



FIRST ROUND MUTUAL EVALUATIONS - POST EVALUATION PROGRESS
REPORT OF SOUTH AFRICA

Covering the period August 2017 – July 2018

ESAAMLG (2018), First Round Mutual Evaluation - Post Evaluation Progress Report of South Africa on Anti- Money Laundering and Counter-Terrorist Financing Measures.

REPUBLIC OF SOUTH AFRICA

I. BACKGROUND INFORMATION

1. The Republic of South Africa was evaluated jointly by FATF and ESAAMLG (by virtue of its being member of the two bodies) in February 2009. Its Mutual Evaluation Report (MER) was adopted by the ESAAMLG Council of Ministers in August 2009.
2. According to its MER, out of the Core and Key Recommendations, the jurisdiction was rated PC in respect of Recommendations 5, 10, 23 and Special Recommendation III. It did not register any NC on the Core and Key Recommendations. Details of South Africa's PC and NC ratings for all Recommendations are set out in Tables 1 and 2 below:

TABLE 1: Core & Key Recommendations rated PC

R5, R10, R23, SRIII

TABLE 2: Other Recommendations rated NC & PC

Rated NC
R6, R7, R9, R12, R21, R22, R33
Rated PC
R8, R11, R15, R16, R17, R18, R24, R25, R29, R32, R34, SRVI, SRVII, SRVIII, SRIX

3. South Africa was on the FATF regular follow-up process. However, in June 2014, as the FATF third round follow-up process was terminated, its Plenary decided to place South Africa in the targeted follow-up process. The country was therefore requested to report on the old R.5 and R.10 only.
4. During the ESAAMLG meeting in September 2014, the Task Force discussed South Africa's Follow-up report. It was noted that the country had made progress on several Recommendations, including R.9, R.12, R.16, R.23 and

SR.VI. It was also noted that the Financial Intelligence Centre (the Centre) had conducted a comprehensive review of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001, the FIC Act). In particular, the proposed amendments to the FIC Act and subordinate regulations were intended to address the identified deficiencies with respect to R.5, R.10 and other Recommendations, including R.6, R.8, R.9, R.11, R.12 and R.15.

5. Following the February 2017 FATF Plenary, the FIC Amendment Act was signed into law by the President on 26 April 2017. The Amendment Act was published in the Government Gazette on 2 May 2017. On 13 June 2017, the Minister issued Notice No. 563 to announce the commencement of the Act. In terms of the Notice, the implementation of different provisions of the FIC Amendment Act would start on different dates; 13 June 2017, 2 October 2017 and dates to be determined after 2 October 2017 (but expected to be no later than the end of 2018).
6. On the basis of the information provided in the June 2017 Follow up report, the Review Group, at the September 2017 ESAAMLG meeting, undertook analysis of the FIC Amendment Act on the basis of the text published in the Gazette. While it appeared that the legislation rectifies a number of deficiencies with old recommendation 5 in particular, a complete analysis would not be possible until South Africa had prepared the implementing regulations and decided whether any exemptions would apply. Considering the need to promptly address the deficiencies identified under South Africa's targeted follow-up process, the FATF Plenary in June 2017 decided that South Africa would report back to the Plenary in October 2017.
7. Following the June 2017 FATF Plenary, South Africa issued two Government Notices: "Amendments to Money Laundering and Terrorist Financing Control Regulations" and "Withdrawal of exemptions issued in terms of the Act", which addressed several of its remaining deficiencies. South Africa also issued Guidance Notes on how to comply with the amendments included in the FIC Act and the Regulations, to assist accountable institutions in implementing the new requirements. The amendments to the Money Laundering and Terrorist

Financing Regulations and the withdrawal of the exemptions issued under the Act came into operation on 2 October 2017. This coincides with the commencement of a number of amendments to the FIC Act which the Minister had announced on 13 June 2017.

8. The FATF plenary in October 2017 agreed that South Africa has reached a level of compliance for old Rs.5 and 10 that is substantially equivalent to largely compliant and South Africa should therefore be removed from the targeted follow-up process taking into account that it has already started preparing for its 4th round mutual evaluation which begins imminently (the TC annex is due in May 2019).
9. However, since the Follow-up report did not cover the rest of the Recommendations, it was not possible to establish South Africa's position with respect to Recommendations 6, 8, 9, 11, 12 and 15 which were noted as outstanding as per the June 2014 report which was submitted to the ESAAMLG for discussion at its meeting in September 2014. In view of this, the Task Force, at the April 2018 meeting, directed South Africa to submit a progress report focusing on Recommendations 6, 8, 9, 11, 12 and 15. South Africa has submitted its fifteenth progress report for discussion at the September 2018 ESAAMLG meeting. Below is the analysis of the Review Group.

II. ANALYSIS OF SOUTH AFRICA'S PROGRESS

2.1 Progress made regarding the key Recommendations

Customer Due Diligence (R5-rated PC)

The Assessors recommended that there should be specific legal obligation for an accountable institution to undertake CDD when there is a suspicion of money laundering or terrorist financing or when it has doubts about the veracity or adequacy of previously obtained customer identification data.

Section 21D of the Amendment Act requires an accountable institution to repeat all CDD steps when it has doubts about the veracity or adequacy of previously

obtained customer identification data. The requirement to conduct CDD when there is a suspicion of ML or TF is expressly included in the risk management obligations of accountable institutions by requiring that accountable institutions describe in their Risk Management and Compliance Programmes how they “will perform the customer due diligence requirements in accordance with sections 21, 21A, 21B and 21C when, during the course of a business relationship, the institution suspects that a transaction or activity is suspicious or unusual”. The authorities indicated that they have issued a detailed guidance note regarding this matter how accountable institutions must apply the CDD steps to mitigate money laundering and terrorist financing risk.

Conclusion

The recommendation substantially addressed.

The Assessors recommended that the 2001 FIC Act be amended to require accountable institutions to verify the identification information relating to directors and senior management by comparison with the CM29 form filed with CIPRO (Companies and Intellectual Property Registration Office).

Section 21B(2)(a)(iii) of the Act requires accountable institutions to verify the identity of the natural person who exercises control over the management of the juristic person, including his/her capacity as executive officer, director, manager, etc. South Africa advised that the CM29 form filed with CIPRO is no longer in use.

Conclusion

The recommendation is addressed.

The Assessors recommended that there should be a specific requirement in law or regulation that requires accountable institutions to identify beneficial owners (i.e. the natural persons who ultimately controls and owns the customer) or to verify their identities. Therefore, there is no obligation to identify the beneficial owner before or during the course of establishing a business relationship or conducting transactions for occasional customers.

Section 21B on additional due diligence measures relating to corporate vehicles requires an accountable institution to establish the ownership and control structure of the client. If a client is a legal person, the identity of the beneficial owner of the client needs to be established, and reasonable measures have to be taken to verify the identity of the beneficial owner.

Conclusion

The recommendation is addressed.

The Assessors recommended that there should be specific requirement to understand the ownership and control structure of a customer that is a legal person or arrangement, beyond the requirements described above to identify: the manager and 25% shareholders of a company; the members of a close corporation; the partners in a partnership; and the founders, trustees and beneficiaries of a trust.

Section 21B(1) on additional due diligence requires an accountable institution to establish the ownership and control structure of the client.

Conclusion

The recommendation is addressed.

The Assessors recommended that there should be explicit requirement that information on the purpose of a business relationship be obtained.

Section 21A of the Amendment Act requires an accountable institution, when it engages with a client to establish a business relationship, to obtain the information describing the nature and purpose of the business relationship.

Conclusion

The recommendation is addressed.

The Assessors recommended that there should be an explicit requirement to conduct on-going due diligence.

Section 21C requires an accountable institution to conduct on-going due diligence, which includes (a) monitoring of transactions throughout the course of the business relationship, including the source of funds, and (b) keeping information obtained for the purpose of establishing and verifying the identities of clients up-to-date.

Conclusion

The recommendation is addressed.

The Assessors recommended that there should be a specific requirement that accountable institutions apply enhanced due diligence for higher risk categories of customers, business relationships or transactions.

Section 42 requires accountable institutions to (among others) mitigate and manage ML and TF risks, by means of a Risk Management and Compliance Programme

which must specify how CDD is to be implemented in the institution in order to achieve this. An accountable institution may include measures for enhanced due diligence for higher risk customers in its Programme and conduct its CDD in accordance with the Programme.

The Assessors recommended that certain exemptions should comply with the FATF Recommendations in that they fully exempt certain accountable institutions from all CDD requirements (as well as some or all record keeping requirements).

The exemptions are withdrawn by issuing a notice

Conclusion

The recommendation is addressed.

The Assessors recommended that once a business relationship has been established, there should be specific requirement to terminate the business relationship or to consider filing an STR if doubts about the veracity or adequacy of previously obtained customer identification data arise.

Section 21D of the Act requires an accountable institution to repeat all CDD steps under section 21 through 21B, when it has doubts about the veracity or adequacy of previously obtained customer identification data. Section 21E requires an accountable institution, when it is unable to establish and verify the identity of a client, not to establish a business relationship nor conduct a transaction with the client, or terminate any existing business relationship with the client and consider filing an STR under Section 29 of the Act.

Conclusion

The recommendation is addressed.

The Assessors recommended that the Uncovered Financial Institutions should be subjected to the CDD obligations of the FIC Act.

The coverage of the FIC Act, which appears in Schedule 1 of the Act as a list of accountable institutions, has not been changed.

Conclusion

The recommendation is not addressed.

Overall Conclusion

The outstanding issues under R. 5 are largely addressed.

Record keeping and wire transfer rules (R.10 rated PC)

The Assessors recommended that there should be a specific requirement that the transaction records include the date of the transaction or the address of the customer. Outside of the banking sector, there should also be a general obligation to keep transaction records sufficient to permit the reconstruction of account activity. There should further be a requirement to maintain account files or business correspondence as part of the record-keeping obligation. Effective application of the record keeping obligations is eroded by Exemptions 4, 6, 14, 16 and 17 which exempt accountable institutions from maintaining records of customer identification and verification. Uncovered Financial Institutions should also be subject to the record keeping obligations of the FIC Act.

Section 22A of the FIC Act requires accountable institutions to keep information on the date a transaction [22A (b)] was concluded and to determine how record-keeping is done in their compliance programmes. All information about customers that is obtained in the course of CDD processes must be kept in records. Section 22A also requests that transaction records are kept in a manner that permits the reconstruction of account activity. 22A (e) requires accountable institutions to maintain business correspondence. In addition, section 22A(f) also requires accountable institutions providing account facilities to their clients, to keep the identifying particulars of all accounts, and the account files at the accountable institution that are related to the transaction. Financial institutions are not exempted anymore from compliance with the record keeping requirements of the FIC Act. However, the FIC Amendment Act does not contain provisions to include financial institutions that are not covered as accountable institutions (i.e. leasing companies). South Africa reported that the scope of the FIC Act as determined in Schedule 1 to the Act is being reviewed with a view to recommending to the Minister of Finance to include additional categories of institutions. Consultations with affected sectors are currently underway.

Conclusion:

This recommendation is largely addressed. Progress made regarding the Non key and non-core Recommendations

2.2.1 BUILDING BLOCK III- PREVENTIVE MEASURES –FINANCIAL INSTITUTIONS

Politically Exposed Persons (R.6-Rated NC)

The Assessors recommended that South Africa should have enforceable obligation for financial institutions to identify politically exposed persons (PEPs) or take other measures as indicated in Recommendation 6.

Though Sections 42(2)(l), 21F, 21G, 21H and Schedules 3A and 3B of the FIC Amendment Act, 2017 address the identified deficiencies under the MER, persons having prominent functions in international organizations outside South Africa are not clearly covered under Schedules 3A and 3B of the Act. In addition, the FIC Amendment Act does not contain provisions to include financial institutions that are not covered as accountable institutions.

Conclusion:

This recommendation is largely addressed.

New technologies & non face-to-face business (Recommendation 8- rated PC)

The Assessors recommended that there should be specific legal or regulatory requirements to have policies in place to address the potential abuse of new technological developments for ML/FT. The general requirements for non-face-to-face customers should also extend to when conducting on-going due diligence. Additionally, there should be elaboration of how this general requirement should be applied other than in the context of the banking sector and in relation to cell phone products. Uncovered FIs should further be subjected to the CDD obligations of the FIC Act.

The provisions cited by the authorities seem not relevant to address the identified deficiencies under this recommendation. Moreover, the FIC Amendment Act does not contain provisions to include financial institutions that are not covered as accountable institutions.

Conclusion:

This recommendation is largely addressed.

Third parties and introducers (Recommendation 9- rated NC)

The assessors identified under the MER that exemption 5 does not require the institution relying on third-party verification/identification to immediately obtain the relevant CDD information. It also does not require the accountable

institution to satisfy itself that copies of identification data and other relevant documentation relating to CDD requirements will be made available from the other institution “without delay.” For Exemption 5, there is no explicit requirement that the financial institution satisfy itself of the adequacy of applicable AML/CFT measures applicable to the foreign financial institution. Despite the lack of determinations by relevant supervisory bodies, some accountable institutions are applying Exemption 5 and fully exempting from verification requirements all customers from FATF membership countries. Moreover, Uncovered Financial Institutions are not subject to the CDD obligations of the FIC Act.

The authorities confirmed that exemption 5 no longer exists. No accountable institution is allowed to do business with an anonymous customer and all accountable institutions are required to establish and verify the identities of customers in business relationships and single transactions above R5000. However, the FIC Amendment Act does not contain provisions to include financial institutions that are not covered as accountable institutions.

Conclusion:

This recommendation is largely addressed.

Unusual transactions (Recommendation 11-rated PC)

The Assessors identified that the FIC Act does not contain a provision which expressly requires financial institutions to pay special attention to transactions based on complexity, size or unusual patterns. There is also no requirement to make a record that includes customer and transaction information for complex and unusually large transactions or unusual patterns of transactions or to prepare written findings and to maintain them unless it is part of an STR. Since there is no requirement to prepare any written findings concerning the background and purpose of transactions with no apparent business of lawful purpose, there can be no requirement to keep them available for at least five years. They recommended that the obligation to pay attention to transactions with no apparent business or lawful purpose should be extended to Uncovered Financial Institutions.

All businesses are required to monitor and report suspicious and unusual transactions which include transactions with no apparent business or lawful purpose in terms of Sections 21C, 42(2)(h) and 29. In terms of Section 23 C of the

FIC (Amendment) Act, FIs are required to keep a record relating to a transaction or activity which gave rise to a report contemplated in section 29, for at least five years from the date on which the report was submitted to the FIC. However, the FIC Amendment Act does not contain provisions to include financial institutions that are not covered as accountable institutions.

Conclusion:

This recommendation is largely addressed.

DNFBP –R.13-15 & 21 (Recommendation 12-rated NC)

Under the MER, it is indicated that the deficiencies identified in R.5, 6, and 8-11 that apply in the financial sector also apply to all DNFBPs. Scope issues further reduce the application of the requirements of R.5 and R.8-11 in that: accountants are not covered when conducting all of the activities prescribed in R.12 and the applicability of the requirements when providing investment advice is not clear to the industry; attorneys are not covered when performing company services in relation to legal persons and arrangements within South Africa; the majority of dealers in precious metals and stones sector are not covered and the others are only subject to limited CDD and record keeping requirements; and trust and company service providers (other than lawyers or accountants providing investment advice) are not covered in the situations specified in R.12. Applying R.5: Casinos are permitted to apply reduced CDD in all cases, and this was not based on demonstrated low risk. In particular, casinos are fully exempt from collecting and verifying the residential address and income tax registration number of natural persons (Exemption 14). Exemption 10 for attorneys does not comply with the FATF Recommendations in that it fully exempts attorneys from all CDD requirements (as well as some or all record keeping requirements) even where there is a suspicion of ML/FT. Applying R.9: The characteristics of the real estate market (often cash-based) make it troubling that the full range of preventative measures required by Recommendation 9 do not apply to non-face-to-face transactions in the real estate sector. Applying R.10: (Dealers): Only very limited information on limited transactions is recorded. The results of the EAAB inspection process show that, overall, implementation of AML/CFT measures, including CDD requirements, is low among estate agents.

See the analysis made on Recs 5, 6, 8-11. The amendments to the FIC Act also apply to DNFBPs except the dealers in precious metals and stones. All exemptions that previously provided for restrictions in the scope of application

of the FIC Act's provisions in respect of DNFBPs, e.g. attorneys and casinos, have been withdrawn (as determined in Schedule 1 of the FIC Amendment Act). The issues raised on Recs. 6 and 8 remain outstanding.

Conclusion:

This recommendation is largely addressed.

Internal controls, compliance & audit (R15-rated PC)

The Assessors recommended that for financial institutions other than banks, there should be a requirement that the compliance officer be at the management level. Other than for banks, there should be requirement for accountable institutions to maintain an adequately resourced and independent audit function to test compliance (including sample testing) with AML/CFT procedures, policies and controls. There should be a general requirement for financial institutions to put in place screening procedures to ensure high standards when hiring all employees. There should also be a requirement that training be conducted on an ongoing basis. Uncovered Financial Institutions should be subjected to FIC Act requirements relating to internal controls.

In terms of Section 42A (2) of the Financial Intelligence (Amendment) Act, 2017, An accountable institution which is a legal person is required to designate a compliance officer with sufficient competence and seniority to ensure the effectiveness of the compliance function. Under Section 42A(3), the person or persons exercising the highest level of authority in an accountable institution which is not a legal person must ensure compliance by the employees of the institution. Section 43 of the same Act requires the reporting entities to provide ongoing training to their employees to enable them to comply with the provisions of the Act and the Risk Management and Compliance Programme which are applicable to them. However, the other deficiencies in relation to the requirements for FIs to have an adequately resourced and independent audit function; and to put in place screening procedures to ensure high standards when hiring employees remain outstanding. Moreover, the FIC Amendment Act does not contain provisions to include financial institutions that are not covered as accountable institutions.

Conclusion:

This recommendation is largely addressed.

III. CONCLUSION

South Africa submitted its 15th progress report with respect to Recommendations 6, 8, 9, 11, 12 and 15. The Review Group noted that South Africa has largely addressed the deficiencies against all the Recommendations. However, it was noted that there are some minor deficiencies including the scoping issue against Recs. 5, 6, 8, 9, 10, 11, 12¹ and 15. However, the authorities indicated that they are in the process of widening the scope of financial institutions. The Review Group noted that South Africa was due to be evaluated in 2019 and as the core issues had largely been addressed the outstanding matters were not material enough to warrant the continued reporting biannually. The Review Group encouraged the Authorities to attend to the outstanding issues under R. 15.

IV. RECOMMENDATIONS

10. In view of the foregoing, the Review Group recommends that:

- i. South Africa should exit the follow-up process as the core issues have largely been addressed and the outstanding matters are not material enough to warrant South Africa remaining in the follow up process.
- ii. The country should be encouraged to attend to the minor deficiencies against R.5, 6, 8, 9, 10, 12 and 15.

¹ No scoping issue is arising with respect to DNFBPs.
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