



MINISTRY FOR FINANCE

RESULTS OF THE ML/TF NATIONAL RISK ASSESSMENT

REPUBLIC OF MALTA

2018

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World Bank disclaimer

The National ML/FT Risk Assessment of Malta has been conducted as a self-assessment by the Maltese authorities, using the National Money Laundering and Terrorism Financing Risk Assessment Tool that has been developed and provided by the World Bank. The World Bank team's role was limited to delivery of the tool, providing guidance on technical aspects of it and review/feedback to assist with the accurate use of it. The data, statistics, and information populated into the National Money Laundering and Terrorism Financing Risk Assessment Tool templates, and any other finding, interpretation, and judgment under the scope of National Money Laundering Risk Assessment process completely belong to the Maltese authorities and do not reflect the views of World Bank.

Acronyms

4AMLD	4th Anti-Money Laundering Directive (version as of 20 May 2015)
AML	Anti-Money Laundering
AMLCFT	Anti-Money Laundering and Combatting the Financing of Terrorism
CBM	Central Bank of Malta
CVO	Commissioner for Voluntary Organisations
DNFBP	Designated Non-Financial Businesses and Professions
EU	European Union
FATF	Financial Action Task Force
FIAU	Financial Intelligence Analysis Unit (Malta)
FIU	Financial Intelligence Unit
MFSA	Malta Financial Services Authority
MGA	Malta Gaming Authority (formerly the Lotteries and Gaming Authority)
ML	Money Laundering
ML/TF	Money Laundering/Terrorism Financing
MLA	Mutual Legal Assistance
MONEYVAL	Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism
MOU	Memorandum of understanding
NCC	National Co-ordinating Committee on Combating Money Laundering and Funding of Terrorism
NRA	National Risk Assessment
NSO	National Statistics Office
Working Group	The Working Group established for the purposes of carrying out the NRA
PF	Proliferation Financing
PMLA	Prevention of Money Laundering Act (Chapter 373 of the Laws of Malta)
PMLFTR	Prevention of Money Laundering and Funding of Terrorism Regulations (Legal Notice 180 of 2008)
STR	Suspicious Transaction Report
TF	Terrorism financing

Foreword

The fight against money laundering and terrorism financing is critical to ensuring Malta's security and prosperity. Financial crime threatens the safety of our society, the integrity of our financial system, and the stability of our economy.

Malta is deeply committed to preventing, detecting and prosecuting money laundering and terrorism financing activities. We have put in place an institutional framework to supervise, gather intelligence and take legal action against financial crimes. However, we recognise that it should be further strengthened to be fully effective.

The National Risk Assessment (NRA) is at the centre of the fight against financial crime. The NRA identifies and assesses Malta's threats and vulnerabilities. In particular, we have identified the illegal activities that generate the most proceeds and threaten the most our safety and prosperity (e.g. local criminal groups, drug trafficking, tax evasion) as well as the sectors that are the most vulnerable to being abused or misused (e.g. banking, corporate service providers).

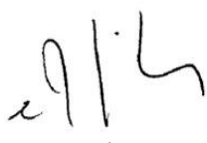
The results of the NRA form the basis of Malta's National AML/CFT Strategy. It enables the various competent authorities to focus their efforts and allocate resources where the threats and vulnerabilities are higher. It also helps us to identify a number of "structural" shortcomings in our institutional framework and, as a result, design an action plan aiming at addressing these deficiencies. The National AML/CFT Strategy details initiatives that will be implemented in the next three years in order to strengthen the national mechanisms aimed at preventing, detecting and prosecuting financial crime.

I am proud to publish this document, which summarises the results of the NRA exercise which was finalised as of February 2018. The results provide a comprehensive overview of the ML/TF threats and vulnerabilities that present risks to Malta's economic and societal stability.

I am very grateful to the many public and private sector stakeholders who took part in the assessment. The completion of the NRA took extensive effort and required a tremendous amount of cooperation across policy-makers, supervisors, law enforcement agencies, Attorney General, law courts, judiciary, other authorities and the private sector. Their input was critical to the development of this report. I would like to thank them for their dedication, continuous support and involvement.

Updating the NRA results document will be an ongoing and recurring process. We will regularly update and improve the document so that it takes into account the demographic and economic evolution of Malta, emerging threats and vulnerabilities, and the evolution of international standards.

This ongoing process will maintain the dialogue between policy-makers, supervisors, law enforcement, the judiciary and the private sector so that we can continuously work together to ensure Malta's national security, economic stability and financial integrity.



Prof. Edward Scicluna
Minister for Finance

1. Introduction

Money laundering (ML) and terrorism financing (TF) are financial crimes that threaten the world's safety, economic stability and the integrity of the financial system. The United Nations Office on Drugs and Crime (UNODC) estimates that the annual amount of money laundered ranges between 2% and 5% of global GDP.¹ The laundering of proceeds of crime supports and incentivises criminal and terrorist activities. While money laundering is essential to criminal activities as it allows criminals to integrate, transfer and store the value of proceeds of crime, terrorism financing enables terrorist activities. However, AML/CFT controls are still not sufficient to prevent, detect and deter criminal activities. Europol estimates that, during the 2010–2014 period, only ~2.2% of criminal proceeds were seized and ~1.1% were eventually confiscated in Europe². Fighting ML/TF activities is a matter of urgency in the global effort against crime and terrorism.

Malta is deeply committed to preventing, detecting and prosecuting money laundering and terrorism financing activities. We have put in place an institutional framework to supervise, gather intelligence and take legal action against financial crimes. However, we recognise that it should be further strengthened to be fully effective.

As part of its commitment and in line with international standards, Malta completed its first NRA in 2015 and updated it in 2017. This document summarises the findings and lays out the results of the exhaustive risk assessment that was finalised as of February 2018, taking into consideration the various national threats and vulnerabilities in Malta. A wide range of public and private sector stakeholders took part in the assessment including:

- Policy-makers (e.g. Ministries of Finance, Justice and Home Affairs)
- Supervisors (esp. FIAU, MFSA, MGA)
- Law enforcement authorities (e.g. Police, Customs Department)
- Attorney General
- Law courts
- Representatives of the private sector (e.g. Chamber of Advocates, the College of Notaries, the College of Stock Brokers, the Federation of Real Estate Agents, the Institute of Financial Services Practitioners, Malta Bankers' Association, Malta Institute of Accountants)

The NRA was conducted using a wide breadth of data sources, collected from a diverse range of stakeholders. Qualitative data such as contextual information was used in conjunction with quantitative data and statistics to enable a comprehensive understanding of Malta's ML/TF threats and vulnerabilities.

Insights gained from this exercise form the basis of Malta's AML/CFT Strategy. It allows for the identification, assessment, mitigation and monitoring of the ML/TF risks that Malta is exposed to. These results also serve as the basis to take a risk-based approach to fighting ML/TF (e.g. prioritising its efforts or the allocation of resources) and to defining an AML/CFT strategy to address risks that remain too high. This strategy, informed by results of the NRA, is to be prepared and published in 2018 and shall set out clear actions for all identified competent authorities with specific timelines up until the end of 2020. Progress against the action plan underlying the national strategy will be regularly tracked at the national level to ensure Malta's effort on combating ML/TF risks is on track.

¹ United Nations Office on Drugs and Crime (UNODC), *Estimating illicit financial flows resulting from drug trafficking and other transnational organised crimes*, 2011

² Europol, *Does crime still pay? – Criminal asset recovery in the EU*, 2016

The structure of this report closely follows the process undertaken to conduct the NRA based on FATF recommendations. Section 2 provides an overview of Malta's political and legal systems and economy. Section 3 details the NRA approach including the governance, process and methodology that were used. Section 4 and 5 contain the results of the National Risk Assessment for ML and TF. Section 6 provides an assessment of proliferation financing risk in Malta and, finally, Section 7 outlines emerging ML/TF threats and vulnerabilities such as cybercrime, geopolitical risk and cryptocurrencies.

2. Contextual and structural elements

Malta is an island country which lies 93 km away from Sicily to its north and 288 km from Tunisia to its south. The Maltese archipelago consists of three main inhabited islands: Malta, Gozo and Comino. These islands altogether occupy an area of around 316 km².

Figure 1: Malta's location and geography



Malta is home to a total population of 435,000 in 2016, and is a densely populated country with close to 1,400 people per km².³

2.1. Malta's political and legal system

Malta has been an independent state since 1964 and a constitutional Republic within the Commonwealth since 1974. Malta joined the European Union (EU) with nine other countries on 1 May 2004. It is the smallest Member State of the EU in terms of both population and area. On 1 January 2008, Malta adopted the Euro and the Central Bank of Malta (CBM) became a member of the Eurosystem.

Malta is a parliamentary democracy. The President is the Head of State and has executive authority. The President is elected by the House of Representatives for a period of five years. Further, the President is responsible for appointing the Chief Justice, as well as the judges who sit on the independent Constitutional Court and the Court of Appeal. Legislative authority resides with Parliament. The Prime Minister of Malta is the head of government and cabinet. Cabinet

³ Eurostat, 2017

oversees the general direction and control of the Government of Malta and is hence collectively responsible to Parliament.

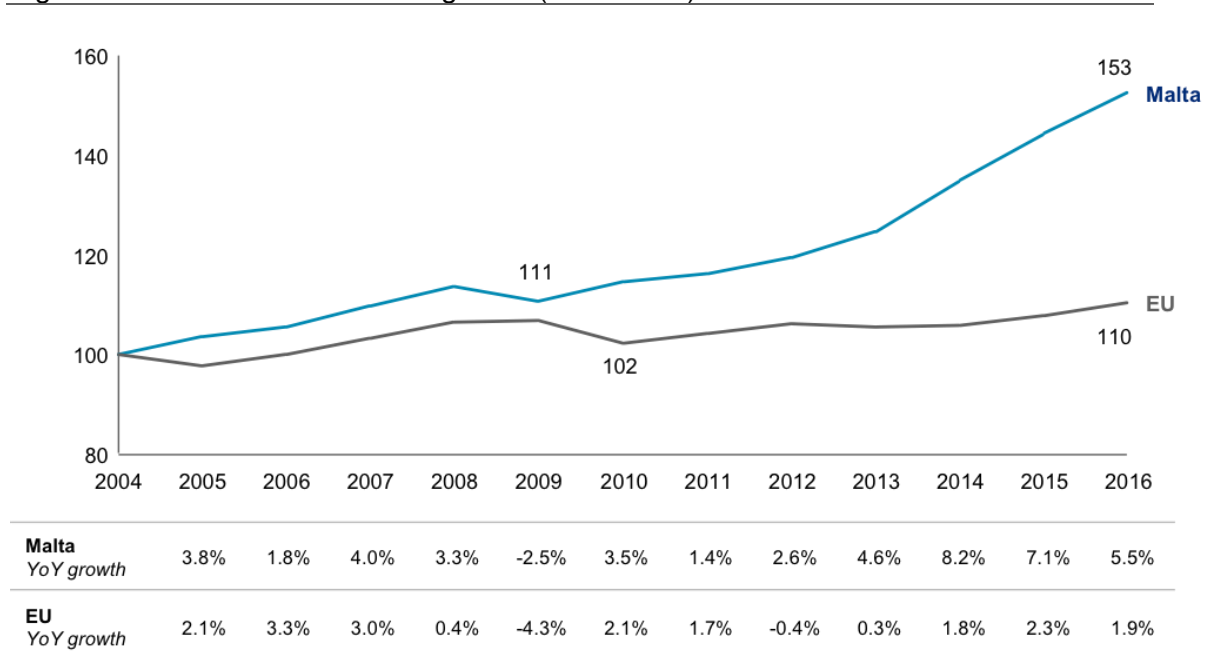
Malta has a mixed legal system. The Maltese legal system has its roots in the Civil Law (continental) family, but has absorbed many features of the Common law (British) tradition. Malta’s laws are regulated by a written constitution, which requires a two thirds parliamentary majority to amend.

2.2. Malta’s economy

Malta has a small, open economy with a nominal GDP of €9.9 BN, thus contributing ~0.06% to the EU’s GDP in 2016.⁴

Malta is one of the fastest-growing economies in the EU with a compounded rate of growth of ~3.3% in 2004–2016, compared with ~1.1% for the EU as a whole. It also proved quite resilient during the Great Recession of 2008-2010. As shown in Figure 2, this rate of growth has translated into a cumulative GDP growth of ~50% for Malta vs. ~10% for the EU between 2004 and 2016.

Figure 2: Malta vs EU Real GDP growth (2004-2016)

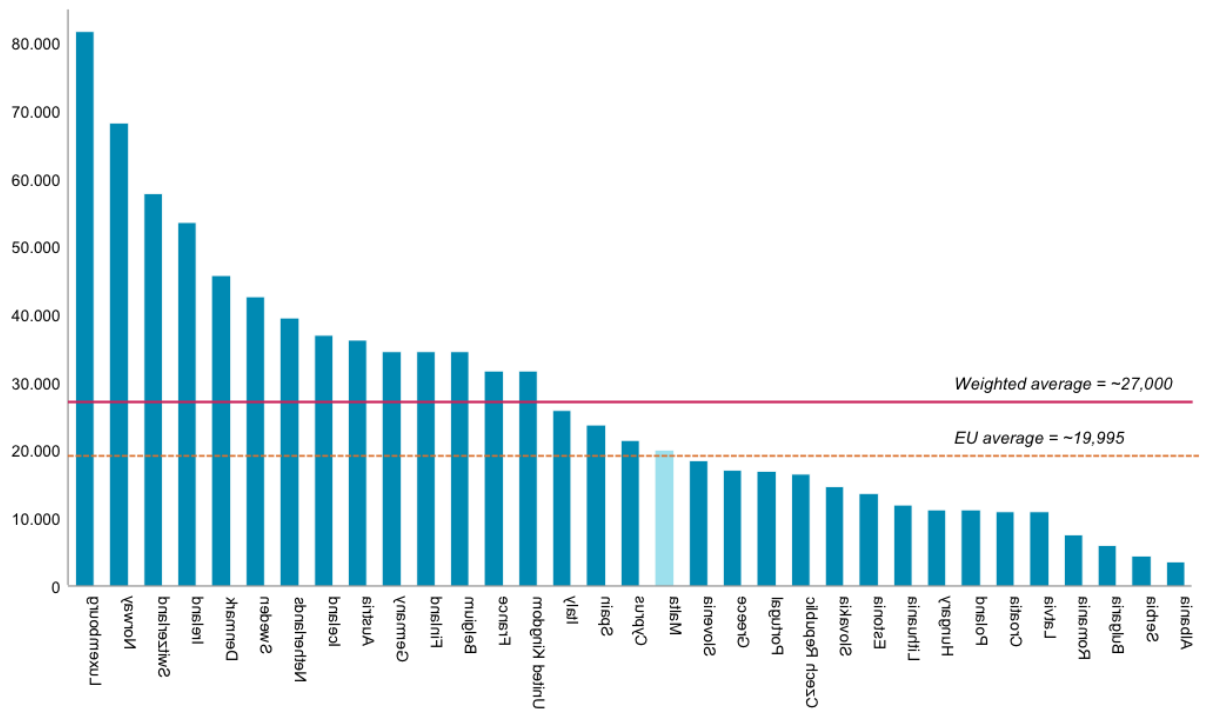


As a result, Malta’s GDP per capita has increased from €14,300 in 2004 to €20,100 in 2016.⁵

⁴ Eurostat

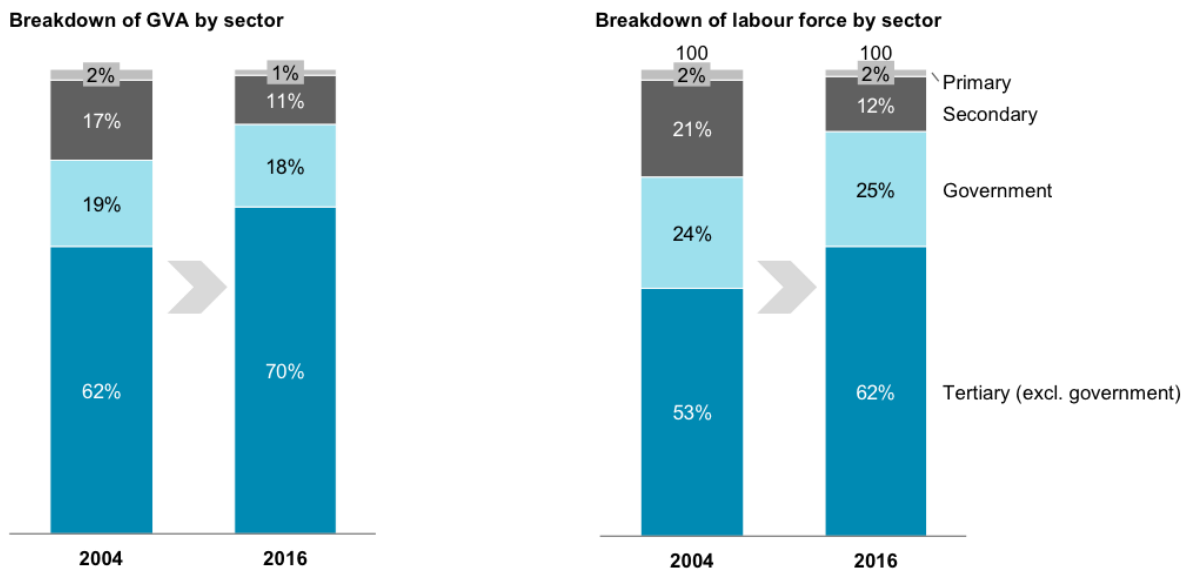
⁵ Eurostat

Figure 3: GDP per capita across EU member states (€), 2016



The economy is largely service-based, representing about 70% of GDP. In addition, the service industry has grown faster than other sectors following accession to the EU in 2004, thus resulting in an increase of its share in GDP.⁶

Figure 4: Breakdown of GDP and labour force by economic sector (2004–2016)⁷

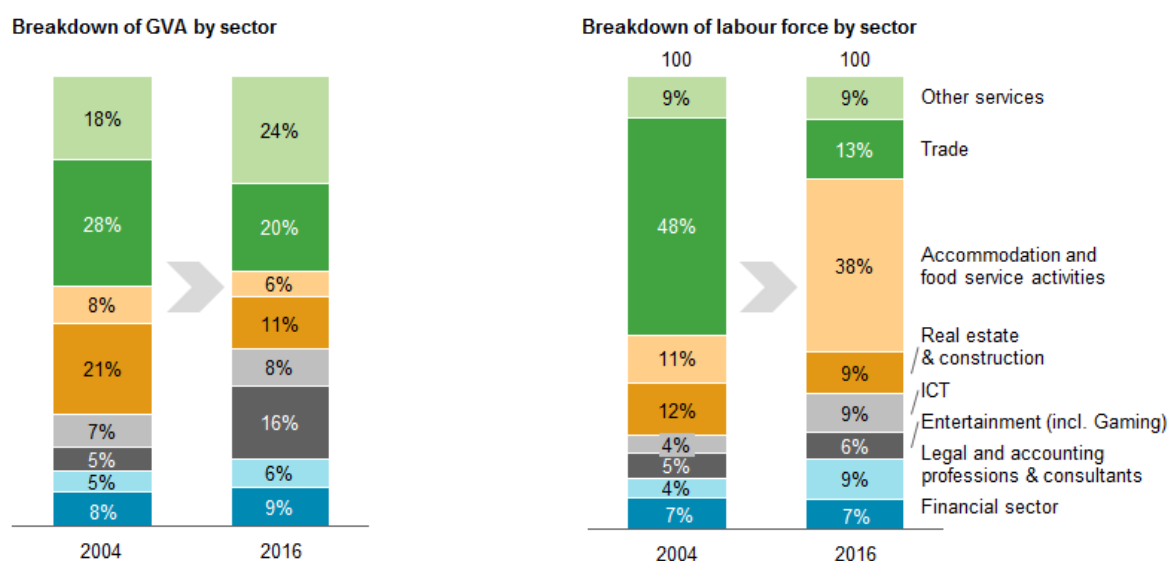


⁶ Note that the industrial activities of General Government are spread across 21 industries and include local councils and extra budgetary units that are financial dependent on government

⁷ Eurostat

In particular, the gaming, financial and tourism sectors have grown rapidly over the past years. Figure 5 shows the contribution of the service sectors to GDP and employment since 2004.

Figure 5: Breakdown of GDP and labour force by service sectors (2004–2016)⁸



The financial sector has developed deep expertise in certain areas and has therefore become an international financial centre. The financial sector accounts for a large share of the Maltese economy with ~7% contribution to GDP and ~5% of the labour force. In Malta, the financial sector relies predominantly on banking and fund management. Currently, there are 28 banks in Malta, together holding assets worth ~4.7x GDP. Alongside this, the size of the domestic investment funds expanded to reach a value equivalent to ~16% of GDP in 2016, consisting of 541 Investment Services (e.g. funds).⁹ The main driver of the sector is foreign demand, where 80% of the financial services are purchased from abroad.

The gaming sector is large and has rapidly grown over the past twenty years. The gaming sector accounted for ~12% of GDP in 2016 and employs over 6,000 people (i.e. ~2% of the labour force).¹⁰ Gaming consists of four land-based companies (e.g. casinos) and 453 licensed remote gaming companies (e.g. online betting and lotteries). Employment in the land based sector licensed by the MGA stood at 866 and over 5,300 in remote gaming¹¹.

Tourism plays a significant role in the economy. The number of visitors has grown from 1.33 MM in 2010 to 1.98 MM in 2016¹² as a result of a number of factors including: the introduction of low-cost airlines, the development of improved infrastructure and hotels, the investment of the EU to restore historic sites, as well as geopolitical instability and terrorism in neighbouring destinations.

⁸ Eurostat

⁹ MFSA, *Annual Report, 2016*

¹⁰ Malta Gaming Authority, *The Maltese Land-based and Remote Gaming Industry*, January-June 2017

¹¹ Malta Gaming Authority, *Annual Report 2016*

¹² Malta Tourism Authority, *Tourism in Malta, 2012,2017*

3. Approach

The Maltese authorities conducted the NRA through a collaborative approach involving all key stakeholders (from both the public and private sectors), using the World Bank's National ML and TF Risk Assessment Tool (NRA Tool) and FATF guidance.

This section details the process undertaken and the technical methodology used to identify and assess Malta's ML/TF risks.

3.1. Process

The process of conducting the first NRA began in November 2013. The first version was completed in 2015 and was updated in the second half of 2017. In order to mitigate the systemic weaknesses identified through the NRA, the Maltese Authorities prepared a National AML/CFT Strategy and underlying action plan.

3.1.1. Project governance and management

The FIAU was responsible for the co-ordination of the exercise. FIAU officials were responsible for drawing up questionnaires, collecting relevant data, populating templates, organising workshops in cooperation with the World Bank experts, chairing working group and sub-group meetings, coordinating efforts with other authorities and private sector bodies and drafting the report and action plan.

In the summer of 2013 the Board of Governors of the FIAU, with financial assistance from the Central Bank of Malta and the MFSA, determined that the World Bank's NRA Tool was the most suitable methodology for Malta. The Director of the FIAU led the management of the project.

Alongside this, an NRA Working Group was established, composed of a wide representation of public sector bodies involved in the control and prevention of ML/TF, as well as a number of private sector representatives.

A number of high-level public officials were appointed to the Working Group. The following public sector bodies were represented: the Office of the Attorney General, the Police (representatives from the Legal Office, the Economic Crimes Unit, the Criminal Investigations Department, the Drug Squad and the Counter-Terrorism Unit), the Customs Department, the Registry of the Courts of Criminal Judicature, the Malta Financial Services Authority, the Malta Gaming Authority, the Central Bank of Malta, the Department of Criminology of the University of Malta, the Ministry of Finance, the Ministry for the Economy, Investment and Small Business, the Ministry for Home Affairs and National Security, the Inland Revenue Department and the V.A.T. Department.

Several private sector representatives were invited to form part of the Working Group. Representatives of the private sector added significant value to the risk assessment of the financial and "DNFBP" sectors. The following private sector bodies were represented: Chamber of Advocates, the College of Notaries, the College of Stock Brokers, the Federation of Real Estate Agents, the Institute of Financial Services Practitioners, the Malta Bankers' Association, the Malta Funds Industry Association, the Malta Institute of Accountants, the Malta Insurance Association, the Malta Insurance Managers Association, the Malta Remote Gaming Council and the Society of Trust and Estate Practitioners. Representatives of the Malta Stock Exchange, money transfer businesses, land-based casinos, financial institutions and banks also participated in the exercise as members of the Working Group.

The Working Group started with a three-day workshop run by four experts from the World Bank. The aim of the workshop was to introduce the NRA Tool and establish applicable milestones.

Following this, the Working Group was divided into seven sub-groups. The sub-groups continued to meet throughout 2014 to analyse available data, collect additional information and carry out a risk assessment of their respective area using the NRA Tool. The national working groups (sub-groups 1 and 2) composed solely of representatives of public sector bodies, focused on national threat levels and on the national vulnerability and combatting ability. The remaining sub-groups, which had the benefit of representation from industry as well as from regulatory authorities and other relevant public bodies, further considered threats and vulnerabilities at sector level. The sub-groups were divided as follows:

- Group 1 – Threat Analysis
- Group 2 – National Vulnerability
- Group 3 – Banking Sector Vulnerability
- Group 4 – Securities Sector Vulnerability
- Group 5 – Insurance Sector Vulnerability
- Group 6 – Other Financial Institutions’ Vulnerability
- Group 7 – DNFBP Vulnerability

A further workshop was held in July 2014, once the work of the sub-groups had progressed substantially. During the three-day event, sub-groups came together to integrate and share results of their analysis. Preliminary results and outcomes were shared with high level policy-makers including the Minister of Finance, the Governor of the Central Bank of Malta, the Director General of the Malta Financial Services Authority, the Attorney General and a representative of the Commissioner of Police. Following this, preparation for the comprehensive action plan began.

The National Vulnerability Sub-Group generated an overall ML vulnerability for Malta, once each sub-group had completed their own module. The overall ML vulnerability combined sectoral data with an additional assessment of the country’s ability to combat ML. Finally, an overall risk level for Malta was computed on the basis of the conclusions of the assessment of the threat and vulnerability rating.

3.1.2. NRA document update in 2017

The NRA was updated in the second half of 2017 to reflect recent developments (e.g. in terms of threats and sectors) and to include some improvements. The results were reviewed and updated based on new data available and to reflect developments in the form of regulations or supervisory activity. The relevant competent authorities reviewed and signed off all updates and additions.

3.2. Methodology

The NRA was conducted in a structured manner with a rigorous approach. First, the level of ML/TF inherent risk (the risk *before* mitigating actions) was assessed as a function of threats (i.e. crimes generating proceeds to be laundered) and vulnerabilities (e.g. sectors most exposed to ML/TF). Then, the national combatting ability of the AML/CFT framework (legal and institutional) was assessed. These reflect the mitigating measures (i.e. all actions by the government that can result in a decrease in the overall level of ML/TF risk such as investigation and prosecution). In addition, the methodology also considers risk of proliferation financing and risks that are yet to manifest completely (emerging risks) to ensure that the NRA considers existing risks with an eye on the future.

The assessment of the levels of ML/TF threat, vulnerability and risk was conducted using the World Bank’s NRA tool. The NRA tool is an Excel-based template that utilises a matrix approach in assessing the ML and TF risk. The template focuses on the assessment of threats and

vulnerabilities, with each of the assessment areas containing carefully selected indicators to assess threats and vulnerabilities. Note that the primary focus of the NRA tool is ML risk, while an additional, more concise module is focused on the assessment of TF risk.

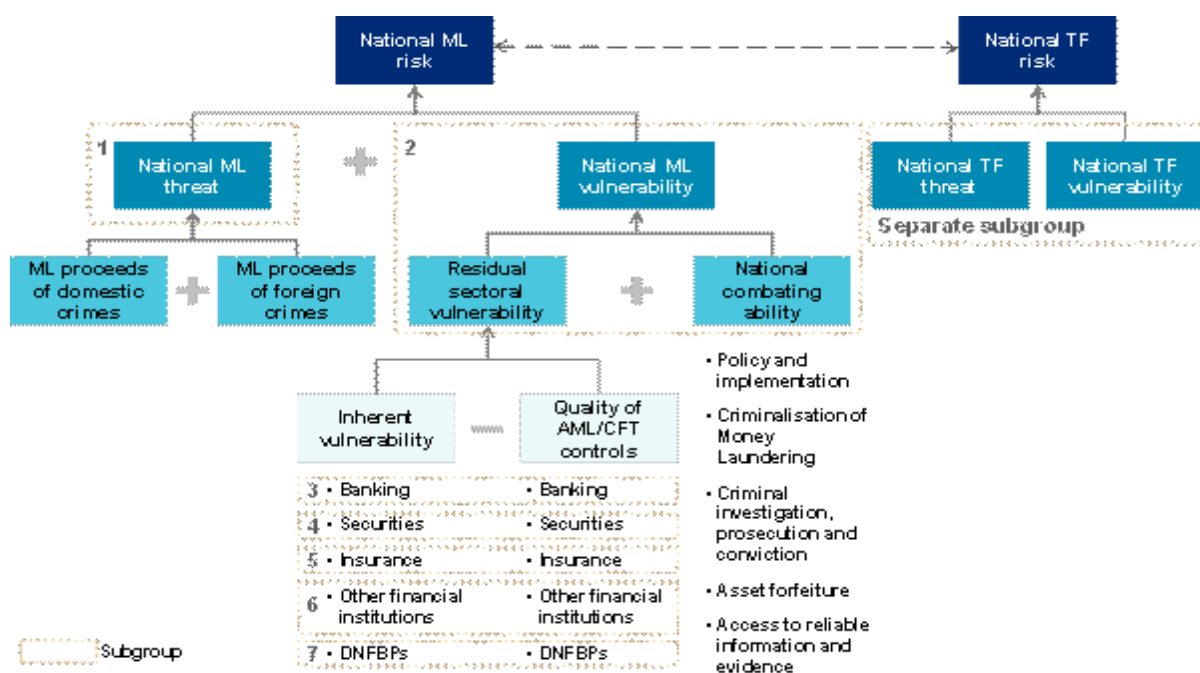
3.2.1. NRA Tool

The NRA Tool provided the Working Group with a structured model to enable the collection of all required data and statistics. Once the information was inputted into the NRA Tool, a rating for overall national and sectoral ML vulnerability was produced. These outcome ratings highlighted priority action areas. The four World Bank experts, assigned to this project, provided advice and support during the completion of the NRA process and reviewed the draft documents produced by the Working Group.

The risk analysis for terrorism financing and proliferation financing was carried out by a separate sub-group. The NRA Tool focused primarily on ML. TF risk was considered separately using a similar methodology to the one used to cover the assessment of ML threats and vulnerabilities.

Figure 6 illustrates the structure of the NRA Tool. The separate chapters of this report address the respective parts of the structure, providing analysis and key findings.

Figure 6: Schematic representation of the World Bank NRA Tool applied to Malta



3.2.2. Data and limitations

The data for the NRA was collected and analysed in line with the FATFs guiding principles on AML/CFT related data and statistics¹³. As recommended by FATF, Malta had one designated lead

¹³ FATF, *AML/CFT-Related Data and Statistics*, 2015

agency, the FIAU, take the role of lead agency in the data collection process. The FIAU identified and approached all relevant institutions involved in the AML/CFT regime to collect the relevant data required to achieve an exhaustive risk assessment.

A wide breadth of data was leveraged for the assessment including data on international cooperation, AML/CFT supervision, financial intelligence, AML legal systems and operational issues, TF and financing of proliferation. Contextual information and qualitative data were used alongside quantitative data and statistics allowing for a comprehensive understanding of Malta's ML/TF threats and vulnerabilities.

Using the World Bank NRA Tool, National ML and TF risk were calculated based on a function of Malta's threats and vulnerabilities. ML threat was calculated based on an assessment of statistics regarding ML proceeds of both domestic and foreign crimes.

National ML vulnerability was assessed as a function of residual sector vulnerability and national combating ability. To assess residual sectoral vulnerability, each sector outlined in FATFs guidance and additionally the gaming sector were assessed based on the inherent vulnerability present and the quality of AML/CFT controls in place. This was assessed alongside quantitative and qualitative data on Malta's national combating ability including policy and implementation, criminalisation of ML, criminal investigation, prosecution and conviction, asset forfeiture and access to reliable information and evidence.

For the risk of TF on the other hand, the World Bank Model is set out in a way which means a rating is not produced through the sum of input variables but through consideration of the evidence.

The data and statistics used as risk analysis input into the NRA Tool covered the three-year period up to the end of 2013. Some sub-group assessments were able to update data up to the end of 2014. Additional data was collected in the second half of 2017 for those sectors that had significantly changed in the last 3 years. This includes organised crime, gaming, drug trafficking, banks and TCSPs.

Statistics used for this exercise by the courts and the law enforcement and prosecutorial bodies concerned, had limitations which although they are now being addressed, somewhat inhibited the members of the Working Group in their review. In fact, "ad hoc" exercises were eventually carried out to collate data that was not maintained previously.

The NRA is an ongoing process as it serves to identify the actions to be taken to reduce the country's level of vulnerability to ML/TF. As progress is made and new factors are brought into play, priorities will change. Consequently, the NRA document will need to be updated to reflect both the positive developments and also any new realities or challenges. Maltese Authorities are currently working with the National Statistics Office to put in place processes that will automate and ease the process of obtaining latest data to allow for regular updates to the NRA document.

4. Results of the National ML Risk Assessment

This section provides an overview of the National ML threats and vulnerabilities based on findings of the Working Group in relation to the assessment carried out in Malta as at 2017. Threats are measured in terms of exposure to ML of domestic proceeds of crime and foreign proceeds of crime while vulnerabilities are measured on a sector level.

Overall, ML/TF risk in Malta was rated as Medium – High and is primarily driven by three components:

- By the threat of foreign proceeds of crime (especially given the size and openness of the economy and financial system) and, domestically, by local criminal groups and tax evasion
- Sectoral vulnerabilities reside primarily with international business activities, especially the relatively large banking, securities, gaming and DNFBP sectors
- Malta has established a legal and institutional AML/CFT framework; however, the capacity and expertise of law enforcement agencies are not sufficient to fully support investigations, prosecutions and asset recovery, thus translating into low levels of convictions and confiscation compared with the ML/TF risk profile

In addition, a number of institutional deficiencies have limited the effectiveness of domestic efforts to mitigate ML/TF risks, including: the lack of a national coordination mechanism (though this is being addressed currently through the set up a National Coordinating Committee), the lack of transparency of the ownership of legal entities and arrangements (legislation to address these deficiencies was enacted by the end of 2017), and limited capabilities (e.g. lack of resources, scarcity of expertise, and limited use of adequate IT tools).

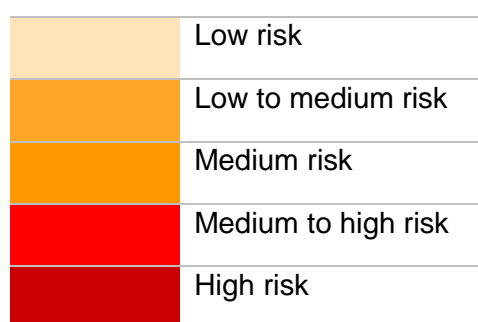
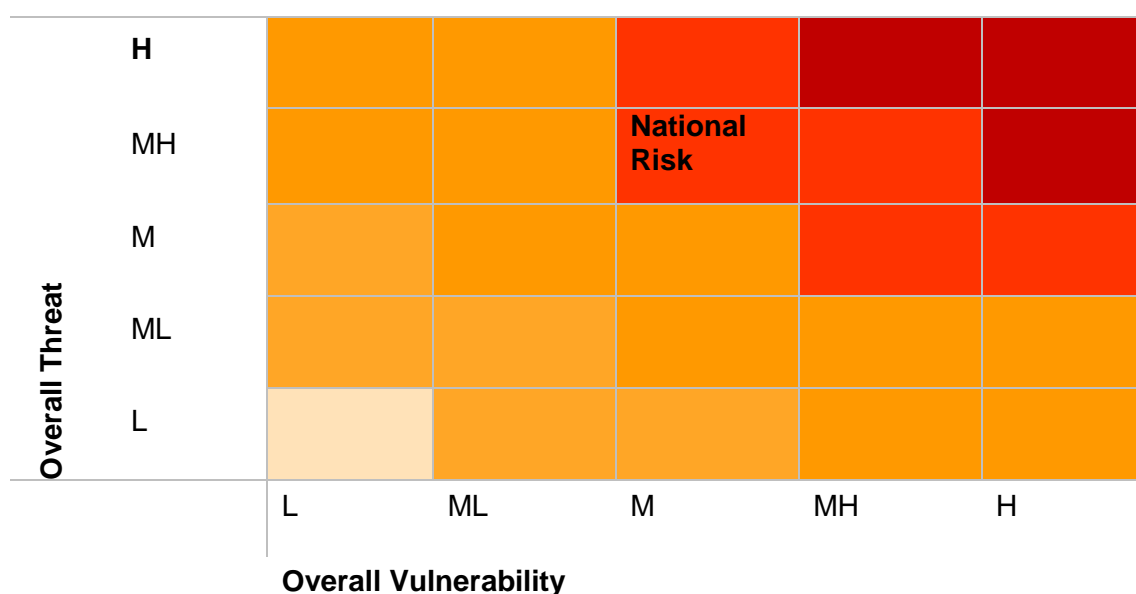
4.1. Summary Assessment

Upon the completion of the NRA, the level of ML risk in Malta was computed on the basis of the findings of the Working Group on the overall threat to which the country is exposed, the vulnerabilities of its combatting abilities and the vulnerabilities of its financial and DNFBP sectors. The ML risk was plotted on the heat map in

as a sum of the overall threat rating of Medium-High and a vulnerability rating of Medium.

The overall ML risk for Malta was rated as Medium-High.

Figure 7: Heat map on national risk



4.2. National ML Threat

The report provides an overview of the findings of the Working Group in relation to the assessment carried out on the ML threat to which Malta is exposed as a jurisdiction both in terms of predicate offences committed within its territory and outside its territory when Malta may be used as a pass-through jurisdiction. The report highlights the fact that Malta is an international financial centre and therefore provides a platform for transactions and operations of a diverse nature to take place through its financial system.

The exercise aimed at assessing and determining the ML threat in Malta was coordinated by a sub-group of the Working Group chaired by an official of the Financial Intelligence Analysis Unit (FIAU), which also included high level representatives from the Office of the Attorney General, the Enforcement Unit of the Malta Financial Services Authority (MFSA), the Police force, the Courts of Justice and the Criminology Department of the University of Malta.

The sub-group was largely responsible for completing two sets of input variables. The first set aimed at identifying the ML threat arising from predicate offences committed in Malta and included several variables on proceed-generating offences, including the number of police investigations with regard to each offence, the number of prosecutions, and information originating from STR among other relevant information which could be indicative of the ML threat arising from each predicate offence.

The second set of variables aimed at identifying the level of ML threat arising from predicate offences which were committed outside Malta. For this assessment, the World Bank's threat assessment tool included financial as well as on financial information such as information on trade statistics, the volume and value of cross-border financial transactions and information from international requests for mutual legal assistance.

The input variables were assessed and rated in accordance with the descriptions and criteria outlined in the methodological document that had been circulated by the World Bank.

Although the sub-group gave due consideration to the statistical and other data made available to them to the largest extent possible, a number of ratings were necessarily based on the reasoned perceptions and judgement of the members of the sub-group who are highly experienced in their area of expertise.

4.2.1. Money laundering of domestic proceeds of crime

The exercise to assess and quantify the ML threat arising from predicate offences committed in Malta was carried out through the review of data obtained from the Financial Intelligence Analysis Unit (the Maltese FIU), the Police, the Inland Revenue Department and the Attorney General's Office. A rating outlining the level of ML threat arising from each offence was assigned to the different money-generating offences taken into consideration. In the absence of any information being maintained by any authority in Malta on the actual rate of crimes committed in Malta, the ratings assigned to the separate predicate offences were based on the data relating to the number of investigations by the Police, the FIAU and the tax authorities, the number of cases prosecuted and the value of the criminal proceeds generated from the offences. The overall ML threat arising from domestic predicate offences has been rated as Medium-High.

The level of ML threat posed by the different domestic offences assessed has also been categorized separately according to whether these offences pose a high, medium or low risk to the jurisdiction.

4.2.2. Money laundering of foreign proceeds of crime

The external ML threat assessment examined the ML threats to which Malta may be exposed as a jurisdiction. The focus of the exercise was the potential laundering of funds originating from predicate offences committed abroad. For this purpose, the sub-group took into account an extensive range of factors which identify the recorded dealings, transactions and relations with all other countries. Data from a representative number of entities and authorities was then gathered and considered within the context of other non-quantifiable factors in order to assess the level of ML threat posed by each country.

The statistical data used for the purposes of determining the extent of the external threat included the following information:

- Trade-related financial inflows and outflows;
- Financial inflows and outflows through the banking system;
- Requests for information received by the tax authorities in Malta;
- Requests for information made by the tax authorities in Malta;
- Cross-border cash declarations;

- Requests for information received by the FIAU from other FIUs;
- Requests for information made by the FIAU to other FIUs;
- Values of financial inflows and outflows sent via money remitters;
- Requests for Mutual Legal Assistance received and sent by the Maltese authorities; and
- The links to specific countries in STRs received by the FIAU and in FIU requests received by the FIAU.

The data was examined carefully and, using the NRA Tool, the flows of funds from twelve countries were identified as constituting the main external threat of ML to Malta.

For the purpose of this exercise, the ML threat rating assigned to the countries has been sub-divided into four categories – High, Medium-High, Medium and Low.

4.3. ML vulnerability

This section summarises the findings of the sectoral vulnerability assessment which outlines the level of ML vulnerability that Malta's major sectors are exposed to, namely banking, securities, insurance, gaming, other financial institutions and DNFBPs.

Malta's sectoral vulnerabilities are mostly driven by its open economy and large financial sector (especially banking and securities), gaming sector (especially remote gaming) and DNFBPs (especially TCSPs, legal professionals, real estate). Supervisors have recently intensified their efforts to regulate and supervise high risk sectors, and sanction non-compliant entities. In 2016, 96 on-site AML/CFT examinations were conducted by the FIAU and the MFSA, effectively doubling the number of on-site inspections since 2014. Gaming companies became subject persons in January 2018 when the MGA began ramping up to start conducting AML/CFT inspections. In addition, dedicated resources have increased the number of supervisors. However, the number and value of reprimands and penalties remains challenging.

The Maltese economy is a cash-intensive economy where many sectors still rely significantly on cash transactions. Cash transactions can be found in the real estate and luxury goods sector. The extensive use of transferable cheques is an ML/TF vulnerability as it obscures the link between the payment and payer.

Table 1: Summary of Malta's ML/TF threat assessment

Threat category	Overall threat level	Sub-category	Threat level
Money laundering of domestic proceeds of crime	Medium-High	Tax evasion	High
		Local criminal groups	High
		Drug trafficking	Medium-High
		Fraud and misappropriation	Medium-High
		Corruption and bribery	Medium-High
		Smuggling	Medium
		Theft and receipt of stolen goods	Medium
		Armed robbery	Low
		Living of the earnings of prostitution	Low
		Usury	Low
		Illegal gambling and violations of the Gaming Act	Low
		Human trafficking	Low
		Arms trafficking	Low
Smuggling of persons	Low		
Unlicensed financial services	Low		
Money laundering of foreign proceeds of crime	High	ML of foreign proceeds of crime threat level has been calculated for a number of countries	

Table 2: Summary of Malta's ML/TF sectoral vulnerability assessment

Sector	Sector vulnerability		Sub-sectors	Sub-sector vulnerability		
	Inherent	Residual		Inherent	Controls	Residual
Banking	High	Medium-High	Core domestic banks	High	Medium-low	Medium-High
			Non-core domestic & international banks	High	Medium-low	Medium-High
Securities	Medium-High	Medium-High	Collective investment schemes	Medium-High	Low	Medium-High
			Custodians	Medium-High	Low	Medium-High
			Foreign exchange	Medium-High	Low	Medium-High
			Fund administrators	Medium-High	Low	Medium-High
			Fund managers	Medium-High	Low	Medium-High
			Stockbrokers	Medium	Low	Medium
Insurance	Medium	Medium	Insurance	Medium	Medium-low	Medium
Other Financial Institutions	Medium-High	Medium-High	Payment services	High	Medium-low	Medium-High
			Lending	Medium-Low	Medium-low	Medium-Low
			Other activities	Medium	Low	Medium
Gaming	Medium-High	Medium-High	Land based gaming	Medium	Medium-low	Medium-Low
			Remote gaming	High	Low	High
DNFBP	High	High	Company service providers ¹⁴	High	Low	High
			Lawyers	High	Low	High
			Trustees and fiduciaries	High	Low	High
			Notaries public	Medium-High	Low	Medium-High
			Accountants and auditors	Medium-High	Low	Medium-High
			Real estate agents	Medium-High	Low	Medium-High
			Dealers in high value goods	Medium	Low	Medium

¹⁴ Excluding legal and accounting professions acting as company service providers

4.3.1. Sectoral ML vulnerability

Financial sector

While the **banking sector** is inherently exposed to ML/TF due to the nature of the products offered and the volume of clients and transactions, the sector's controls are generally more mature than other sectors. The six core domestic banks hold €21.8 BN of assets (i.e. ~220% of GDP) and employ a total of ~3,300 employees, the five non-core domestic banks hold €2.5 BN of assets (i.e. ~25% of GDP)¹⁵ and undertake limited business with Maltese residents, and the remaining 14 international banks mostly serve large, international corporates and hold €22.5 BN of assets (~230% of GDP). A number of the products and services offered by core, non-core and international banks present ML risk, such as non-retail deposits, correspondent accounts, wire transfers and wealth management services. This is predominantly due to the banking sector's large size and exposure to foreign investors. While some banks are enhancing their AML/CFT controls, recent inspections show that the controls in place in some banks remain insufficient to effectively prevent ML/TF. An increase in efforts and resources at the FIAU and MFSA resulted in an increase in the number of inspections to reach 37 in 2016. However, the result of supervision remains limited, as reflected in the enforcement outcomes: for instance, Credit Institutions only received penalties of approximately €80,000, based on just 6 penalties in 2016.

The **securities sector**'s vulnerability to ML/TF is primarily driven by its high volume of transactions and the limited capacity and resources of the authorities to carry out regular AML/CFT supervision across the sector. In 2016, there were 451¹⁶ licence holders within the securities sector. Foreign exchange traders are exposed to higher levels of vulnerability than other licensed entities within the securities sector, due to the high volume of transactions. This is compounded by the speed with which transactions are completed, the non-face-to-face nature of the transactions and the use of pre-paid cards. Transactions with international centres and services to high net worth individuals are also identified as factors that contribute to the high level of vulnerability. While certain, generally larger securities firms have established suitable AML monitoring systems and corporate transparency mechanisms, quality of controls in the securities sector is generally low. This is partly due to limited resources and focus of supervisors to ensure adequate supervision and enforcement. Numbers of inspections have however increased from one on-site examination in 2016 to 19 in the first three quarters of 2017.

Among the **other financial institutions**, payment and e-money financial institutions are particularly exposed due to the transactional nature of the activity, the volume of transactions of the sector, and the number of entities involved (30 payment licenses and 13 e-money licenses¹⁷). Lending providers are however relatively small and the nature of their activities is less risky than deposit-taking and transactional activities (e.g. payments).

The **insurance sector** is generally less exposed to ML due to the nature of its activities and the size of the sector in Malta. The domestic life insurance sector is relatively small (gross written premiums of €3.7BN for long-term insurance vs. €2.6 BN for general insurance) and limited to 8 licensees. New pension products have grown rapidly since amendments to the regulation in 2016 and may present some vulnerabilities given the nature of most products (personal retirement schemes), the size of the schemes (a total of €3.7 BN of assets under management¹⁸) and the number of products (49 schemes and 2 funds¹⁹).

¹⁵ Central Bank of Malta, *Ninth Financial Stability Report*, 2016

¹⁶ MFSA, *Annual Report*, 2016

¹⁷ MFSA, *Statistical Tables*, September 2017

¹⁸ MFSA, *Annual Report*, 2016

¹⁹ MFSA, *Statistical Tables*, September 2017

Gaming sector

Malta has a large gaming sector representing ~12% of GDP.²⁰ It consists of land-based companies (e.g. casinos, betting shops) and remote gaming companies.

There are four **land-based casinos operating** in Malta. Total gross gaming revenue (GGR) amounted to ~€45 MM. Other land-based gaming entities involve activities that are less vulnerable to ML/TF (e.g. bingo, lottery) or generate low GGR.

As of June 2017, 275 **remote gaming** companies operate in Malta, holding a total of 558 remote gaming licences. Remote gaming is inherently vulnerable to ML due to the high number of customers (~12 MM active customer accounts), high volume of transactions (e.g. GGR reaches close to ~€3 BN), the non-face-to-face nature of the business, the high percentage of non-resident customers and the use of prepaid cards that are not linked to a bank account. This is further evidenced by the high number of STRs received. Certain remote gaming activities are more vulnerable than others. For instance, P2P and sports betting are more exposed than bingo or lotteries as they involve a transfer of value or predictable, low losses.¹⁹

While the remote gaming sector has been subject to some AML/CFT regulations for a number of years²¹, it will become a subject person under the PMLFTR starting in January 2018.²² The MGA and FIAU will supervise the sector more effectively with a comprehensive AML/CFT supervisory approach, incl. risk assessments, off-site and on-site inspections and enforcement actions. The MGA has already formed an AML/CFT-dedicated team of five members (to increase to at least eight) which will supervise the sector (e.g. 40–50 AML/CFT-focused inspections annually). The MGA also plans to finalise its risk-based approach (e.g. entity-level risk assessment), update its AML/CFT policies & procedures to reflect the 4AMLD, and conclude a MoU outlining its cooperation with the FIAU.

Other Designated Non-Financial Businesses and Professions (DNFBPs)

The ML risk assessment of each sub-category was carried out separately in view of the big differences that exist in the activity carried out and the type of products and services offered. As such, each sub sector includes, in addition to the vulnerabilities and quality of controls assessment, also an analysis of the sectoral threats.

Trust and company service providers (TCSPs) are exposed to ML/TF as companies, complex corporate structures and legal arrangements are vulnerable to abuse or misuse. Such vehicles are known to have been used to obscure beneficial ownership and complicate the tracing of proceeds of crime. The TCSP sector is particularly large²³ and handles a high volume of international business. While TCSPs are regulated by the MFSA and subject to the PMLFTR, not all company services providers are officially registered, and AML/CFT inspections and enforcement currently do not reflect the risk profile of the sector. In 2017, the supervisors conducted 27 on-site inspections.

Similarly, **legal and accounting professionals** are exposed to ML/TF given the nature of their activities and in many instances, the international nature of their activities. There are 1,415 legal professionals in Malta, however only a proportion of these carry out “relevant activity”, as described in the PMLFTR, and hence not all legal professionals fall under the relevant regulation. When carrying out “relevant activity”, the legal profession often handles many international clients and faces challenges with regards to the identification of non-face-to-face clients. The weakness in controls is driven by a low level of

²⁰ NSO

²¹ In particular, licensing requirements under Lotteries and Other Games Act 2001 (Chapter 438 of the Laws of Malta) and some AML obligations under Remote Gaming Regulations 2004 (Subsidiary Legislation 438.04)

²² Note that some remote gaming companies filed STRs before the enforcement of the PMLA (87 STRs in 2016)

²³ There are ~260 registered CSPs; however it is believed that not all CSPs are officially registered

supervision of those lawyers who carry out a relevant activity and would therefore be subject to AML/CFT regulations. The absence of a special law regulating the profession, apart from ethical standards issued by and subject to monitoring by the Commission for the Administration of Justice is a relevant weakness in terms of the controls in place. In addition, the ~3,000 accounting professionals' exposure to ML/TF is attributable to the large size of the sector and the fact that some of the services they provide are considered to be particularly vulnerable to misuse for ML purposes. The measures in place to mitigate the risk are not effective enough as reflected by the limited number of STRs received, as well as observations made during on-site visits. Notaries are particularly exposed to ML/TF with regards to real estate transactions. Notaries are public officers warranted to receive acts done by any person during his/her lifetime and to attribute public faith to those acts.²⁴ At present, there are 299 notaries in Malta. In 2016, the FIAU carried out onsite inspections for 53 accounting firms, notaries, advocates, tax advisors and legal procurators, representing only a small fraction (<10%) of supervised entities in the DNFBP sector.

Real estate agents and dealers in high value goods are also vulnerable to ML/TF. Between 2000 and 2015 house prices nearly doubled, increasing at an annual rate of ~5%.²⁵ It is estimated that over 100 real estate agencies operate in Malta. They are not regulated by sectorial legislation, however they are subject to the PMLFTR. They are exposed to being misused or abused to invest proceeds of crime in real estate assets, possibly through layers of legal entities and arrangements to obscure the trail of evidence. Some high value goods could be used to launder proceeds of crime in Malta (e.g. yachts, aircrafts) although further analysis would be required to assess the extent of the vulnerability. In 2016, the FIAU carried out onsite examinations of 13 real estate agents.

4.4. ML national combating ability

Malta has established a legal and institutional AML/CFT framework. However, the capacity and expertise of law enforcement agencies is not sufficient to fully support investigations, prosecutions and asset recovery, thus translating into low levels of convictions and confiscation compared with the ML/TF risk profile. As a result of limited data gathering and storing practices in the past, there are insufficient statistics available to track the evolution from STRs to conviction and consequently, confiscation.

With Malta's legal framework (e.g. definition of ML offence, applicable penalties), the criminal justice system is equipped to prosecute and convict ML offences. However, it sometimes struggles to prioritise cases due to the absence of a definition of "serious offences" in relation to ML. Malta has a track record of domestic and international cooperation and adheres to international auditing and tax disclosure standards.

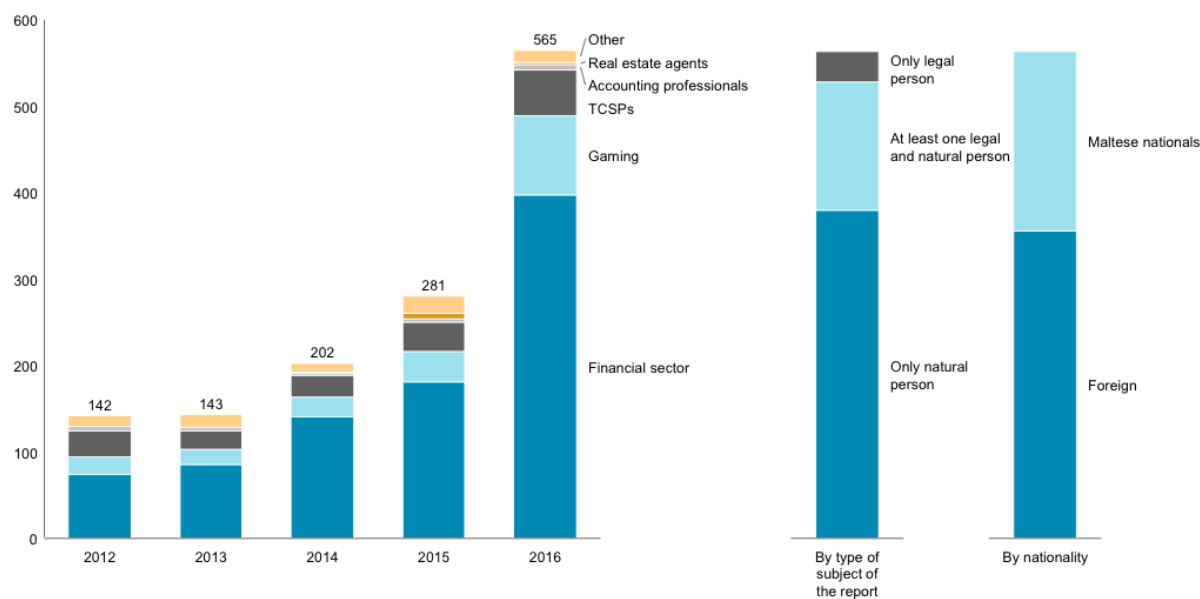
The number of STRs received by the FIAU has increased from ~140 in 2012 to over 560 in 2016. A majority of STRs concern natural persons, and generally foreign nationals. These STRs have triggered the FIAU to analyse ~520 cases in 2016 (up from ~170 in 2014), in addition to the 47 it had self-initiated. In parallel, the quality of STRs received has increased.²⁶

²⁴ Cap. 55 of the Laws of Malta.

²⁵ Central Bank of Malta, *An Assessment of the Maltese Housing Market*, 2016

²⁶ The FIAU's direct feedback system indicates that the number of well-rated STRs increased from ~60% of STRS in 2014 to over 80% in 2017.

Figure 8: Evolution and breakdown of STRs received by the FIAU



While Malta has put in place a legal framework to prosecute ML/TF, the Police Economic Crime Unit and the Attorney General’s office lack sufficient staff and specialisation, access to databases, and analytical tools to tackle complex third-party money laundering cases.²⁷

While the FIAU and the Police are responsive in international cooperation (e.g. FIAU responds promptly to the 100-130 requests every year and makes 110–180 requests to foreign FIUs, and the Police received ~40 MLA requests last year), there is limited data on MLAs sent to foreign authorities.

The ability to trace, freeze and forfeit the proceeds of crime has been limited so far. To date, the Police and Courts play the role of Asset Recovery Office; however, their staff and expertise are ill-equipped to deal with these tasks. This explains the low number and value of assets frozen and confiscated. For example, in 2014, only 83 freezing orders were made by the Courts leading to a sum of ~€90,000 forfeited in favour of the Government of Malta²⁸. The establishment of a dedicated Asset Recovery Bureau is expected to enhance the ability to trace, freeze and forfeit the proceeds of crime.

²⁷ Refers to cases where external facilitators help criminal organisations and terrorists conceal illicit funds. Examples include attorneys, accountants, investment managers, trust companies and real estate professionals., Business Crimes Bulletin, *Third-Party Money Launderers*, 2017

²⁸ Ministry of Justice, *Annual Report*, 2014

5. Results of the National TF Risk Assessment

This section provides an overview of the TF threats and TF vulnerabilities present in Malta, identified by the National TF Risk Assessment. In the World Bank model for TF, a risk rating is not produced through the sum of these input variables but through consideration of the evidence.

Although there was no hard data to suggest that Malta is particularly exposed to TF, there are a number of other factors which cannot be ignored and should drive the authorities to maintain a high level of scrutiny and to ensure that defences are at their highest levels.

As such, although the effectiveness of the Maltese system to address terrorism and TF as a specific threat is generally untested, the TF risk for Malta has been rated as Medium-High. The level of risk was calculated on the basis of an assessment of the threat, rated as Medium-High, and a Medium-High vulnerability rating.

5.1. National Combatting Ability

The 24 National Combatting Ability input variables were divided into five key sections:

- Policy and Implementation;
- ML Criminalisation;
- Criminal investigation, prosecution and conviction;
- Asset forfeiture;
- Access to reliable information and evidence.

5.1.1. Process

The 24 input variables relating to the country's national combatting ability, together with certain country-specific factors, were assessed and rated in accordance with the descriptions and criteria outlined in the methodological document that had been circulated by the World Bank. Although the sub-group gave due weight to the statistical data and other information made available to them, for a number of ratings reliance had to be made on the reasoned views and judgement of the experienced officers involved in the process.

Although Maltese authorities have always claimed during the course of mutual evaluations carried out by international assessment bodies that the ML and TF risks in Malta are low, this assessment has never been based on a scientific study grounded in empirical evidence. Similarly, an actual comprehensive assessment of the AML/CFT vulnerabilities to which the jurisdiction is exposed on the basis of its geographical location, the effectiveness of its regulatory authorities, its ability to combat crime, systems in place for the formulation of national policy, national coordination, capacity to exchange information with foreign authorities and other relevant criteria, has never been carried out.

For the country's assessment to be reliable it must take into consideration the particular characteristics of the country and its financial sector, an area that has evolved considerably over the past fifteen years. Malta is today a jurisdiction that is an international business and financial centre, it has a competitive tax regime that attracts investment by non-residents and has a thriving gaming sector. The authorities are, in fact, aware that the increasing growth in these sectors present accompanying AML/CFT risks

which need guarding against and proportionate preventative, supervisory and law enforcement structures.

The national vulnerability assessment was coordinated by a sub-group of the Working Group chaired by an official of the FIAU, which also included representatives from the Office of the Attorney General, the MFSA, the Central Bank of Malta ('CBM'), the Money Laundering Section of the Economic Crimes Unit of the Police force, the Ministry for Finance, the Ministry for the Economy, Investment and Small Business, the Inland Revenue Department, the Criminology Department of the University of Malta and the Malta Gaming Authority, .

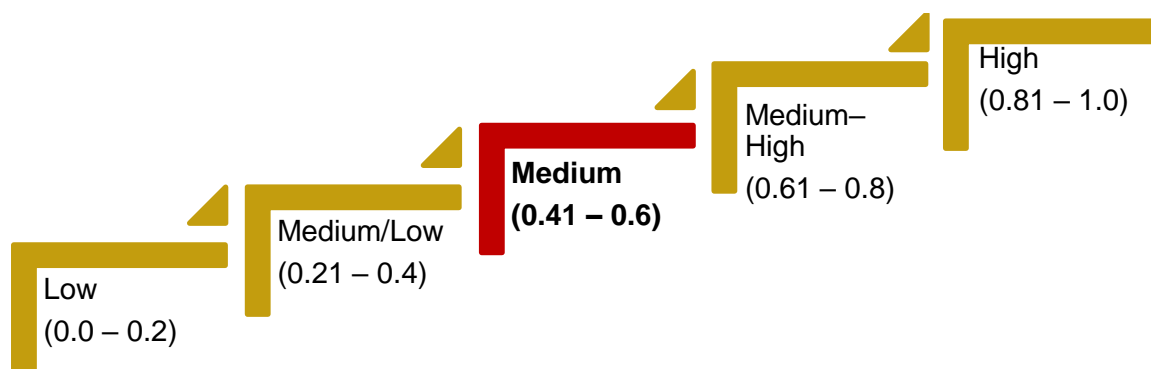
The sub-group was largely responsible for completing the input variables dealing with the national combatting ability. Upon completion of this exercise, the vulnerability ratings generated by the sub-groups involved in the assessment of the banking, securities, insurance, financial institutions and DNFBP sectors were factored into the assessment for the overall national vulnerability rating to be determined.

5.1.2. Combatting Assessment

This assessment is derived from a national combatting ability that has been rated as Medium and a Medium-High sector vulnerability.

The overall national vulnerability has been rated at 0.6 (a Medium rating, which however leans towards the higher side of the medium range). The vulnerability ratings were assigned in accordance with the World Bank methodology on a scale ranging from 0.0 to 1.0, with each additional decimal point representing a progressively higher level of vulnerability:

Figure 9: World bank vulnerability rating methodology



Going forward, it is envisaged that improvements will be made by the country upon implementation of the action plan accompanying this report. Various issues identified will be addressed, thereby reducing the specific and overall vulnerability ratings and the consequential risk.

Besides the specific vulnerabilities for the sectors examined, the vulnerability rating is also largely driven by shortcomings in the national combatting ability, such as the area of investigation, prosecution, conviction and asset forfeiture.

5.1.3. Policy and Implementation

Countries are expected to be in a position to formulate and implement appropriate AML/CFT policy to address AML/CFT risks effectively as they present themselves in the jurisdiction, utilising appropriate means available in the jurisdiction. In assessing whether the country effectively formulates, informs and implements AML/CFT policy, responding adequately to the risks and location conditions as they change, it was noted that since no previous risk assessment was carried out in the jurisdiction and no exercise on the quantification of overall economic loss from crime is carried out routinely, it is admittedly very difficult for policy to be formulated effectively.

Government policy in the area of AML/CFT appears to be reactive, mainly because of the absence of a formal policy-making structure and the fact that no assessment of the risks, threats and vulnerabilities to which the country is exposed is carried out routinely. This NRA process including its concomitant Strategy and Action Plan is seen to be a major step to rectify this deficiency since its conclusions will assist the authorities in the identification of these gaps.

Over the past years, the Board of Governors of the FIAU has been the main body responsible for establishing and implementing AML/CFT policy at a national level. In the absence of a specially designated body that coordinates national policy and oversees all AML/CFT aspects, including investigation, prosecution, freezing, seizure, confiscation, reporting of suspicious transactions, supervision, cross-border controls and law enforcement, and thereby providing overarching policy direction, this role has been fulfilled by the Board of Governors of the FIAU. The reason for this is that by law it is composed of representatives at senior levels from the Office of the Attorney General, the MFSA, the Central Bank of Malta and the Police.

The Board of Governors of the FIAU therefore has a dual role: a policy-making role within the FIAU and a role as national policy coordinator. Currently, the FIAU takes a leading role even when it comes to drafting legislation, representing the Government of Malta in EU fora and providing advice to the Government on AML/CFT matters. The approach has served the country well over the years especially in view of the small size of the jurisdiction, the limitation of specialised resources and the concentration of expertise within the FIAU. Nonetheless, since the scope of AML/CFT legislation is broad and impacts upon several areas that go well beyond the remit of the FIAU, including law enforcement, prosecution, court orders, customs controls and other segments, difficulties may arise in imposing policies and implementing action covering areas that fall outside the sphere of influence of the FIAU.

Particularly in the light of the revised FATF Recommendation 1, which requires the designation of an authority or mechanism to coordinate actions to assess risks and apply resources aimed at ensuring that risks are mitigated effectively, and Recommendation 2, which deals specifically with national AML/CFT policy coordination, the importance of having an overarching policy-making body has increased. The setting up of a body empowered to coordinate national policy in this area, to mandate the collection of statistics and to implement action on the basis of that statistical data is essential for the effectiveness of the system to be measured and assessed periodically. Although this role has been fulfilled by the governing body of the FIAU over the years, this approach should be re-examined to determine its effectiveness.

Being a small state, the response to changes in risk factors can potentially be quite fast, especially since meetings are normally held within short timeframes and the legislative process can be triggered expeditiously. Therefore, once a policy framework is formalised, significant improvements should be achievable within a short timeframe. Authorities, in fact, would be likely to become more responsive to signs of new potential channels for the laundering of funds, especially when these fall outside the regulatory and supervisory sphere.

Within the financial services sector, on the other hand, authorities are already responsive and action has been taken on various occasions to address the risks posed by particular products even where these falls outside the scope of EU legislation and international standards. The Maltese authorities and policy-makers are fully aware of the need to introduce AML/CFT measures where potential risks may arise

(as in the case of specific insurance set-ups like affiliated insurance business and protected cell companies) and in situations where new programmes attracting foreign investment are considered, as in the case of the Individual Investor Programme, where customer due diligence considerations were given significant importance.

Moreover, a number of instances were identified by the sub-group where the authorities in Malta could implement regulations and provide guidance expeditiously to react to particular situations requiring urgent action. These included: (1) the circulation of information on the increased risk to financial institutions on UN Resolutions; and (2) the issuance of guidance to subject persons by the FIAU on the need to carry out enhanced due diligence.

5.1.4. Money Laundering Criminalization

In the assessment of the variable as to whether the country defines the ML offence comprehensively and employs appropriate penalties, Malta received a very high rating, meaning that the pertinent legislation is in place and the criminal justice system is considered to be in a position to act effectively against ML. No vulnerabilities were identified in this area, even though it was noted there seem to be inconsistencies among prosecutors in the interpretation of the elements of the offence of ML, causing a certain level of unwarranted confusion, especially in relation to the link of the ML offence with the predicate offence and the level of proof that needs to be established that the proceeds have been generated from a specific predicate offence. The provision of specific training for prosecutors and judges should serve to ensure that interpretation of the law is more consistent and more in line with internationally accepted practices.

5.2. TF threat

Based on available statistical data and evidence has led to the need for Maltese authorities to take a conservative view of the country's TF threats hence resulting in an assessment of threat as Medium-High. The national threat is twofold – stemming from the risk of terrorism itself and the risk of terrorism financing.

Malta's geographical location exposes the islands to enhanced migration flows from the African region. Due to continuous geopolitical unrests in the region, terrorist organisations may exploit the situation to infiltrate the European Union.

While the Counter Terrorism Unit investigated several cases on this topic in the last few years and the FIAU received numerous information requests, no concrete further measures were required in relation to TF in Malta, with the exception of the prosecution of two plane hijackers in 2016, whose links to Malta were only circumstantial.

6. Proliferation Financing

Proliferation financing refers to the act of providing funds or financial services which are used, in whole or in part, for the manufacture, acquisition, possession, development, export, trans-shipment, brokering, transport, transfer, stockpiling or use of nuclear, chemical or biological weapons and their means of delivery and related materials (including both technologies and dual use goods used for non-legitimate purposes), in contravention of national laws or, where applicable, international obligations.²⁹

FATF recommendation 7 stipulates that jurisdictions should implement targeted financial sanctions to comply with United Nations Security Council Resolutions³⁰ relating to the prevention, suppression and disruption of proliferation of weapons of mass destruction and its financing. These resolutions require countries to freeze without delay the funds or other assets of, and to ensure that no funds and other assets are made available, directly or indirectly, to or for the benefit of, any person or entity designated by, or under the authority of, the United Nations Security Council under Chapter VII of the Charter of the United Nations.

The implementation of UN Security Council Resolutions, as described in the preceding section, falls within the remit of the Sanctions Monitoring Board and systems are in place to ensure that licensed entities are aware of any new UN and EU sanctions or any changes to existing sanctions.

The Working Group nevertheless concluded that, although the financial sector is informed about the applicable sanctions, there is limited awareness within the financial and DNFBP sectors on what would actually give rise to a risk of proliferation financing. No red-flag indicators have been circulated and it does not appear that officers within financial institutions are being trained to identify risky transactions. The failure to designate any institution to instruct and inform the industry is seen to be a serious weakness, as financial institutions do not seem to be sufficiently equipped to abide by their obligations to adhere to financial sanctions. Neither do they have the sensitivity as to the type of transactions and products that constitute a high risk.

The lack of any mechanism bringing together authorities that have competence in the area of proliferation finance to cooperate and coordinate the development of policies and activities in this area is seen as another major shortcoming that the country should address. No initiatives are known to have been taken to bring together the manufacturing sector, the Malta Freeport, the banking sector (especially banks providing trade finance services) and the Customs Department to understand the level of risk exposure. The need for a public body to take ownership within this area would probably be the first step that would need to be taken to ensure that the country is in a position to prevent the proliferation of weapons of mass destruction through the effective implementation of financial sanctions in compliance with FATF Recommendation 7.

²⁹ FATF, Status report on proliferation financing,

³⁰ Numerous resolutions require compliance, such as UNSCRs 1540 (2004), 1673 (2006), and 1810 (2008) on non-proliferation in general; as well as country-specific resolutions, such as UNSCRs 1695 (2006), 1718 (2006) and 1874 (2009) related to North Korea; and UNSCRs 1737 (2006), 1747 (2007) and 1803 (2008) related to Iran. Further to this, a number of EU regulations require compliance, such as 329/2007, 267/2012, 137/2013, and 522/2013.

7. Emerging Risks

The Maltese authorities monitor new or rapidly evolving ML/TF risks as they emerge and will take decisive action if required. The National Coordinating Committee, with the support of the relevant competent authorities, monitors developing trends and statistics, continues to engage in discussions of emerging risks with leading experts, and takes adequate actions when required.

Emerging risks are defined as new and unforeseen risks whose potential impact is not fully known or rapidly evolving. The NRA focused on two emerging threats, namely the development of cybercrime (e.g. ransomwares, identity theft) and the evolving geopolitical environment of neighbouring countries; and an emerging vulnerability, i.e. the increasing use of virtual currencies and cryptocurrencies which could be used by criminals to transfer and store value anonymously.

7.1. Emerging Threats

Two threats are evolving rapidly: the threat of ML of proceeds from cybercrime; and the evolving geopolitical environment.

7.1.1. Cybercrime

Cybercrime is an unlawful activity that involves the internet, a computer, or computer technology. It includes crimes such as ransomwares, identity theft, phishing, falsification of accounts, Nigerian scams and social engineering. Cyber-threats are evolving fast: ransomware attacks have increased by 300% since 2015 reaching over 4,000 ransomware attacks per day in the EU in 2016. 80% of all EU companies experienced at least one cyber security incident last year.³¹ Malta's has a large ICT sector and as such cybercrime is an important threat to combat.

The nature of cybercrime makes the laundering of its proceeds particularly difficult to detect. For instance, ransomwares are often paid in cryptocurrencies and later converted to cash, thus obscuring the trail of evidence. The subsequent laundering of money is simpler when there are a large number of online exchanges.³²

Despite the growth and evolution of cybercrime, EU joint cross-border law enforcement in cooperation with the private sector have resulted in some significant successes. Close cooperation with the private sector is essential to combat cybercrime in a proactive and coordinated manner.

7.1.2. Geopolitical risk

Increased geopolitical instability in the past years, especially in the Middle East and North Africa, has particularly impacted Malta. For instance, Tunisia, Algeria and Libya have been the victims of a number of terrorist incidents and have been reported to have the presence of terrorist groups. The Libyan revolution has also increased the risk of Libyan nationals laundering proceeds of crime and fuel smuggling.

³¹ PWC, *Global State of Information Security Survey*, 2016

³² Europol, *Why is cash still king? a strategic report on the use of cash by criminal groups as a facilitator for money laundering*, 2015

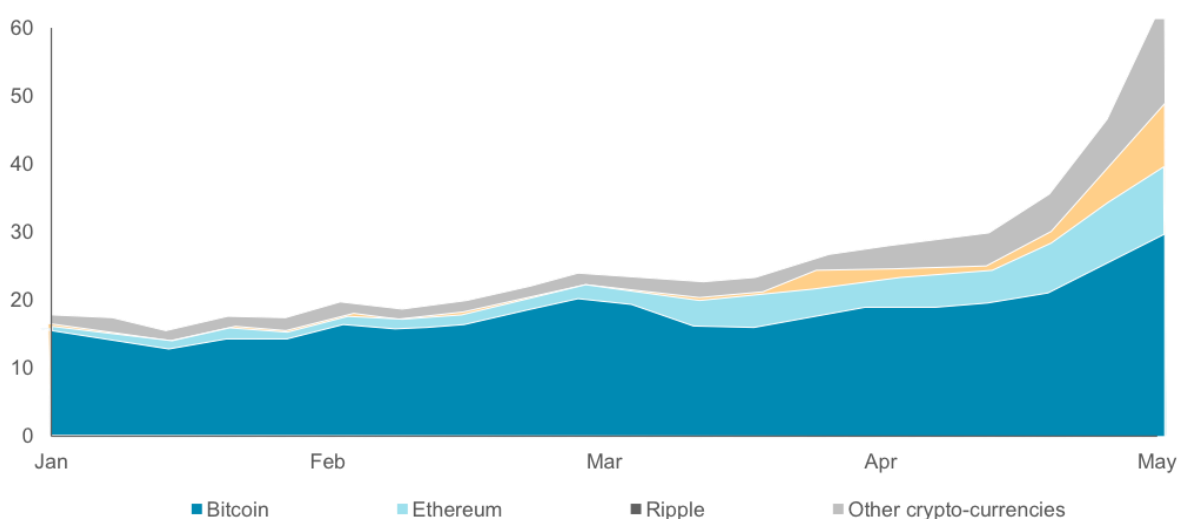
To help combat the smuggling of fuel by sea, the UN Security Council has in June 2017 extended sanctions on illegal oil exports from Libya.

7.2. Emerging vulnerabilities

The rise in use of virtual currencies and in particular of cryptocurrencies may be an emerging vulnerability. Virtual currencies are a digital representation of value that can be digitally traded. It functions as a medium of exchange, a unit of account or a store of value.³³ Virtual currencies are not legal tender and fulfil their function only by agreement within the community of users of the virtual currency. Virtual currencies are different from e-money as electronic transfer of value denominated in fiat currency. Cryptocurrencies are a virtual currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a central bank.

The market value of cryptocurrencies has grown rapidly over the past few years. Since the start of the year, Bitcoin, the world's biggest cryptocurrency, has risen in value from \$997 on 1 January 2017 to \$6,447 on 31 October 2017.³⁴ There are now close to 800 cryptocurrencies with a combine value of ~\$96 BN.³⁵ Figure 10 illustrates the recent increase in the market value of cryptocurrencies.

Figure 10: Market value of crypto-currencies in 2017 (\$ BN)



Cryptocurrencies may be exposed to ML as they involve encrypted data, instantaneous settling of transactions and higher levels of anonymity compared to traditional bank transactions. FATF highlights virtual currencies as one of the key emerging risks to ML, TF, tax evasion and fraud.³⁶ FATF identifies a particular high risk in those currencies that can be used to exchange value into and out of fiat currencies and the regulated financial system.

³³ FATF Report, *Virtual currencies – key definitions and potential AML/CFT risks*, June 2014

³⁴ Coindesk, Bitcoin USD tracker, 2017

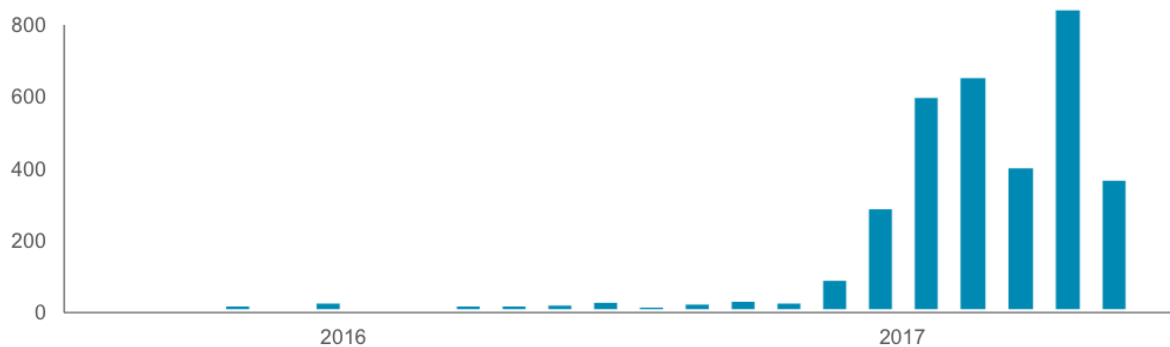
³⁵ Visual Capitalist, *The Coin Universe Keeps Expanding*, 2017

³⁶ FATF Report, *Virtual currencies – key definitions and potential AML/CFT risks*, June 2014

In addition, cryptocurrencies could be used to finance terrorist activities. While knowledge and experience of how to investigate, trace and seize virtual currencies continues to grow in the law enforcement community, this is often limited to Bitcoin, and not the other cryptocurrencies.

The recent surge in Initial Coin Offerings (ICOs) raises ML/TF concerns. ICOs are an unregulated means of raising capital and may therefore be exposed to abuse (e.g. Ponzi scheme, pump-and-dump) or misuse (e.g. store of value for proceeds of crime).³⁷

Figure 11: Initial coin offerings, amount raised (\$MM)



In conclusion, emerging risks associated with cryptocurrencies are yet to fully materialise yet the ability to make instant, encrypted and autonomous transactions allows cryptocurrencies to be an arena ripe for ML/TF. As such, Malta recognises the need to remain on high alert to the potential misuse of cryptocurrencies and any associated technologies for the purpose of ML/TF. In order to better understand these potential ML/TF risks, the country's competent authorities will conduct an assessment of the ML/TF risk in this regard in 2018. To date no licenses to operators in this sector have been issued.

³⁷ The Economist, *Regulators begin to tackle the craze for initial coin offerings*, 11 November 2017