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[redacted]

The Select Committee on Finance, National Council of Provinces
P O Box 15
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Attention: The Committee Secretary
Mr Nkululeko Mangweni

BY EMAIL: nmangweni@parliament.gov.za

Dear Sir

DRAFT AMENDMENTS TO SCHEDULES 1, 2 AND 3 TO THE FINANCIAL INTELLIGENCE CENTRE ACT, 2001

1. INTRODUCTION

1.1 The Briefing by National Treasury (**Treasury**) and the Financial Intelligence Centre (**FIC**) in terms of the Joint Meeting of the Standing and Select Committees on Finance of 20 September 2022 (**Briefing**) refers.

1.2 In terms of the presentation concerning the Briefing as circulated following the presentation, the NCRF would like to respond to certain aspects of the Briefing document, and we set out the response below.

2. RESPONSE

Ad Briefing Slides 5 – 7 of the Briefing (Item 11 – Credit Providers)

2.1 As noted in the first bullet point of Briefing Slide 5, in the submission from the NCRF to the Select Committee on Finance of the National Council of Provinces (**NCoP**) dated 19 September 2022 (**19 September 2022 Submission**), proposed alternative wording for draft item 11(a) of Schedule 1 to the Financial Intelligence Centre Act, 2001 (**FICA**) (**Draft Item 11(a)**) was suggested. This proposed alternative wording (as set out in paragraph 3.2 of the 19 September 2022 Submission) effectively seeks to exclude the category of 'retail store cards' (which is a type of "*credit facility*") as defined in the National Credit Act, 2005 (**NCA**) from Draft Item 11(a).

2.2 Despite this, the last three bullet points on Briefing Slide 5; the last bullet point on Briefing Slide 6; as well as the two bullet points on Briefing Slide 7, speak to the wholesale exclusion of the category "*credit facilities*" from Draft Item 11(a). While that was part of the suggested wording put forward by the NCRF in the written submissions regarding the proposed amendments to Schedule 1 of FICA to the Standing Committee on Finance of the National Assembly (**NA**) (**12 August 2022 Submission**), this it no longer what the NCRF is proposing.

Ad Briefing Slides 11 and 12

2.3 The NCRF members are large industry players, and would be categorised as large businesses, not small businesses.

2.4 Briefing Slide 12 states:

> *"The FIC Act does not impose an obligation to obtain proof of residence. Credit providers already obtain and verify sufficient information about their customers to enable them to recover the loan amount. This should be sufficient to meet the FIC Act requirements in low-risk cases.*
>
> *… [T]here is no requirement in the FIC Act or Money Laundering and Terrorist Financing Control Regulations that requires that an accountable institution to collect proof of residence from a customer. The 2017 amendments to the FIC Act and the Regulations ensured that we have a risk-based approach to ML/TF rather than a rules-based approach".*

2.5 It is common cause that the 2017 amendments to FICA and the Money Laundering and Terrorist Financing Control (**MLTFC**) Regulations introduced a risk-based approach to ML/TF (as opposed to the previous rules-based approach).

2.6 It is indeed correct that there is no longer a black-letter law requirement in FICA or the MLTFC Regulations that requires an accountable institution to obtain proof of residence as part of meeting their FICA-imposed customer due diligence requirements.

2.7 Nonetheless, it is our experience that **market practice** is such that accountable institutions generally still require proof of residence in order to meet the section 21(1)(a) FICA requirement to establish and verify the identity of a client.

2.8 '*Guidance Note 7 on the Implementation of various aspects of FICA*' (**Guidance Note 7**) describes various potential ML/TF risk indicators, including indicators relating to clients being onboarded. Insofar as client indicators are concerned, according to the FIC, it is trite that not all clients of an accountable institution pose the same ML/TF risk. For an accountable institution to accurately identify all the factors that may be relevant to a particular client and to include all those factors in an assessment of ML/TF risks, it is necessary that the institution have a wholistic view of the information gathered about the client across all the points of engagement between the institution and the client.

2.9 We also note that in terms of Guidance Note 7 as it relates to 'establishing and verifying clients' identities, paragraph 83 states that:

> *"[e]stablishing a client's identity entails that an accountable institution obtains a range of information about the client. In most cases this information is provided by the client in response to questions being asked by the accountable institution as part of its on-boarding process (in the case of a business relationship) or its client engagement process (in the case of a single transaction). Verification of the client's identity entails that the accountable institution corroborates the person's identity information by comparing this*

information with information contained in documents or electronic data issued or created by reliable and independent third-party sources (our emphasis).

2.10 Paragraphs 86 and 87 of Guidance Note 7 state that:

> "[86] *Information about a natural person's identity may be supplemented by applying other attributes of a natural person including his/her physical appearance or other biometric information, place of birth, family circumstances, place of employment or business, residential address, contact particulars (e.g. telephone numbers, e-mail addresses, social media), contacts with the authorities (e.g. tax numbers) or with other accountable institutions. This list of examples is not exhaustive and there may be other attributes of particular persons or categories of persons which accountable institutions may include in their identification processes. The nature and amount of other attributes which an accountable institution applies in a given case is dependent on the extent to which the institution relies on the verification of the client's identity as a means to mitigate ML/TF risk in that case (see the discussion on risk mitigation in Chapter 1 above).*
>
> *[87] Verification methods vary and are mostly dictated by the type of information used to establish a person's identity in a given scenario. Regardless of the method applied, it is important that verification be done using information obtained from a reliable and independent third-party source and, as far as possible, the original source of the information. Accountable institutions should evaluate the adequacy of corroboration of a person's identity attributes. This implies that institutions must determine the level of confidence they have that any particular method of corroboration provides certainty as to the relevant identity attributes. A factor that accountable institutions should bear in mind in this context, is the controls which are applied to ensure that information reflected in a particular source is accurate. Information sources created or generated by the client him/herself are not considered to be reliable and independent third-party sources."*

2.11 While it may therefore be so that "*[a]ccountable institutions must now choose the type of information by means of which they will establish clients' identities and also the means of verification of clients' identities*",[1] the practical reality is that the risk-based approach implemented by accountable institutions, as matter of **market practice**, is that they choose to verify the identities of clients by way of proof of residence. Then, in accordance with section 42(2)(d), the accountable institution sets out the manner and processes by which the establishment and verification of the identity of persons takes place in its Risk Management and Compliance Programme (**RMCP**).

2.12 This is hardly surprising, in our view, given the fact that despite the repeal of certain of the MLTFC Regulations, which previously required (among other things) proof of residential address to be obtained and verified by accountable institutions, '*Guidance for accountable institutions on client identification and verification and related matters*' (**Guidance Note 3A**), as far as we are aware, has not been repealed.

2.13 This is noteworthy as it is submitted that one would be hard pressed to find an accountable institution that does not require one of the documents listed in paragraph 11 of Guidance Note 3A in order to verify the residential address of a natural person.[2]

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[1] Paragraph 84 of Guidance Note 7.

[2] Guidance Note 3A sets out that documents that may offer confirmation of residential address include the following:
- a utility bill reflecting the name and residential address of the person;
- a bank statement from another bank reflecting the name and residential address of the person if the person previously transacted with a bank registered in terms of the Banks Act;
- a recent lease or rental agreement reflecting the name and residential address of the person;
- municipal rates and taxes invoice reflecting the name and residential address of the person;

2.14 We also note that the Financial Sector Conduct Authority (**FSCA**), in its capacity as a supervisory body of the entities listed in items 4, 5 and 12 of Schedule 1 to FICA, has published a document, entitled '*RMCP: what to consider when you draft / review your RMCP*',[3] which suggests that proof of residence is "*documentation required to verify information*" for medium and high-risk clients. Assuming the entities supervised by the FSCA follow the regulator's guidance, as they should, this represents further evidence that proof of residence is a common requirement used to verify identity.

2.15 In October 2021, the FATF published its '*Mutual Evaluation Report relating to South Africa's Anti-money laundering and counter-terrorist financing measures*' (**FATF Mutual Evaluation Report**). One of the key findings of the FATF Mutual Evaluation Report was that "*[b]asic customer due diligence (CDD) is applied by many accountable institutions (AIs) satisfactorily but [beneficial owner] requirements only to some extent*." While is it unclear to us what exactly was evaluated as it relates to 'basic CDD', if we assume that the starting point was that South African market practice is that accountable institutions require proof of residence as part of their risk-based approach to FICA, then it would follow that the FATF found such an approach 'satisfactory', *albeit* that the FATF does not require proof of residence, as indicated by the FIC during the Briefing.

2.16 On 30 August 2022, and as part of addressing the concerns arising from the FATF's evaluation of South Africa, the FIC issued, among other publications, Public Compliance Communication 53 (**PCC 53**). It is our view that PCC 53[4] is strongly indicative of the FIC's views and is a pivotal publication given the backdrop of the FATF Mutual Evaluation Report. This is especially so as in our experience with a non-DNFPB client, we have seen the FIC apply PCC 53 (in its then-form, prior to finalisation, as Draft Public Compliance Communication 114 (**PCC 114**)), in practice, in an on-site assessment, which included an RMCP review, carried out in respect of one of our clients. The FIC went so far in this regard as to advise our client to refer to Guidance Note 7 and PCC 114 (as it then was) when revising its RMCP.

2.17 In terms of PCC 53, a risk-based approach must provide for a client level risk assessment, indicating the risk that different business relationships or single transactions pose. By way of an example referred to in PCC 53, geographic area characteristics (e.g. countries / regions / areas / towns, etc), both domestic and international, may be indicative of risk (for example, the risk may increase where a client resides in a large metro with high crime rates). In terms of the FIC's practical application, with reference to the on-site assessment referred to above, the FIC required the RMCP concerned to set out a risk rating methodology, detailing how various client types, products and services offered, delivery channels used, as well as the geographical areas where clients are located, to be risk rated.

2.18 It is our assessment that the FIC, as a matter of practice requires accountable institutions to determine the geographical location of their clients. This resonates with the requirement for

- mortgage statement from another institution reflecting the name and residential address of the person;
- telephone or cellular account reflecting the name and residential address of the person;
- valid television licence reflecting the name and residential address of the person;
- recent long-term or short-term insurance policy document issued by an insurance company and reflecting the name and
- residential address of the person;
- recent motor vehicle license documentation reflecting the name and residential address of the person; or
- a statement of account issued by a retail store that reflects the residential address of the person.

[3] Available here: https://www.fsca.co.za/Regulatory%20Frameworks/Temp/Risk%20Management%20and%20Compliance%20Programme%20Framework%202022%20Reviewed.pdf

[4] PCC 53 details the drafting of an RMCP and is limited to assisting accountable institutions that are Designated Non-Financial Businesses and Professions (**DNFBPs**) to better understand how to approach the issues of risk assessment, identification and management within their businesses. While we appreciate that clothing retailers do not qualify as DNFBPs (according to the FATF's assessment of DNFPB, see Table 1.3 of p30 of the FATF's Mutual Evaluation Report), the FIC has, in our experience, practically applied the requirements set out in PCC 53 to accountable institutions that are not DNFBPs when testing RMCPs against the FICA requirements.

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accountable institutions to carry out wholistic client level risk assessments. It is submitted that the only accurate means of verifying a client's geographic area is for the client concerned to provide appropriate proof of residence, which can then be verified by the accountable institution.

Ad Briefing Slide 13

2.19 As stated in paragraph 4.2.1 of the 19 September 2022 Submission, the estimated cost of R25.00 to R30.00 per credit applicant (which translates into additional 'hard costs' for clothing retailers of between R275 million and R330 million) is for the initial FICA CDD / KYC requirements only. The ongoing compliance costs to adhere to the numerous other obligations imposed under FICA have not been estimated. Owing to the nature of the ongoing obligations imposed by FICA, the cost of adherence for credit providers impacted by Draft Item 11(a) will be considerably higher.

3. CONCLUDING REMARKS

3.1 All our client's rights remain reserved.

Yours faithfully

Bowman Gilfillan
per: James McKinnell / Kirsten Kern / Keryn Layton-McCann
Transmitted electronically without signature