

10 June 2020

Circular addressed to all Company Service Providers

Sectoral Risk Assessment & Action Plan – Key Results on Legal Entities, Legal Arrangements and Voluntary Organisations

Introduction

Malta's Authorities are committed to preventing, detecting and prosecuting money laundering and terrorist financing activities, in recognition that financial crime threatens the safety of our society, the integrity of our financial system, and the stability of our economy.

The institutional framework to supervise, gather intelligence on, and take all necessary action against financial crime is continuously under improvement.

The [National Risk Assessment](#), in which the MFSA played a key role, was the first step to identify Malta's highest threats and vulnerabilities, followed by a gap assessment to identify those areas which needed to be revisited, improved or strengthened and the development of the comprehensive National AML/CFT Strategy which tackles all key elements of our national framework: from supervision and intelligence gathering, to investigation to prosecution and confiscation.

The MFSA recognise that weaknesses in regulated firms' conduct and prudential arrangements often increase the incidence of financial crime risk, making firms more vulnerable targets for criminals seeking to disguise the proceeds of crime or to support the financing of terrorism. It is for this reason that, in addition to continuing in its ongoing cooperation with the FIAU, the MFSA has further embedded AML/CFT matters in its supervisory approach, as announced in the [MFSA AML and CFT Strategy](#).

Through its supervisory engagement with regulated firms and industry outreach, the MFSA is seeking to raise further awareness of risks and vulnerabilities in the different sectors and assist industry players in identifying possible red flags.

Sectoral Risk Assessment on Legal Entities, Legal Arrangements and Voluntary Organisations

The sectoral risk assessment on legal entities, legal arrangements and voluntary organisations (“VOs”) was a nationwide initiative led by the by the National Coordinating Committee on Combating Money Laundering and Funding of Terrorism (“NCC”)¹. The MFSA was a significant contributor to this exercise which incorporated data and expertise from all relevant authorities, as well as the private sector.

This Sectoral Risk Assessment was finalised and endorsed by NCC board members in July 2019. The purpose of the risk assessment was to evaluate Malta’s ML/FT risk exposure from the perspective of legal entities and arrangements, to improve the understanding of the nature of these risks (e.g. through the identification of typologies and patterns), and to identify measures that would strengthen the AML/CFT regime to mitigate the risks. It also addressed one of the key recommendations made by Moneyval in its [Fifth Round Mutual Evaluation Report](#) of Malta of July 2019 where it was recommended that the relevant authorities finalise their assessment of the vulnerabilities and the extent to which all types of Maltese legal persons and legal arrangements could be misused for ML/FT.

Since Company Services Providers (“CSPs”) play a key role in relation to ‘legal entities’, particularly with respect to private limited companies, public limited companies, partnerships and foundations which they can set up, the MFSA would like to draw the attention of all CSPs to the [Key Results Documents of the Sectoral Risk Assessments](#) available on the NCC website, in particular to the document entitled ‘Key Results on Legal Entities, Legal Arrangements and Voluntary Organisations’. The key results document presents an overview of the methodology and key findings of the risk assessment specific to the sector, together with the planned action plan aimed at mitigating the identified risks.

MFSA Expectations

The MFSA expects CSPs to recognise the findings outlined in the Key Results document and to familiarise themselves thoroughly with its contents, with a view to reviewing the sectors they operate in. This increases the understanding of the threats and vulnerabilities outlined and will have a direct bearing on the structures which they may service or transact business with. CSPs are expected to implement risk mitigating measures where required in this regard.

By way of example, the Key Findings Document illustrates how legal entities, particularly private limited companies, may be used for tax evasion (which has been identified as posing the highest threat of money laundering vis-à-vis legal entities and legal arrangements in the sector) for example by layering illicit proceeds through shell corporations, often across jurisdictions, to create a complex ownership structure. Typical structures used for these purposes would consist of networks of interconnected companies holding shares in one another, and therefore receive payments and dividends from one another, obscuring ultimate beneficial ownership behind an intricate web of entities. Further concealment of ultimate beneficial ownership could also take place with the use of nominee shareholders and other like instruments within corporate structures. As a result, any profits

¹ The NCC was established within the Ministry for Finance and Financial Services through Subsidiary Legislation S.L. 373.02, enacted on the 13 April 2018. The NCC is the governing body responsible for the general oversight of Anti-Money Laundering and Countering the Funding of Terrorism (AML/CFT) policy.

earned by these companies might remain under the control of the ultimate beneficial owner but might not be declared to authorities and subsequently taxed. CSPs should therefore assess the structures currently being administered by them to ensure that they are not enabling or facilitating tax evasion structures, and also incorporate checks into their assessments at the onboarding stage to identify red flags.

CSPs are expected to evaluate their findings and act upon them including by either exiting the relationship or reporting the structure where their regulatory and legal obligations so require.

Similarly, the Key Findings Document also highlights that bribery and corruption is a relevant threat to legal entities and arrangements in Malta, with private companies, trusts and foundations being typically linked to this predicate offence. This could take the form of payments of cash or a direct transfer of assets to individuals who are typically in a position of influence, in return for favourable treatment. Payments of this type would frequently be executed through legal entities and arrangements beneficially owned by the recipient. With respect to private companies, for example, payments for counterfeit goods or services delivered by the company may be used to disguise bribes.

These transactions will often be supported by false documentation and invoicing. In other instances, the company will actually provide the good or service but does so at a vastly inflated price. CSPs should therefore approach transactions relating to clients who are more susceptible to these risks (such as PEPs) in a critical manner and ensure that they probe sufficiently to ascertain the source and destination of funds which may be channeled through structures they set up or service. CSPs should also be alert with respect to possible channeling of funds emanating from unlicensed financial services products which may be placed through corporate structures, resulting in revenues earned from this predicate offence entering the system through a legal entity.

The above are merely examples. CSPs are expected to incorporate the findings outlined in the Key Findings Documents in their internal business risk assessment and client risk assessment exercises. A gap analysis should be conducted to develop proportionate and effective controls and undertake any necessary risk mitigating measures.

Contacts

For any queries in relation to this Circular, kindly send an e-mail on csu@mfsa.mt