AMENDMENTS OF THE SCHEDULES TO THE FINANCIAL INTELLIGENCE CENTRE ACT, 2001 (ACT 38 OF 2001)
RESPONSES TO THE DOCUMENT OF THE SELECT COMMITTEE ON FINANCE AND QUESTIONS RAISED : 23 SEPTEMBER 2022

AD PARA 1 –

1.1 The proposed amendments to the Schedules are also intended to widen the scope of the FIC Act and bring South Africa's Anti-money-laundering and Combating the financing of terrorism and proliferation (AML/CFT/PF) legal framework in line with the international standards set by the Financial Action Task Force ("the FATF"). The FATF standards require member countries to extend the scope of the AML/CFT/PF regulatory framework to a specified list of financial institutions (such as banks and credit providers) and designated non-financial businesses and professions (DNFBPs) (such as casinos, estate agents, trust and company service providers and dealers in precious metals and precious stones) and virtual asset service providers (in the Intergovernmental FinTech Working Group referred to as crypto asset service providers (CASPs)). The mutual evaluation report (MER) of South Africa which was discussed at the FATF Plenary in June 2021 and published in October 2021 identified a number of deficiencies, among others relating to the scope of South Africa's AML/CFT/PF regulatory framework. These amendments are intended to deal with the deficiencies relating to scope. The widening of the scope of the FIC Act concerning AML/CFT obligations for financial institutions, DNFBPs and CASPs, and reorganising the structure of its supervisory bodies through proposed amendments to Schedules 1, 2 and 3 of the FIC Act will address the scope issue that affect the customer due diligence Recommendations as well as supervision and enforcement weaknesses identified in Immediate Outcomes 3 and 4 in the Mutual Evaluation Report.

AD PARA 2.1 – bullet point 3 "Trust Service Providers" –

1.2 This proposed amendment is intended to deal with a deficiency identified in the MER which requires the inclusion of certain activities of "Trust and Company Service Providers", including accountants, to be regulated for AML/CFT purposes. Item 2 currently only deals with trust service providers as accountable institutions. The amendment of item 2 to address the MER deficiency will see that trust and company service providers, including accountants, fall under the scope of item 2 as accountable institutions.

AD PARA 4 – COMMITTEE OBSERVATIONS

1.3 AD PARA 4.1 – *"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 marginalized people, rather than the current one-size-fits-all approach."*

1.4 The National Treasury reiterates that there is not a one-size-fits-all approach that I applied in terms of the FIC Act, as was pointed out in the SeCoF sessions. The amendments to the FIC Act in 2017, the repeal of a large part of the Money Laundering and Terrorist Financing Control Regulations and the withdrawal of the Exemptions, were to ensure we moved from a rigid rules-based approach to a flexible risk-based approach – in line with the revised FATF Standards of 2012. The application of a risk-based approach that is prescribed by the FIC Act requires businesses to manage their own risks. As a consequence, each business is required to apply a differentiated approach, based on its understanding of its inherent money laundering and terrorist financing risks, which takes into account factors such as the size of credit, turnover, types of client, and products offered to the clients, etc. These factors are not "hard-coded" in the law, as they will differ from one institution to another.   The FIC Act does not contemplate a rules-based approach where a small business or businesses whose products or services constitutes lower money laundering/terror financing/proliferation financing (ML/TF/PF) risks must deal with AML/CFT compliance in the same manner as a large business with higher ML/TF/PF risks.

1.5 The representatives from Business (NCRF) allege that although this may be the case, market practice is, however, different. The market practice issues as alleged by NCRF may have been in respect of the credit legislation which is very distinguishable to the FIC Act ML/TF/PF risks-based concerns. Whilst we acknowledge the NCRF’s comments, the National Treasury would urge caution in extrapolating from supervisory practices relating to one set of accountable institutions to what would be applicable in relation to the NCRF. This is because risks and therefore regulatory requirements are not applied in the same manner in relation to different sets of accountable institutions with the risk based approach. As NCRF entities have not previously been subject to the FIC Act as credit providers under the current item 11 designation – provider of credit against security, the precise application of the risk based approach that will be taken in relation to those entities is currently unknown to them, but it is affirmed the FIC will apply a proportionate risk based approach that consistent with the risk profile of the particular entities.

Addressing current industry practices that may be inconsistent with a risk-based approach should be achieved through additional clarification of supervisory expectations and engagement. During further engagement with NCRF, the National Treasury has confirmed that such business is already conducting some type of simplified due diligence – by obtaining personal information on a customer before providing credit to them. Indeed , the NCRF members currently obtain much more information from a customer before providing credit to them that what is required for simplified due diligence. It is reiterated that Guidance Note 7 published by the FIC in collaboration with National Treasury and SARB, FSCA clarifies this. In particular, Chapter 2 covers this – para 74 – “…the obligation to apply a risk-based approach…gives accountable institutions greater discretion to determine the appropriate compliance steps to be taken in given circumstances. This means that accountable institutions now have the flexibility to choose the type of information by means of which it will establish clients’ identities and also the means of verification, instead of following the rigid steps provided for the MLTFC Regulations.” If businesses that are not accountable institutions and, save for suspicious and unusual transaction reporting, and the prohibition to deal with sanctioned persons and entities, do not have any FIC Act obligations, choose to require proof of residence as a condition to extending credit to a customer, then they are doing so on their own initiative and not because of an obligation under the FIC Act. They are, therefore, themselves responsible for any exclusionary practices.

AD PARA 4.5 –

1.6 The proposed set of amendments to the Schedules to the FIC Act is not a "knee-jerk" reaction to the MER and possible-grey-listing, but is the result of a very lengthy consultation process. The consultation process commenced in March 2017 and consultations with relevant sectors and supervisory bodies continued until 2019. The Minister approved and National Treasury published the proposed amendments to the Schedules on 19 June 2020, with a closing date of 18 August 2020 (two months for comments to be submitted). The comments that were received were incorporated, where relevant.

See information below regarding risk assessment/impact study.

AD PARA 4.6 –

1.7 There are no carve-outs for other Schedule 1 items similar to what the NCRF requests in respect of item 11 (credit providers). Item 8 deals with life-insurance businesses that are already accountable institutions. The amendment excludes reinsurance business; however, this is business received from existing accountable institutions and not between business and the public (as is the case in the carve-out requested by NCRF).

AD PARA 4.8 –

1.8 It is relevant to refer to the European Union's (EU) annexure of high risk third countries with "strategic deficiencies" in its anti-money laundering and counter terrorist financing regime (the EU's AML Annex) is often referred to as the EU's AML Blacklist. The following links to the relevant material and useful background material on the EU listing process:

https://finance.ec.europa.eu/financial-crime/high-risk-third-countries-and-international-context-content-anti-money-laundering-and-countering_en https://www.intertrustlaw.com/cayman-islands-and-the-eus-aml-high-risk-third-country-list-limited-or-no-impact-to-the-cayman-islands/

2. AD PARA 5 – ISSUES FOR CONSIDERATION AND FOLLOW-UP

AD PARA 5.1 – FIC's response to the financial implications of the proposed amendments and how could the risks to the financial consumers and SMMEs be mitigated?

2.1 Note Bowmans correspondence to SeCoF dated 23 September 2022, para 2.3 – "The NCRF members are large industry players, and would be categorised as large businesses, not small businesses."

During the SeCoF session, the NCRF submitted that additional compliance costs will be at least R25.00 to R30.00 per credit applicant – this appears to be the initial costs that Business estimates for KYC/CDD. The National Treasury submits that this is not the case. As the NCRF has been stating, the majority of relationships with customers in this sector could be classified as "low-risk" for ML/TF where simplified due diligence may be justified. An accountable institution may determine that it will conduct simplified due diligence by obtaining the customer's identity particulars (e.g., name, surname and identification number and verifying these against an identity document). Credit providers that have obtained this information from their existing customers already (including in many cases financial records / bank statements) may choose to continue using the information that they have already verified and would not have to repeat this exercise. Other FIC Act compliance obligations will be applicable, such as ensuring a Risk Management and Compliance Programme is in place and providing training to staff members, but the FIC is unable to estimate full costs on the additional FIC Act compliance obligations. It is however, submitted that once such measures have been implemented, the ongoing costs of maintaining should be minimal.

2.2 The question of the retrospective application of the FIC Act was raised during the Select Committee on Finance meeting, pointing out section 21(2) of the FIC Act, and that this may result in the additional costs. This section does not apply in this case. Section 21(2) was a transitional provision that was applicable when the FIC Act entered into force.

2.3 As stated above (Ad para 4.1), there is not one-size-fits-all approach that is applied in terms of the FIC Act. The amendments to the FIC Act in 2017, the repeal of a large part of the Money Laundering and Terrorist Financing Control Regulations (MLTFC) and the withdrawal of the Exemptions, were to ensure we moved from a rigid rules-based approach to a flexible risk-based approach – in line with the revised FATF Standards of 2012. The application of a risk-based approach that is prescribed by the FIC Act requires a business to manage their own risks.

2.4 Further, it is reiterated that the information already collected by such credit providers before credit is provided to a customer is much more than what is required for simplified due diligence in respect of a low-risk customer. The credit provider already collects information such as name, surname, identity number, copy of identification document, financials (such as bank statements), contact and references – and apparently claim that the FIC Act requires this of them.

2.5 What did come out of the session is that although the legislation has been amended to allow for a risk-based approach, the market practice seems to be applying, not a flexible risk-based approach, but a rigid approach. It is submitted these comments about market practice are not in respect of the NCRFs actual experience as accountable institutions that have been supervised under the FIC Act, as they are not yet accountable institutions. However, as indicated to SeCoF, additional clarification of supervisory expectations and awareness sessions with accountable institutions on FIC Act obligations and application of a risk-based approach will provided. Measures to ensure the appropriate implementation of the risk-based approach should be relied upon and effectively implemented by accountable institutions based on their own understanding of their risks of products/services and clients. Education and awareness raising among the accountable institutions are required.

3. **AD PARA 5.2 –** What would the impact be if the FIC considers some of the recommendations made, such as excluding, certain types of products, limiting the transactions to cash transactions to the value of R100 000,00 , instead of "payment in any form", excluding some sectors considered low-risk (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 FICA?

3.1 With respect to the proposed item to include High-value goods dealers, the FATF Standards include the non-financial businesses that should be covered by a country's legislation against money laundering and terrorist financing such as casinos, estate agents, trust and company service providers and dealers in precious metals and dealers precious stones. Dealers in precious metals and precious stones are businesses which are not covered at all by the scope of Schedule 1 to the FIC Act.

In relation to the comments relating to carve-outs, the application of a risk-based approach that is prescribed by the FIC Act requires businesses to manage their own risks. As a consequence, each business is required to apply a differentiated approach, based on its understanding of its money laundering and terrorist financing risks, which takes into account factors such as the size of credit, turnover, etc.

3.2 It would be a huge loss of information to the FIC if the transactions were limited to cash only. It is unlikely that a customer will use R100 000,00 in cash to purchase a high value item such as a motor vehicle or jewellery. By including payments in any form, we can see the purchasing power of individuals. Different methods of payment are used. In fact, there have been reports that luxury motor vehicles have been purchased from a car dealership in Gauteng using Bitcoin: https://www.news24.com/wheels/News/car-buying-is-changing-as-customers-now-use-bitcoin-to-make-vehicle-transactions-in-sa-20210525

3.3 Once the amendments are approved and enter into force, inspections and enforcement will only commence after a window period of 12 to 18 months.

Guidance aimed at clearly communicating supervisory expectations and approaches will take place during this time for the new accountable institutions to understand their FIC Act obligations.

4. **AD PARA 5.3 –** Criteria to identify which credit providers or type of credit providers are included or excluded? Or is everything based on the FATF standards.

4.1 In respect of Item 11 of Schedule 1 (credit providers), the current coverage of credit providers was inadequate and did not include all types of credit providers as is required by the FATF Standards. The FATF Standards require that all types of financial institutions be covered under the AML/CFT scope – this includes those entities that provide the activity of lending. "Lending" is defined in the FATF Standards (the FATF Glossary) to include, *inter alia*, consumer credit; mortgage credit…"

No exclusions or thresholds are identified in the FATF standards for this item.
In addition, the legal reference point in South African law for the inclusion of credit providers in the scope of the FIC Act, namely the National Credit Act, defines the relevant terminology (e.g. credit facility) in very wide terms, which makes it impossible to maintain legal certainty when attempting to refer to sub-categories of credit providers within the larger categories provided for in the National Credit Act.

5. **AD PARA 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 various types of lending businesses?

5.1 When a proposed Bill is tabled in Cabinet a Social and Economic Impact Assessment Study (SEIAS) is done, which Cabinet must consider when deciding whether to approve the Bill for introduction in Parliament. This was not required in this case, because the Minister's Notice to amend the Schedules is not a Bill and did not go through a Cabinet Process.

5.2 A sector risk assessment (SRA) is focussed on determining what the ML/TF risks in a particular sector is, so that the risks are understood and can be mitigated. Although the FATF Standards do not envisage that each country should do a prior SRA on each sector that is covered or designated by the FATF Standards to decide whether that sector should be included in the scope of its AML/CFT framework, the National Treasury, working with other departments, do on a regular basis undertake sectoral risk assessments. The covered or designated sectors which must be included in a domestic regime are determined jointly through agreed FATF Standards, however the intensity of supervision is determined nationally commensurate to the risk faced in that jurisdiction. The point of an SRA in this case is, therefore, not to determine whether a sector should be covered or not, but to determine what the risks are that should be mitigated in a sector that is already included. Moreover, an impact assessment (as opposed to a risk assessment) cannot provide the basis for a decision to exclude a sector from the scope of a country's AML/CFT framework if that sector is covered by the FATF Standards.

5.3 The only basis for an exclusion of a sector that is covered by the FATF Standards is that in a particular scenario there is no risk of money laundering / terrorist financing / proliferation financing happening in that sector.

6. AD PARA 5.5 – Money remitters

6.1 Current Item 19 includes money remitters as accountable institutions. The proposed amendment takes into account the deficiency identified in the MER that the FIC Act does not fully cover the concept of "money or value transfer providers" ("MVTS") as described in the Standard. The current item 19 covers those entities that are authorised dealers (such as banks) and authorised dealers with limited authority such as money remitters other than banks) that are required to be authorised by the Financial Surveillance department of the South African Reserve Bank to conduct their business. This amendment intends to cover the informal money remittance business as required under the FATF Standards. The FATF Standard describes "Money or Value Transfer Services" as "financial services that involve the acceptance of cash, cheques, other monetary instruments or other stores of value and the payment of a corresponding sum in cash or other form to a beneficiary by means of a communication, message, transfer, or through a clearing network to which the MVTS provider belongs. Transactions performed by such services can involve one or more intermediaries and a final payment to a third party, and may include any new payment methods. Sometimes these services have ties to particular geographic regions and are described using a variety of specific terms, including hawala, hundi, and fei-chen".

7. AD PARA 5.6 and 5.7

7.1 See information under Ad Para 5.4 and Ad Para 5.5 above.

8. With respect to the Bowman's correspondence to the Select Committee dated 23 September 2022, please note the following – (the information provided above also covers issues raised by Bowmans/NCRF) -

8.1 AD PARA 2.12 -2.13 of Bowmans correspondence

GN3A was withdrawn and replaced by Guidance Note 7, specifically Chapter 1 and 2 – which explains the obligation to apply a risk-based approach.

8.2 AD PARA 2.16, 2.17 – PCC 53

Draft PCC 114 has been replaced by the final version PCC 53. PCC 53 is intended for DNFBP accountable institutions (casinos, estate agents, etc.) and not for financial institutions (such as credit providers).

8.3 AD PARA 2.18 – Geographic location of a customer

Refer to information above regarding simplified due diligence.