

## Executive Summary

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### Mutual Evaluation Report Anti-Money Laundering and Combating the Financing of Terrorism: South Africa

Evaluation completed on 26 February 2009

#### 1 Key words

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Financial Action Task Force; Eastern and Southern African Anti-Money Laundering Group; Financial Intelligence Centre Act; anti-money laundering; money laundering; terror financing; corruption; fraud; legal systems; preventative measures; compliance; international cooperation; transparency; good governance; financial sector; non-profit organisations; non-financial businesses; customer due diligence; suspicious transaction reporting; terrorism.

#### 2 Commissioned and supported by

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The evaluation was commissioned by the Financial Action Task Force (FATF); and, it was therefore external to the Financial Intelligence Centre and other involved South African Government stakeholders. The Financial Intelligence Centre is the South African government agency responsible for liaising with the FATF and coordinating the cooperation of stakeholders, and the establishment of the evaluation steering committees. The evaluation was funded by the FATF through the member countries that provided assessors for the evaluation.

#### 3 Conducted by

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The evaluation was conducted by a FATF assessment team, which consisted of members of the FATF Secretariat and FATF experts in criminal law, law enforcement and regulatory issues. The team included: Ms. Valerie Schilling and Mr. Kevin Vandergrift from the FATF Secretariat, and Ms. Yotsna Lalji from the ESAAMLG Secretariat; Mr. Hay Hung Chun, State Counsel, Criminal Justice Division, Attorney-General's Chambers, Singapore (legal expert); Dr. Michalis Mersinis, Attorney-at-law, Legal Department, Hellenic Capital Market Commission, Greece (financial expert); Ms. Indira Crum, Senior Policy Advisor, Office of Terrorist Financing and Financial Crime, United States Department of the Treasury (financial expert); Mr. Shi Yongyan, Anti-Money Laundering Bureau, People's Bank of China (financial intelligence unit expert); and Mr. Joseph Jagada, Chief Law Officer, Attorney General's Office, Zimbabwe (law enforcement expert).

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#### 4 Background to evaluation

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South Africa has been a member of the FATF since 2003. It has implemented a number of measures to combat money laundering and the financing of terrorism through legislation and other means such as Financial Intelligence Centre Act of

2001 (FICA), Protection of Constitutional Democracy against Terrorist and Related Activities Act (POCDOCTARA) and Prevention of Organised Crime Act of 1998 (POCA). This report assesses the extent of South Africa's Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) measures as well as its compliance with the FATF's 40+9 recommendations on combatting money laundering and the financing of terrorism.

The evaluation was motivated by concerns of the possibility of South Africa becoming a destination for money laundering and terrorist finance given its vulnerability to other international crimes and its exposure to drug trafficking. Further motivation was that South Africa had not yet undergone a typologies study of money laundering and financing of terrorism at a domestic level.

## 5 Overall purpose of the evaluation

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The purpose of the evaluation was:

- To describe and analyse the Anti-Money Laundering (AML)/ Combating the Financing of Terrorism (CFT) measures in place in South Africa.
- To provide recommendations on how certain aspects of the system could be strengthened.
- To set out South Africa's levels of compliance with the Financial Action Task Force (FATF) 40+9 Recommendations.

## 6 Scope of the evaluation

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- The evaluation focuses on the period of implementation of AML and CFT measures from the point that South Africa joined the FATF to the completion of the on-site visit of the evaluation in August 2008.
- The evaluation focussed on the legislative, regulatory, policy and institution components of AML and CFT measures in South Africa and set out in the FATF's recommendations.
- It covered the full geographic area of South Africa and engaged stakeholders across all institutions involved in AML and CFT as well as across all relevant business sectors including financial institutions, NGOs and non-profits and precious metal and stone dealers.

## 7 Evaluation questions

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The evaluation compared the South African AML/CFT legislation, regulations, institutions and implementation to the 40+9 recommendations of the FATF. The assessment was made through testing whether the recommendations were met when the local measures were tested against a set of criteria established in the methodology.

The areas covered by the recommendations were:

- Legal systems;
- Measures to be taken by financial institutions and non-financial businesses and professions to prevent money laundering and terrorist financing;

- Institutional and other measures necessary in systems for combating money laundering and terrorist financing; and
- International co-operation.

## 8 Evaluation methodology

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### 8.1 Type of evaluation

The evaluation, called a mutual evaluation by the FATF, amounts to an implementation evaluation with aspects of a diagnostic evaluation in that it assesses the mechanisms (legislation, policy, regulations and institutions) in place to combat money laundering and terrorist financing activities. It looks at the outcomes and outputs of interventions to combat money laundering and the financing of terrorism. In addition, it offers recommendations to improve existing institutions and systems.

### 8.2 Methodology

The evaluation methodology used was the standard FATF Mutual Evaluation Methodology of 2004 (updated as of February 2008.) This is a methodology developed by the FATF and approved by its plenary council of which South Africa is a member. It is applied internationally in all mutual evaluations of FATF members (at the time of this evaluation there were 35 members).

The methodology was designed to guide the assessment of a country's compliance with the international AML/CFT standards as contained in the FATF 40 Recommendations 2003 (updated as of October 2004) and the FATF 9 Special Recommendations on Terrorist Financing 2001 (updated as of February 2008).

The methodology comprised a desktop review of all the relevant legislation, regulations, policy and institutional data in comparison with the 40+9 Recommendations. Performance on a given recommendation was measured in terms of a set of criteria and a country is marked as compliant, largely compliant, partially compliant, non-compliant or not applicable. Data was analysed primarily in terms of legal interpretation and assessment of the extent of implementation through the cumulative analysis of cases.

### 8.3 Data collection

Data was collected by the FATF through liaison with the FIC from all stakeholders. Initially relevant data was sent by stakeholders to the FIC between May and August 2008, before more data was gathered through on-site visits by the assessors between 4 and 15 August 2008. Sources were either the relevant legislation or any data the stakeholders had that they considered relevant.

## 9 Findings

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The evaluation findings were categorised within six thematic areas. These are outlined below.

### *Legal systems and Related Institutional Measures*

- South Africa has criminalised ML in three separate provisions of the POCA, which cover the conversion or transfer, concealment or disguise, possession,

acquisition of property in a manner that is largely consistent with the 1988 United Nations (UN) Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances (Vienna Convention) and the 2000 UN Convention against Transnational Organised Crime (Palermo Convention).

- South Africa criminalised terrorist financing in section 4 of the POCDATARA.
- The POCA provides for both criminal and civil forfeiture.
- Provisions in POCDATARA allow authorities to freeze assets pursuant to United Nations Security Council Resolutions S/RES/1267(1999) and S/RES/1373(2001).
- The Financial Intelligence Unit (FIU) of South Africa is the Financial Intelligence Centre ("the Centre") which is an "administrative" FIU under the Ministry of Finance.
- The South African Police Service (SAPS) is the main agency that is responsible for the investigation of money laundering and terrorist financing.
- To implement Special Recommendation IX, South Africa uses a combination of a declaration system and an exchange control regime.

#### *Preventative measures – Financial institutions*

- South Africa had implemented AML/CFT preventative measures through the application of the FICA, the Money Laundering and Terrorist Financing Control Regulations (MLTFC Regulations) and Exemptions in Terms of the Financial Intelligence Centre Act (Exemptions).
- Financial institutions covered by the FICA (so-called "accountable institutions") are prohibited from establishing a business relationship or concluding a single transaction with a customer before establishing and verifying the customer's identity, and the identity of any person acting on behalf of the customer or on whose behalf the customer is acting.
- Financial secrecy provisions do not inhibit implementation of the FATF standards.
- The Government established a project team to implement changes to South Africa's National Payment System (NPS) which would enable full originator information to accompany wire transfers (domestic and cross-border being transmitted using the SWIFT messaging formats).
- Transactions with no apparent business or lawful purpose must be reported to the Centre.
- South Africa has a broad reporting regime in which all financial institutions and businesses (not just accountable institutions) are required to report suspicious transactions.
- Accountable institutions are required to formulate and implement internal rules that address CDD, record keeping and reporting obligations.
- South African licensing requirements effectively prevent the establishment of shell banks.
- 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 FICA does not provide any of the designated supervisory authorities with specific powers of AML/CFT supervision or enforcement.
- Both legal and natural persons (including directors and/or senior management of a financial institution who are responsible for the institution's contraventions or failures) are liable to criminal sanctions for violating the FICA.
- Prudentially regulated financial institutions are subject to strict licensing requirements, although fit and proper tests do not apply to the directors and senior management of long-term insurers, or all directors of financial service providers and collective investment schemes.

#### *Preventative measures – Designated Non-Financial Businesses and Professions*

- The following designated non-financial businesses and professions (DNFBP) are designated as accountable institutions pursuant to the FICA: attorneys (which includes notaries), trust service providers, (real) estate agents, casinos and public accountants who carry on the business of rendering investment advice or investment broking services.
- Although dealers in precious metals and stones are not subject to the CDD and record keeping requirements of the FICA, the industry is very committed to the Kimberly process, begun under the auspices of the UN, which seeks to improve transparency in the diamond trade.
- The obligations to report activity suspected of being related to money laundering or terrorist financing, protection for reporting and the prohibition on tipping off apply to all DNFBPs.
- The FICA designated authorities responsible for supervising certain DNFBP sectors for AML/CFT compliance, but does not provide them with any specific powers of AML/CFT supervision or enforcement.
- Although the Centre has no official supervisory functions or powers of its own, designated supervisors who wish to have Centre participation may use their general powers to appoint employees of the Centre to their inspection teams.

#### *Legal Persons and Arrangements & Non-Profit Organisations*

- In preventing the use of legal persons for illicit purposes, South Africa relies primarily on an investigatory approach, supplemented by a company registry and corporate record keeping requirements.
- South Africa relies primarily on an investigatory approach for preventing the use of legal arrangements for illicit purposes, supplemented by a national trust registration system whereby a national registry records details on trusts, including information on the settlers, trustees and beneficiaries.

#### *National and International Co-operation*

- South African authorities have established effective mechanisms to cooperate on operational matters to combat ML and FT.
- South Africa ratified the Palermo Convention on 20 February 2004 and the Terrorist Financing Convention on 1 May 2003, and acceded to the Vienna Convention on 14 December 1998.
- South Africa has a flexible approach in dealing with mutual legal assistance requests, and is able to render a wide range of mutual legal assistance under the International Cooperation in Criminal Matters Act (ICCMA), South

Africa can render assistance without the need for a treaty or agreement and there is also no requirement for dual criminality or where the request is to obtain evidence, there is no requirement that judicial proceedings should have already been instituted before assistance can be rendered.

- The ICCMA provides for the confiscation and transfer of proceeds of crime or property of corresponding value through the execution of “foreign confiscation orders”, which are complemented by domestic provisions in the asset forfeiture regime under the POCA, and provisions in the CPA that are used to cover the search and seizure of instrumentalities intended for use in ML, FT and predicate offences.
- South Africa’s extradition framework is comprehensive and flexible.
- The Centre, law enforcement agencies, and supervisors are able to provide a wide range of international co-operation to foreign counterparts, and generally do so in a rapid, constructive, and effective manner.

#### *Resources and Statistics*

- South African authorities have committed substantial and appropriate human and financial resources to the Centre, police, financial supervisors and prosecutors.
- South Africa maintains comprehensive statistics regarding STRs received, analysed, and disseminated, and statistics relating to financial supervisory cooperation.

## **10 Conclusions and recommendations**

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Based on the findings and the analysis thereof, the following recommendations were identified:

#### *Preventative measures – Financial institutions*

- Effective application of the record keeping requirements is eroded by some of the Exemptions provisions, which exempt accountable institutions from maintaining records of customer identification and verification. Accountable institutions should be required to maintain account files or business correspondence.
- There is no direct prohibition on financial institutions from entering into, or continuing, correspondent banking relationships with shell banks, and no requirement that financial institutions satisfy themselves that respondent financial institutions in a foreign country do not permit their accounts to be used by shell banks. Additionally, there should be specific requirements that foreign branches and subsidiaries apply AML/CFT measures consistent with the FATF Recommendations, and apply the higher of domestic or South African standards, and inform the home supervisor if it is unable to do so.

#### *Preventative measures – Designated Non-Financial Businesses and Professions*

- South African authorities should continue working with the dealers in precious metals/stones and real estate sectors to determine whether they are adequately identifying and reporting suspicious activity.
- Only the four regional law societies have statutory inspection authority and enforcement power to supervise the conduct of attorneys. This situation has stalled implementation of AML/CFT requirements in the legal profession.

South Africa should bring into effect as soon as possible provisions that will provide adequate authority for the DNFBP supervisors/monitoring bodies to inspect for and apply a range of sanctions that is effective, proportionate, and dissuasive for noncompliance with the FICA.

#### *Legal Persons and Arrangements & Non-Profit Organisations*

- Steps should be taken to ensure that the information held in the Trust Registry is accurate, and that the remaining paper files are uploaded.
- South Africa should assess the potential risks of terrorist financing posed within its NPO sector and review the level of oversight measures to ensure that these are effective and proportional to the risk of abuse. More outreach should also be undertaken with the specific aim to protect the NPO sector from terrorist financing abuse.

#### *Resources and Statistics*

- South African authorities should record and maintain more detailed statistics of money laundering investigations, prosecutions and convictions, so as to be able to effectively assess the effectiveness of the AML/CFT system.

## **11 Evidence of use**

According to Advocate Pieter Smit of the Financial Intelligence Centre, there has been substantial use of the evaluation after its completion. Many of its findings are being incorporated into new amendments of the FICA. There have been joint committees set up between stakeholders to improve on issues emerging from the evaluation, for example between the SAPS and the NPA, to improve their relationship and the investigation and prosecuting of money laundering cases. Adv. Smit reports that there has been a significant increase in the number of prosecutions following the release of the evaluation. In response to the evaluation many regulators have also increased their activities and improved their compliance with FATF recommendations.

According to Adv. Smit the evaluation experience was valuable as a guide to conducting future evaluations. Finding easy ways to share and access information was a key lesson learnt as was the need to identify early who stakeholder representatives would be and obtain the support of their superiors.

## **12 Note on quality of report**

The Quality Assessment Score of this evaluation is an overall 4.16 applying the Evaluation Quality Assessment Tool [EQAT].

This was a particularly well implemented evaluation with high quality levels of coordination with stakeholders. It has also been a very useful evaluation for stakeholders who have found significant intervention to improve FATF compliance. It has some limitations in that the methodology applied was not designed specifically for South Africa. In terms of the evaluation report and its presentation, the report is long, highly detailed and structured in a manner that is sometimes difficult to engage with.