

Notarial Acts “inter vivos” and customer due diligence.

Forward

1. In the definition of “relevant activity”¹ Notaries are the prime protagonists. Their mere participation or their assistance in the planning and execution of financial or real estate transactions for their clients without the implementation of the “measures and procedures”² of the regulations may result in hefty fines or imprisonment, or both³.

1.1 The Work of a Notary has grown at an exponential rate. But so have the aides provided by sophisticated software. This notwithstanding, what is to be discussed in this short paper is the human input which no computer can substitute. Throughout The Money Laundering Act and its Regulations the buzz words are “suspicious” and “risk assessment” These are subjective criteria and impose on us as subject persons the need for constant vigilance. Non-vigilance may result in non-implementation of the measures and procedures of Article 4 of the Regulations. This state of affairs may, even in the absence of an underlying “criminal activity”, expose the Notary to the convictions and punishments as those of Article 4 (5).

1.2 In this paper I shall highlight the risks, hazards and dilemmas which a Notary experiences in all the stages of deeds “inter vivos” namely in the set-up, preparation and eventual publication of deeds which make up the bulk of a Notary’s professional work and which makes a Notary a subject person in terms of the definition⁴. Such are Deeds of Sale preceded or not preceded by konvenji, Deeds of Loan or Acknowledgement of Debts, Deeds of Datio in Solutum, Deeds of Partition, and Trust Deeds. Besides risks arising from the publishing of public deeds there are those arising from services as for example when a Notary acts as a depositary Notary of private trusts.

1.3 In maintaining the due diligence requirements of the cases 1 to 4⁵ of Regulation 2 in the definition of a business relationship, a Notary tests their application to all new applicants for business when contact is first made between him and the applicants, particularly where it concerns the “clean” provenance of the items to be sold, transferred or partitioned, and the clean provenance of their consideration.

¹ S.L. 373.01

² Regulation 4 of S.L.373.01

³ Regulation 4 (5) of S.L.373.01

⁴ Regulation 2 in the definition of “relevant Activity”

⁵ Regulation 2 in the definition of “business relationship”

The law imposes on a subject person due diligence measures which have to be executed to a high degree of vigilance and detail.

1.4 However an analysis of the wording of the Regulations demands on a Notary the ability to perform a sort of delicate balancing act. On the one hand he is expected to be thorough and leave nothing to chance in the prevention of Money Laundering. On the other hand “customer acceptance policies” are not to be restrictive.

An example of this are:

a) *Regulation 7(9)* where the Notary “must develop and establish “effective customer acceptance policies and procedures” that are not **restrictive** in allowing the provision of financial and other services to the Public in general”⁶, and

b) *Regulation 7(8)* where the Notary must “determine the extent of the application of Customer due diligence on a risk sensitive basis depending on the type of Customer, business relationship, product or transaction”.

Notarial Acts

2. Notarial Acts are classified into acts “inter vivos” or acts “causa mortis”. I shall concentrate on the former but I do not exclude that the latter may pose problems that may instil in the Notary publishing the Will suspicion of criminal activity in the case of movables (say bequests of jewellery by the testator which the Notary suspects to be the fruit of theft) or in the cases of immovable property acquired by a testator through money laundering.

Acts “inter vivos”.

3 Acts “inter vivos” are those contracts entered into between legal or natural persons in accordance with the formal requirements prescribed by the respective applicable laws⁷ and which, on their publication confer probatory evidence in a Court of Law and which are referred to in Civil Law Jurisdictions as “authentic instruments” recognised as such by the European Court of Justice⁸. Such are deeds drawn up and executed by Notaries when

⁶ Regulation 7(9)

⁷ Civil Law, Company law, the application of diverse Fiscal laws to a particular transaction and The Notarial Profession and Notarial Archives Act (Chapter 55) of the Laws of Malta

⁸ *Unibank vrs Christensen (17.06.1999 C-260/97)*

- a) “they participate, whether by **acting** on behalf of and for their client in any financial or real estate transaction, or
- b) by **assisting** in the planning or execution of transactions for their clients concerning (i) the buying and selling of real property or business entities, (ii) managing of client money, securities or other assets, (v) when they concern the creation, operation or management of trusts, Companies or similar structures, or when acting as a trust or Company Service Provider ”⁹ as in the case of a depositary Notary of Private Trusts.

Additional activities

4. Sub-regulation (i) of the definition of “relevant activity” and sub-regulation (j) of the definition of “relevant financial business” of Regulation 2 would qualify Notaries as subject persons of additional activities which they may opt to provide other than the traditional or principal relevant activities mentioned in the preceding paragraph.

Salient Notarial deeds “inter vivos”.

5. For economy of time and in view of the state of mind and disposition of this audience after several hours of Money Laundering gibberish, I shall be brief and analyse the salient Notarial deeds traditionally published by a Notary in the light of the requirements of the law and its Regulations, with particular reference to Regulation 7¹⁰ (Customer due diligence), 8¹¹ (Verification of identity), 12¹² (Reliance on performance by third parties), particularly sub-regulations (8) and (9) of this regulation, 13¹³ (Record Keeping Procedures), and 15¹⁴ (Reporting Procedures and Obligations).

The Pre-contract stage.

The Preliminary Agreement.

6. With the coming into force of the Act and Regulations and the registration of preliminary agreements for fiscal requirements the preliminary has assumed a special place in contractual relations.

⁹ Regulation 2. Definition of “relevant activity”

¹⁰ Customer due diligence

¹¹ Verification of identification

¹² Reliance on performance by third parties

¹³ Record Keeping procedures

¹⁴ Reporting Procedures and obligations

6.1 This applies to so called “konvenji” leading to contracts of sale of movable or immovable property and also to all documents that are in the nature of preparatory documents to be followed by a binding contract, as are Memoranda of Understanding. These are intrinsically entered into for a period of time within which due-diligence measures and requirements are executed by the Notary or, in the case of an MOU, by either of the parties.

No preliminary agreement

7. It is my opinion that the protagonists of the business relationship cannot do without the preliminary agreement.

7.1 Applicants for business who do away with a preliminary because of the reciprocal trust which they claim exists between them should normally trigger “Case 2 (suspicion)” business relationships¹⁵ unless such applicants were already habitual clients of the Notary and the nature of their business was known to him. It is a fact that new applicants for business who do away with the preliminary would under normal circumstances induce a Notary to consider making a suspicious transaction report to the Financial Intelligence Analysis Unit in accordance with sub-regulation 6 of Regulation 15. The dilemma of the Notary in such case of a transaction which would qualify as “high risk” as whether he should nip the relationship in the bud (viz refuse to proceed outright) or whether time should be gained so as not to frustrate any investigation being carried out by the appropriate authorities as the proviso to Regulation 8 sub-regulation 5 seems to imply. The proviso states: “where to refrain in such a manner is impossible or is likely to **frustrate efforts** of investigating a suspected money laundering or funding of terrorism operation, that business **shall proceed** on condition that a disclosure is immediately lodged with FIAU in accordance with Regulation 15 sub-regulation 6. Choosing to proceed in this case of no preliminary would mean the publication by the Notary of the deed itself and the need to report to FIAU within five days from such publication.

7.2 I consider this as expecting too much from a subject person. The Notary in case of no konvenjo should have a choice of terminating the business relationship or proceeding with the contract. As the regulation states “shall proceed” the proviso excludes the possibility of the Notary terminating the business relationship.

¹⁵ Regulation 2 of the Regulations

Where a preliminary is signed.

8. Conversely where a preliminary is requested by one party (who in contracts of sale is normally an acquirer) particularly, if the final deed is subject to Bank finance, the Notary should logically consider the transaction as “low risk” for three reasons:

- a) the unlikely existence of any criminal activity particularly with the insertion of “subject to Bank loan” or “subject to building permits” clauses the insertion of which would logically exclude the existence of connivance between the parties for money laundering purposes.
- b) the fact that the applicant for business (the acquirer) would be under the scrutiny and vigilance of another subject person, namely the financial provider and
- c) the Notary would have more time (the period of the preliminary) to undergo the Customer due diligence procedures.

Where therefore the parties sign a preliminary, reporting procedures are the exception not the rule and the process leading to completion and final deed can proceed.

Identification of the applicants and verification

9. Identification of the parties at this very early stage of the business relationship is a must.

9.1 This is not a novel requirement for Notaries. Article 26 of the Notarial Profession and Notarial Archives Act¹⁶ states: “The notary must personally be certain of the identity of the parties, **or** where such parties do not appear personally, of the identity of their agent. Such identity shall be ascertained by the production of the official identity card, passport or other similar official document, or where such document cannot be produced, on the testimony of two attestors personally known to the notary.....” .

9.2 However the requirements of the Notary as a subject person under the regulations necessitate a much stricter identification process. For the purposes of Regulation 7 sub-regulation 3 “Where an applicant for business is or appears to be acting otherwise than as principal, in addition to the identification and the verification of the identity of the applicant for business:

¹⁶ Chapter 55 of the Laws of Malta

- (a) subject persons **shall ensure** that the applicant for business is duly authorized in writing by the principal;
- (b) subject persons shall establish and verify the identity of the person **on whose behalf** the applicant for business is acting;
- (c) where the principal is a body corporate, a body of persons, or any other form of legal entity or arrangement, subject persons shall, in addition to verifying the legal status of the principal, identify **all** directors and, where such principal does not have directors, **all** such other persons vested with its administration and representation, and shall establish the ownership and control structure of the body of persons;
- (d) in addition to the requirements under paragraph (c), where the principal is a body corporate, a body of persons, trust or any other form of legal entity or arrangement in which there is a shareholding, or any other form of ownership interest or assets held under a trustee or any other fiduciary arrangement, a subject person **shall not undertake any business with or provide any service to the applicant for business unless that applicant for business discloses the identity of the beneficial owners, his principal, and the trust settlor,** as the case may be, and produces the relevant authenticated identification documentation, and such disclosure procedures shall also apply where there are changes in beneficial ownership, or principal;

9.3 At this juncture a question comes to mind. Is it logical to expect the Notary to be provided with all such requirements **before** the signing of the preliminary? It may not seem so. In fact if due diligence requirements have to be applied on a “risk sensitive basis”, in terms of sub-regulation 8 of Regulation 7, particularly in view of the fact that this is as yet the promise of sale stage, not the actual sale, is it not sufficient for the Notary to verify the identity of the attorney (or the representative in the case of a body of persons) and to leave the verification of the identity of the mandatory, directors, beneficial owners and trust settlor for the stage of the publication of the deed of sale itself, at which stage the transaction is deemed to be complete, and the property and consideration exchange hands?

9.4 In my opinion this line of thought holds good also in cases where a deposit is paid on account of the purchase price of the sale, whether this is retained by the Notary, or is paid directly to a sellor. Payment of deposit should not at the stage of the signing of the preliminary give rise to the full requirements of the regulations unless there exists suspicion with regard to the provenance of the consideration, in which case, the Notary is to play safe and report to FIAU not later than five days.

9.5 Adopting a different reasoning would contradict the generally accepted notion that preliminary agreements in the business of real estate are indicators of a healthy economy and,

saving “Case 2 (suspicion)” transactions which exclude simplified customer due diligence measures in terms of Regulation 10, this should carry enough ground with the FIAU or the Notarial Council (“any other supervisory Authority”) that the “extent of the application on a risk sensitive basis” in a particular case “**is appropriate**”¹⁷.

9.6 The counter argument would be that each case be treated according to its own merits. No one argues against such approach or should be willing to risk acting otherwise, but an oversensitive approach may be counterproductive.

This is also in the spirit of regulation 8 sub-regulations 1 and 2 – “subject persons may complete the verification **during the establishment of a business relationship** where this is necessary for the continued normal conduct of business provided that the risk of money laundering or the funding of terrorism **is low** and provided further, that the verification procedures be completed as soon as is reasonably practicable after the initial contact”.

9.7 The period of time for the verification of title and the raising of the required finance which the parties stipulate in the promise of sale should provide the Notary with sufficient time to carry out the full identification procedures in accordance with Regulations 7, 8, 10 sub-regulations 1(e), 2, 5, 6 and 7 and in accordance with regulation 12 sub-regulation 8 and 9 relating to reliance on Performance by third parties, and Record Keeping procedures as in Regulation 13. Basically in an office like ours consisting of two Notaries and two assistants this requirement boils down to adequate filing and retention of documents for the prescribed period in terms of the said regulation.

So far so good. Up to now the requirements of identification will not stall the publication of the deed and they would have been made without the knowledge or connivance of the parties.

But should unfortunately, during the term of the preliminary agreement facts, or as the regulation refers to them, “unusual patterns of transactions which have no apparent economic or visible lawful purpose” emerge which would reasonably induce the Notary to suspect money Laundering “Case 2 (Suspicion)” Reporting procedures and obligations prior to the Deed of Sale as in regulation 15 sub-regulation 6 cannot be avoided or set aside.

¹⁷ Proviso to Sub-regulation 8 of Regulation 7

Deed of sale and post publication of deed.

10. With the publication of the deed of sale a particular transaction is deemed to be complete. If the transaction turns up to be a cover-up for Money Laundering as defined to be in the Second Schedule of the Act as “Any criminal offence” a Notary needs to prove his compliance¹⁸ with the provisions of the Act and the Regulations.

10.1 Apart from the production of information and documents which the Financial Intelligence Analysis Unit may request in terms of Article 26 of the Act dealing with compliance, a Notary has to prove that in terms of the due diligence measures and procedures listed in the Regulations he could not have suspected that the sale involved money laundering. His reasons need to be good!

10.2 The Notary’s best defence in such a case would be proof of the strict application on his part of the due diligence measures and procedures listed in the Regulations, and if he adopted a low risk approach and decided not to apply Enhanced Customer Due Diligence in accordance with Regulation 11 and decided not to report, he would have to explain to the Unit (FIAU) his reason/s why he did not consider that the transaction presented a higher risk of money laundering or the funding of terrorism.

10.3 From my experience, in 99.99% of deeds executed by me after 1994 (the coming into force of the Money Laundering Act) I have never experienced a “Case 2 (suspicion)” transaction unlike the innumerable “Case 3” (single large transaction) - €15,000 - which as far as deeds of sale of immovable property are concerned are the rule not the exception.

Difficulty in verification of identity

11. The difficulties which I envisage in Customer Due Diligence Procedures particularly “Verification of Identity” procedures and requirements concern:

11.1 Purchases by Foreign Companies or other legal persons where the purchasing company is a subsidiary Company in a group of Companies with the parent Company holding a controlling interest being registered in a non-EU or non EEA State which may not qualify as a reputable jurisdiction for the purposes of sub-regulation 7 of Regulation 10.

¹⁸ Article 26 of the Prevention of Money Laundering Act

11.2 Purchases by Companies who although registered in EU or EEA States have their shares registered in the name of Trustees or persons acting as fiduciaries of the beneficial share holders.

11.3 Purchases made by foreign trustees where these are not willing to reveal the identity of the beneficiaries and the settlor and are prohibited to do so and would in terms of the law of the Trust be held in breach if they did so. Particularly in this last case, when the Trustees are asked to allow me to have sight of the Trust Deed or certified extracts of it for me to ascertain a) the existence or otherwise of their powers, and b) the extent of such powers, they normally refuse and invariably cite as a reason for such refusal the confidentiality of the Trust. They do present a document wherein they as trustees certify the existence and extent of their powers! Perhaps there is a case for the Authority¹⁹ to be in a position to confirm the Trustees' credentials and powers. But as the law stands, unlike private Trustees, where one finds the Depositary Notary, there is no central depositary for the Trust Documents in the case of licensed trustees. In Private Trusts enrolment in the Public Registry at least confirms the existence of a Trust. But that is as far as the information goes. Even in this case (of Private Trusts) the confidentiality rule applies.

11.4 In the case of purchases by physical persons situate in a Member State or in a reputable jurisdiction (whether they be principal or mandatories) the Notary must request and retain proof of identity by means of valid original passports or other legal documents of identification. In cases of legal persons the Notary should request and retain certified true and authentic copies of the latest Statutes, Memoranda and Articles of Association from a foreign Notary of a Member State who shall, using the Apostille method of the Hague Convention, attest to the right of the Notary to certify the correctness and authenticity of the latest updated documents relating to the corporate structure of such legal person and of the physical or legal persons having ultimate control of such legal person and further must attest to the correctness and authenticity of the identification of such legal person's officers/directors having the right to represent such legal person and having the power to bind the legal person in contractual relationships.

Identity of a Dominant holding interest

12. Identification data and procedures where complicated pyramid corporate structures are concerned, make it well nigh impossible to extract and verify the correctness or otherwise of the identity of a dominant holding interest.

¹⁹Malta Financial Services Authority

Reliance on third parties

13. Notwithstanding Regulation 12 which categorically states that a subject person remains responsible for compliance with the requirements under regulation 7 sub-regulation 1 (a) to (c) if he relies on a third party or other subject person, provided that the transaction is not one that may likely qualify as a “Case 2 (suspicion)” transaction, the sub-regulations 8 and 9 of regulation 12, would deem a Notary complaint and entitled “to recognize and accept the outcome of the customer due diligence requirements carried out “in accordance with the provisions **equivalent** to these regulations by a **third party** who undertakes an activity **equivalent** to any of those in paragraph (a), (c) (Notary) or (f) of the definition of “relevant activity under regulation 2”.

13.1 It is to be noted that it need not be a case of Notaries relying on other Notaries. The sub-regulation speaks of reliance on “third parties”. It would not make sense otherwise as not everywhere in the EU do we find Notaries. For example there are no Civil Law Notaries in Cyprus, Sweden or Denmark, but one does find “third parties” who undertake an equivalent Activity. In this respect guidelines and instructions from the FIAU come handy and the Notary must follow such directives and instructions even if he is inclined to act otherwise. There is too much at stake to rely unduly on experience and instinct.

13.2 The tendency in deeds of sale is to limit due diligence procedures on purchasers or those exchanging the funds for the immovable. It is the provenance and origin of the immovable **and** such funds which need to be examined.

For example, if these originate from a trust fund remitted by the trustees of a trust these have to provide the Notary with details of the beneficiaries and the settlor which information is to be treated confidentially by the Notary and if for reasons of confidentiality inherent in the trust such information is not provided, or if in the case of discretionary trusts the beneficiaries of a class have only a possibility of being appointed not a certainty as in fixed or bare trusts, this would shift a low risk transaction into a high risk one. And in such event a Notary opting not to resort to the reporting procedures would be risking. If, on the other hand the funds are transmitted to the Notary (or evidence is provided to him) that these have been remitted to the purchaser by established Banks or other financial institutions from reputable jurisdictions authorised to provide relevant financial business, the transaction would qualify as low risk and identification and verification procedures would be sufficient.

13.3 Vendors or other transferors, particularly where the sale of immovable property is concerned, need to be identified and such identity verified in accordance with the procedures explained earlier. As sales of immovable property require the Notary to effect searches of transfers and liabilities on vendors and the outcome of whether or not the deed will reach completion stage depends on the correctness of these, the Notary is not required to go beyond verification of the identity of the Vendors.

Other deeds “inter vivos”.

14. **Bank loans and acknowledgements of debts** made by a client in favour of a Bank. These are low risk and do not require a Notary to implement any particular due diligence measures other than identification and verification procedures.

14.1 On the contrary **private loans or acknowledgement of debts** between individuals, or between individuals and legal persons without the involvement of Banks may possibly be a cover-up for criminal activity. A common such criminal activity is the crime of usury notably where the capital sum loaned or acknowledged in debt is inflated artificially, or for the purpose of laundering considerations of illicit gains from all sorts of criminal activity. Such deeds should logically be considered as high risk transactions particularly if they are made by private writing. The formality of the public deed kept in the Notary’s records in a deed drawn up by him gives the transaction a measure of authenticity. From a practical point of view however, when one considers that these are every day transactions, it is practically impossible to delve into the real “causa” of a particular transaction. However certain guiding principles have to be observed. First of these is the need to know the applicants for business. Or at least one of them. Not just by identifying them and verifying their identity, but also because of the fact that you may have provided your services to a particular client on several occasions over a period of time. One would logically treat a first encounter with both parties with more vigilance as a high risk transaction than if you were to know one (or preferably both) of them on a habitual basis and you had never had reason to suspect their integrity.

14.2 Other potentially suspicious transactions are deeds known as “**datio in solutum**”, namely contracts where movables or immovable property are assigned to a creditor in settlement of a debt, especially if such assignment is utilised to extinguish what is referred to as a pre-existing loan “*brevi manu*”, that is an unrecorded loan and the authenticity and the veracity of which the Notary is not in a position to ascertain unlike the case

where the debt originates from a public deed of loan. All this – the debt and the item extinguishing it - may be fictitious or cover-ups of illicit activities qualifying as criminal activity.

14.3 Deeds of partition and exchange. The former, being the remedy for termination of co-ownership or for the partition of inheritances are normally considered low risk and do not presuppose strict preventive measures provided that the instrument by virtue of which the community of property or the subject matter of inheritances came about is not tainted with criminal activity. The latter – deeds of exchange - need more circumspection and are riskier stuff, especially if the exchange is of an exaggerated unequal value or if the movables are exchanged with immovables. I have seen several highly “innovative” exchanges where an immovable property has been exchanged with movables where the deed inevitably (for post-registration purposes) gives a detailed description of the immovable but few or no details of the movables.

Depositary Notaries

15. A problem would arise in this connection where the settlor in an “inter vivos” Trust would wish to add to the Trust Fund movable or immovable property the provenance of which might not be as clean as the initial Trust Fund, with the unpleasant consequence that although at the commencement of the Trust such Trust and its fund were legal and beyond any suspicion or reprehension, the Settlor started passing on to the trust fund illicit or dubious donations with or without the Trustees’ connivance but noticed by the Depositary Notary, or giving sufficient reason to the Depositary Notary to believe that the additions to the Trust Fund are tainted with money laundering. In such event, reporting procedures would be in place and in the absence of anything to be found in the constitutive document of the Trust guidance from the Authority²⁰ or the Financial Intelligence Analysis Unit should be sought by the Depositary Notary as the Law²¹ is mum on this matter.

Tax evasion or Tax avoidance

16. The very last observation concerns the all embracing definition of Criminal Activity as defined in the Second Schedule of the Act as being – Any Criminal Offence. It concerns the perennial question whether tax avoidance or tax evasion, constitute a criminal offence. Conceptually there is a fine line between Tax Evasion and Tax Avoidance. An example of tax avoidance is the measure of freedom which the parties

²⁰ Malta Financial Services Authority

²¹ Trust and Trustees Act –Chapter 331 of the Laws of Malta

have at law to attribute a value to immovable property that are being exchanged rather than transferred by title of sale. Technically the parties are at liberty to attribute any value after due warning by the Notary. When tax evasion qualifies as criminal activity a Notary who suspects price fixing for reduction of Duty on Documents and Tax on the transfer would have to adopt the preventive measures hitherto discussed including reporting procedures and obligations, and if the Notary proceeds with the transaction knowing or suspecting a breach of fiscal laws that may be serious enough as to be considered as a criminal offence, he would risk incurring the fines and punishment of sub-regulation 5 of regulation 4. Here the logical solution would be to terminate the business relationship.

Conclusion

17. My opinions in this paper are based on years of dealing with a multitude of clients. I have come to the conclusion that by adopting a narrow and strict approach to the subject of money laundering or customer due diligence, this would be detrimental to commerce and business on a macro level and would have unpleasant consequences on the economy of Malta where the business of real estate is an important segment of the economy. Moreover, from a purely egoistical point of view, applying the regulations by playing it safe, that is by invariably considering all transactions as “high risk” and resorting to reporting procedures so to speak “to be on the safe side” would inevitably have a negative effect on the volume of ones professional output. In fact the result would mean “Closing Shop”.