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Submissions by Corruption Watch: Draft Financial Intelligence Centre Amendment Bill, 2015

Introduction

1. Corruption Watch is a non-profit civil society organisation. It is independent, and it has no political or business alignment. Corruption Watch intends to ensure that the custodians of public resources act responsibly to advance the interests of the public. Its ultimate objectives include fighting the rising tide of corruption and the abuse of public funds in South Africa, and promoting transparency and accountability to protect the beneficiaries of public goods and services.

2. Corruption Watch's has a vision of a corruption free South Africa, one in which educated and informed citizens are able to recognise and report corruption without fear, in which incidents of corruption and maladministration are addressed without favour or prejudice and importantly where public and private individuals are held accountable for the abuse of public power and resources.

3. Corruption Watch welcomes the opportunity to make submissions on the Draft Financial Intelligence Centre Amendment Bill ("the Bill") and hopes that these submissions will be useful in improving the Financial Intelligence Amendment Act ("the Act"), particularly in relation to the refinement of Anti Money Laundering ("AML") provisions and the enforcement of sanctions.[1]

4. In preparing our submissions, we considered *inter alia*, the Memorandum on the Objects of the Financial Intelligence Centre Amendment Bill, 2015 ("the

[1] All recommendations are underlined for ease of reference.

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Memorandum"), the International Monetary Fund's Technical Note on AML and Combating of Financing of Terrorism ("CMT") on South Africa ("the Technical Note"),

5. We note from the Preamble of the Bill that it is primarily aimed at establishing a stronger AML and CMT regulatory framework; extending the objectives of the Centre to mete out financial sanctions and at strengthening accountable institutions by adopting a risk based approach to AML and CFT risks in order to allow them to improve customer due diligence measures in respect of beneficial ownership and prominent persons.

6. Although we are greatly impressed by the commitment shown by National Treasury ("NT") and the Financial Intelligence Centre ("FIC") in formulating a more effective approach to AML by enhancing the oversight and intervention powers of the FIC in relation to accountable institutions, we are concerned about the following:

   6.1. The definition of beneficial ownership;

   6.2. The definition of domestic and foreign prominent influential persons

   6.3. The Dissolution of the CMLAC without introducing new provisions on co-ordination;

   6.4. Inadequate measures for the sanctioning of accountable institutions by supervisory bodies; and

   6.5. Inadequate measures to allow the FIC to exercise oversight and impose sanctions on supervisory bodies for non-compliance.

   6.6. Changes to the penalties for non-compliance, specifically changes which replace 'offences' with 'administrative sanctions.'

Definition of beneficial ownership

7. The definition of beneficial ownership as proposed in the Bill, should take into consideration the natural person(s) who ultimately owns or control the legal person or arrangement.

    7.1. Use of a quantitative approach to identify and qualify beneficial owners, in line with the FATF definition of “the natural person who ultimately owns or controls a customer and / or the natural person on whose behalf a transaction is being conducted. It also includes those persons who exercise ultimate control over a legal person or arrangement” is not adequate. Within this framework, control is often defined based on the holding of a certain percentage of shares or voting rights or property, however this quantitative approach is not always useful. A person may exercise control over a corporate entity without holding shares or a position within the management of the company through for example kinship or other types of affiliation, shareholder agreements, nominee shareholders, convertible stock, directors and persons in senior management position, among others.

    7.2. When defining beneficial ownership, this should go beyond quantitative analysis of controlling shareholders based on a threshold (e.g. persons owning more than a given percentage of a company) and consider that measurement as just one evidential factor among others. Those with reporting obligations must be mandated to use additional means to identify the beneficial owner in the case of suspicious transactions.

    7.3. Legal persons should maintain beneficial ownership information onshore and that information is adequate, accurate, and current. The FATF Guidance on beneficial ownership and methodology underscore a series of issues to be taken into account to ensure that companies can effectively maintain beneficial ownership information.

    7.4. Authorities have timely access to adequate, accurate and current information regarding the beneficial ownership of legal persons. We consider a central

(unified) register to be the most effective and practical way to record information on beneficial ownership and facilitate access to competent authorities, including foreign authorities. A central registry also supports the harmonisation of the country's legal framework, avoiding double standards. Registries should be public but at a minimum, beneficial ownership information should be made accessible in a direct manner (without restrictions or necessity of requests) to accountable institutions as well as to financial institutions and DNFBPs with anti-money laundering obligations. Beneficial Ownership registries should have the mandate and sufficient human, technical and financial resources to collect, verify and maintain beneficial ownership information and have the power to request information and sanction legal entities for non-compliance. The provision of false or out-of-date information by legal entities should be subject to dissuasive sanctions. Beneficial ownership registries should be publicly available, in open data format and free of charge.

7.5. In addition to identifying the beneficial owners of their costumers, accountable and financial institutions should, verify whether the person(s) identified as the beneficial owner are in fact the one (s) exercising control and benefiting from the legal entity or arrangement. Differentiation between verification and independent verification should be made here.[2] Independent verification on the other hand relates to the process of conducting additional verification using independent sources such as watch-lists, commercial databases, information found on the internet, social networks, among others. According to financial institutions and DNFBPs surveyed within the framework of the BOWNET project carried out by Transcrime[3], data on companies' shareholdings is the most used information in the identification and verification of beneficial owners

[2] StAR, 2011. StAR Initiative, 2011. *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It.* http://star.worldbank.org/star/sites/star/files/puppetmastersv1.pdf

[3] Transcrime, 2013. The identification of beneficial owners in the fight against money laundering. Final report of project BOWNET – Identifying the beneficial owner of legal entities in the fight against money laundering networks.

(82,7%). Followed by information on companies' board members and managers (47.2%), PEP and other watch-lists (37,5%), internet / blogs (23%), news/press (20,2%), tax agency records 18,3%, police and judiciary records (17.7%), social networks (17.4%). Within this context at least in circumstances considered of high-risk accountable and financial institutions verify whether the information on beneficial ownership is correct.

7.6. Non-compliance should result in administrative, civil and criminal sanctions to punish both natural and legal persons, including to accountable and financial institutions, directors and senior management.

Domestic and foreign prominent influential persons

8. Domestic and foreign prominent influential persons closely resemble what has internationally become known as "politically exposed persons", oft defined as individuals who have held or are in public office.

8.1. Although the definition promulgated in the Bill does expand on this definition, it is important to note a number of other terminological inconsistencies that need further definition for adequate identification of domestic and foreign prominent influential persons.

8.2. Lack of consistent terminology in relation to the definition of "family members" and "close associates" need to be taken into account. UNCAC includes in the definition of "close associates" both natural persons and companies, while the FATF and the EU only mention the former. In the definition of "family members," the EU focuses on immediate families, while the FATF and the UNCAC leave the exact definition open to interpretation. We strongly suggest that these categories of persons be further defined and clarified.

8.3. The current definition of domestic and foreign prominent influential persons places emphasis on influence being defined in terms of leadership roles within prominent institutions. However, this definition is limiting and should be expanded to include public functions considered high risk.

Public Registries

9. Registries containing information pertinent to the identification, verification of beneficial owners or company ownership should be consolidated to include information currently made available by the CIPC.

9.1. Collating information about company control and ownership, including beneficial ownership enhance verification abilities of all accountable institutions.

9.2. These registries should also be available to the public, allowing citizens, journalists, academics, and the private sector to have access to company ownership information and scrutinise the data provided. Public scrutiny could also support the accuracy of the data provided. This information should be open and free of charge. To mitigate privacy infringements, the information collected for each beneficial owner would be limited to what is strictly necessary: full name, birth date, business address, nationality, and a description of how the ownership or control is exercised. Important precedents already exist in many countries where information is publicly reported for the general interest, including political donations, lobbying activities and salaries of public officials.[4]

Dissolution of the CMLAC

4 Transparency International EU http://www.transparency.de/fileadmin/pdfs/Themen/Finanzmarkt/TI-EU-Policy-Paper-Beneficial-Ownership.p

10. It is common cause that South Africa has a number of strategies and frameworks for addressing corruption. Task teams and working groups have been set up in almost every state department in order to co-ordinate efforts in addressing corruption. In a recent report on government's anti-corruption initiatives the following bodies were mentioned:

10.1. The Anti-Corruption Inter-Ministerial Committee established the role of the ACTT as the central state body mandated to deal with corruption. The ACTT's work is aimed at fulfilling national and international obligations and targets and several state institutions have been selected for participation. These include the National Prosecuting Authority ("NPA"), the Asset Forfeiture Unit ("AFU"),[5] the NPA's Specialised Commercial Crimes Unit ("SCCU"), the Special Investigation Unit ("SIU")[6] and the Directorate for Priority Crime Investigation (Hawks); Auditor General, South African Police Services, South African Revenue Services ("SARS"), the Department of Cooperative Governance, the FIC and NT.

10.2. Justice Crime Prevention and Security Cluster, a task team established to fast-track investigations and prosecution;

10.3. Public Service Special Anti-Corruption Unit, established to consolidate the fight against corruption within the public service and the work done within the Department of Public Service and Administration in order to fast track the processing of disciplinary cases within the public service.

10.4. The Multi-Agency Working Group ("MAWG") set up by the Minister of Finance to coordinate and investigate corruption related to supply chain management practices.

[5] Located within the NPA, it is tasked with seizing assets which are the proceeds of crime.

[6] Established by law as an independent statutory body that fights corruption through investigations and litigation and which acts in terms of proclamations from the President directing it to probe maladministration and corruption within the public service.

10.5. Asset Recovery Inter-Agency Network of Southern Africa (ARINSA – established by the Ministry of Justice and Constitutional Development and supported by the UNODC. ARINSA's secretariat function resides with the AFU and is also supported by the SIU and the Hawks.

11. In addition to national initiatives and legislation and policy aimed at preventing and combatting corruption, South Africa has also ratified international instruments which impose certain obligations and responsibilities on the State. These include the United Nations Convention against Corruption, the Southern African Development Community Protocol against Corruption and the Organisation for Economic Co-operation and Development ("OECD") Convention on Combatting Bribery of Foreign Officials in International Business Transactions.

12. The proposed amendments should therefore be seen in light of a complex arrangement of laws, policies and initiatives aimed at addressing corruption and financial crimes. We appreciate that the CMLAC is one of a number of anti-corruption co-ordinating bodies to have been set up in recent times and it is understandable that it is now being dissolved. Its functions and mandate are similar to those of other anti-corruption bodies and as the memorandum states, '*the decision to dissolve the CMLAC has been informed by the fact that a number of platforms exist within the country to discuss matters of concern and mutual interest, which obviates the need for consultations by a platform such as the CMLAC*.'

13. However, if the CMLAC is dissolved, it is unclear as to how the work of the FIC will be co-ordinated with other state bodies, working groups and departments. Money laundering is a crime without borders, committed on a regional and international scale, requiring extensive co-ordination efforts locally, regionally and internationally. If the CMLAC does not play a role in this, it is unclear as to where the FIC will be located within such co-ordination efforts.

14. In terms of section 3 of the Act, the objectives of the FIC include the sharing and exchange of information. Section 4 sets out the functions of the FIC which include informing, advising and co-operating with investigating authorities, supervisory

bodies, SARS and the intelligence services. In addition, section 44 deals with referral of suspected offences to investigating authorities and other public bodies.

15. The dissolution of the CMLAC without the introduction of co-ordination measures raises questions around the role that the FIC will play in regard to information gathering and sharing and the ability of the FIC co-ordinate efforts to address money laundering from conception to conviction.

16. Inasmuch as the Bill's focus is on accountable institutions and the creation of additional mechanisms to allow the FIC to intervene in relation to suspicious transactions, these vital questions cannot be left aside. The FIC cannot rely on the other anti-corruption co-ordination bodies which each have their own focus and objectives

17. CW therefore recommends amendments to address the hiatus which results from the dissolution of the CMLAC and to ensure that there are holistic and practical steps introduced to co-ordinate referrals, information gathering and sharing. In light of the FIC's increased powers to deal with reports and initiate investigations, it is also uncertain as to whether there will be co-ordination with civil society organisations.

18. Moreover, there are state departments which may not necessarily form part of existing anti-corruption task teams but which may nevertheless be required to provide information and support to the FIC. An example which arises from an analysis of Corruption Watch's own reports is the Department of Home Affairs ("DHA").

19. In this regard, the Bill amends section 21 of the Act to impose additional due diligence on all accountable institutions, requiring them to keep records of their clients and all beneficial owners. Required information includes positive identification of parties and verification of sources of funds. No specific mention is made of how identities are to be positively verified with the Department of Home Affairs and how such information would be validated. We have received a number

of reports involving fake permits and identification documents, often obtained directly from corrupt DHA officials. The scope for abuse by criminals, particularly those with deep pockets is evident and although this speaks to a larger corruption problem within DHA. It is therefore recommended that provision be made for better co-ordination and additional validation procedures especially for high risk individuals.

20. The same applies to co-ordination with the accountable institutions like the Gambling Boards. In light of the obvious risks which arise from the relationship between money launderers and gambling institutions, we recommend more focused and contextual provisions to address risks in this space.

Inadequate measures for the sanctioning of accountable institutions by supervisory bodies

21. Section 45 currently deals with the supervisory body's responsibility to supervise and enforce compliance by accountable institutions and their members. It requires supervisory bodies to take into account a member's involvement in any money laundering activity in making a determination of whether such person is fit and proper to hold office in an accountable institution.

22. It appears that members of accountable authorities can only be sanctioned if they are directly involved in money laundering activities. It is unclear whether such members can be sanctioned for indirect involvement or failing to report suspicious activities and the current amendments do not address this issue. In light of the involvement of estate agents, attorneys and other professions in aiding and abetting certain criminal activities or allowing suspicious transactions to go unreported, it is recommended that this section be amended to specify additional circumstances under which supervisory bodies can take action against their members.

Inadequate measures to allow the FIC to exercise oversight and impose sanctions on supervisory bodies

23. Section 45 (1D) to 45(3) states the following:

> "*(1D) The Centre and a supervisory body must co-ordinate their approach to exercising their powers and performing their functions in terms of this Act to ensure the consistent application of the Act, and must enter into a written memorandum of understanding in respect thereof.*
>
> *(2) When the Centre refers a matter to a supervisory body or other public body or authority in terms of section 44, that supervisory body or other public body or authority must investigate the matter and may, after consultation with the Centre, take such steps within the scope of its powers as it considers appropriate to remedy the matter.*
>
> *(3) Should a supervisory body or other public body or authority to which a suspected contravention or failure is referred in terms of section 44 fail to take adequate steps to ensure that the suspected contravention ceases or the suspected failure is rectified, the Centre may, after consultation with the supervisory body or other public body or authority concerned, take such steps within the scope of its powers as the Centre considers appropriate to remedy the matter."*

24. This above section provides for the FIC and supervisory bodies to enter into agreements on approaches to accountable institutions, to refer matters to the FIC for investigation and sanction and to consult with and "take steps" to remedy the matter. It is unclear as to whether the FIC can compel supervisory bodies to take steps against members of its accountable institutions or to take steps directly against members and the current amendments do not clarify the position.

25. Given that it is imperative that supervisory bodies, accountable institutions and their members be held accountable for non-compliance, it is recommended that this section be amended to provide more clarity and on the nature and extent of the powers of the FIC to hold supervisory bodies accountable for non-compliance.

Changes to the penalties for non-compliance from "criminal sanctions" to 'administrative sanctions'

26. Sections 32 to 45 propose that certain acts of non-compliance in respect of obligations in the Act should carry purely administrative sanctions instead of criminal sanctions.

27. CW is concerned that these amendments may diminish the severity of non-compliance on the part of accountable institutions and supervisory bodies. We recommend that the amendments differentiate between "lesser" acts of administrative non-compliance and more egregious acts of non-compliance so that the amendments do not diminish its impact and efficacy.

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