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What does the future hold for South Africa now that we have been grey-listed?

On 25 February 2023, the long awaited and expected decision was announced: South Africa was included in the list of “jurisdictions under increased monitoring”, also commonly known as the Financial Action Task Force (FATF) Grey List. This outcome was predicted in our 2022 annual insurance industry survey.

The FATF is the global money laundering and terrorist financing watchdog that sets international standards, called the **FATF Recommendations**, aimed at preventing illegal activities. The FATF monitors jurisdictions committed to the implementation of such recommendations through ongoing rounds of peer reviews called Mutual Evaluations.

In October 2021 the FATF published the Mutual Evaluation Report on South Africa which showed poor results. In respect of technical compliance, South Africa was only fully compliant with three and largely compliant with seventeen of the forty FATF recommendations, with twenty negative ratings achieved on the remaining recommendations. When it came to effectiveness of compliance, South Africa did not achieve any positive scores in the eleven immediate outcomes. Due to the severity of the deficiencies, South Africa was given one year to remediate them and avoid being included in the Grey List in the FATF Plenary held in February 2023.

Unfortunately, South Africa did not achieve any re-rating since the Mutual Evaluation or the grey-listing, either in February or in June 2023 and there is a lack of visible progress and information, transparency on the action plan.

There are currently eleven African countries on the FATF Grey List. The presence of a large number of countries with systemic deficiencies in their anti-money laundering (AML)/combating the financing of terrorism (CFT) regime only means additional financial crime risks and challenges for South Africa, which is one of the main financial hubs of the continent.

The other grey-listed African countries are:

- Burkina Faso
- Cameroon
- The Democratic Republic of the Congo
- Mali
- Mozambique
- Nigeria
- Senegal
- South Sudan
- Tanzania
- Uganda

How long will South Africa remain on the Grey List and what are the consequences?

The month before the grey-listing was announced, our discussions with a number of financial institutions revealed that the impact of the potential grey-listing in the capital market was starting to be felt, along with an increase in funding costs. Immediately after the announcement, the Rand depreciated by 1.12% against the US Dollar. Though the continuous depreciation of the Rand is due to many other contributing factors, the grey-listing only adds weight to the existing burden of negative factors on the South African economy. This may be only the beginning of a negative long-term impact of the grey-listing.

Disinvestment and de-risking by international investors and commercial partners is a costly process. Considering that some countries like Mauritius were able to be removed from the Grey List in a relatively short period of time - for example Mauritius took less than three years - investors may take a more passive approach to the grey-listing and observe the progress over remediation actions.

When South Africa was grey-listed, the FATF put in place the following action plan to address the strategic deficiencies:

- demonstrate a sustained increase in outbound mutual legal assistance (MLA) requests that help facilitate money laundering (ML)/terrorist financing (TF) investigations and confiscations of different types of assets in line with risk profiles;
- improve risk-based supervision of designated non-financial business and professions (DNFBPs) and demonstrate that all AML/CFT supervisors apply proportionate and effective sanctions for non-compliance;
- ensure that competent authorities have timely access to accurate and up-to-date beneficial owner (BO) information on legal persons and arrangements and apply sanctions for breaches of violation by legal persons to BO obligations;
- demonstrate a sustained increase in law enforcement agencies' requests for financial intelligence from the Financial Intelligence Centre (FIC) for its ML/TF investigations;

- demonstrate a sustained increase in investigations and prosecutions of serious and complex money laundering and the full range of TF activities in line with its risk profile;
- enhance its identification, seizure and confiscation of proceeds and instrumentalities of a wider range of predicate crimes, in line with risk profiles;
- update TF risk assessment to inform the implementation of a comprehensive national counter financing of terrorism strategy; and
- ensure the effective implementation of targeted financial sanctions and demonstrate an effective mechanism to identify individuals and entities that meet the criteria for domestic designation.

Many actions have been taken since the grey-listing of South Africa. The FIC Act was amended in December 2022 with many enhancements, and the Prudential Authority has imposed actions and reporting duties on banks and insurance companies to strengthen the enforcement of different AML/CFT obligations. However, there is very little information and transparency on the coordinated actions that are being taken by government at the jurisdictional level.

In the latest published FATF Plenary outcome, it was recognised that South Africa had taken steps towards improving its AML/CFT regime during its first cycle of reporting, including improving its criminalisation of terrorist financing, but such improvements have not resulted in any re-rating so far.

If we take Mauritius as an example, by the time it was grey-listed one year after the results of its Mutual Evaluation was published, Mauritius had already reduced its negative technical compliance ratings to seventeen, from the initial 26 negative ratings identified. After the grey-listing took place, Mauritius developed an action plan that was agreed between different supervisory agencies, with clear awareness strategies, outreach sessions and formalised forums to exchange information. The results of such joint efforts and transparency on the action plan led Mauritius to be de-listed from the Grey List in less than three years, ahead of the timeline set by the FATF.

Coming back to South Africa, the lack of transparency on a coordinated action plan is likely to lead to reduced levels of confidence by international investors, commercial partners and counterparties. Unless more progress is made, additional negative economic impacts may be observed in the coming years. These may include:

- an increase in the regulatory burden imposed on both South African entities and their foreign counterparties and economic restrictions from international funders such as the International Monetary Fund (IMF) or World Bank;
- restrictions imposed by individual banks and businesses in doing business with South African entities, leading to a loss of trading and business partners as well as loss of financial flows;
- an increase in the cost of doing business and the cost of capital due to increased compliance requirements and restrictions imposed;
- a decrease in South Africa's ability to remain competitive and in its ability to obtain foreign investment;
- macroeconomic impacts, such as on the exchange rate, interest rate and inflation, and negative effects on economic growth and employment; and
- reputational damage.

Next steps for the South African financial services sector

Regardless of whether South Africa is grey-listed or not, it is obvious that the country faces huge financial and proceed-generating crime risks. At this point, and especially considering the regional risk we are facing as a financial hub in Africa, a number of financial institutions still do not have the right set of risk-based approach measures to identify the financial crime risks they are facing.

South African life insurers that are making progress in this area have:

- **Introduced adequate risk assessment at an institutional and customer level and over third-parties.**
- **Implemented improved oversight by the first and second lines of defence:** this was achieved by ensuring that the role of the compliance and anti-financial crime functions are not limited to regulatory compliance with policies and procedures. It is also important to ensure that these functions have oversight over the implementation of controls and compliance assurance activities.
- **Implemented centralised risk management systems and processes:** a centralised automated system allows for the exchange and centralised processing of risk data. This in turn allows the compliance and risk management functions to have a comprehensive overview of the business-wide risk exposure.
- **Introduced the ability to risk assess clients through a single client view:** this was achieved through the implementation of a centralised know-your-client (KYC) system that assigns unique identifiers to clients. This ensures that the client is assigned the same KYC profile across the organisation and allows for adequate application of due diligence measures to better detect financial crime risks.
- **Implemented automated monitoring of suspicious activities:** these insurance companies have moved away from manual detection processes without having to rely on the subjective judgement of business unit staff. In addition, the implementation and application of a lookback control has proven to be effective in identifying suspicious activities.





Some of the most critical best practices are:

- **Implementation of adequate business-wide risk assessment processes** following a risk-based methodology that quantifies different risks in an empirical and objective manner. It is also important to ensure that adequate risk mitigation measures are implemented in a timely manner to address the identified risks.
- **Enable a better understanding of customer risk** by processing information obtained in a centralised manner, allowing the exchange of KYC information and predicting the activities of the customer based on such information.
- **Better control of third-party risk**, such as banks, brokers, intermediaries and agents, by implementing applicable policies and procedures and performing the necessary controls and assurance activities.
- **Effective ongoing monitoring and enhanced due diligence measures:** ongoing monitoring should be performed based on the risk information of the customer like behaviour patterns and red flag typologies. This should be automated in order to enable better detection and lookback controls.
- **Investment in technology:** for larger insurers with thousands or even millions of customers, proper risk management is only possible through the implementation of technology solutions to automate different processes.
- **Enhancement of training at all levels:** all staff and members of management should receive AML/CFT training when joining as well as regular refresher training during the employment relationship. Functions with additional AML/CFT related duties, such as compliance, risk management, forensic, internal audit, business units and operational units, should receive additional targeted trainings.
- **Reinforcement of risk control functions, with sufficient authority, access and resources:** the second line of defence should not have its role limited to regulatory compliance of policies of procedures, but should be able to exercise effective oversight on the implementation of controls in the first line of defence functions. In order to achieve these objectives effectively, the second line of defence must have sufficient authority.

Conclusion

It is uncertain how long South Africa will stay on the FATF Grey List. All South African companies have a duty to proactively implement effective AML/CFT measures to fight against financial crime and do their part in getting South Africa off the list as quickly as possible.