



## REPORT 2

# REGULATORY FRAMEWORK FOR ILLICIT FINANCIAL FLOWS IN SOUTH AFRICA

## A SCOPING EXERCISE

### 1. INTRODUCTION

The role of South Africa as the major financial centre in Africa makes it vulnerable to illicit financial crime by organized and unorganized groups. As at 2013, the major source of laundered funds was proceeds from drugs (US State Department Money Laundering Report, 2013). Other main money laundering activities and revenue generating crimes are fraud, theft, corruption, racketeering, precious metals smuggling, corruption, currency speculation, credit card skimming abalone poaching, “419” Nigerian-type economic/investment frauds and pyramid schemes (Financial Action Task Force, 2009). While most of these activities are done by illegitimate organizations, some are done by legitimate organizations.

### 2. SUMMARY OF LEGAL PROVISIONS IN SOUTH AFRICA

Generally South Africa has solid legal framework and sound constitution. In terms of illicit financial flows, South Africa has a solid legal and regulatory framework for anti-money laundering and counter-terrorist financing. However there is little focus on other forms of illicit financial flows, especially those perpetrated by the multi-nationals. South Africa has the following Acts that govern Anti-Money Laundering as well as Illicit Financial Flows;

- Financial Intelligence Centre Amendment Act
- Financial Intelligence Centre Act (FICA)

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- Prevention of Crime Act (POCA)
- Protection of Constitutional Democracy Against Terrorist and Related activities Act (POCDATARA)
- FICA Commencement of S29

In addition, South Africa has in place legislation covering the following;

- Criminalized Drug Money laundering as well as non-drug money laundering;
- By law banks are required to maintain records of large transactions in currency or other instruments
- By law banks are required to keep records, especially of large or unusual transactions for a specified period of time, e.g 5 years
- By law banks are required to report and record suspicious or unusual transactions to designated authorities
- Law authorizing the tracing, freezing, seizure and forfeiture of assets identified as relating to or generated by money laundering activities
- Law requiring and permitting the sharing of seized assets with third party jurisdictions that assisted in the conduct of the underlying investigations
- Laws requiring and permitting banks to cooperate with authorized investigations involving or initiated by third party jurisdictions, including sharing of records or other financial data
- Law regulating and controlling the flow of currency in and out of the republic
- Law to freeze assets without delay
- Law providing “safe harbor” defense to banks or other financial institutions and their employees who provide otherwise confidential banking data to authorities in pursuit of authorized investigations
- Law criminalizing the provision of material support to terrorists and or terrorist organizations



- The Republic is party to the 1988 United Nations Convention against Illicit Traffic in Narcotic drugs and Psychotropic substances or territorial entity to which the application of the convention has been extended by a party to the Convention
- The Republic is party to the International Convention for the Suppression of the Financial Terrorism, or a territorial entity to which the application of the Convention has been extended by a party to the convention
- Law requiring banks and or other covered entities to adopt and implement “Know your customer/Customer Due Diligence” programs for their customers or clientele
- Law requiring banks and or other covered entities to record and report transactions suspected to relate to the financing of terrorists, terrorist groups or terrorist activities to designated authorities
- Law criminalizing the disclosure and reporting of suspicious or unusual activity to an individual who is the subject of such a report, or to a third party.
- The Republic is party to the United Nations Convention against Transnational Organized Crime (UNTOC) or a territorial entity to which the application of the convention has been extended by a party to the convention
- Party to the United Nations Convention against corruption (UNCAC) or a territorial entity to which the application of the Convention has been extended by a party to the convention.

*(Source: US State Department International Narcotics Control Strategy Report)*

In addition, South Africa is a member of the Financial Action Task Force (FATF) and the Eastern and Southern Africa Anti-Money Laundering Group (ESAAMLG).



### 3. INSTITUTIONS INVOLVED IN COMBATING ILLICIT FINANCIAL FLOWS

This section outlines the role and effectiveness of key institutions mandated with addressing illicit financial flows in South Africa.

#### 3.1. Financial Intelligence Centre

The key international framework used to evaluate the extent of illicit financial flows in general and anti-money laundering in particular is the Forty Recommendations 2003 and the Nine Special Recommendations on Terrorist Financing 2001 of the Financial Action Task Force (FATF).

The Financial Intelligence Centre (FIC) is the prime Institution and the nerve centre of efforts to curb illicit financial flows. It serves as an operative central, national agency responsible for receiving (and as permitted, requesting) analysing and disseminating to the competent authorities disclosures of financial information concerning suspected proceeds of crime, or required by national legislation or regulation in order to counter money laundering. This is as per requirement for members of the Egmont group<sup>1</sup>.

To date the Financial Intelligence Centre has enhanced its ability to provide high-quality, timely and actionable financial intelligence as opposed to larger volumes of lower quality intelligence. As at 2011/12 the FIC evaluated almost 15000 suspicious transactions reports (STR), 4 million electronic funds transfers and froze 482 bank accounts (US State Department Money Laundering Report, 2013). The FIC requires banks, financial institutions, car dealers, attorneys, gold dealers, gambling establishments, real estate agents, foreign exchange dealers, security traders, money lenders (including those who lend against shares such as brokers), entities selling travellers cheques, and Johannesburg stock-exchange registered people and companies to perform customer due diligence, record keeping, suspicious transaction

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<sup>1</sup> Members of the Egmont Group of Financial Intelligence Units have access to a wide range of financial, administrative and law enforcement information to enhance its ability to analyse STRs.

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reporting and internal control requirements. The FIC Act imposes customer due diligence, record keeping, and suspicious transaction reporting and internal control requirements.

In accordance with the Prevention of Crime Act (POCA), South Africa requires all financial institutions and businesses to report suspicious transactions (STR). Overall, the STR reporting regime is being implemented effectively. The law requires that all suspicious transactions be reported to the FIC, including attempted transactions, regardless of amount. During the period 2007/08, the FIC received 24 585 STRs, representing a 15% increase in comparison to the previous year (Financial Action Task Force, 2009).

To further enhance its effectiveness the Financial Intelligence Centre has to date signed memoranda of understanding with the Financial Intelligence Units of Singapore, Albania, Angola, Botswana, Mali, Canada, Ghana, Lesotho and Tanzania. To date the Financial Intelligence Centre has been regarded as an effective financial intelligence unit by FATF.

### **3.2. Accountable Institutions**

Accountable institutions are designated non-financial businesses and professions (DNFBP) in accordance with the FIC Act. They include; attorneys (which includes notaries), trust service providers, (real) estate agents, casinos and public accountants. These institutions are normally in the business of providing investment advice or investment broking services. These institutions are included in the FIC Act because they are authorized to handle and receive cash on behalf of clients and are an important component of the non-banking system. They have the duty to establish and verify the identity of clients, duty to keep records, duty to report suspicious transactions to the FIC, as well as duty to register with FIC.



### 3.3. Supervising institutions

Supervising institutions are apex bodies responsible for ensuring that the accountable institutions are performing their roles as per the FIC Act. For example, the Estate Agents Board has responsibility of supervising individual estate agents registered with it to ensure compliance with FIC Act. Similarly the National gambling Board has responsibility to supervise all casinos to ensure compliance with FIC Act.

In South Africa, the following institutions play a supervisory role for anti-money laundering and IFF:

- South African Reserve Bank (SARB)
- Financial Services Board (FSB)
- National Gambling Board (NGB)
- Estate Agents Board (EAAB)
- Law Society of South Africa (LSSA)
- Companies and Intellectual Property Registration Organisation (CIPRO)
- Independent Regulatory Board for Auditors (IRBA)
- JSE Securities Exchange (JSE)

### 3.4. Law enforcement institutions

In addition, the below institutions help with law enforcement and the Financial Intelligence Centre works with these:

- *South African Police Service (SAPS)*. The South African Police Service (SAPS) is the main agency that is responsible for the investigation of money laundering and terrorist financing. Within the SAPS there is a specific unit in the Detective Service which deals with terrorist offences, including terrorist financing. To date there has been very few investigations under this unit. Asset Forfeiture Tracing Teams have been established in all the provinces of South Africa. Between April 2003 and March 2008 there were 64 money laundering cases pending before the courts. Out of this, only 16 resulted in convictions. This low conviction rate has been a key concern in terms of effectiveness of the Anti-Money laundering procedures and Act (Financial Action Task Force, 20011)



- *South African Reserve Bank (SARB)*. The South African Reserve Bank (SARB) is responsible for supervising banking institutions, and overseeing South Africa's exchange control regime—powers which it exercises through its Banking Supervision Department (BSD) and Exchange Control Department (ExCon). The Financial Services Board (FSB) is responsible for supervising financial advisors and intermediaries including investment managers, the insurance industry, retirement funds, friendly societies, collective investment schemes, exchanges, central securities depositories and clearing houses. The Johannesburg Stock Exchange (JSE) is a licensed exchange and self-regulatory organisation which is responsible for supervising authorised users of the exchange. A limited number of financial institutions are not subject to AML/CFT supervision because they are not defined as accountable institutions pursuant to the FIC Act. As well, there is no designated supervisory authority for the following accountable institutions: Postbank and members of the Bond Exchange.
- *Asset Forfeiture Unit (AFU)*. This unit sits in the National prosecution Authority (NPA) and is mandated under POCA to confiscate any proceeds from illicit and criminal dealings. The Criminal Procedure Act provides for the search, seizure, forfeiture and disposal of the instrumentalities of crime.  
The Prevention of Corruption Act (POCA) allows for criminal prosecution and forfeiture of proceeds from illicit financial dealings. To date statistics indicate that forfeiture and confiscation of criminal proceeds arising from illicit financial flows is quite high, pointing to the effectiveness of the forfeiture process.
- South African Revenue Service (SARS)
- National Prosecuting Authority (NPA)
- Special Investigations Unit (SIU)

#### 4. GAPS IN CURRENT LEGAL FRAMEWORK



It should be pointed out that South Africa's framework has a lot of positives and the country has been widely commended by the Financial Action Task Force for making significant progress especially on anti-money laundering and prevention of terrorism. The FIC Amendment Act of 2009, increased the supervisory powers of supervising institutions such as Johannesburg Stock Exchange, South African Reserve Bank, Financial Services Board, among others.

This notwithstanding, the following gaps are noted within the South Africa Legal framework on illicit financial flows and it is on the basis of these gaps that scope for more CSO and citizen involvement in strengthening the framework will emerge.

**a) Too much focus on anti-money laundering at the expense of other forms of illicit outflows.** There is too much focus on money laundering at the expense of more sophisticated illicit outflows by companies. South Africa is one country that faces a low threat from terrorism (and this is likely to continue in the foreseeable future), yet the main focus of its illicit financial outflow regulation is on anti-money laundering and terrorism. Because of the heavy emphasis by the international community on anti-terrorism, the South African legislation and institutions that in charge of acting on illicit outflows are disproportionately focussing on anti-money laundering. In addition, the availability of ready technical support in the form of training and other support from countries such as USA and European countries has increased the institutions' disproportionate focus on anti-money laundering.

According to the Global Financial Integrity Report (2013), 60- 65% of the resources that leave Africa involve multinational companies through transfer pricing, trade mispricing and other corporate malpractices, while 30-35% constitute drug trafficking and smuggling. Only 3% are a result of corrupt activities. Given this scenario, one would expect that South Africa places equal





emphasis on other forms of illicit financial flows and especially those involving transnational corporations.

**b) When prosecuting, Money laundering is often not a standalone charge but secondary to other charges.** Although within the South Africa legislation, anti-money laundering is regarded as a specific offense, it has rarely been charged as a standalone offense. Prosecutors include money laundering as a secondary charge together with other common charges. Because of this the South African government does not keep separate statistics for money laundering related prosecutions, convictions and forfeited assets (US State Department Money Laundering Report, 2013).

In addition, the lack of effective statistics from the key institutions such as FIC makes it difficult to monitor and assess the state of illicit financial flows and anti-money laundering.

**c) Inadequate capacity to monitor and enforce compliance.** While South Africa has exemplary institutions to fight Anti-Money Laundering and other illicit flows, these institutions lack capacity and skilled personal to monitor and enforce compliance (US State Department Money Laundering Report, 2013).

**d) Exemptions to FIC Act still constitute significant loopholes.** While accountable institutions are required to do business with customers after establishing and verifying the customer's identity, and the identity of any person acting on behalf of the customer; there is no legal obligation requiring accountable institutions to identify or verify the identity of beneficial owners (*i.e.* the natural persons who ultimately own and control the customer). The OECD has strongly urged developing country governments and developed country governments to identify company owners to enable them to prevent, uncover or prosecute money laundering.



Another key weakness in the framework is that a limited number of financial institutions are still exempt from some Anti-Money Laundering requirements. Thus the scope of the Anti-Money Laundering requirements is not large enough to include all relevant institutions. For example, there are no explicit requirements to understand the ownership and control structure of a customer, obtain information on the purpose of the business relationship or conduct on-going due diligence. In the same vein, there is no specific requirement that accountable institutions apply enhanced due diligence for higher risk categories of customers, business relationships or transactions, or cross border correspondent banking relationships. This exposes the financial sector and South African economy to forms of illicit financial flows such as transfer pricing.

- e) **Weak coordination among the state institutions.** There is weak coordination among the FIC and other institutions such as the South African Revenue authorities as well as the South African Police Service. This inspite of the fact that recommendation 5 of the Financial Action task Force requires that “countries have formalized coordination mechanisms which enable authorities to develop and implement these policies. This should facilitate co-operation, informal and formal, between authorities in general and law enforcement in particular.
- f) **Weak stakeholder engagement beyond state institutions.** Illicit Financial flows are a big issue that affect citizens, banks, private sector and development in general. As such every stakeholder has a role to play. In the case of South Africa, there is little interaction and engagement with citizens in terms of detecting and finding solutions to anti-money laundering.
- g) **Weak protection for whistle blowers.** South Africa's illicit financial flows framework still lacks protective mechanisms, such as laws to protect whistle

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blowers and secure data storage by the FIU, this can impede the work of the AML system.

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