PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

Draft Amendment of Schedules to the Financial Intelligence Centre Act

1. Introduction and Background

National Treasury and the Financial Intelligence Centre (FIC) require Parliamentary Committees on Finance to approve the amendments to the Schedules of the FIC Act, which are in a form of Regulations. The proposed amendments to Schedules 1, 2 and 3 to the FIC Act seek to strengthen the financial system and improve its resilience against abuse by money launderers and terrorist financiers.

The FIC Amendment Act, 2017 sought to address some of the weaknesses identified in the country's anti-money laundering system following the 2009 Financial Action Task Force (FATF) mutual evaluation report findings. Some of the weaknesses identified related to compliance, supervision and sanctions in respect of non-banking financial institutions. The amendments to the Schedules, therefore, seek to address the weaknesses identified by including the necessary sectors and business activities into the schedules and streamlining the number of supervisory bodies to enhance the quality of supervision and enforcement identified in the Mutual Evaluation Report.

Emphasis was made that the approval of the amendments has become urgent, since the failure to comply with the set deadline of October 2022 might lead to grey-listing of the country by the FATF. The consequences for the country will be dire and could include severe and adverse economic consequences for trade and transactions; the risk of losing critical correspondent banking relationships with overseas banks; restriction of banking transactions with South African banks by overseas regulators in the United States of America (USA), United Kingdom (UK), European Union (EU), Japan, China and imposition of penalties and fines for breaching such restrictions.

2. Overview of the Schedules 1,2 and 3 of the FICA proposed to be amended

This section summarises the proposed amendments to the FICA as presented by the National Treasury and the FIC.

2.1 Schedule 1 amendments

The proposed amendments in Schedule 1 pertain to the Legal Practitioners, Trust Service Providers, Authorised Users of an exchange, Cooperative Banks, Long term Insurance

Businesses, Ithala Development Finance Cooperation, Money remitters, high-value goods dealers, the South African Mint Company (SA Mint), Crypto Asset Service Providers (CASPs) and Clearing system participants for facilitation of electronic fund transfer.

- **Legal practitioners**: **Technical amendment** to take into account new legislation and include attorneys practising for their account; advocates that practise with a Fidelity Fund Certificate, who can deal directly with the clients from the public; and legal firms.

- **Authorised users of an exchange: Technical amendment** to update the reference to the relevant legislation, following the replacement of the Securities Services Act with the Financial Markets Act. The scope remains the same.

- **Trust Service Providers**: Proposed amendment to include certain activities carried out by Trust and Company Service Providers, where accountants, estate agents, lawyers, notaries and other legal professionals are involved in conducting transactions on behalf of their clients. These activities include buying and selling real estate or managing client money, securities or other assets. Almost 2 000 cases involving South Africans have been identified in the Panama Papers.

- **Co-operative banks:** A proposal to include this category to protect them from exploitation by launderers.

- **Long-term insurance business:** A proposal to amend the legislation**,** Insurance Act, 2017, to ensure that the risk-based approach is followed.

- **Ithala Development Finance Corporation:** A proposal to delete the Corporation from Schedule 1 of the FICA. The entity will fall under Item 11 as a credit provider.

- **Money remitters:** A proposal to widen this category. Item 19 of Schedule 1 to the FIC Act applies to a "person who carries on the business of a money remitter". However, it is not expressly clear that this includes any type of value transfer provider, including those who facilitate value transfers where funds are not sent from one location to another. The FATF found that the authorities have not taken any substantial action to address the informal remittance sector.

- **High-value goods dealers:** A proposal to include a new item which will include all businesses dealing in high-value goods that are priced at R100 000 or more, whether payments are a single transaction or more operations. These include motor vehicle dealers, Kruger rand dealers, and precious metals and stones dealers.

- **South African Mint Company:** A proposal to include this item on request by the South African Reserve Bank (SARB) and SA Mint. Its business includes selling collectable and non-circulation coins of different precious metals to the retail trade.

- **Crypto Asset Service Providers (CASPs):** A proposal is made to include this item following the revision in the FATF standards which require that countries regulate CASPs for anti-money laundering purposes. Recently South Africa has received attention for being the country that has had the largest scams/fraud/money laundering, possibly going into billions of Rands, with the cases of Mirror Trading International and Africrypt.

- **Clearing system participants for facilitation of electronic funds transfer:** The SARB's National Payment System Department (NPSD) requested that this item be included. It will enable the capture of electronic payments made through non-bank clearing houses. It will facilitate the origination or receipt of any electronic funds transfer and or act as an intermediary in receiving or transmitting the electronic funds.

2.2 Schedule 2 amendments

The amendments to Schedule 2 of the FICA aim to reorganise the structure of supervisory bodies that are responsible for supervising compliance with the FICA. This reorganisation is required partly because of amendments in other legislation and partly because certain supervisory bodies do not actively perform a supervisory function as far as the FIC Act is concerned.

- **Technical amendments to Items 1 and 2**: The enactment of the Financial Sector Regulation Act, 2017 requires certain technical amendments to Schedule 2 of the FICA. This includes replacing the reference to the Financial Services Board (FSB) with a reference to the Financial Sector Conduct Authority (FSCA) and the reference to the Registrar of Banks with a reference to the Prudential Authority (PA).

- **Independent Regulatory Board for Auditors (IRBA): A proposal to remove** IRBA from Schedule 2, on its request, as its function of regulating the auditing profession does not fall within any category of accountable institutions.

- **National Gambling Board (NGB)**: A proposal to delete Item 6 of Schedule 2. Gambling activities such as casinos, racing and wagering fall within the scope of Item 8 of Schedule 1 to the FIC Act. The NGB has no responsibility currently for the regulation of gambling activities by any institution that falls within the scope of the FICA.

- **Law Societies**: A proposal to remove this category as the provincial Law Societies are no longer responsible for the regulation of the relevant services of attorneys that fall within the FICA. The FIC will become responsible for the supervision of legal practitioners in this respect. Also, the FATF found that attorneys are subject to no AML/CFT oversight.

2.3 Schedule 3 amendments

Motor Vehicle Dealers and Kruger Rand Dealers: A proposal to delete this category and include it as accountable institutions in the scope covering high-value goods dealers in Schedule 1. Currently, these sectors have no compliance or legal obligations to conduct customer due diligence or retain client and transactional records.

3. Key issues raised during the Committee's Public Participation Process

3.1 National Clothing Retail Federation of South Africa

The NCRF made a submission to the Standing Committee on Finance (SCoF) regarding the proposed change in Draft Item 11(a). The NCRF clarified that its current submission is not the same as the one submitted to SCoF.

The current proposed draft amendment to the Select Committee on Finance (SeCoF) is based on a FATF standard which requires that the 'act of lending' is to be included in the scope of a country's measures against Money Laundering and Terrorist Financing (MLTF). The NCRF formally objects to the blanket inclusion of credit providers in Draft Item 11(a), in light of the drastic and materially adverse unintended consequences that inclusion will have on both credit retailers and retail credit consumers.

NCRF proposed this wording: *A person who carries on the business of a credit provider as defined in the National Credit Act, 2005 (Act 34 of 2005), excluding credit providers offering credit as provided for in section 8(1)(a) read with section 8(3), in circumstances where the credit facility in question constitutes a closed-loop, revolving credit store card where a credit limit is available to the consumer and an instalment is payable monthly.*

The NCRF identified the following key adverse practical implications should the current draft item 11(a) be implemented in its current form:

- **Inevitable exclusion of a large segment of South African consumers** from access to 'safe' and well-regulated credit, because they are not able to provide proof of residence. FICA requires accountable institutions to conduct appropriate, and

ongoing, Client Due Diligence (CDD) or 'Know-Your-Customer (KYC) processes, which include proof of residence.

- **Additional compliance costs** to be borne by Draft Item 11(a) registered credit providers and, ultimately, by (credit and non-credit) consumers. These costs would materially impact the NCRF members and if absorbed by the retailer will directly impact the retailer's profitability, thereby potentially jeopardising jobs and commitments to the government to create jobs in the retail and manufacturing sector

- **Potential Constitutional issues.** A quote from Truworths Ltd and Others versus the Minister of Trade and Industry, par 53, reads thus "In my view, in discriminating against a section of the population that represents the less privileged, and probably also many previously disadvantaged persons, in a manner that is not fair, the regulation falls foul of s 14(2) and (3) of the Promotion of Equality and Prevention of Unfair Discrimination Act 4 of 2000. The applicants also submit that it contravenes s 9(3) of the Constitution in that it effectively discriminates based on race. It is clear to me that this could never have been the intention of the Minister, but it may well be an unintended result. If so, it would offend against s 9(3), but I make no finding on this point".

- **In support of the alternative wording proposed for Item 11(a) of the FICA, the NCRF believes it should be excluded because:**

    - The nature of the business it conducts in the form of retail store credit translates into **a low risk of MLTF:** The NCFR's concern is that it appears the **FIC** did not conduct a **sector study** for the inclusion of credit providers as accountable institutions, which if correct, is surprising and irrational.

    - **Other 'carve-outs'[1] of sectors are already catered for in Schedule 1 to FICA**. Non-life insurers and authorised financial services providers who intermediate non-life insurance are excluded from being considered accountable institutions based on the low MLTF risk associated with the sectors. The NCRF has a reasonable and legitimate expectation that its industry and its members will be afforded the same consideration and treatment as those already carved-out in Schedule 1 of FICA.

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[1] Carve out is a term which refers to the elimination of coverage of a specific category of benefit services, most commonly medical services which are not included in a standard health insurance contract and are paid for separately, like vision care, dental care, mental health cover or prescription drugs.

- **Perceived unequal treatment in the practical assessment of MLTF risk** across different categories of accountable institutions, in terms of the currently proposed amendments, because of (1) disjunct between 'high-value goods dealers' who become accountable institutions at a transaction value of R100,000 or more and providers of a credit facility where the average facility value is R3.348, (2) proposed alternative wording Draft Item 11(A) is far more **proportionate relative to the mischief** the proposal is seeking to prevent, and (3) Botswana implemented a 'knee-jerk' response as a result of FATF grey-listing which had untenable results and which has since been reversed.

The NCRF **recommended** that the Committee should insist that the FIC conducts an MLTF risk assessment on the credit provider sector **before** item 11 of Schedule 1 to FICA is implemented.

3.2 Vodacom payment Services (Pty) Ltd

Vodacom noted that "*A person who carries on the business of a money [remitter] or value transfer provider*" will be an accountable institution in terms of the FICA 38 of 2001. Vodacom is seeking clarity and guidance regarding the following:

- What would be considered the business of a money remitter or a value transfer provider and which institutions will fall within the scope of the business of a money remitter or value transfer provider;

- How do accountable institutions deal with other areas of their business where the business falls outside the scope of a money remitter or value transfer provider and as such the business conducts unrelated activities to a money remitter or value transfer provider?

- Whether the activities that fall outside the scope of money remitter or value transfer provider can be excluded from the provisions of FICA. For example, would the accountable institution be able to apply for an exemption to exclude the activities that fall outside the scope of the money remitter or value transfer provider from the application of FICA?

- Whether the new accountable institutions will be given time within which to comply with the provisions of FICA.

Vodacom **proposed** that there should be a transitional period of 12 months applicable to the Draft Amendments to allow new accountable institutions to comply with FICA.

4. Committee observations

4.1 The role played by the retail clothing industry in the economy and financial inclusion, in particular, was acknowledged. It was recommended that the FIC should consider applying a differentiated approach which takes into account the size of credit, and turnover and does not exclude marginalised people, rather than the current **one-size-fits-all approach**.

4.2 The **compliance with FICA's proposed amendments**, which may be costly, time-consuming, and labour-intensive, was noted.

4.3 A concern raised by the NCRF on the potential **Court challenge** if the amendments are approved and implemented in the current form and the FIC's response that when these regulations are passed, the Constitutional Court would not entertain a hypothetical question of what the implications would be, and its assertion that it is unlikely that the Constitutional Court would rule on these amendments, were noted.

4.4 A comment was requested on **potential challenges** if the rest of the proposed amendments in the FICA Schedules are acceptable except for the issues raised by the NCRF. The Committee requested legal advice from the Parliamentary Legal Services on this and the Constitutional Court matter.

4.5 Members noted the NCRF's concerns that **FATF has not conducted a risk assessment impact study** to determine the impact on the retail clothing sector, as financial inclusion might be compromised. This was seen as a knee-jerk reaction and the FIC was cautioned that the proposed amendments should not set the government up for failure (unintended consequences of these regulations).

4.6 Noting that other **'carve-outs'** of sectors are already catered for in Schedule 1 to FICA, a whether the FIC conducts sector studies on carve-outs.

4.7 Members noted the FIC's response that the **requirement of proof of address** when consumers apply for credit, is not a FICA or FATF requirement. The FIC further clarified that the FATF requirements are not prescriptive on the documents required and are clear and focused on the issue of financial inclusion.

4.8 In the **example of Botswana**, which was grey listed and later on removed from the list, the FIC clarified that the EU declared Botswana "red-listed" until the country addressed the challenges identified by FATF and later removed from the grey list and that Botswana's matter was not related to the provision of credit.

4.9 Members noted the NCRF's concern that for many years, it had conversations with the NT through its workshops and made written submissions to SCoF but it has not received a response. The Committee resolved that the NT, FIC and NCRF should meet in the next 48 hours to address outstanding issues and that Parliamentary legal services must provide legal advice on the matters raised.

4.10 Overall, the FIC remains adamant that it has adequately applied its mind to the wording proposed by the NCRF and that these words are not legally defined terms. The FIC's concern is that the NCRF is only looking at itself whereas the regulations apply to all financial service providers.

4.11 **NT and FIC's response to the wording proposed on item 11 by the NCFR and others**, to exclude credit providers that offer credit in terms of a credit facility and exclusion of certain credit transactions such as mortgage agreements, secured loans and leases were that the FATF Standards required that lending businesses be included in the regulatory measures against money laundering and related activities. These included the provision of consumer credit and the financing of commercial transactions. They however assured that the application of risk-based measures will allow businesses to manage risks and apply simplified measures where money laundering risks were low (SCoF report).

5. Issues for consideration and follow up

5.1 Concerns were raised about **the impact of the costs of compliance with FICA regulations** on the affected parties' operational costs and that these costs might be passed onto the consumers. What is the FICs response to the financial implications of the proposed amendments and how could the risks to the financial consumers and SMMEs be mitigated?

5.2 There appears to be confusion about the impact of the proposed amendments. What would the impact be **if the FIC considers some of the recommendations made**, such as excluding, certain types of products, limiting the transactions cash transactions to the value of R100 000, instead of "payment in any form", excluding some sectors considered low-risk (the retail sector, SMMEs, agricultural sector), considering a transitional period for implementation of the proposed amendment to provide new accountable institutions sufficient time to implement and comply with the provisions of the FICA?

5.3 Can clarity be provided on what criteria were used to identify which credit providers or the type of credit providers are included or excluded from the proposed amendments? Or is everything based on the FAFT standards?

5.4 In the absence of an independent risk assessment/study, what ways have been used to get a sense of the extent of the level of money laundering and related activities? Has the approach been applied to the various types of lending businesses?

5.5 With respect to money remitters or value transfer providers, who falls within this category and who does not? What are the criteria used to determine who is excluded from this category?

5.6 Has there been a study/work done on whether there are unintended consequences of applying the proposed amendments to specific types of money remitters or value transfers?

5.7 If so, what have been the findings? And in what way have these findings informed the proposed amendments?