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Doc Ref: STUARTG/#158305_V1 & 158473 (Annexure)
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Attention Mr. Raymond Masoga

Dear Sir

INDUSTRY COMMENTS ON FINANCIAL INTELLIGENCE CENTRE AMENDMENT BILL (the Bill)

We thank you for the opportunity to comment on the Bill.

The banking industry fully supports the alignment of the Bill to the FATF[1] Recommendations (FATF) and recognizes that it is in the interest of both the country and the industry to maintain South Africa's membership to FATF and the G20 in order to combat money laundering and terrorist financing.

1. **Purpose**

   This letter together with the attached Annexure is intended to provide a consolidated view of the comments and suggestions from the banking industry. The general and thematic comments in this letter must be read together with the detailed comments provided in the Annexure (Doc 158473).

2. **General Comments**

   The application of this Bill to a limited number of designated accountable institutions appears to be misaligned with the new thrust of the Financial Services Regulation Bill 2014 (FSR Bill). It was anticipated that the list of accountable institutions would be expanded to include other providers of equivalent financial services and products suppliers, e.g. mobile network operators and other providers of financial and payment services, and non-bank credit providers. This misalignment will perpetuate the inequality amongst accountable institutions; other financial services providers and mobile network operators, as well as being out of alignment with the FATF Recommendations. There will therefore be a distinct difference between the

[1] Financial Action Task Force Recommendations 2012

regulatory requirements of the market conduct framework and the amended FIC Act. This may increase the risk of regulatory arbitrage and the Financial Intelligence Centre may lose the opportunity to expand its coverage and intelligence gathering capability.

We therefore recommend that Bill be amended to ensure that all providers of financial services and products have equal or equivalent "know your customer" identification, verification, monitoring and reporting requirements, in line with the evolving Twin Peaks regulatory framework.

3. Themes

3.1 Identification and Verification (Customer Due Diligence)

The Bill introduces a risk based approach to managing Anti Money Laundering and the Combatting of Financing of Terrorists (AML / CFT) risks; however, the detailed requirements on customer identification and verification set out in the Bill will, in fact, result in more onerous and prescriptive customer identification and verification requirements than the current Financial Intelligence Centre Act (FICA) or as intended by the FATF Recommendations. FATF states that the rationale for a Risk Based Approach (RBA) allows countries, within the framework of the FATF requirements, "to adopt a more flexible set of measures in order to target their resources more effectively and apply preventative measures that are commensurate to the nature of risks, in order to focus their efforts in the most effective way[2]".

We emphasise that many of the detailed prescriptive requirements on customer identification and verification are far more onerous than those required by the United States Financial Crimes Enforcement Network (FINCEN) and United Kingdom Joint Money Laundering Support Group (JMLSG); therefore, the South African banks would continue to be faced with increased customer due diligence requirements which may further marginalise South African financial institutions from the international arena, as well as imposing higher compliance costs than should otherwise be necessary. By way of example, currently when South African banks participate in syndicated international loan arrangements, the South African requirements on customer identification and verification are already more onerous than those of the United States and United Kingdom, resulting in South African banks being excluded from participating in such syndicated lending activities due to the refusal of counterparties to comply with the more onerous SA requirements.

3.2 Directors, partners or trustees

FATF Recommendation 10 on customer due diligence and the interpretive notes thereto illustrate the due diligence expectations relating to an entity, its management and ownership or beneficial ownership structure. The "ultimate beneficial owner", defined as the natural person/s who ultimately owns or controls a customer, or the natural person on whose behalf a transaction is being conducted, must be established (identified).

We support that executive directors, partners or trustees that manage the entity, or have signing powers on transactions or accounts, should be identified and verified because they are the controllers of the legal entity or business relationship. However, the Bill continues to impose the requirement (without any cognisance of a risk based approach) to identify and verify "every

[2] "The guidance for risk-based approach by FATF – the Banking sector" issued in October 2014, section B14 page 6.

director, partner or trustee" of a legal entity. This is often not pragmatic or possible, and a disproportionately onerous way of achieving the objectives behind the amendments.

We therefore recommend that the requirement to identify and verify "every director, partner or trustee" be removed, and that the risk based approach be applied to focus on those persons in effective control, and who transact on behalf of the institution.

3.3 Risk Based Approach (RBA)

The concept of the RBA has not been defined in the Bill. The RBA should be clearly defined to align with international best practice and to avoid ambiguity in interpretation and uneven compliance requirements. A clear definition will aid both supervisors and banks to respectively evaluate and implement industry wide measures and controls.

The following definition is proposed, based on the FATF Recommendations[3] and definition of risk.

"A Risk Based Approach requires an organisation to identify, assess, manage and mitigate the risk of money laundering or terrorist financing based on risk factors such as inter alia product, channel, geography and customer type (inherent and industry)." In this regard please refer to FATF Recommendation 1 and the definition of Risk contained therein.

It should also be noted that a key underpin to institutions' successful implementation of a RBA is the development and disclosure of the country's own risk assessment relating to money laundering and terrorist financing. To date no such risk assessment has been done and disclosed by the local authorities.

3.4 Exemptions

The Bill maintains existing FICA exemptions (alternatively there is no provision for an orderly transition away from the current processes that have legitimately been relied on the existing exemptions) despite various verbal indications from the South African Reserve Bank and The Financial Intelligence Centre that the current exemptions would be removed by the Bill and replaced with an application of different levels of due diligence, such as simplified due diligence and enhanced due diligence, based on the risk rating of a customer in accordance with the FATF Recommendation 1. We note that Section 74 is retained and only the reference to the Council removed.

We therefore recommend that clarity be provided relating to the exemptions, and that any exemptions be removed per a negotiated transition process in accordance with the FATF expectations and in line with the flexibility of a focussed RBA.

3.5 Simplified Due Diligence and Once-Off transactions

FATF Recommendation 10 provides for the setting of a minimum threshold below which simplified due diligence is conducted on once-off (or single) transactions. The Bill does not provide for this despite repeated motivations over the years for the necessary FICA amendment. It is suggested that such a threshold be included in the Bill, to simplify the compliance burden as provided

[3] FATF Recommendation1

for in the international standards set by the FATF and a risk based approach to such single transactions.

3.6 Time frames for implementation

The implementation of the new requirements will have a significant impact on people, processes and systems. This requires accountable institutions to design and implement extensive and distinct change management programmes depending on the size, footprint and nature of the accountable institution and its AML/CFT RBA. Therefore an appropriate implementation period after publication of the Amendment and any subsidiary Regulations is required in order to ensure compliance implementation with the new requirements.

It is therefore suggested that a phased implementation and adequate transition period be allowed for the different risk categories, including depending on the nature of any remediation that may be required for existing accounts.

4. Definitions and Terms

4.1 Beneficial owner (BO), or Ultimate Beneficial Owner (UBO)

The FATF general glossary defines 'beneficial owner' as the natural person(s) who ultimately owns or controls a customer and / or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement.

This intent finds inconsistent application in the Bill. While the definition in the Bill has been confined to a natural person who (a) owns the juristic person, or (b) exercises effective control of the juristic person, section 21B (3) (a) seems to amend the definition of beneficial owner to include "controlling ownership interest".

The nature of ownership of a listed entity presents practical challenges to the identification and verification of each natural person behind each shareholder, especially as shareholding of such entities is constantly changing. Innovations such as online and algorithmic trading result in the ownership of these entities changing by the minute. Tracking of ultimate beneficial ownership in these instances presents significant operational challenges.

The following is submitted as a possible alternative:

'A Beneficial Owner is the natural person(s) who ultimately owns or controls a customer and/or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate effective control over a legal person or arrangement. This means that an individual (natural person / warm body) who ultimately owns or controls a primary customer and / or the individual on whose behalf a transaction is conducted, is considered to be the Ultimate Beneficial Owner of the customer.'

We further submit that the level of detail required with regards to beneficial owners of public companies be determined by the accountable institution's risk and compliance management programme. This will promote a proportionate approach where more resources can be concentrated on areas of higher risks. This is in line with the move to a risk based approach to customer due diligence and will ensure that the requirements are workable and enforceable.

Finally, it should be noted that as currently proposed the obligation to identify and verify BO or UBO falls to the accountable institutions. There is, however, no commensurate obligation on any local or foreign juristic person to disclose

such required information, nor on any local or foreign registers of juristic persons (e.g. companies registers) to record such information. Identification and verification is therefore almost impossible to achieve by the accountable institutions without the necessary support of the authorities. In the short term, therefore, the requirements should be restricted to "disclosures where possible of UBO/BO by the legal entity, with verification when appropriate official disclosure and records are made available."

4.2 Corporate Vehicles

The absence of a definition of the term 'juristic person' implies that the phrase will attract its ordinary legal interpretation. The uncertainty regarding this definition can be illustrated in section 21B of the Bill. Additional due diligence measures relating to corporate vehicles, imply that a partnership, trust or similar arrangement is contemplated as a juristic person. For the sake of clarity it is suggested "juristic person" be defined and used rather than "Corporate Vehicles".

The following wording, as used in other legislation, may be more appropriate and in line with current concepts

> Companies Act
>
> In this Act the term "juristic person" includes-(a) a foreign company (also defined); and (b) a trust, irrespective of whether or not it was established within or outside the Republic;
>
> The National Credit Act (NCA)
>
> In this act the definition describes a juristic person as inclusive of partnerships, associations or other body of persons, corporate or unincorporated, or a trust if there are three or more individual trustees; or the trustee is itself a juristic person, but does not include a stokvel;

4.3 Connected Person

This term should be deleted as it creates ambiguity and differences in interpretation. The term "Related Party" is already established in the local and international jurisprudence. A suggested definition of related party follows below.

> "Related Party" - Any party associated with a customer or prospective customer, such as an additional cardholder, authorised signatory, key official, partner, shareholder, director, settlor and/or ultimate beneficial owner that the accountable institution is required to identify under its AML KYC / Customer Due Diligence Policy.

Should the term "connected person" be retained a definition should be provided.

It is our recommendation that if the definition of "connected person" is retained, the definition be aligned to the definition in the Income Tax Act, 1962

4.4 Business Relationship

The words "and includes three or more single transactions that appear to be connected to the same person utilizing the same product at regular intervals" introduces confusion and ambiguity. The expansion of business relationship to include three single transactions over an undetermined period creates insurmountable practical and operational challenges for banks and detracts from the objective to identify and verify the customer of the bank because it

has the potential to extend customer identification and verification requirements to non-customers. As noted above, the FATF provision for "single transaction exemptions" below significant thresholds should also be introduced to reduce compliance burden from those isolated, non-business relationship transactions.

We therefore recommend that the existing definition of business relationship in FICA be retained.

4.5 Domestic Prominent Influential Person (PIP)

The introduction of the concept of "Prominent Influential Person" (PIP) as opposed to the internationally accepted "Politically Exposed Person" (PEP)[4] presents a significant departure from the FATF Recommendations and accepted international compliance terminology.

Further to the above, this requirement would be impossible to implement in the absence of approved publicly available database or lists of PIP's (e.g. requiring a correspondent bank to certify that it has a PIP risk management programme in place will be met with confusion, while it may well have a PEP programme in place).

The practical implementation of this change will cause operational challenges and may well prove to be an insurmountable hurdle for banks with international operations, where home regulations and group policy implementation are the compliance norm, as the Banks Act requires the application of the higher standard as applicable in the home or host jurisdictions. The interaction with correspondent banks will also be impacted negatively if this unique locally imposed concept is retained.

4.6 Risk Management and Compliance Programme

Typically, risk management programmes contain rules, standards, operational procedures and policies. The boards or designated sub-committees of the boards of banks approve the policies, but not the more detailed and expansive secondary rules, standards and operational procedures.

The requirement for the board to approve the risk management and compliance programme is neither practical nor in line with general governance principles, as it would require inter alia that every change to the risk management procedures or requirements would have to be approved by the board.

We therefore recommend that the term should rather be amended to read "Risk Management and Compliance Policies", for approval by the Board.

4.7 Monitoring, Enhanced Monitoring, Ongoing Monitoring and Profile Monitoring

The terms appear to find inconsistent application in the Bill and it is proposed that the above terms be clearly defined to distinguish between monitoring of the client (business relationship) and the monitoring of the client's account behaviour (surveillance).

It is proposed that the term "monitoring" be limited to activities of intelligence gathering in line with the objectives of FICA and that the term ongoing monitoring be removed from the Bill because "monitoring" by definition is an ongoing process.

[4] Refer to the General Glossary to the FATF Recommendations 2012

5. **Financial Sanctions Comments**

The Bill does not state which regulator will be tasked with the enforcement of compliance to applicable sanctions nor does it align with the enforcement mechanisms in POCDATARA.

The due process required to ensure administrative justice when affecting the rights of individuals as contained in POCDATARA is not repeated in the Bill. Sound legal principles require checks and balances in the interest of legal certainty and the rule of law.

The reservation of the ability to authorise permitted financial services / transactions as well as the dealing with terrorist property will create an untenable situation for South African banks reliant on international inward funding and correspondent banking relationships.

The concept of sanctions is not currently defined, save for the reference to Chapter VII of the Charter of the United Nations. It is respectfully recommended that the applicability of sanctions imposed by other authorities such as the Office of Foreign Asset Control (OFAC) or the European Union should be clarified because, internationally, these sanctions play a significant role in commence and finance. By not specifically including these requirements in the Bill, South African banks and financial institutions may be exposed to negative consequences when transacting or operating internationally.

This Bill will have significant interpretation and compliance challenges, as noted in this letter and the attached detailed Annexure. We therefore request the opportunity to discuss these concerns with National Treasury in more detail.

Yours Sincerely

STUART GROBLER
SENIOR GENERAL MANAGER
MARKET CONDUCT