervisors to take necessary measures to prevent criminals or their associates from obtaining ownership or a managerial role in a financial institution. Furthermore, the Recommendation recognises that obliged entities which are financial institutions are generally subject to a prudential framework and subject to financial supervision. In accordance with the Recommendation, regulatory and supervisory

⁴ FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation", [2012-2022]

⁵ Usman W Chohan, "The FATF in the global financial architecture: challenges and implications." [2019] CASS Working Papers on Economics & National Affairs, EC001UC

⁶ Sisira Dharmasri Jayasekara, "Deficient regimes of anti-money laundering and countering the financing of terrorism: An analysis of short term economic implications." [2020] Journal of Money Laundering Control.

⁷ FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation", [2012-2022], p. 23-26

measures applied by financial supervisors for the purposes of prudential supervision, should also apply to AML/CFT supervision in the same way⁸.

In order to facilitate the supervision of financial entities and prevent criminal entry into the regulated financial system, the Recommendation also requires the establishment of a licensing or registration regime for financial entities which enables supervisors to undertake compliance monitoring. In this regard, competent authorities overseeing a licensing or registration regime usually conduct a fit and proper assessment on the beneficial owner and senior management of an obliged entity prior to authorising it to operate in their jurisdiction⁹. Such fit and proper assessment includes, in particular, an assessment of a person's integrity and where a person fails such assessment, an operating licence or registration is not granted by the competent authority, which acts as a gatekeeper to the financial system. The fact that obliged entities are subject to a registration or licensing regime also enables supervisors to impose various supervisory and enforcement measures, including where necessary, revoking the authorisation of an obliged entity or person when such person or entity is no longer fit and proper, or where serious AML/CFT deficiencies are identified, or where ML/TF facilitation is detected.

The Recommendation, updated along the years, sets out that jurisdictions are to adopt a risk-based approach to supervision in order to maximise the effectiveness of supervision, particularly when considering the supervisory resources of a given jurisdiction when compared to the size of its financial system. In this way, the FATF standards recognise that supervisory resources may be limited compared to the size of the sectors subject to supervision and applying a risk-based approach where high-risk obliged entities or sectors are placed under greater scrutiny than low-risk sectors is a more effective way to supervise in this regard. For the manner in which compliance with AML/CFT requirements should be supervised, the FATF Guidance sets out that AML/CFT supervision should utilise a combination of on-site supervision, which involves supervisors conducting AML/CFT

⁸ Ibid, p. 23

⁹ European Central Bank, "Guide to fit and proper assessments" [2021]

inspections at the operating sites of obliged entities and off-site supervision, which entails offsite review of documentation and reports requested from the obliged entities¹⁰.

To enable AML/CFT supervision, the FATF Recommendations set out that supervisors should be able to request and access any relevant information from obliged entities and should have powers to access the offices of obliged entities in order to carry out on-site supervisory examinations. AML/CFT supervisors are also required to ensure they have adequate human, technical and financial resources to undertake supervision. Furthermore, AML/CFT supervisors are required to adhere to principles of integrity and independence and are to adhere to the highest standards of confidentiality when dealing with AML/CFT intelligence¹¹.

In order for supervisors to be able to effectively supervise and implement the jurisdiction's AML/CFT framework, Recommendation 27 compliments the previous recommendation by setting out the minimum powers which jurisdictional AML/CFT supervisors should have so that they may ensure compliance by financial entities with their requirements. These powers include the powers to compel the production of relevant information, impose a range of disciplinary and financial sanctions including the power to restrict, suspend or withdraw the registration or licence of a financial institution when systemic AML/CFT breaches have been identified through compliance monitoring¹².

The FATF Recommendations aim to provide an AML/CFT framework for financial entities as intermediaries of a financial nature which are best placed to prevent ML/TF. In time, a number of intermediaries began to emerge in non-financial sectors which could also be used to facilitate ML/TF and which should therefore be brought within scope of AML/CFT legislation. Recognising that relevant non-financial intermediaries should also be subject to AML/CFT requirements, FATF's Recommendation 28 deals specifically with the regulation and supervision of designated non-financial business and professions ('DNFBPs'), which includes inter alia casinos, real estate agents, company service providers and dealers in precious metals. In this regard, the FATF's guidance requires that casinos, in particular, should be

¹⁰ FATF, "Interpretive Note to Recommendation 26 (Regulation and Supervision of Financial Institutions)"

¹¹ Ibid

¹² FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation", [2012-2022], p. 23

subject to an extensive regulatory and supervisory framework wherein the supervisor has the ability to authorise and revoke such authorisation so as to ensure compliance¹³. As is the case with financial entities, such supervisor is also expected to ensure that beneficial owners of such entities are subject to a 'fit and proper' test prior to their authorisation.

1.3 Effectiveness in AML/CFT supervision

In order to assess the extent to which countries abide by the international AML/CFT standards set by the FATF, mutual evaluations are undertaken on all jurisdictions either by the FATF or one of its regional bodies, in order to rate the effectiveness of jurisdictions' frameworks with regard to preventing ML/TF¹⁴. To date there have been five mutual evaluation rounds, each round lasting 4 to 5 years, which have seen jurisdictions assessed for their compliance with FATF Recommendations. In 2013, the FATF updated its methodology for assessing compliance with the Recommendations in order to also assess the effectiveness of national AML/CFT frameworks¹⁵. To assess effectiveness, the FATF established a number of 'Immediate Outcomes' which, depending on the extent to which outcomes are achieved, provide an indication of the effectiveness of a given AML/CFT regime, going beyond a simple assessment of a jurisdiction's technical compliance with the Recommendations¹⁶.

The methodology for the assessment of effectiveness also includes an outline of the characteristics of an effective AML/CFT system, which are reflected in eleven (11) immediate outcomes established for mutual evaluations. In particular, Immediate Outcome 3 seeks to assess the effectiveness of a jurisdiction's AML/CFT supervision by assessing the extent to which supervision and monitoring are successful in preventing criminals and known associates from holding ownership of financial entities and DNFBPs, and whether violations of AML/CFT requirements by obliged entities are successfully identified, remediated and where appropriate sanctioned in order to deter non-compliance. Considerations in this regard

¹³ Ibid, p.24

¹⁴Riccardo Sansonetti, "The Mutual Evaluation Process: A Methodology of Increasing Importance at International Level." [2000] *Journal of Financial Crime* 7.3: 218-26.

¹⁵ FATF, "FATF issues new mechanism to strengthen money laundering and terrorism financing compliance" [2013]

¹⁶ FATF, "Methodology for assessing technical compliance with the FATF Recommendations and the effectiveness of AML/CFT systems" [2013] Updated 2020, p. 15-16

include the extent to which the risk-based approach to supervision is applied, the level of cooperation amongst domestic supervisors and whether dissuasive sanctions are applied in practice¹⁷.

On the basis of Immediate Outcome 3, supervisory effectiveness can therefore be broken down into 6 components, namely: (i) the use of licensing or registration as a mechanism for preventing criminal entry into the financial system, (ii) the understanding and identification of ML/TF risks, (iii) the application of the risk-based approach, (iv) remedial actions and sanctions on obliged entities for AML/CFT breaches, (v) effective supervisory enforcement actions and (vi) outreach and guidance in relation to AML/CFT compliance with obliged entities¹⁸. It is therefore important for a jurisdiction to give due consideration to each of these areas in order to ensure effective supervision of obliged entities.

1.4 The Role of Financial Intelligence Units

In order to effectively critically analyse Malta's FIAU, it is also necessary to first understand why the FIU was created and the functions which a FIU is required to undertake in line with international standards. Elements on the establishment and functioning of FIUs were incorporated into the FATF recommendations following the adoption of a revised set of recommendations in 2003. In this regard, FATF Recommendation 29 sets out that jurisdictions should establish FIUs at a national level, the purpose of which is to serve as national hubs for the receipt, analysis and dissemination of AML/CFT intelligence and suspicious transaction reports ('STRs'). In this regard, FIUs should have the power to obtain additional information from reporting entities in a timely manner so as to enable them to carry out their functions effectively. Furthermore, FIUs should be able to efficiently respond to requests for information from local and foreign institutions and should be able to exchange relevant information both nationally and internationally to contribute to the international fight against ML/TF¹⁹.

¹⁷ Ibid, p. 102-105

¹⁸ Ibid, p. 151-152

¹⁹ FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation", [2012-2022], p. 24

FIUs were therefore established specifically to serve as national centres for the receipt and analysis of STRs and other relevant AML/CFT intelligence, and to subsequently disseminate the results of their analysis to the relevant law enforcement and judicial authorities to be used in ML/TF investigations and prosecutions. The interpretive note to Recommendation 29 provides further clarity on functions of the FIU as well as other important considerations in the setting up of a FIU such as independence and ensuring the FIU's ability to obtain and share information in a secure manner²⁰.

With regard to the main functions of the FIU, these lie in the receipt, analysis and dissemination of data. Data received by FIUs comprises STRs, threshold-based reports such as cash transaction reports and other relevant AML/CFT information received by the FIU from inter alia reporting entities, competent authorities and counterpart FIUs. This information is then subject to appropriate analysis by the FIU depending on the type, quantity and quality of information received. Any relevant intelligence emanating from the data analysis should be transmitted onwards to supervisors, law enforcement agencies and judicial authorities, in order to contribute to ML/TF investigations and subsequent prosecutions of ML/TF cases²¹. The rise of the digital age has seen a significant increase in the volume and type of data received by FIUs, and in recent years these agencies have been encouraged to adopt the use of analytical software and digitally transform their operations²² in order to be able to support the analysis of the vast amount of information received and dedicate the limited human resources available to in-depth analysis of relevant data on a risk-sensitive basis to achieve the best results. Once analysis is completed, FIUs should be able to disseminate information on the results of their analysis to the relevant authorities, and also respond to information requests from competent authorities and counterpart FIUs in a timely manner.

The processing and sharing of AML/CFT information being the main function of the FIU, these agencies are also expected to have adequate powers to obtain or access information from reporting entities upon request. Furthermore, FIUs should also be able to tap into other sources of information such as intelligence from national and international supervisors and

²⁰ Ibid, p. 102-104

²¹ Ibid, p. 102-103

²² FATF, "Digital Transformation of AML/CFT for Operational Agencies" [2021]

law enforcement authorities to inform their analysis²³. FIUs are required to have high security standards and ensure appropriate confidentiality of information at all times. While the structuring and placement of a FIU is at the discretion of national government, it is vital that the FIU has operational independence and that it is not subject to undue influence or interference both from a jurisdiction's governing body and the obliged entities subject to its supervision²⁴.

The FATF guidance also refers directly to the Egmont Group's Statement of Purpose²⁵ and principles for information sharing and cooperation, indicating that all jurisdictional FIUs should apply for membership in the group. With the increasingly cross-border nature of the financial system, the Egmont Group has also over the years published operational guidance for FIUs which focus on international cooperation and information exchange and other FIU functions such as the receipt and analysis of information and the powers of the FIU to obtain information from reporting entities and other sources²⁶.

With these overarching standards and principles in mind, decisions pertaining to the establishment of a FIU, its functions and operational setup, may differ according to the ML/TF risk of a jurisdiction, the resources available to it and its policies, objectives and priorities in the fight against financial crime. In this regard, the structure and type of FIU selected at national level may have an overall bearing on the effectiveness of AML/CFT supervision in that jurisdiction²⁷. While international standards set a minimum set of responsibilities which should be assigned to a FIU, countries may choose to bestow further responsibilities on the FIU including the compliance monitoring of obliged entities²⁸, as is the case in Malta. Where the FIU is assigned the responsibility of AML/CFT supervision, it is noted that care should be taken to ensure that the FIU is able to cope with all of its responsibilities²⁹. It is further noted

²³ FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation", [2012-2022], p. 103

²⁴ Ibid

²⁵ Egmont Group, "Statement of Purpose of the Egmont Group of Financial Intelligence Units, The Hague, 13 June 2001"

²⁶ Egmont Group, "Egmont Group of Financial Intelligence Units Operational Guidance for FIU Activities and the Exchange of Information" [2013] Revised in 2017.

²⁷ Sisira Dharmasri Jayasekara, "Administrative model of financial intelligence units: an analysis of effectiveness of the AML/CFT regime." [2021] Journal of Money Laundering Control

²⁸ International Monetary Fund, "Financial Intelligence Units: An Overview" [2004] p.70

²⁹ Ibid, p.73

that in some cases the role of AML/CFT supervision may be better and more effectively undertaken by other agencies, and in such cases, overlapping AML/CFT supervision should be avoided³⁰.

Where the FIU is granted the AML/CFT supervisory mandate, a separate compliance department is generally established within the FIU responsible for compliance monitoring, deciding on enforcement action in cases of non-compliance and cooperating and exchanging information with the primary supervisory authorities of financial institutions. The advantage of having the FIU conduct AML/CFT supervision is that the AML/CFT expertise is concentrated in one agency³¹. Nevertheless, AML/CFT supervision requires a lot of time and resources, and therefore this should be taken into consideration when staffing a FIU which is also intended to undertake compliance monitoring. In such cases, arrangements are also necessary to ensure that the FIU has the cooperation of other local authorities in carrying out its task. Furthermore, where AML/CFT supervision is undertaken by the FIU, the responsibilities of the FIU and other competent authorities should clearly feature in the law in order to ensure clear mandates for all institutions involved³².

Despite this, prudential supervisors are often better placed to conduct AML/CFT supervision in light of the fact that they would have extensive knowledge of the sector under their supervision and experience supervising. In this regard, it is in line with the core principles of sectoral financial supervision to also integrate financial crime, including ML/TF, into prudential supervision³³. Furthermore, the task of AML/CFT supervision is an onerous one and it should be considered whether such mandate impinges on the FIUs primary responsibilities to receive, analyse and disseminate AML/CFT intelligence.

In conclusion, the international standards on AML/CFT set forth principles which jurisdictions should adhere to when establishing national AML/CFT regulation and supervisory structures. The FATF does not mandate a particular methodology for achieving compliance with its standards but rather sets out the elements required for effective AML/CFT regulation and

³⁰ Ibid

³¹ Ibid, p.72

³² Ibid, p.73

³³ The Joint Forum (BCBS, IOSCO, IAIS), "Core Principles: Cross Sectoral Comparison" [2001]

supervision. It is therefore pertinent to note that while the FATF standards require the establishment of a FIU with its main scope being intelligence analysis, the standards do not require that AML/CFT supervision be undertaken by FIUs and it is left to the discretion of each respective jurisdiction to design its AML/CFT supervisory architecture taking into account the specific ML/TF risks and vulnerabilities faced by different jurisdictions. Despite this, in its guidance on effective supervision and enforcement by AML/CFT supervisors, the FATF notes that the integration of AML/CFT supervision into prudential supervision may be advantageous since it can leverage synergies, competences and resources to enhance overall supervision. Nevertheless, advantages may also lie with the undertaking of AML/CFT supervision by FIUs since this may result in more targeted supervision based on the identified ML/TF risks.³⁴

1.5 AML/CFT Supervisory Architectures

Having outlined the international and EU standards surrounding AML/CFT supervision, and prior to analysing Malta's supervisory architecture in this regard, it is also pertinent to conduct an analysis of AML/CFT supervisory architectures in the EU. On the basis of a study on the economic and legal effectiveness of AML/CFT policy in the EU ('ECOLEF')³⁵ undertaken between 2009 and 2012, which sought to analyse the AML/CFT policies of 27 EU Member States against pre-determined criteria, four models of AML/CFT supervisory architecture were identified: (i) the FIU Model, (ii) the external model, (iii) the internal model and (iv) the hybrid model³⁶, as further elaborated in the following sub-sections:

i. The FIU Model

At the time, the ECOLEF Study identified the FIU Model as the prevalent model in the EU at the time of writing, wherein the FIU is the national authority which holds ultimate responsibility for local AML/CFT supervision, as is the case with Malta's FIAU. In such

³⁴ FATF, "Guidance for a Risk-based Approach: Effective Supervision and Enforcement by AML/CFT Supervisors of the Financial Sector and Law Enforcement" [2015]

³⁵ DG Home Affairs, "Project 'ECOLEF' The Economic and Legal Effectiveness of Anti-Money Laundering and Combating Terrorist Financing Policy" [2013] Project funded by the European Commission, JLS/2009/ISEC/AG/087

³⁶ Melissa Van den Broek, "Designing supervision under the preventive anti-money laundering policy in the European Union." [2014] Utrecht L. Rev. 10: pg 151.

scenarios, the FIU acts as an external supervisor and may establish cooperative agreements with other national competent authorities which undertake supervision on the FIU's behalf.

Advantages cited with regard to the FIU model include the fact that there is a focus of AML/CFT experience, competence and resources due to the FIU's role as a hub for AML/CFT intelligence when considering inter alia STRs, law enforcement intelligence and prudential supervisory reporting received by FIUs³⁷. These factors contribute to the FIU's expertise and knowledge with regard to AML/CFT and makes them well placed to undertake comprehensive compliance reviews on subject persons in terms of AML/CFT. Nevertheless, FIUs acting as the AML/CFT supervisor often lack the resources and staff required to effectively supervise the obliged entities in their jurisdiction and at times may lack sectorial knowledge or expertise, impairing their ability to effectively supervise certain sectors³⁸.

ii. The external model

The external model as identified by the ECOLEF study involves the use of external AML/CFT supervisors who have no professional relationship with the institutions that they supervise. In this scenario, all external supervisors share the responsibility for AML/CFT supervision of their particular sector. In this regard, it has been noted that the external supervisor model has the advantage of the supervisor having broader sectorial AML/CFT knowledge and the fact that a professional relationship does not exist between the supervisor and the obliged entity also allows the supervisor to take a stricter stance when sanctioning cases of non-compliance.

Despite this, external supervisors may lack the resources and supervisory experience of internal supervisors which may impinge on their ability to undertake suitable supervision through onsite inspections and effective enforcement action. The external supervision model also makes it more difficult for the external supervisor to identify obliged entities which should be within the remit of its oversight, particularly in the case of unregulated sectors (ex. dealers in high value goods). The external supervisory model also means that AML/CFT

³⁷Alvaro Pinilla Rodríguez, "Cooperation and Exchange of Information on Supervision of Institutions in Relation to Prevention of Money Laundering and Terrorist Financing." [2007] *Working Together*. International Monetary Fund.

³⁸Melissa Van den Broek, "Designing supervision under the preventive anti-money laundering policy in the European Union." [2014] *Utrecht L. Rev.* 10: pg 157-160.

supervision must be integrated into the existing supervisory remit of the external supervisor, and as such, AML/CFT supervision may not be given the importance it deserves in the overall supervisory plans of the external supervisor³⁹.

iii. The internal model

In the internal model identified by the ECOLEF study, the AML/CFT supervisory mandate for supervision of sectors is vested in relevant sectorial professional associations. As a result, this model often involves a large number of supervisors since each profession has its respective professional body. The advantages of this model are that professional associations often have adequate resources and knowledge of the sector and engage in regular dialogue with the industry, which may be conducive to promoting AML/CFT compliance. Despite this, this model holds conflict of interest risks particularly in the case of professional associations since the objective of professional associations is usually to further that profession. If professional associations acting as AML/CFT supervisors were to issue a large number of sanctions, this might reflect negatively on the profession and therefore independence may be difficult to achieve⁴⁰.

iv. The hybrid model

The hybrid model combines characteristics of the first three models, specifically in so far as supervision involves a mixture of internal and external supervision. In this regard, supervisory responsibility is shared between internal and external supervisors and the FIU. In some instances, the FIU may serve as the supervisor for those industries which have no professional association which may act as a supervisor, or where there is weak supervision under such arrangement. Depending on the supervisory combination found in the hybrid model, risks may arise, for example some of the supervisors may lack adequate enforcement powers⁴¹.

A follow-up to the ECOLEF study aiming to assess the effectiveness of select EU supervisory models carried out in 2015 noted a shift from the FIU model to the internal model as the predominant model in the EU. Furthermore, the study found the UK's Financial Conduct

³⁹ Ibid, p. 160-162

⁴⁰ Ibid, p. 163-166

⁴¹ Ibid, p. 166-167

Authority ('FCA') to be the most effective supervisory model due to the clear legal framework, integrated AML/CFT supervision and the broad set of sanctioning powers available to the FCA in case of non-compliance resulting in the highest inspection and enforcement activity. On the other hand, Spain, which has adopted the FIU model, was identified as having the least effective supervision in the context of the selected jurisdictions. It was noted that, apart from the FIU having insufficient operational independence, the supervisor also displayed serious resource issues, resulting in very limited inspections targeted largely at credit institutions and excluding other regulated sectors⁴².

1.6 Upcoming AML reform in the EU

In the EU, the fifth AML Directive is the legislative instrument which establishes the EU's AML/CFT framework. Member States are required to transpose the provisions found in the directive, however this does not include provisions which specify a particular architectural setup for AML/CFT supervision and the supervisory model selected for this purpose is therefore left to the discretion of the Member States. Despite this, following various notable AML/CFT failures in EU credit institutions⁴³, steps have been taken to strengthen the EU's AML/CFT framework and further reform is being proposed in order to address the deficiencies resulting from defragmented supervisory processes among Member States⁴⁴.

In the wake of the AML/CFT supervisory failures by EU competent authorities and AML/CFT supervisors, the Council of Europe issued a short-term Action Plan intended to further improve the EU's AML/CFT framework. The Action Plan highlighted the need for enhanced supervisory convergence with regard to prudential and AML/CFT supervision through increased integration of the latter into prudential supervision, as well as the need for prudential supervisors to have the necessary discretion to revoke authorisations in cases of serious and systemic breaches of AML/CFT requirements, particularly where the prudential supervisors does not have the AML/CFT supervisory mandate.

⁴² Melissa Van Den Broek, "Preventing money laundering: A legal study on the effectiveness of supervision in the European Union" [2015] Doctoral dissertation, University of Utrecht.

⁴³ Council of Europe, Anti-Money Laundering Action Plan – Council Conclusions (4 December 2018)

⁴⁴ Joshua Kirschenbaum and Nicolas Véron, "A better European Union architecture to fight money laundering" [2018] Bruegel Policy Contribution No. 2018/19

In 2019, the European Supervisory Authorities ('ESAs') issued a joint opinion on the ML/TF risks affecting the EU's financial sector⁴⁵. Among the risks identified was the risk arising from diverging AML/CFT supervisory practices across the Member States, specifically noting findings by MONEYVAL and FATF of inadequate supervision, and the EU having had recently finalised the first case of breach of Union Law against an AML/CFT supervisor for the failings of Malta's FIAU with respect to its supervision of Pilatus Bank. In this regard, the European Banking Authority ('EBA') also reviewed competent authorities' approach to AML/CFT supervision, with the aim of complementing and supporting the EU AML Action Plans set at improving EU AML supervision going forward. To this end, guidelines⁴⁶ were also issued with the aim of clarifying how AML/CFT should be integrated into the Supervisory Review and Evaluation Process for credit institutions, highlighting the fact that AML/CFT failures may have implications on inter alia the operational risk and sound governance of financial institutions.

In July 2021, building on the recommendations of a joint action plan established by the ESAs, the European Commission announced an ambitious legislative package which seeks to introduce significant AML/CFT reform through the introduction of a single AML/CFT rulebook in the EU, the establishment of a centralised AML Authority ('AMLA') to supervise significant obliged entities in the EU, and the improvement of internal cooperation and co-ordination mechanisms amongst EU FIUs and supervisory authorities.

As part of the AML reform taking place in the EU, the proposal for a regulation establishing a new AML/CFT authority in the EU⁴⁷ proposes the establishment of the AMLA with its primary focus being the prevention of ML/TF through its contribution to enhanced supervision and improved cooperation and co-ordination between FIUs and supervisory authorities. The text of the AMLA proposal notes that although initially it was foreseen that the EBA would take on the role of a supra-national AML/CFT supervisor in the EU, it was later noted that the synergy effects of having EBA take on this role would be very limited given that the EBA had little

⁴⁵ ESAs Joint Opinion on the risks of money laundering and terrorist financing affecting the Union's financial sector (JC-2017-07) 20/02/2017

⁴⁶ EBA, Opinion of the European Banking Authority on how to take into account ML/TF risks in the Supervisory Review and Evaluation Process [2020]

⁴⁷ Proposal for a regulation of the European Parliament and of the Council establishing the Authority for Anti-Money Laundering and Countering the Financing of Terrorism and amending Regulations (EU) No 1093/2010, (EU) 1094/2010, (EU) 1095/2010

experience with direct supervision of entities, and would therefore have to build expertise to supervise not just the financial sector but also the non-financial sector⁴⁸.

The AMLA shall have a direct role in the supervision of large group entities operating on a cross-border basis. Furthermore, the AMLA will also be mandated with the undertaking of periodic reviews on Member States to ensure that jurisdictional financial supervisors are adequately resourced and empowered to effectively perform their tasks and shall contribute to the convergence of AML supervisory practices acting as a coordinator and a facilitator for the efficient exchange of information in this regard. The AMLA will also contribute to the conduct of joint analysis by EU FIUs and support FIUs through specialised training, access to efficient information exchange networks and expert knowledge. In order to achieve its mandate, the AMLA will also have powers to adopt various remedial measures in connection with deficiencies identified in its supervision of certain obliged entities, financial supervisors and FIUs.

As part of the proposed reform, the sixth AML Directive⁴⁹ will lay down overarching principles in relation to inter alia AML/CFT risk assessments both at national and supra-national level, FIUs and AML supervision and cooperation among relevant authorities and supervisors. With regard to FIUs, the Directive requires the establishment of a FIU in each Member State and sets the requirements for such institutions to be operationally independent, with the primary objective of receiving and analysing suspicious transaction or activity reports. The Directive places a renewed importance on the principle of information access and exchange between FIUs, and their power to suspend transactions within forty-eight hours in the case of genuine STRs.

Requirements are also introduced for the establishment of national AML supervisors, setting out the responsibilities and powers that such supervisors should have and their obligations to cooperate with FIUs and third country supervisors. The new AML Directive will also stress the importance of adopting an effective risk-based approach to supervision, for which the AMLA

⁴⁸ Ibid, p. 8.

⁴⁹ Proposal for a directive of the European Parliament and of the Council on the mechanisms to be put in place by the Member States for the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and repealing Directive (EU) 2015/849

will work to issue regulatory and implementing technical standards. In order to further ensure a harmonised approach to enforcement action, the Directive also provides for a range of sanctions commensurate to the nature of AML/CFT breaches, setting the minimum and maximum amounts for fines that are to be set in all Member States.

The proposed EU AML/CFT Regulation⁵⁰ forms another significant part of the EU's AML package and shall incorporate requirements which are currently found in the EU's AML Directive. In this regard, it was noted that the diverging application of the requirements of the Directive across the Member States hindered the effectiveness of the AML/CFT framework⁵¹, and therefore such requirements will now feature in a comprehensive regulation which shall be directly applicable in all EU jurisdictions. The proposed changes will also aim to harmonise the quality and effectiveness of AML supervision in the EU by inter alia ensuring that AML supervisors will have adequate human and financial resources, skills and priority to AML supervision commensurate to the size of the financial sector of the given Member State and the ML/TF risks to which it is vulnerable. The proposal will not however impact how Member States choose to undertake AML/CFT supervision at the national level. National supervisors will however be required to coordinate with AMLA accordingly in relation to cross-border activities.

Regardless of the upcoming reform, and as previously noted, AML/CFT supervision at the Member State level is still left to the discretion of the individual jurisdictions, and the selection of the supervisory architectural model is therefore left to the discretion of the Member States, taking into account the resources it has available, the vulnerabilities and risks faced by the jurisdiction as well as the size and nature of the financial sector. In this regard, based on a list of designated competent authorities as published by the EBA⁵², it may be noted that the internal model continues to be prevalent in the EU, and the FIU model remains present in very few Member States. In this regard, the majority of Member States currently have

⁵⁰ Proposal for a regulation of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing

⁵¹ David Muradyan, "The efficiency of the European Union's Anti-money laundering legislation: An analysis of the legal basis and the harmonisation of the EU Anti-money laundering legal framework." [2022] Stockholm University, Faculty of Law, Department of Law.

⁵² See [Anti-Money Laundering and Countering the Financing of Terrorism | European Banking Authority \(europa.eu\)](https://www.europa.eu/anti-money-laundering-and-countermeasures)

appointed multiple AML/CFT supervisors in order to ensure robust supervision of all sectors. The FIU acts as the sole AML/CFT supervisor in only 3 Member States⁵³, namely Lithuania⁵⁴, Malta and Spain⁵⁵. In most Member States, the supervisor of the financial sector generally has a direct role in AML/CFT supervision of financial entities. The following chapter shall analyse the AML/CFT supervisory architecture in Malta as well as findings arising from AML/CFT failures and mutual evaluations.

⁵³ Ibid.

⁵⁴ The Financial Crime Investigation Service under The Ministry of the Interior of the Republic of Lithuania (FIU)

⁵⁵ Servicio Ejecutivo de la Comisión de Prevención del Blanqueo de Capitales e Infracciones Monetarias ('SEPBLAC'), in cooperation with local supervisory authorities

CHAPTER 2: AML/CFT SUPERVISION IN MALTA

This chapter seeks to outline the AML/CFT supervisory architecture in Malta, focusing on particular on the role of the FIAU, the MFSA and the MGA in Malta's fight against ML/TF. The Chapter will focus on the role of the MFSA and MGA as agents of the FIAU, and assess recent mutual evaluations undertaken on Malta's framework, as well as some local case studies, in order to inform the critical analyses of the framework in Chapter 3.

2.1 Roles and Responsibilities of the FIAU

Malta's AML/CFT regulatory framework is enshrined in the Prevention of Money Laundering Act ('PMLA'), the Prevention of Money Laundering and Funding of Terrorism Regulations ('PMLFTR') and the Implementing Procedures, which the FIAU is empowered to issue in terms of the PMLFTR. The FIAU is the sole AML/CFT supervisor in Malta and launched its operations in 2002⁵⁶ following its establishment through Article 15 of the PMLA in 2001 with the functions to inter alia receive, analyse and disseminate financial information received through reporting from subject persons, including suspicious transaction reporting, to gather and analyse information on the financial and commercial activities in Malta, to promote AML/CFT training and consult and advise on matters relating thereto and to exchange information with its foreign counterparts.

Further to these functions, the FIAU also notably holds the AML/CFT supervision function and is required to monitor Subject Persons' compliance with their applicable AML/CFT requirements emerging from the PMLFTR and Implementing Procedures. This supervisory architecture is therefore in line with the FIU model for AML/CFT supervision as discussed in Chapter 1, with the AML/CFT supervision of the jurisdiction being carried out by the national FIU. The following sections shall provide a breakdown of the FIAU's operational functions with the objective of understanding the full scope of the FIAU's activities and how these are carried out.

⁵⁶ Robert Vella-Baldacchino, "Malta's Role in the International Fight against Money Laundering." [2005] Journal of Money Laundering Control 8.3: 263-70. Web.

Intelligence Analysis and International Cooperation

As is the case with FIUs, the FIAU's primary function is that of AML/CFT intelligence analysis. To this end, one of the sections of the FIAU is dedicated to the receipt and analysis of AML/CFT reporting and financial information, and the subsequent transmission of that intelligence to foreign counterparts, supervisory authorities, law enforcement and judicial agencies. A large part of the intelligence processed by the FIAU consists of STRs submitted by Subject Persons through a dedicated system hosted by the FIAU. Any pertinent intelligence found through analysis of STRs is brought to the attention of the FIAU's Financial Analysis Committee, which subsequently decides whether and to whom such intelligence should be disclosed.

Conscious of its resources, the FIAU has introduced an Intelligence Process and Prioritisation Team within its Intelligence Analysis section⁵⁷. The agency also conducts periodic strategic analysis on the individual sectors falling within its supervisory remit to identify new vulnerabilities, risks, trends and typologies, the findings of which are subsequently reflected in sector-specific AML/CFT guidelines and reports issued by the FIAU for the benefit of subject persons. In recent years, a greater focus has also been placed on the FIAU's international cooperation abilities, in order to ensure efficient and secure transmission of information to local and foreign AML/CFT agencies and ultimately contribute to the global fight against ML/TF⁵⁸.

Over the past years, increased focus has been placed on the FIAU's intelligence analysis and dissemination functions following findings of the MONEYVAL mutual evaluation, with the STRs of Subject Persons increasing fourfold since 2018⁵⁹. During 2020, the FIAU also increased human resources in its intelligence analysis section, bringing the staff complement to thirty (30) personnel. During the same year the FIAU established GoAML, its reporting tool accessible to all Subject Persons, and also achieved more efficient intelligence analysis timeframes resulting in increased disseminations to local law enforcement, competent authorities and foreign counterparts⁶⁰.

⁵⁷ FIAU, "Annual Report 2020" [2021], p. 110

⁵⁸ FIAU, Intelligence Analysis <https://fiaumalta.org/intelligence-analysis/>

⁵⁹ FIAU, "Annual Report 2020" [2021], p. 30

⁶⁰ Ibid, p. 30

AML/CFT Supervision

The FIAU is also the local authority which has been mandated with monitoring Subject Persons' compliance with their AML/CFT obligations in terms of the PMLA, PMLFTR and Implementing Procedures through a combination of onsite and offsite supervisory examinations. The FIAU's onsite inspections are carried out at the premises of the Subject Person, or online as was the case during the COVID-19 pandemic, while offsite supervision consists of the review of regulatory deliverables provided by the obliged entities. The FIAU carries out different types of supervisory examinations with varying focuses such as full-scope, thematic, targeted and follow-up examinations⁶¹. These examinations involve a mix of onsite and offsite reviews and may target particular requirements or procedures which Subject Persons are required to have in place by law.

In order to support the FIAU's supervisory practices, various provisions in the PMLA create a framework for cooperation between the FIAU and the supervisory authorities. In particular, Article 27(3)(b) of the PMLA permits the FIAU to request the assistance of other supervisory authorities to carry out, either on behalf or jointly with the FIAU, supervisory examinations on the Subject Persons falling within the remit of the respective authorities. In order to carry out this function, the FIAU may coordinate with supervisory authorities, namely Malta's Central Bank, the MFSA, the Companies Registrar, the MGA, the Accountancy Board, the Trade Licensing Unit which authorises dealers of precious metals and the recently established Licensing Board for real estate agents. In this regard, Article 26(5) provides that for the purpose of its compliance monitoring function, the supervisory authorities are considered agents of the FIAU, and may be empowered by the FIAU to act on its behalf.

Where AML/CFT supervision is undertaken by the supervisory authorities, the FIAU typically notifies the Subject Person that a supervisory examination will be undertaken by the supervisory authority, as an agent of the FIAU, following which the supervisory authority carries out the examination through a combination of onsite interviews and offsite document reviews. At the conclusion of the examination, the supervisory authority issues a report outlining the findings and potential AML/CFT breaches to the Subject Person. The latter is

⁶¹ Ibid, p.60

then allowed 30 days to provide representations to the findings of the supervisory authority, following which, the representations are assessed by the FIAU's Compliance Monitoring Committee for a final decision on any enforcement action to be taken by the FIAU.

The FIAU carries out its supervisory functions on a risk-sensitive basis through the carrying out of AML/CFT compliance inspections. Such inspections are either carried out by the FIAU or one of its agents. The FIAU assesses and determines risk through its Compliance and Supervision Platform for Assessing Risk ('CASPAR') system which serves as a centralised repository for all intelligence pertaining to Subject Persons and automates the risk assessment process. The Risk Evaluation Questionnaire, which Maltese Subject Persons are required to submit on an annual basis, and which takes into account sector-specific considerations, also feeds into the CASPAR system. CASPAR also includes information on inter alia Subject Persons' ownership structure, business risk assessment, turnover, target market and any related entities forming part of the same group as the Subject Person. As at 2020 the FIAU had 22 different Risk Evaluation Questionnaires targeting different sectors ensuring broad application of the risk-based approach to all sectors⁶².

Enforcement Powers

In order to effectively carry out its functions, the FIAU is granted various powers with respect to the Subject Persons falling under its supervision. Where the FIAU suspects a Subject Person is being used for the purposes of ML/TF, the FIAU may demand information from Subject Persons, and may require them to monitor specified transactions or banking activities. Furthermore, the FIAU is empowered to issue written reprimands and directives to take remedial actions to Subject Persons which the latter are required to comply with in the manner and time period stipulated by the FIAU within the Directive. This includes the power of the FIAU to require a Subject Person to terminate a business relationship in case of high ML/TF risks⁶³.

In case of failures by Subject Persons to comply with AML/CFT requirements, Article 21 of the PMLFTR sets out in detail the administrative penalties which the FIAU may impose. Despite

⁶² Ibid, p. 56

⁶³ Ibid, p.72

this, it may be noted that the FIAU's powers do not extend to the suspension or revocation of operating licences in case of serious AML/CFT deficiencies, such power lies only with the supervisory authorities, as evidenced by the proviso contained in the legislation which clarifies that the power of the FIAU to impose these penalties is without prejudice to the powers of the supervisory authorities to take any regulatory action which they are empowered to take as they may deem appropriate, including the cancellation of any registration or licence. Interestingly though, given that the FIAU is the lead AML/CFT supervisor, the supervisory authorities may be hesitant to exercise their powers vis-à-vis AML/CFT breaches, given that this is not expressly their mandate. The FIAU may publish any administrative measure it imposes on a Subject Person on its website as a mechanism to dissuade non-compliance, although administrative penalties below a certain threshold are published anonymously⁶⁴.

The FIAU has a dedicated Enforcement Section which is responsible for the implementation of administrative penalties decided by the Compliance Monitoring Committee ('CMC') and the monitoring for failures by Subject Persons to comply with AML/CFT requirements or FIAU directives. The CMC is composed of three senior officials from the FIAU's compliance section, a senior official from the legal section, the Deputy Director and the Director of the FIAU⁶⁵. The process which is followed when administrative sanctions are imposed by the FIAU as well as their quantum is detailed in the Implementing Procedures⁶⁶. In this regard, the FIAU's enforcement process commences through a notification to the Subject Person in writing detailing the breaches and providing a period of time in which the Subject Person may make written representations, supported by evidence, to contradict the FIAU's findings.

Evidence of the Subject Persons' AML/CFT breaches, along with written representations, if any, are brought to the consideration of the CMC, which was established to determine whether Subject Persons are in breach of AML/CFT requirements and decide the appropriate administrative measure depending on the nature of the breach and is made up of the Director and Deputy Director of the FIAU as well as representatives from the FIAU's legal and

⁶⁴ These include (i) administrative penalties not exceeding fifty thousand euro and (ii) administrative measures imposed by FIAU excluding those envisaged in terms of Article 13(1) of the PMLA

⁶⁵ FIAU, "Annual Report 2019" [2020] p. 54

⁶⁶ FIAU, "Implementing Procedures" [2011] Updated May 2021 Annex A

enforcement sections. Cases of AML/CFT non-compliance are brought to the attention of the Committee, and any decisions taken by it are governed by established principles and a dedicated framework, and guided by the FIAU's Sanctions Policy⁶⁷, taking into consideration the seriousness of breaches and whether these are systematic and repetitive in nature. Any administrative penalties decided by the CMC are subsequently brought to the attention of the Board of Governors of the FIAU, which ensures that the decision taken is proportionate, dissuasive and effective⁶⁸.

Although vested with a wide range of administrative powers, the FIAU's enforcement powers fall short of enabling it to revoke a financial institution's authorisation. In this regard, where serious AML/CFT deficiencies are identified which would merit stopping the activities of a subject person, the FIAU would have to request the assistance of the supervisory authority, which through its establishing legislation or through sectoral legislation, has the power to revoke or cancel the authorisation of the entity or person in question.

2.2 Roles and Responsibilities of the Supervisory Authorities

The MFSA and MGA are the competent authorities of two of the largest regulated sectors in Malta⁶⁹ and are considered Supervisory Authorities in terms of the PMLFTR. The PMLA contains legal provisions setting out the FIAU's relationship with the supervisory authorities and their role in the fight against ML/TF. In this regard, the FIAU is mandated to exchange information and cooperate with the supervisory authorities, who are also required to cooperate with the FIAU in return. Such cooperation includes the supervisory authorities' responsibilities to undertake on-site or off-site inspections, either jointly with the FIAU or on its behalf. Article 26 of the PMLA sets out the provisions governing monitoring of Subject Persons' compliance with AML/CFT requirements, for which the FIAU is ultimately responsible. Interestingly, this article provides that those supervisory authorities are considered agents of the FIAU in its compliance monitoring function and may be authorised to act on the FIAU's behalf in this regard.

⁶⁷ FIAU, "Annual Report 2019" [2020], p.54

⁶⁸ FIAU, "Annual Report 2020" [2021], p. 68

⁶⁹ In 2020, the financial services sector contributed to 8.7% of Malta's Gross Value Added, while the gaming sector contributed a further 8% - see MGA Annual Report 2020, p.58

Apart from assisting the FIAU in carrying out AML/CFT supervision, the supervisory authorities also oversee licensing or registration frameworks in their sectors, and act as gatekeepers by ensuring that no criminals or associates are allowed to have ownership of a financial intermediary which falls within scope of AML/CFT Regulation, another vital component in the fight against ML/TF. To this end, apart from carrying out coordinated supervisory examinations, the FIAU interacts with supervisory authorities on other AML/CFT related matters⁷⁰. The MFSA, for example, communicates with the FIAU vis-à-vis applications for licences, sharing information on the business model, governance structure and AML/CFT processes and procedures of the applicant at an early stage in the authorisation process in order to ensure adequate assessment from an AML/CFT perspective prior to the MFSA issuing its authorisation⁷¹. Furthermore, during the authorisation process, the MFSA also holds tripartite meetings with applicants and the FIAU to discuss AML/CFT related matters during the application phase. Although the MFSA and the MGA are ultimately the authorities responsible for the approval of prospective Money Laundering Reporting Officers ('MLRO'), they may also request the FIAU's attendance at MLRO competence interviews on a risk-sensitive basis in order to incorporate the FIAU's feedback in their final decisions⁷².

From an ongoing supervision perspective, the supervisory authorities also channel risk-driven data on authorised persons under their supervision to the FIAU on an annual basis. This prudential information feeds into the CASPAR system to derive Subject Persons' risk profiles and use this information in devising the risk-based approach to supervision.

As prudential supervisors, the supervisory authorities are vested with a range of powers within their establishing legislation or sectoral legislation as the case may be⁷³. Although there is nothing to preclude these powers being utilised in the event of AML/CFT breaches, it is understood that the FIAU is mandated with monitoring Subject Persons' compliance with AML/CFT regulations in terms of the PMLA, and it is therefore the FIAU that may take

⁷⁰ FIAU, "Annual Report 2020" [2021], p. 63

⁷¹ Ibid

⁷² Ibid

⁷³ For example, MGA is granted powers in terms of Article 7 of the Gaming Act; MFSA holds powers in terms of Article 16 but also in terms of sectoral acts, for example Article 7 of the Investment Services Act and Article 12 of the Virtual Financial Assets Act

enforcement action in relation to AML/CFT breaches. The role of the supervisory authorities in the fight against ML/TF is therefore primarily to act as a gatekeeper through oversight of the licensing or registration system. Oversight of entities' compliance with AML/CFT requirements is done by supervisory authorities in their role as Agents of the FIAU, and the supervisory authorities exercise very little discretion in the oversight, with the risk-based approach as well as supervisory procedures being established by the FIAU. In this regard, the supervisory authorities generally funnel information to the FIAU, and it is the FIAU which is expected to take appropriate enforcement action in relation to the findings. This supervisory architecture may give rise to the principal-agent problem⁷⁴, manifesting itself in lower prioritisation of AML/CFT supervision by the supervisory authorities, as was observed during the last mutual evaluation of Malta, since this is finally the mandate of the FIAU. The implications of this issue shall be further discussed in Chapter 3. The following section shall discuss, in more detail, the role of the supervisory authorities vis-à-vis their respective sectors.

The Malta Financial Services Authority

The MFSA is the single regulator for financial services in Malta and was established by the Malta Financial Services Authority Act ('MFSA Act')⁷⁵ in July 2002, taking over what was previously regulated by the Malta Financial Services Centre, the Central Bank of Malta and the Malta Stock Exchange. All areas of financial services activity fall within the remit of the MFSA's supervision, including credit institutions, financial institutions, investment firms, insurance undertakings, corporate service providers, trustees and crypto-asset service providers.

The MFSA's primary supervisory focus consists of prudential and conduct supervision of the financial sector, however it also undertakes AML/CFT supervision on behalf of, and in conjunction with, the FIAU⁷⁶. In this regard, the MFSA applies a risk-based approach to its supervision, which also incorporates AML/CFT risk intelligence gathered by the FIAU from

⁷⁴ David EM. Sappington, "Incentives in principal-agent relationships." [1991] *Journal of economic Perspectives* 5.2: 45-66.

⁷⁵ The Malta Financial Services Authority Act, Chapter 330 of the Laws of Malta

⁷⁶ MFSA, "Annual Report 2020" [2021], p. 73

Subject Persons⁷⁷. As the sole Authority responsible for authorising financial entities in Malta, the MFSA therefore holds AML/CFT responsibilities both at authorisation stage, when granting licences or registrations, and at supervision stage, where the Authority holds powers enabling it to monitor compliance and apply a range of dissuasive enforcement actions in case of non-compliance by authorised persons with the MFSA’s licensing conditions, including the suspension or cancellation of licence where required.

Showing the increased importance of AML/CFT supervisory convergence, the MFSA in 2019 established a Financial Crime Compliance Function, comprising a dedicated team of AML/CFT experts to inter alia act as the primary point of contact with the FIAU and to assist and coordinate the integration of AML/CFT supervision into the conduct and prudential supervision already undertaken by the Authority⁷⁸. According to the MFSA’s Supervisory Effectiveness Dashboard⁷⁹, the MFSA began undertaking a limited amount of AML/CFT driven inspections following the establishment of the Financial Crime Compliance Function, with an increased focus being made in the following 2 years resulting in increased levels of AML/CFT compliance monitoring of entities falling under the MFSA’s supervision. Through the integration of AML/CFT into its prudential supervisory visits⁸⁰, the MFSA has in recent years significantly increased its AML/CFT coverage undertaking more inspections and supervisory meetings than required by the FIAU’s supervisory plans for financial entities⁸¹. The last two years have also seen a marked increase in enforcement actions taken by the MFSA in relation to prudential breaches and unlicensed activity⁸².

The MFSA’s Financial Crime Compliance Function undertakes a risk-based approach to supervision⁸³ through a combination of on-site and off-site supervision in line with the FIAU’s methodology and holds weekly meetings with the latter to discuss technical matters⁸⁴. The

⁷⁷ MFSA. “Risk-Based Supervision, Strengthening our Supervisory Approach” [2020], p.11

⁷⁸ MFSA, “Annual Report 2019” [2020]

⁷⁹ [MFSA’s Supervisory and Enforcement Effectiveness Dashboard - MFSA](#)

⁸⁰ MFSA, “MFSA AML and CFT Strategy, Integrating AML and CFT within our conduct and prudential supervisory activity” [2019] p. 7

⁸¹ MFSA, “MFSA AML/CFT Strategy – A status update on the implementation of the 2019 MFSA AML/CFT Strategy” [2021] p. 24

⁸² [MFSA’s Supervisory and Enforcement Effectiveness Dashboard - MFSA](#)

⁸³ MFSA. “Risk-Based Supervision, Strengthening our Supervisory Approach” [2020]

⁸⁴ MFSA, “MFSA AML/CFT Strategy – A status update on the implementation of the 2019 MFSA AML/CFT Strategy” [2021] p. 14

establishment of a dedicated function for AML/CFT oversight has resulted in an increase in the number of supervisory examinations undertaken on entities in the financial sector. The Function also assesses the competence of MLROs, both at authorisation stage and on an ongoing basis, and ensures that adequate training on AML/CFT is provided on an Authority-wide basis⁸⁵.

The Malta Gaming Authority

The MGA was originally established as the Lotteries and Gaming Authority in 2001 and supervises Malta's gaming sector. The MGA's role in AML/CFT supervision in Malta first began in 2016, when the Authority began its collaboration with the FIAU for the implementation of the fourth AML Directive⁸⁶, which made gaming service providers obliged entities in terms of EU AML/CFT legislation. To this end, the MGA established an AML Unit within its Enforcement Directorate in 2017, dedicated to conducting risk-based AML/CFT supervision on the MGA's licensed operators in coordination with the FIAU. The MGA has since proactively collaborated with the FIAU to inter alia publish sector-specific guidance and training on AML/CFT, and to formulate the national sectoral AML/CFT risk assessment which informs the supervisory framework.

The MGA also acts as a gatekeeper owing to its powers to grant or refuse to grant licences to gaming operators in Malta, it also undertakes AML/CFT supervision throughout a gaming operators' lifecycle. At authorisation stage, an applicant's business model is analysed from an AML/CFT perspective through analysis of policies and procedures including the company's business and customer risk assessments and its onboarding policies. Furthermore, applicants for a gaming licence are required to appoint a MLRO. Once licensed, the MGA collaborates with the FIAU by carrying out off-site and on-site examinations as agents of the FIAU in terms of Article 26(5) of the PMLA, at times jointly with the FIAU⁸⁷ and MLROs of licensed operators are also subject to competence interviews. In this regard, the MGA's supervisory plan is informed by the FIAU's CASPAR system, which all licensed operators are required to submit on an annual basis. When undertaking supervisory inspections, the MGA communicates its

⁸⁵ MFSA, "Annual Report 2020" [2021]

⁸⁶ Malta Gaming Authority, "Annual Report 2016" [2017] p.17

⁸⁷ Malta Gaming Authority, "Annual Report 2019" [2020] p.49

findings to the licensee, following which the latter has thirty days to provide clarifications or representation in this regard. Following this, the findings of the MGA and clarifications of the licensee are then presented to the FIAU for analysis.

Supervisory Cooperation

While the FIAU is the agency responsible for AML/CFT supervision, the main sectoral regulators, namely the MFSA and the MGA, play a significant role in the prevention of the use of the Maltese financial system for ML/TF, by acting as gatekeepers and preventing criminal entry into the financial system, and in their role as agents of the FIAU undertaking supervision on Subject Persons.

The Maltese supervisory architecture therefore sets the FIAU as the AML/CFT supervisor with the cooperation and support of the other supervisory authorities. This model relies on the highest degree of coordination and cooperation in order to work effectively. In this regard, the PMLA contains numerous provisions which set the basis of cooperation between the FIAU and supervisory authorities, including provisions governing the exchange of information and cooperation between the Authorities. Over and above these provisions, various Memoranda of Understanding ('MoU') have been entered into between the FIAU and the MFSA and MGA over the years to enhance efficient and effective cooperation⁸⁸.

Although the cooperation between the FIAU and the supervisory authorities with regard to supervision and information exchange preceded a formal agreement, the MFSA and FIAU first entered into a bilateral MoU in 2014⁸⁹, which dealt primarily with on-site and off-site examinations undertaken by the MFSA as an agent on the FIAU's behalf. It also further addressed other matters such as cooperating in the rendering of mutual assistance and the exchange of information between the two institutions⁹⁰. In 2020, the MGA also entered into a MoU with the FIAU in order to consolidate the long-standing relationship between the

⁸⁸ These include: MoU between MFSA and FIAU, signed on 18 March 2014; MoU between MGA and FIAU, signed on 15 April 2020; MoU between the FIAU, MFSA, MGA and the Sanctions Monitoring Board concerning their cooperation in Countering Terrorism, Financing of Terrorism and Financing of Proliferation of Weapons of Mass Destruction, signed 31 May 2018.

⁸⁹ MFSA, Media Release: "Memorandum of Understanding with the Financial Intelligence Analysis Unit (FIAU)" [2014]

⁹⁰ FIAU, "Annual Report 2014" [2015], p. 34

authorities⁹¹ both in terms of supervision and exchange of information. When entering into the MoU, the FIAU noted the MGA's role as a strategic partner and that there was excellent long-standing cooperation and collaboration between the agencies, which dates back to the initial inclusion of the gaming sector in the scope of AML/CFT legislation in 2016.

Through the legislative framework set by the PMLA, as well as the supporting MoUs entered into between the FIAU and the sectoral supervisors, the FIAU therefore relies on the support of the MFSA and the MGA in order to supervise compliance of subject persons in the financial and gaming sectors. To this end, the MFSA and MGA channel supervisory data, including the findings of AML/CFT supervisory examinations, to the FIAU as the main AML/CFT supervisor. Subsequently, the power to take regulatory action with respect to AML/CFT breaches lies with the FIAU, which through its CMC, assesses the findings of the supervisory authorities as well as the representations of the Subject Person in order to decide which dissuasive sanctions should be applied. The FIAU does not, however, have the power to revoke the authorisation of an institution, and relies on the supervisory authorities in this respect. This mechanism requires the highest levels of coordination, cooperation and efficient information exchange, which the Maltese authorities have sought to achieve over the years.

2.3 AML/CFT supervision in Malta: Historical Findings

In 2021, Malta was placed on the FATF grey-list, following a MONEYVAL mutual evaluation which identified deficiencies in Malta's AML/CFT supervision. Since its grey-listing, significant steps have been made to improve the overall effectiveness of Malta's supervision. This section seeks to analyse the findings of past mutual evaluation reports as well as notable events which initially indicated deficiencies in Malta's AML/CFT framework. The section also discusses subsequent changes made with respect to AML/CFT supervision and the role of the MFSA and MGA in this regard. It is pertinent to note that the role of the MGA was not addressed in the second and third mutual evaluations rounds, since the Authority had not

⁹¹ FIAU, Press Release: Memorandum of Understanding between the Financial Intelligence Analysis Unit and the Malta Gaming Authority concerning their cooperation in the field of Anti-Money Laundering and Combating the Financing of Terrorism" [2020]

been involved in AML/CFT supervision at the time and commenced its role in this regard in 2018.

MONEYVAL Mutual Evaluations

The second MONEYVAL mutual evaluation round was completed in 2003 and at the time of the evaluation, the FIAU was just being established, as was the MFSA as the single regulator for financial services (previously, supervision was undertaken by the Malta Financial Services Centre, the Malta Stock Exchange and the Central Bank of Malta). At this initial assessment, assessors noted that the establishment of these supervisory institutions was a positive development, however highlighted the need that compliance inspections be carried out by all supervisors with equal quality and depth. It was further noted that while the FIAU would be entrusted with the supervision of notaries, accountants and auditors, such professionals should eventually be made subject to AML/CFT legislation⁹².

The third mutual evaluation round was carried out between 2005 and 2009. At the time, the FIAU did not itself have sanctioning powers, and would refer cases of potential or actual non-compliance to the MFSA to investigate and take appropriate sanctions. The FIAU and the MFSA also had an agreement in place wherein the MFSA undertook onsite inspections and reported its findings to the FIAU. The MFSA also reported STRs with respect to any suspicious transactions identified in the course of prudential inspections to the FIAU⁹³.

During the Fourth Mutual Evaluation Round, carried out between 2009 and 2015, it was noted that the FIAU, jointly with the MFSA as its agent in terms of Article 27 of the PMLA, carry out monitoring of Subject Persons' compliance with AML/CFT requirements. It was further noted that there was a strong basis for cooperation between the two, with other provisions in the PMLFTR also supporting the exchange of information in this regard.

As of 2012, the MFSA would devise its annual compliance plan with the FIAU in order for the latter to determine whether it would participate in such compliance visits plan. The mutual

⁹² MONEYVAL, "Second Round Mutual Evaluation Report on Malta" [2003] Adopted at the 11th Plenary meeting of Committee MONEYVAL, p.4

⁹³ MONEYVAL, "Third round detailed assessment report on Malta – Anti-money Laundering and Combating the Financing of Terrorism" [2007] p. 118-9

evaluation report noted that the number of AML/CFT driven onsite inspections undertaken by the FIAU and the MFSA during the evaluation period was not commensurate to the size of the financial markets, especially with respect to other financial institutions which are not credit institutions⁹⁴. On the basis of this finding, it was recommended that the coordination mechanism between the FIAU and MFSA vis-à-vis the supervision of financial institutions be enhanced in order to maximise the utilisation of resources of the supervisory authorities. It was further recommended that the FIAU strive to increase the frequency and scope of its supervision on a risk-sensitive basis in all sectors, including other DNFBPs such as lawyers, notaries, jewel traders and real estate agents. It was recommended that the FIAU leverage the support of the supervisory authorities, such as the MFSA or the MGA (known at the time as the Lotteries and Gaming Authority), in order to achieve its goals.

Another notable finding during the fourth-round evaluation related to the lack of dissuasive sanctions imposed on Subject Persons and their senior management, noting that penalties were either not sufficiently publicised or that financial penalties were too low to be effectively dissuasive. This, coupled with the low number of AML/CFT driven visits carried out resulted in very little or no infringements material enough to warrant sanctions from being found. The recommendations ensuing from the fourth round therefore concluded that those authorities should increase on-going monitoring and ensure that sanctions imposed for non-compliance are proportionate to the size of the financial market. Furthermore, it was recommended that the use of dissuasive sanction also be extended to the senior management of Subject Persons, and that these are made public by the FIAU in order to increase their dissuasiveness⁹⁵.

Case Studies occurring prior to the fifth mutual evaluation

In the period leading up to Malta's last assessment and subsequent grey-listing, some notable AML/CFT supervisory failures featured in the media and were subject to attention from various EU institutions. The most notable case in this regard pertains to Pilatus Bank, a credit institution authorised by the MFSA in 2014. In 2015, the MFSA's banking unit undertook inspections on the bank, wherein, based on a review of the bank's AML/CFT controls, which

⁹⁴ MONEYVAL, "Report on Fourth Assessment Visit, Anti-Money Laundering and Combating the Financing of Terrorism: Malta" [2012], p. 10

⁹⁵ Ibid, p. 133

formed part of the MFSA's inspection, the MFSA recommended that the FIAU utilise its expertise and intelligence to undertake an independent review of the bank, particularly on politically exposed persons which were customers of the bank⁹⁶. The FIAU undertook its inspection and issued its findings in May 2016 indicating serious deficiencies in the bank's AML/CFT framework. The bank was allowed to provide representations to these findings prior to the FIAU taking a final decision, and in this regard Pilatus Bank claimed that documentation which would negate such findings existed but were not made available to FIAU officials during their first visit⁹⁷.

On the basis of the bank's response, the FIAU undertook a second supervisory visit later the same year, focused solely on the documentation indicated by the bank. The FIAU subsequently communicated to the bank that the supervisory inspection and any issues identified were being considered closed. The FIAU did however note that the company's failure to present the evidentiary documentation to its inspectors during the first visit would be noted in future supervision of the bank. In October 2017, the European Commission requested that the EBA launch an investigation into breach of union law by the FIAU due to its failure to apply proportionate and dissuasive sanctions for AML/CFT non-compliance in an effective manner⁹⁸. Amid this investigation, the MFSA in March 2018 placed Pilatus Bank under the control of a competent person who was appointed to take control of all of the bank's assets and overseeing the bank's service offerings until such time as the MFSA directed otherwise⁹⁹.

Through its investigation the EBA found that insufficient record of the evidentiary documentation and findings observed by the FIAU during the visit resulted in the FIAU being unable to counter Pilatus Bank's challenges. Furthermore, it was found that the decision by the CMC to close the case was not sufficiently reasoned and documented, with the EBA being

⁹⁶ EBA, "Recommendation to the Maltese Financial Intelligence Analysis Unit (FIAU) on action necessary to comply with the Anti-Money Laundering and Countering Terrorism Financing Directive" [2018] EBA/REC/2018/02, p. 1

⁹⁷ Ibid, p. 2

⁹⁸ Ibid

⁹⁹ MFSA, "Public Notice concerning Pilatus Bank" [2018] Ref 30-2018

unable to identify why the case was closed and why no action was taken by the FIAU¹⁰⁰. The EBA's findings and recommendations contributed to the Commission's Opinion addressed to the FIAU¹⁰¹ which noted that the EBA's findings indicated breaches of various articles of the prevalent AML Directive through the FIAU's failure to ensure Pilatus Bank was compliant with its AML/CFT requirements and its failure to take proportionate and dissuasive enforcement action to ensure remediation of the bank's AML/CFT deficiencies. The case resulted in various recommendations to the FIAU to inter alia gain a better understanding of prevalent ML/TF risks, to adopt a risk-based approach to supervision in light of its limited resources and to implement policies and procedures for the carrying out of its supervisory functions and the imposition of proportionate and dissuasive sanctions and administrative measures by the CMC. In the days leading up to the Commission's Opinion, the European Central Bank, upon the proposal of the MFSA, withdrew Pilatus Bank's licence¹⁰². Although the bank tried to appeal its licence withdrawal, this appeal was overturned by EU courts in February 2022¹⁰³. In 2021, two years after the bank's licence withdrawal, the FIAU published an administrative penalty of 4,975,500 euros on the bank, citing a lengthy list of breaches which were identified during the 2018 inspection. This penalty is however not final, given that it has been appealed by the bank.

During 2018, another notable case occurred involving a credit institution, Satabank plc. In October 2018, the MFSA first issued a directive against the bank restricting it from onboarding new customers and transferring clients' funds or assets and placing the bank under the direction of an audit firm¹⁰⁴. In March 2019, the FIAU published a notice setting out the Unit's decision to impose an administrative penalty of over three million euros, which was eventually revised to around 850,000 euros when appealed through the courts, despite the findings indicating systemic deficiencies¹⁰⁵. The MFSA eventually made a recommendation to the European Central Bank to have Satabank's licence revoked, and this was actioned by the

¹⁰⁰ European Commission, "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" [2018], p.3

¹⁰¹ Ibid

¹⁰² MFSA "Public Notice regarding Pilatus Bank" [2018]

¹⁰³ Judgment of the General Court of 2 February 2022 — Pilatus Bank and Pilatus Holding v ECB (Case T-27/19)

¹⁰⁴ MFSA, "Public Notice concerning Satabank plc" [2018] MFSA Ref: 87- 2018

¹⁰⁵ FIAU, "Administrative Measure Publication Notice: Satabank Plc" [2019] Updated December 2020

European Central Bank in June 2020¹⁰⁶. The auditors appointed to control the company following the findings noted a significant amount of money which went through the bank in a suspicious manner, all transactions which were unreported by the bank¹⁰⁷. From an external point of view, it is difficult to tell whether the MFSA acted upon the FIAU's instruction when imposing Directives on the company and subsequently making a recommendation to the ECB to withdraw its licence. What is clear, however, is that in this case, the separation between the prudential supervision and AML/CFT supervision may have resulted in a drawn-out process, and with a major downward revision of the original penalty levied by the FIAU on the company putting to question the dissuasiveness of such sanctions.

Portmann Capital Management Limited was also a noteworthy case, where an authorised investment firm was found to be in breach of AML/CFT requirements. Here, the MFSA in 2019 imposed a directive on the company in order to prevent it from onboarding new customers and undertaking transfers on behalf of existing customers, in view of the deficiencies found in relation to entities internal AML/CFT controls¹⁰⁸. This directive was appealed before the Financial Services Tribunal, which noted that such directives were tantamount to the cancellation of a licence, and the MFSA was ordered to provide a remediation plan which the company could carry out to have the directives lifted¹⁰⁹. This subsequent amended directive was not appealed, and the MFSA proceeded with the cancellation of the entity's licence in 2022¹¹⁰. Of note in this case is that there is no public record of a fine being issued on the FIAU's website, although some media articles indicate a fine was issued. Furthermore, as at 31st December 2020, the MFSA indicated in its last two annual reports that there is a pending case in the Court of Appeal (Civil, Inferior) lodged by the company against the FIAU and the MFSA. Regardless, the case shows that AML/CFT deficiencies of a systemic nature were identified, however it is unclear which authority in this case made the decision to have the entities authorisation withdrawn.

¹⁰⁶ MFSA, "Public Notice concerning Satabank plc" [2020]

¹⁰⁷ EY, "12-month report at 30 October 2020 issued by the Competent Person" [2020]

¹⁰⁸ MFSA, "Directive of the 22 August 2018 issued to Portmann Capital Management Limited" [2018]

¹⁰⁹ The Malta Financial Services Tribunal amended decision, "Portmann Capital Management Limited vs Malta Financial Services Authority" [2018]

¹¹⁰ MFSA, "Public Notice concerning Portmann Capital Management Limited" [2022]

The fifth mutual evaluation round

Following the AML/CFT failures which preceded the fifth mutual evaluation round, during 2015, the MFSA had undertaken prudential inspections on the institution wherein it had recommended, on the basis of findings, that the FIAU carry out a dedicated AML/CFT inspection on the company. The FIAU subsequently carried out its inspection on the bank, resulting in findings indicating serious AML/CFT deficiencies in the institutions' framework. During the inspection, as well as a narrow scope follow-up inspection undertaken, the FIAU failed to adequately document and evidence its findings, resulting in the bank repeatedly evading its regulatory actions. Due to the failures arising from this event, the European Banking Authority in 2018 issued a Recommendation to the FIAU¹¹¹, citing a Breach of Union Law in terms of the EU Regulation establishing the European Banking Authority as a basis for such. Another communication encouraging the remediation of the breach of union law by the FIAU was issued by the European Commission in 2018¹¹².

In 2019, the fifth mutual evaluation was undertaken, with the ultimate result of having Malta eventually grey listed in 2021. The fifth round was the first round of evaluations to apply the new FATF methodology which gave greater importance than ever to the effectiveness of a country's AML/CFT regime. With regard to AML/CFT supervision, the evaluation report noted that the FIAU, as the lead AML/CFT supervisor, along with the supervisory authorities, did not have adequate resources to effectively carry out AML/CFT supervision of Malta's financial sector, and the risk-based approach was not being effectively applied in this regard. It was further noted that with regard to sanctions, these were applied limitedly and never to a senior management official of the Subject Person. Furthermore, the FIAU's analysis of whether breaches of AML/CFT requirements were of a systemic nature was limited, impinging the effectiveness of supervision.

¹¹¹ EBA, "Recommendation to the Maltese Financial Intelligence Analysis Unit (FIAU) on action necessary to comply with the Anti-Money Laundering and Countering Terrorism Financing Directive" [2018]

¹¹² European Commission, "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" [2018]

With regard to sanctions and enforcement actions, the evaluation found that although the FIAU had begun taking steps to increase the dissuasiveness of its sanctions, the FIAU was unable to provide information on how many cases of non-compliance had been remediated, and assessors noted that in many cases, written feedback from the FIAU was received long after the date of the inspection or not at all. This was caused due to a back-log of inspections held between 2015 and 2017. With regard to the supervisory authorities, the evaluators noted that the MGA had been active in exercising its powers with regard to AML/CFT, through the suspension or revocation of various gaming licences, particularly during 2018. The MFSA, on the other hand, was criticised for not having effectively integrated AML/CFT into its supervision. To this end, Malta was rated to have a low level of effectiveness for Immediate Outcome 3, the criteria of which are discussed in Section 1.3 of this study.

Findings were also noted with respect to the FIAU's intelligence analysis function, where assessors found that very limited use was being made of financial intelligence, including STRs received by FIAU, in criminal investigations and prosecutions in Malta. This was also evidenced by the limited number of disseminations made from the FIAU to the police when considering the amount of STRs received from Subject Persons¹¹³. At the time of the last MONEYVAL assessment, the FIAU and the supervisory authorities were already in the process of updating their processes and procedures in order to address the deficiencies identified¹¹⁴.

The various cases, findings and recommendations indicated the need for increased supervisory effectiveness, through inter alia increased cooperation and the use of efficient, effective, proportionate and dissuasive sanctions to subject persons. In case of systemic AML/CFT breaches, remedial action should be proportionate, and may include the suspension or revocation of licences where required, powers which ultimately lie with the MFSA and the MGA under the current framework. The findings also highlight the need for the MFSA to integrate AML/CFT supervision into its prudential supervisory plan. Furthermore, with regard to the FIAU, the findings also highlight the need for enhancing the quality and effectiveness

¹¹³ MONEYVAL, "Anti-money laundering and counter-terrorist financing measures, Malta Fifth Round Mutual Evaluation Report" [2019]

¹¹⁴ Francesca Mezzapelle, "Financial crime: an assessment of Moneyval reports on top AML scandal countries and the integration of the new institutional architecture for anti-money laundering." [2021] MS thesis. University of Malta

of intelligence analysis and ensuring that this is shared with law enforcement and prosecutor authorities in a timely manner in order to add value to ML/TF investigations and prosecutions and ultimately increase the effectiveness of the local AML/CFT framework.

The findings emerging from the case studies and the MONEYVAL's fifth mutual evaluation round showcased the low effectiveness of Malta's AML/CFT framework when it comes to supervision. Initially, Malta was found to have been technically compliant, since relevant sectors were subject to licensing or registration regimes as required by the FATF standards. Despite this, other components of effective supervision, including the application of an informed risk-based approach, and the failure to apply proportionate and dissuasive sanctions where AML/CFT breaches were identified, were not present, resulting in overall low effectiveness. The FIAU and supervisory authorities took immediate action to remediate the deficiencies identified, and this was noted by the FATF in its evaluation and follow-up report¹¹⁵. The following chapter will critically analyse the Maltese supervisory setup, taking into consideration the improvements which have been made, with the aim of identifying whether an alternate architectural model for AML/CFT in Malta could further improve Malta's effectiveness rating with respect to Immediate Outcome 3.

¹¹⁵ FATF, "Malta's progress in strengthening measures to tackle money laundering and terrorist financing" [2021]

CHAPTER 3: CAN THE CURRENT SUPERVISORY ARCHITECTURE BE IMPROVED?

3.1 Introduction

Chapters 1 and 2 sought to analyse the international standards which set out the requirements for jurisdictions to conduct AML/CFT supervision on obliged entities, and the supervisory architecture adopted in Malta, with the FIAU being the sole AML/CFT supervisor and having sectoral supervisory authorities acting as its agents, carrying out supervision on its behalf and reporting findings back to its CMC for decision on administrative action to be taken by the FIAU in relation to any breaches identified. Malta's supervisory model was put to the test during the last round of MONEYVAL evaluations, which also sought to assess the level of effectiveness of Malta's supervisory architecture. The initial findings of the MONEYVAL evaluation included a lack of onsite inspections carried out by the FIAU and the MFSA, and the absence of appropriate enforcement action in relation to AML/CFT breaches which should be proportionate and dissuasive. Maltese authorities took swift action to remediate the identified deficiencies, with the FIAU, MFSA and MGA all prioritising AML/CFT supervision in recent years. The culture reform has led to increased administrative action by the FIAU and increased integration of AML/CFT supervision into the regulatory supervision undertaken by the MFSA and the MGA.

Despite the recent AML/CFT failures, the following sections seek to critically analyse the current supervisory setup in Malta in order to identify shortcomings which are inherent to the model and understand whether an alternate supervisory model, whereby supervisory authorities, namely the MFSA and the MGA, are given a primary role in AML/CFT supervision and enforcement within their respective sectors, could prove to be beneficial in the long term. In order to inform the critical analysis, interviews were carried out with five senior officials at the FIAU, the MFSA and the MGA. The interviews were held in a semi-structured format with questions on the role of the supervisory authorities as agents of the FIAU, the AML/CFT enforcement process and the ability of the supervisory authorities to take enforcement action in this regard, and the perceived advantages and disadvantages of the current supervisory setup versus an alternate setup wherein the supervisory authorities would have a more primary role in AML/CFT supervision within their sectors.

3.2 Identified limitations of the current model

The Supervisory Process

The current model involves the FIAU having the final responsibility for AML/CFT supervision, with the supervisory authorities being identified as agents of the FIAU when it comes to monitoring subject persons' compliance with the PMLFTR and AML/CFT requirements emanating therefrom. This supervisory setup may give rise to the principle-agent problem¹¹⁶ which may manifest itself since the supervisory authorities are likely to prioritise their regulatory or prudential supervision over AML/CFT supervision, since they are not specifically mandated, within their establishing laws, to undertake AML/CFT supervision. The phenomenon may also impinge on the supervisory authorities' effectiveness in this space, since all AML/CFT supervision undertaken by them is done in their role as agents of the FIAU, and on behalf of the FIAU. The principle-agent problem was evidenced during the last mutual evaluation round, wherein it was noted that minimal AML/CFT supervision was undertaken by the supervisory authorities at their own initiative¹¹⁷. During this time, the FIAU also had been in early stages of developing its risk-based approach and supervisory planning, leading to an overall poor outcome vis-à-vis AML/CFT supervision in the mutual evaluations. As clearly evidenced through the research and interviews held, the FIAU and the supervisory authorities have significantly improved their cooperation and coordination when it comes to AML/CFT supervision, resulting in a dramatic increase in compliance inspections undertaken in recent years. The supervisory authorities have also taken steps to ensure increased AML/CFT supervision, not only by supporting the FIAU in its supervisory plan, but also by integrating AML/CFT supervision into their regulatory or prudential supervision, ensuring maximum AML/CFT supervisory coverage. Despite these improvements, the principle-agent problem may still impinge on the effectiveness of the supervisory setup, since at the end of the day, it is still the FIAU which is the lead authority on AML/CFT supervision and subsequent

¹¹⁶ Sean Gailmard. "Accountability and principal-agent models." [2012] Chapter prepared for the Oxford Handbook of Public Accountability.

¹¹⁷ MONEYVAL, "Anti-money laundering and counter-terrorist financing measures, Malta Fifth Round Mutual Evaluation Report" [2019]

enforcement, and any supervision and supervisory measures taken by the supervisory authorities are done on the instruction of the FIAU, or with the clearance of the FIAU.

During interviews held, it was noted that the success of the current model depends greatly on supervisory cooperation and coordination between the FIAU and the supervisory authorities. Such cooperation and coordination, though present, was minimal prior to the last mutual evaluation and has been drastically improved through inter alia the signing of an updated MoU and the creation of policies and processes which govern the relationship and correspondence between the FIAU and the supervisory authorities. In 2021, the PMLFTR was also amended¹¹⁸ to inter alia widen the existing list of supervisory authorities acting as agents of the FIAU, showcasing the reliance the current model has on supervisory cooperation between the FIAU and the supervisory authorities. In this regard, it was noted through interviews that there appears to be a stronger and more effective relationship between the FIAU and the MGA, which is also evidenced through the number of inspections carried out on the gaming sector when compared to the financial sector during MONEYVAL's initial evaluation. This may be owed to the fact that the FIAU and the MGA worked hand-in-hand on the implementation of the AML Directive which brought the gaming sector within scope of AML/CFT supervision, ensuring a strong relationship between the two authorities from the start, as noted in interviews. Despite the fact that the inter-relationship between the FIAU and the supervisory authorities has been significantly strengthened following the MONEYVAL evaluation, the principal-agent problem may still arise, given that it is the FIAU that is ultimately responsible for AML/CFT and the relationship between the FIAU and the supervisory authorities may still be threatened, particularly since the supervisory authorities often must rely on the FIAU for enforcement action in relation to AML/CFT breaches, as shall be further discussed in the following sub-section.

The MFSA and the MGA have both conducted their regulatory supervisory work before the introduction of the AML/CFT framework in their respective sectors. In this regard, both authorities have over the years established supervisory systems and procedures in order to ensure effective and efficient supervision as outlined in Chapter 2. When conducting AML/CFT

¹¹⁸ Legal Notice 199 of 2021, Amendments to the Prevention of Money Laundering and Funding of Terrorism Regulations.

supervision, supervisory authorities are required to utilise the FIAU's systems and procedures, which personnel of the supervisory authorities may need to adjust to, since these are likely to differ from the systems and procedures adopted by the supervisory authority in question. In this regard, an interview subject noted that the systems utilised by the FIAU differed greatly from those utilised by the supervisory authority and having to utilise the FIAU's systems limited the extent to which efficiencies incorporated into systems utilised for regulatory supervision could be applied to AML/CFT supervisory systems. This factor could limit the extent to which AML/CFT supervision may effectively be integrated into the regulatory supervision undertaken by the supervisory authorities.

Furthermore, an interview subject noted that the process of reporting findings externally for supervisory authorities, as well as the process of receiving such information and presenting it to the CMC, creates streams of communication additional to those which the supervisory authorities must undertake internally between their FCC functions and respective sectorial supervisory functions, resulting in excessively burdensome administrative procedures and adding more instances of potential delay to the supervisory and enforcement process.

The Enforcement Process

One of the most relevant perceived shortcomings of the current model, as well as the central argument to this study, relates to the enforcement process which is triggered upon identification of AML/CFT breaches by subject persons. In this regard, any AML/CFT breaches identified by the FIAU or by the supervisory authorities constitutes a breach of the provisions of the PMLFTR. To this end, Article 21 of the PMLFTR sets out the types of penalties and actions the FIAU may take where subject persons are found to be non-compliant, which include imposition of administrative penalties proportionate to the level of breaches identified, or other administrative measures in low-risk cases. The FIAU may also, in the case of systemic AML/CFT breaches, impose larger fines, however its powers fall short of being able to suspend or cancel an operator's licence, as implied by the proviso which allows the FIAU to place recommendations to supervisory authorities in this regard. Despite this, the MONEYVAL findings did indicate that at the time of assessment, the FIAU did not issue such recommendations to supervisory authorities.

Interestingly, Article 21(8) also clarifies that the penalties outlined therein are without prejudice to the ability of supervisory authorities to take any enforcement action available to them under applicable law as they may deem appropriate in case of breaches. In this regard, interviewees noted that the FIAU may propose or recommend that a supervisory authority take such regulatory action, however this is ultimately the decision of the supervisory authority. To this end, the MFSA Act and the Gaming Act, which establish the MFSA and the MGA, as well as a number of other laws applicable to the sectors overseen by these supervisory authorities, contain provisions on the enforcement powers available to them. Despite this, supervisory authorities are hesitant to take regulatory action on the basis of AML/CFT breaches for a number of reasons, first of those being that it is the FIAU which ultimately has the power to impose penalties with respect to such breaches. Furthermore, interviewees noted that there are some instances where the law precludes the MFSA from taking action on AML/CFT breaches which are identified and actioned by the FIAU, further limiting the authority's ability to take enforcement action in relation to AML/CFT. It was noted that an exercise is currently being undertaken to amend the necessary laws and enable the MFSA to act in these instances. One interviewee also noted that there may also be a certain degree of reputational risk arising from taking enforcement action in relation to AML/CFT breaches, since supervisory authorities are not specifically mandated to oversee AML/CFT compliance, and supervisory authorities may be seen as overstepping if enforcement action were to be taken on AML/CFT breaches.

Another factor of relevance which was also noted during interviews relates to the notion of 'ne bis in idem' better known as the double jeopardy principle, which sets out that a person may not be tried twice for the same offence. With such principle in mind, supervisory authorities must exercise caution to ensure that no overlapping regulatory action is taken, since this may create significant legal risk and jeopardise meaningful regulatory action which the supervisory authorities may wish to initiate with respect to regulatory or prudential breaches. To this end, supervisory authorities tend to await the final outcome of the FIAU's enforcement decision, including in some cases the outcome of any appeal made by the subject person, prior to taking any enforcement action on AML/CFT breaches themselves. This can often take a very long time, reducing the meaningfulness, effectiveness and relevance of any enforcement action eventually taken by the supervisory authorities. In this

regard, it is also pertinent to note that administrative penalties issued by the FIAU are considered by the supervisory authorities to impinge on the fitness and propriety of that person, and if serious enough, may be sufficient grounds for a supervisory authority to suspend or cancel a licence or registration, which is a factor supervisory authorities often take into consideration.

Overcoming the fact that enforcement action on AML/CFT breaches may only be undertaken by the FIAU, one may also note shortcomings inherent to the model from a practical perspective. During the interviews, subjects also outlined how the FIAU coordinates its risk-based supervisory plan with the supervisory authorities, who undertake inspections on its behalf. Once an inspection is concluded, supervisory authorities communicate their findings to the subject persons, who are given a timeframe within which to submit representations to the supervisory authorities' findings. Following the submission of representations, the supervisory authorities submit a full report to the FIAU. This is subsequently presented to the FIAU's CMC. Once a decision is taken by the CMC, the matter is then raised to the FIAU's Board of Governors to ensure that the penalty is appropriate and dissuasive in light of the specific circumstances of each case.

The process as it is means that although on-the-ground supervision is often actually undertaken by the supervisory authorities, the enforcement process thereon is undertaken by the FIAU. The disconnect between the supervisor and the enforcer in this case can inter alia result in delays in the enforcement process, which until recently were very apparent, with administrative penalties being issued up to two years after the initial inspection wherein the breaches were identified¹¹⁹. In this regard, it was also noted that delays may also have resulted due to the unintended bottleneck which occurs because all enforcement action on AML/CFT must go through the FIAU, and one may consider that enforcement action could be taken more swiftly if the supervisor and the enforcer were one and the same.

Interview subjects noted that the FIAU and the supervisory authorities have gone to great lengths to address the deficiencies in Malta's AML/CFT supervision evidenced by MONEYVAL

¹¹⁹ For example, FIAU Administrative Measures against Pilatus Bank plc, Em@ney plc, Meridian Gaming Ltd and other entities, the penalties for which were below the designated thresholds and published anonymously.

in its mutual evaluation, by increasing resources, establishing a risk-based approach to supervision and enhancing supervisory cooperation amongst themselves in order to ultimately increase the effectiveness of AML/CFT supervision in Malta. The MFSA and the MGA have both prioritised AML/CFT supervision in recent years, establishing dedicated internal teams and integrating elements of AML/CFT supervision into each stage of an operators life-cycle and interview subjects noted that the cooperation and coordination amongst the authorities has increased substantially in recent years. Despite this, the model has certain disadvantages for supervisory authorities, including the fact that they are unable to take action in relation to AML/CFT breaches, and therefore it may be appropriate to consider whether an amendment to the current supervisory architecture for AML/CFT in Malta could reap benefits in the long run, cognisant of international regulatory developments and the size and nature of the Maltese financial sector when compared to the supervisory resources available. In this regard, an alternate model for AML/CFT supervision would involve the MFSA and the MGA having a primary role in AML/CFT supervision of their respective sectors. To this end, the following section shall outline the proposed model, the rationale as to why such model might address some of the issues identified and the benefits which the alternative model could offer.

3.3 Proposal for an alternative model

Based on research and interviews undertaken, this study also sought to understand whether an alternative model to the current setup, which would involve the MFSA and MGA also having direct roles in AML/CFT supervision, could be advantageous. In such scenario, the MFSA and MGA would both have the necessary powers to take supervisory and enforcement action in relation to AML/CFT breaches and would be the sole AML/CFT supervisors of the financial and gaming sectors respectively. In this regard, supervision of other DNFBPs could be undertaken by the FIAU, in cooperation with the other supervisory authorities. The proposed model would still require the highest levels of cooperation and coordination amongst the supervisory authorities and the FIAU, and the FIAU's role as a central intelligence hub would remain vital to the success of the supervisory model, however the supervisory process and remediation process triggered when AML/CFT breaches are identified would be left in the hands of the supervisory authorities, who would subsequently share outcomes of

any supervisory or enforcement actions on Subject Persons within their remit with the FIAU as a central intelligence hub.

The rationale for the proposed model mainly stems from the fact that the MFSA and the MGA readily play a vital role in the fight against ML/TF through their gatekeeping role in the oversight of licensing or registrations regimes in their respective sectors and subsequent supervision of licensed or registered operators to ensure their compliance with the applicable regulatory frameworks. In particular, the MFSA, as the single regulator of financial services in Malta, regulates the banking, investment, insurance and crypto-asset sectors and company service and trust providers, the latter being considered DNFPBs in terms of the FATF standards. Similarly, the MGA oversees operators' activities within the gaming sector, ensuring entities' compliance with the provisions of the Gaming Act and any rules emanating therefrom. In their respective activities, the MFSA and MGA have garnered extensive hands-on supervisory experience and developed their processes in line with the ever-evolving landscapes they oversee. In this regard, synergies may be seen between the regulatory supervision undertaken by these authorities and the AML/CFT supervision, particularly in the case of the financial sector¹²⁰ and significant steps have already been taken by the MFSA and MGA to internally prioritise AML/CFT on the heels of Malta's grey-listing.

Apart from the existing synergies, supervisory authorities are currently limited in their discretion with regard to AML/CFT supervision and actions which may be taken when deficiencies are identified. As primary AML/CFT supervisors, the MFSA and MGA would be able to take direct action in case of AML/CFT breaches and fully internalise AML/CFT supervision and enforcement into their existing processes. Through such setup, a holistic approach to regulatory and AML/CFT supervision may be undertaken through the entire lifecycle of an operator, with the supervisory authority having the necessary discretion to take appropriate and timely enforcement action upon identification of breaches ultimately resulting in supervisory authorities being able to take swifter action with their AML/CFT powers. The cooperation and exchange of information between the supervisory authorities and the FIAU would remain, however the supervisory authorities would no longer be required

¹²⁰ EBA, "Report on Competent Authorities' Approaches to Anti-Money Laundering and Countering the Financing of Terrorism Supervision of Banks (Round 2 – 2020/21)" [2022] EBA/REP/2022/08

to act on the FIAU's behalf and would take decisions internally on what actions to take when AML/CFT deficiencies are identified in entities falling within their supervisory remit.

With the proposed supervisory setup, the supervisory authorities would have the widest range of supervisory and enforcement measures available to them also in relation to AML/CFT, including the ability to suspend and cancel an operator's licence in the case of systemic AML/CFT deficiencies, thereby reducing the legal risk currently faced by the supervisory authorities when taking action on AML/CFT breaches. Furthermore, the centralisation of prudential and AML/CFT supervision would also imply the centralisation of prudential and AML/CFT supervisory data, possibly allowing for swifter internal knowledge sharing and further leveraging the synergies which exist between prudential and AML/CFT supervision. From a process perspective, MFSA and MGA officials would be able to utilise their own in-house supervisory systems and procedures, with which they have a higher degree of familiarity, to carry out AML/CFT supervision. Finally, under the proposed model, the MFSA and MGA would be accountable for AML/CFT supervision in their respective sectors, ensuring that AML/CFT supervision is continuously prioritised by the two authorities in the long run.

In order for the MFSA and the MGA to be granted a primary role in AML/CFT supervision in their respective sectors, amendments would be required to the legal framework, including amendments to the PMLA, to clarify that financial sector and gaming sector AML/CFT supervision would be undertaken by the MFSA and the MGA respectively. Furthermore, the updating of the mandates of the respective supervisory authorities would also need to be reflected in the MFSA Act and the Gaming Act. The enforcement provisions contained within the various sectoral laws falling within the authorities' purview would need to reflect the supervisory authorities' ability to take action in case of identification of supervisory breaches, and these amendments could be executed in a number of ways. From a practical perspective, it was noted during interviews that both the MFSA and the MGA would need to significantly increase the human resources currently allocated to AML/CFT supervision to ensure adequate coverage of their respective sector and this process could take a number of years.

In a scenario where the MFSA and MGA were to take on AML/CFT supervision in their sectors, the FIAU, as a central intelligence hub, would continue to guide the risk-based approach through its CASPAR system, with the MFSA and MGA feeding the FIAU's risk-scores into their supervisory planning guaranteeing continued application of the risk-based approach. The

supervisory authorities would also need to ensure adequate training and upskilling of relevant staff in AML/CFT. Furthermore, the supervisory authorities would also be required to establish internal processes for the taking of supervisory and enforcement action in relation to AML/CFT breaches. To this end, both authorities would also need to establish dedicated decision-making bodies which would take on the functions currently undertaken by the FIAU's compliance monitoring committee. Appropriate controls would need to be established to address any conflicts which may arise between prudential and AML/CFT supervision.

The proposed model would seem particularly beneficial for the MFSA, which has been required to integrate AML/CFT at all levels and has also taken oversight of the framework for company service providers, which are considered DNFBPs in terms of FATF's Recommendation 22. On the other hand, the MGA's supervisory experience in the AML/CFT field is limited when compared to that of the MFSA, and the working relationship between the FIAU and the MGA appears to be very strong, with the gaming regulators leveraging on the knowledge and expertise of the FIAU in the AML/CFT area and vice-versa. Furthermore, interview subjects noted that certain conflicts of interest risks would need to be overcome, particularly if the MGA were to take on AML/CFT supervisory and enforcement powers with respect to the gaming sector. Overall, the FIAU and MGA, through their strong relationship, appear to be adequately leveraging the synergies which exist between regulatory and AML/CFT supervision and the competences of the respective institutions in this regard, and therefore, the proposed alternative model might not be as appropriate in the context of the gaming sector at this point in time.

3.4 Limitations of the proposed alternative model and other considerations

Although many benefits stand to be reaped if the proposed model were to apply, particularly for the supervisory authorities, some limitations may still exist. Furthermore, some considerations are to be taken into account when considering whether an alternative AML/CFT supervisory model should be applied in Malta. The following section will therefore set out such limitations and considerations. The first of such considerations noted by interview subjects is that under the current model, the FIAU offers centralisation of AML/CFT supervision and enforcement, through its risk-based approach which considers all Maltese Subject Persons in all sectors holistically. In this regard, supervisory authorities currently

undertake AML/CFT supervision utilising the FIAU's operating procedures and on the basis of the FIAU's supervisory plans. Furthermore, all enforcement action on the basis of AML/CFT breaches is taken through one decision-making body, the compliance monitoring committee, resulting in one yard-stick being applied for all subject person based on seriousness of breaches. The proposed model may therefore impact the centralisation offered by the FIAU under the current model and result in diverging supervisory and enforcement practices among the supervisory authorities and the FIAU. Furthermore, the advantages of the FIAU's dual role as AML/CFT supervisory and intelligence unit which offer high levels of centralisation can contribute to the overall effectiveness of Malta's framework.

Another consideration which was noted during interviews regarding the proposed model relates to the independence of the AML/CFT enforcement decision-making body within the supervisory authorities since conflicts may arise between regulatory and AML/CFT priorities, and this factor would appear to be of particular concern in the case of the MGA. Despite this, the introduction of adequate Chinese-walls and appropriate composition of independent AML/CFT decision making bodies within the supervisory authorities could address such risks.

As outlined in section 3.2, the proposed alternative model will result in fragmentation of AML/CFT supervisory responsibilities in Malta, with the MFSA and MGA becoming the primary AML/CFT supervisors for the financial and gaming sectors respectively, and the FIAU retaining AML/CFT supervision of other DNFBPs. In this regard, interview subjects noted that with the proposed model, the introduction of multiple AML/CFT supervisors may require new forms of coordination between the FIAU and the supervisory authorities. This might require the introduction of another body or institution to ensure such cooperation and coordination amongst the FIAU and supervisory authorities, placing further strain on the already limited resource pool in Malta. Despite this, it may be noted that a national AML/CFT coordination committee already exists, as established by Article 12A of the PMLA, who's mandate could be extended to require it to have the competence and expertise necessary to coordinate the Maltese supervisors' approach in such a scenario.

Regardless of any alternative architectural models adopted, an issue which will remain to be addressed and which was noted in interviews relates to delays which arise when the appeals process is triggered by a Subject Person following the issuance of an administrative penalty above a certain threshold by the FIAU. In such cases, the appeals process is undertaken

through the Maltese law courts, and can be significantly delayed due to a lack of efficiency in Malta's court system which has been a cause for concern¹²¹. The FIAU has sought to address this problem by publishing administrative penalties even prior to the appeals process being concluded and is currently working to find ways to minimise the impact of the appeals process by possibly introducing a settlement process wherein appeals through the courts would be avoided entirely, shortening the length of time it would take for enforcement action to be concluded.

Finally, one must also consider that great efforts have been made by the FIAU and the supervisory authorities to increase the overall effectiveness of Malta's current AML/CFT supervisory setup, including by increasing cooperation and coordination among the authorities, increasing human resources dedicated to AML/CFT supervision and streamlining the enforcement process to ensure cases are presented to the CMC on a risk-sensitive basis and in accordance with the severity of breaches identified. The recent improvements are being positively noted by international watchdogs and therefore it was noted that the introduction of a new model may not be seen as a sustainable policy-action following the work carried out to improve the current setup. Despite this, the transfer of AML/CFT supervisory competences vis-à-vis a particular sector, whilst maintaining the coordinating role of the FIAU, could allow selected supervisory authorities with larger sectors falling within their supervisory remit to act more independently and swiftly when AML/CFT breaches are identified.

¹²¹ European Commission, "Commission Staff Working Document 2021 Rule of Law Report, Country Chapter on the rule of law situation in Malta" [2021] SWD(2021) 720 final, p. 6.

CONCLUSION

Recent events at EU level as well as the recommendations arising from both the MONEYVAL and FATF assessment indicate the need for an increased focus on both supervisory effectiveness with regard to AML/CFT and utilisation of intelligence in the investigation and subsequent prosecution of ML/TF cases. With the current supervisory architecture in Malta, this means dual responsibilities for the FIAU, which has evidently trickled over to the supervisory authorities, which have been seen to make significant progress in prioritising AML/CFT supervision as part of their parallel regulatory supervision. This dissertation sought to critically analyse Malta's current AML/CFT supervisory architecture, with the central argument revolving around supervisory authorities' abilities to take enforcement action in relation to AML/CFT breaches. In critically analysing Malta's supervisory setup, analysis was undertaken of international standards and EU legislation which ultimately establish Malta's AML/CFT framework. Furthermore, the findings of the recent mutual evaluations along with remediation measures undertaken, or in the process of being undertaken by supervisory authorities were taken into consideration. As part of the critical analysis, the study also sought to understand whether alterations to the current supervisory setup could lead to more efficient and effective AML/CFT supervision by assigning supervisory authorities such as the MFSA and the MGA the primary role for AML/CFT supervision in their respective sectors, allowing them to take potentially swifter enforcement action in relation to AML/CFT breaches by Subject Persons falling within their supervisory remit.

Through the critical analysis and interviews conducted, it is concluded that the synergies and benefits of the FIU model as outlined in Chapter 1 are present within the supervisory relationship present between the FIAU and the MGA. The case for transferring the AML/CFT supervisory mandate may therefore be more appropriate in the context of the financial sector, wherein the MFSA as the single prudential and AML/CFT supervisor in Malta, would hold a broad range of sanctioning powers, ranging from written reprimands to cancellation of licences or registration where AML/CFT of a serious and systemic nature are identified in authorised persons. In this regard it is noted that through proposed AML/CFT reform, increased focus is being placed on EU AML/CFT and prudential supervisory convergence, placing AML/CFT supervision as one of the top priorities for national competent authorities across the EU including the MFSA. It may therefore be beneficial to assign MFSA will full

mandate of AML/CFT supervision for financial sector, with the FIAU continuing its supervision of DNFBPs and acting as the hub for AML/CFT intelligence and supervisory cooperation in Malta.

The proposed alternative setup would certainly address the issue of supervisory authorities not being able to take enforcement action in relation to AML/CFT breaches and could result in greater efficiencies in the enforcement process and more effective supervision in the long run, particularly in the context of the financial sector. Furthermore, although making a change to the Maltese supervisory architecture at this stage may be viewed as unsustainable in view of the actions taken to remediate Malta's AML/CFT supervisory effectiveness, the alternative model might not require significant changes, given that the supervisory authorities have begun to integrate AML/CFT into their supervision and have prioritised AML/CFT in the past two years.

Despite this, the centralisation of AML/CFT supervision and intelligence does also offer synergies which may be impacted if adequate levels of cooperation and coordination are not maintained under the proposed model. Furthermore, time delays arising as a result of the appeals process triggered through Maltese law courts would not be addressed through the introduction of a new supervisory model.

Arguments may also be made that the proposed model would run contrary to EU developments, wherein AMLA is currently being established as the single EU AML/CFT supervisory authority. Despite this, one of the objectives of the AMLA will be to overcome EU cross-border supervisory failures by enhancing cross-border coordination and cooperation in the EU, and by directly supervising certain high-risk operators operating on a cross-border basis in the EU. This same rationale cannot easily be applied to the Malta context and further consideration should be given as to whether the current supervisory setup is in fact the most effective, cognisant of resource limitations in Malta.

In the case of the financial sector, the assignment of primary AML/CFT supervisory responsibilities to the MFSA may be beneficial to Malta's overall supervisory effectiveness and ensure continuous prioritisation of AML/CFT in the financial sector. Furthermore, the proposed change may also address issues supervisory authorities currently face in taking

action in relation to AML/CFT breaches and enable the FIAU to further dedicate supervisory resources to the growing DNFBP sector.

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