



Mr Allen Wicomb
Letter sent via email: awicomb@parliament.gov.za

8 January 2016

Dear Sir

Input Relating to the Financial Intelligence Centre Amendment Bill 2015

It is understood that input relating to the Financial Intelligence Centre Amendment Bill 2015 ("the Bill") may be submitted to yourself. We attach a commentary that addresses various compliance considerations.

It is noted that Compliance & Risk Resources is facilitating a two day industry workshop covering the Bill – on 21 and 22 January 2016. This will include stakeholders from the banking, insurance and financial markets sectors. A workshop write-up will be prepared and we enquire as to whether there will be an opportunity to submit this to yourself for consideration.

Yours sincerely

John Symington
Director

INPUT RELATING TO THE FINANCIAL INTELLIGENCE CENTRE AMENDMENT BILL 2015

1. Introduction

This document has been prepared in order to provide input relating to the Financial Intelligence Centre Amendment Bill 2015 ("the Bill") that has been published.

2. Input provided

The input that is contained hereunder is primarily focused on the sections of the Bill that relate directly to compliance, specifically in respect of:

Amendments to section 1 of the Act – Definitions

- Commentary is supplied in respect of amendments to definitions:
 - The substitution for the definition of "non-compliance"; and
 - Insertion of a definition for "Risk Management and Compliance Programme".

Amendment of section 42 of Act

- Commentary is supplied in respect of requirements relating to Risk Management and Compliance Programmes.

Substitution of section 43 of Act and insertion of section 42A in Act

- Commentary is supplied in respect of requirements relating to the governance of anti-money laundering and counter terrorist financing compliance.

Financial inclusion

- The Bill is considered in the light of the potential impact thereof on financial inclusion.

3. Definition of "non-compliance"

Changes to the definition of "non-compliance" are specified as follows:

"'non-compliance' means any act or omission that constitutes a failure to comply with a provision of this Act or any order, determination, or directive made in terms of this Act and which does not constitute an offence in terms of this Act, and 'fails to comply', 'failure to comply' and 'not complying' have the [same] corresponding meaning;"

It is submitted that there would be value in considering the meaning of the term non-compliance in relation to the adoption of a risk based approach by an institution.

Where regulatory requirements embrace the concept of "risk", the impact of uncertainty should be considered, i.e. accountable institutions will be faced with circumstances / events that will be uncertain, which will represent practical compliance risk identification and assessment challenges. This should include consideration of the concepts of risk appetite and tolerance. Further, there will be benefits from addressing the types of risks that should be addressed by institutions, particularly in respect of the following:

- Non-compliance with regulatory requirements; and

- Money laundering and terrorist financing risk.

It is acknowledged that countries are currently on a learning curve towards developing regulatory frameworks that adhere to the revised FATF Recommendations. Accordingly, there is ground to cover in understanding how the money laundering and terrorist financing risk should be regulated or supervised where a full risk based approach is implemented. The aforementioned could be leveraged off a national risk assessment that would be undertaken in line with FATF Recommendation 1. It is reasoned that this should be undertaken prior to making changes to applicable anti-money laundering and counter terrorist financing regulatory requirements.

4. Insertion of a definition for "Risk Management and Compliance Programme"

The following is included in the Bill:

"'Risk Management and Compliance Programme' means the programme contemplated in section 42 of the Act;

The inclusion of the term “risk management and compliance programme” aligns with the risk based approach that is now required in terms of Financial Action Task Force (FATF) Recommendation 1.

Section 42 of the principal Act is to be amended by the substitution for section 42 of the following section – an extract is included below for ease of reference:

"[Formulation and implementation of internal rules] Risk Management and Compliance Programmes

42. (1) An accountable institution must [formulate] develop, document, maintain and implement [internal rules concerning—

- (a) **the establishment and verification of the identity of persons whom the institution must identify in terms of Part 1 of this Chapter;**
- (b) **the information of which record must be kept in terms of Part 2 of this Chapter;**
- (c) **the manner in which and place at which such records must be kept;**
- (d) **the steps to be taken to determine when a transaction is reportable to ensure the institution complies with its duties under this Act; and**
- (e) **such other matters as may be prescribed]** an anti-money laundering and counter-terrorist financing risk management and compliance programme.

(2) [Internal rules must comply with the prescribed requirements] A Risk Management and Compliance programme must—

- (a) enable the accountable institution to—
 - (i) identify;
 - (ii) assess;
 - (iii) monitor;
 - (iv) mitigate, and
 - (v) manage

the risk that the provision by the accountable institution of products or services may involve or facilitate money laundering activities or the financing of terrorist and related activities;

It is understood that the Bill introduces a comprehensive risk-based approach to customer due diligence. “This approach will simplify the current complex and rules-

based system of compliance, by providing financial institutions with the flexibility to determine how they verify their clients' identity, taking into account the particular circumstances pertaining to that client".¹

This will provide for flexibility and accountable institutions will be able to apply a graduated client due diligence approach. However, the draft regulatory requirements will, by their nature, also mean that there may be high levels of uncertainty relating to what will meet the regulatory requirements relating to different levels of risk. Regulatory guidance will play a crucial role in this regard. The enablement of such guidance at country, sector or institutional levels should ideally involve private and public sector stakeholders and, in the interests of achieving regulatory objectives, in the revised risk based regulatory frame, should be specified in the Act and/or subordinate legislation.

5. Substitution of section 43 of Act - Training relating to anti-money laundering and counter terrorist financing compliance

It is general practice for accountable institutions to appoint a compliance officer, often termed the Money Laundering Control Officer (MLCO). One of the cornerstones of establishing an appropriate compliance officer responsibility profile within an organisation is to recognise that compliance officers are not responsible for "ensuring compliance", i.e. management is responsible for conducting all business activities in compliance with laws, rules and standards (top management / management is in a position to ensure compliance) and the compliance officer's role is to assist top management / management in this regard.

This responsibility profile is reflected in the guidance that has been published by the Basel Committee on Banking Supervision in a publication entitled Compliance and the Compliance Function in Banks, April 2005, i.e. in principle 7 (compliance function responsibilities):

"The responsibilities of the bank's compliance function should be to assist senior management in managing effectively the compliance risks faced by the bank. Its specific responsibilities are set out below. If some of these responsibilities are carried out by staff in different departments, the allocation of responsibilities to each department should be clear."

It is also useful to consider principle 7 contained in Generally Accepted Compliance Practice (GACP) published by the Compliance Institute of Southern Africa:

"The primary role of the compliance function is to assist top management, management and appropriate staff members in discharging their responsibility to comply with applicable regulatory requirements through the provision of compliance risk management services."

The draft changes to section 43 now better reflect the role and responsibilities of a compliance function, i.e. when compared to the current section 43(b) requirements, which specify that an accountable institution must appoint a person with the responsibility to ensure compliance by:

"(i) the employees of the accountable institution with the provisions of this Act and

¹ The National Treasury and the Financial Intelligence Centre. Media Statement - Request For Public Comments on the Draft Financial Intelligence Centre Amendment Bill, 2015.

² FinMark Trust. Conservative compliance behaviour: Drivers of conservative compliance

- the internal rules applicable to them; and
- (ii) the accountable institution with its obligations under this Act.”

The insertion of section 42A in the Act (governance of anti-money laundering and counter terrorist financing compliance) will shift responsibility for ensuring compliance away from the compliance function of an accountable institution and addresses governance considerations relating to compliance with anti-money laundering and counter terrorist financing requirements. This is appropriate from a compliance responsibility perspective.

6. Impact on financial inclusion

The Bill appears to provide room for financial inclusion friendly measures if, for example, risk is mitigated in a manner that does not significantly impede access. However, the new requirements will result in significant operational complexities and challenges.

A number of studies have shown that anti-money laundering and counter terrorist financing requirements can have a significant impact on financial inclusion objectives in a jurisdiction. For example, a FinMark Trust funded report recognised challenges that can arise from overly conservative compliance responses as a result of regulatory requirements and the supervision thereof.² We enquire as to whether an impact study has been undertaken, i.e. in view of the potential implications of the Bill on under-served/under-banked consumers. This could avoid unintended consequences in this regard.

The insertion of sections 21A and 21B imposes requirements relating to understanding and obtaining information on business relationships. These could have a significant operational due diligence implications. For example, there may be limited scope to make reasonable assumptions about the business of the client in the case of low value transactions or accounts.

In terms of the Bill:

“A Risk Management and Compliance programme must—

- (a) enable the accountable institution to—
- (i) identify;
- (ii) assess;
- (iii) monitor;
- (iv) mitigate, and
- (v) manage

the risk that the provision by the accountable institution of products or services may involve or facilitate money laundering activities or the financing of terrorist and related activities;”

This appears to place the full risk identification, assessment, monitoring, mitigation and management burden on accountable institutions. It is reasoned that where there is not adequate regulatory / risk assessment support at a country / sector level, this could have the effect of encouraging conservative compliance responses that will adversely impact financial inclusion opportunities.

² FinMark Trust. Conservative compliance behaviour: Drivers of conservative compliance responses in the South African financial services industry. Louis de Koker and John Symington. August 2011.

Where existing exemptions, for example exemption 17 that has supported the delivery of financial access friendly products to bank clients, are withdrawn with the implementation of the Bill there could be a material impact on financial inclusion opportunities of consumers if accountable institutions are uncertain about risks relating to the access market. A robust understanding thereof could inform the development of regulations / guidance to avoid unfavourable implications of so-called “de-risking” by accountable institutions.

It is noted that a number of organisations are currently undertaking studies relating to anti-money laundering and counter terrorist financing in relation to financial inclusion - notably FinMark Trust (Focus Notes: Anti-Money Laundering and Combating the Financing of Terrorism in Certain SADC Countries) and Financial Sector Deepening Africa (Risk-Based Approaches to Regulation of AML/CFT - These are due to be published in the near future and will provide relevant input that could be considered in the interests of financial integrity and financial inclusion objectives).