FINMARK TRUST

Reviewing the impact of the RBA shift to AML/CTF on financial inclusion

Final presentation

Genesis Analytics

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1. Background and objectives

- FinMark Trust (FMT) has been dedicated to financial inclusion and regional financial integration for almost two decades, working to overcome market-level, supplier and regulatory barriers. **Changes in financial services regulation will therefore affect the work of FMT**.
- On 2 October 2017, various **amendments to the Financial Intelligence Centre Act (FICA) were enacted** to align South Africa's anti-money laundering (AML) and counter terrorist financing (CTF) laws with international best practices. This **saw the introduction of a risk-based approach (RBA) to AML/CTD**. This has had an impact on how financial institutions conduct compliance checks for customers.
- Prior to the regulation change in 2017, financial institutions followed a **rules-based approach** to AML/CTF. The prescriptive approach meant that regulations were originally based on the risks and controls relating to retail banking.
- Regulations tended to be unaccommodating of other business models, particularly smaller financial service institutions. Consequently**, tick-box compliance led to gaps in satisfying regulatory intentions**.
- Furthermore, the **rules-based approach put difficult requirements on lower income individuals which served to reinforce financial exclusion**.
- The **aim of a risk-based approach is to correct for these gaps; making regulation better and more cost-effective**. Control requirements are more flexible as they must be commensurate with actual risk such that greater risks receive greater attention.
- **Greater financial inclusion is, prima facie, promoted under the RBA**. Financial institutions are able to find innovative ways of verifying new customers and are therefore able to open the market to previously excluded groups.
- However, **financial inclusion may be reduced under this approach should financial institutions be ill-equipped to conduct customer due diligence (CDD)**. This may lead to de-risking and therefore diminish financial inclusion.
- FMT was concerned about the implementation of RBA from an operational perspective. FMT developed a set of principles addressing how RBA can be handled. Five Authorised Dealers in Foreign Exchange with Limited Authority (ADLAs) were part of the pilot, but not all ADLAs embraced the principles set out for them.

Against this backdrop, the study aimed to review the impact of the switch from the KYC approach to the risk-based approach on financial inclusion.

This study will entailed the following key activities:

1. **Understanding the KYC requirements** through a desktop review pre and post the introduction of RBA and its impact on financial inclusion among vulnerable groups in South Africa
2. An **assessment of market responses and extent of RBA implementation** across financial service providers (FSPs) such as banks, insurers, ADLAs, and FinTechs
3. A **scan of innovations and developments with regards to CDD and KYC** conducted through desktop review and augmented with insights from FSPs and other stakeholders

2. Understanding the AML/CTF regulatory landscape

Since becoming a member of FATF, South Africa has made headway in implementing a risk-based approach to AML/CTF

Pre-RBA: Overview of the rules-based approach

- Three key pieces of legislation:
  a. **Prevention of Organised Crime AcT** 121 of 1998: officially criminalised money laundering, organised crime and racketeering
  b. **Financial Intelligence Centre Act** 38 of 2001: outlines the administrative frameworks required for institutions to regulate against money laundering and terrorist financing
  c. **Protection of Constitutional Democracy Against Terrorist and Related Activities Act** 33 of 2004: officially criminalised financing of terrorist activities
- There exists a range of other legislation and institutions that support the implementation and enforcement of AML/CTF efforts
- In 2017, the FIC Act was amended to introduce the risk-based approach and replace the rules-based approach to AML/CTF

The rules-based approach is cited to have created frustrations for customers who weren't able to provide valid proof of residence

Overview of the risk-based approach

- The rules-based approach entailed a tick-box exercise to confirm that customers submitted the correct documentation before giving them access to financial products and services. following international pressure to align South Africa's AML/CTF approach with what was recommended by the FATF.
- The RBA came with the requirement for FSPs to know who they are dealing with on both the **sender and recipient side in cases of high risk**; the requirement to **keep sufficiently-detailed records of transactions**; and the requirement for **FSPs to report suspicious transactions** and activities to the relevant authorities

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3. Implementation of the RBA

An FSP's RMCP forms the base for it's RBA. A three-point risk is generally used to risk-rate customers, and this informs the CDD process

In practice, the implementation of the RBA has seen FSPs classifying customers into categories of low, medium and high risk, with the associated know-your-customer (KYC) and customer due diligence (CDD) processes being commensurate with the customer's risk.

- Regulators gave FSPs an 18-month grace period to align control measures with the requirements under the Amendment Act. Enforcement thus only kicked in in April 2019. The initial focus of the FSCA was to strengthen the knowledge among FSPs about the regulatory changes. The authority continues to make annual provision for these awareness campaigns

Not all ADLAs believe they have taken advantage of the change in regulation. This is evident in unchanged customer onboarding processes

- The FATF is currently concluding its next evaluation of South Africa's (SA) AML/CTF environment. This report should become available in June 2021. Previous evaluations outlined that SA is making strong progress toward an effective AML/CTF regime
- Institutions followed a consultative approach to developing their respective RMCPs alongside regulators and supervisors

Note: A mystery shopping exercise revealed that commercial banks still require proof of right-to-work in South Africa before opening a bank account for a migrant, while some ADLAs are willing to accept migrant's passports in order to give the individual access to remittance services and basic banking.

Implementation across FSPs:

> **Commercial banks:** For the larger banks who operate internationally, the introduction of the RBA involved, the formalisation of already-existing frameworks. These FSPs typically have a 3-point scale for rating customer risk levels. The classification of a customer as low, high or medium risk stipulates the CDD process that is followed

> **ADLAs:** ADLAs more explicitly make use of KYC categories that are directly linked to product offerings (i.e the services they can access and amounts customers can remit). ADLAs tend to be more innovative in their customer onboarding

Mukuru has been highly successful in South Africa's remittance. It stands in the 2021 top 100 list of cross-border payments providers globally.

> **Insurers:** Only life and long-term insurance having been impacted by the RBA. implementation of the RBA in the insurance industry is not as straightforward as in the banking and ADLA industries. This industry has been the slowest to adapt, and much headway still needs to be made

4. Innovations and developments relating to KYC and CDD

South Africa employs a number of innovative techniques in its KYC and CDD environments, and is making good progress in this space

International best practice

- On a global scale, RegTech is increasingly becoming a key mechanism for promoting transparency, financial system stability and financial inclusion. The role of collaboration between regulators and industry in effective innovation efforts is being widely acknowledged
- In the **USA**, regulatory and supervisory bodies have encouraged industry to invest increasingly in digital technologies including artificial intelligence, digital identity technology, and digitally-enabled risk assessment and control systems
- The **UK** established the Joint Money Laundering Intelligence Taskforce (JMLIT) which has been an effective consultative mechanism, supporting more effective cross-departmental and cross-sectoral collaboration. Innovation and digital adoption in the UK are prevalent
- Ghana's central bank has launched an innovation sandbox with a focus on blockchain technology, remittance products, e-KYC and RegTech. This is in line with the Bank's ambitions to promote financial inclusion through digital technologies

Innovations evident in SA

- A general consensus across FSPs is that the RBA has allowed more flexibility in employing innovative ways to onboard customers and conduct CDD. FSPs are using WhatsApp for onboarding; selfie verification tools, Power BI dashboards; biometric verification technologies, and goAML (a global online system - developed by the UNODC - used to monitor transactions)
- Innovative payment solutions are helping to solve for the large remittance corridors into SADC. In 2020, the FSCA announced the launch of the Intergovernmental Fintech Working Group - an innovation hub for promoting responsible innovation of financial products and fintech regulation

5. Assessment of RBA impact

The RBA has allowed for a less cumbersome approach to carrying out KYC and CDD processes. Traditional banks claim that their appetites for risk have remained unchanged, while non-bank FSPs have taken advantage of differing risk profiles in designing remittance products

Access to financial services is largely influenced by financial market regulation. Cross-border remittances is a market of key concern within the AML/CTF framework. The regulatory change was intended to simplify the process for (but not limited to) low-value transactions. The likelihood of de-risking has increased as a result of the regulatory change, but traditional banks cite that they do not engage in this practice. Desktop research and stakeholder consultations have surfaced the following:

- Where institutions are MTOs (make to order) and they serve customers in the low-income market, such institutions may be discouraged to provide services to customers. De-risking not only presents harmful consequences to financial inclusion but also to the effectiveness of AML/CTF efforts (as excluding groups from financial services decreases the extent of supervision and pushes demand to unregulated informal sectors). Regulators have observed that larger FSPs are more likely to de-risk as opposed to managing risks presented to them
- In 2017, the FATF expanded their recommendations with a CDD Supplement to support greater financial inclusion. The FIC and commercial banks agreed that asylum documentation can be used to verify clients
- Currently, traceability of cross-border payments is constrained because customer information is held by individual FSPs
- The RBA has resulted in a better experience for low-risk customers, while for higher-risk customers, the RBA has added greater complexity (UBO requirement)
- FSPs have cited that the RBA has kept their appetites for risk the same. For some of the banks that operate internationally and are led by international practice, there is the benefit of risk sharing with international bank affiliates
- Qualitative views on the impact of the RBA are generally quite positive

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6. Concluding remarks and recommendations

South Africa employs a number of innovative techniques in its KYC and CDD environments, and is making good progress in this space

- The risk-based approach has launched relatively well in the South African market. It has been successful in aiding the inclusion of migrant workers into South Africa's formal financial system as ADLAs have been able to offer cross-border remittances services to more migrant workers with less reliance on documentation. Consultations with stakeholders have however, revealed that not all FSPs (traditional banks as well as non-bank FSPs), have embraced the benefits that the RBA offers. This may be as a result of a lack of understanding of the FIC Amendment - in some instances - and in other instances, a low willingness to embrace the regulatory changes.
- There also remains uncertainty among traditional banks as it pertains to immigration laws and what the RBA allows for when it comes to the opening of bank accounts for migrants. Based on the findings in this study, we therefore **recommend that FinMark Trust continues to engage with the relevant regulators to establish common ground on how migrants can be brought into the financial system by clarifying the responsibilities of FSPs that are implementing a RBA, particularly with respect to the Immigration Act**.
- Over and above these issues, it is important to note that the RBA has evidently spurred innovation in KYC and CDD processes. Digital technology has aided quicker onboarding and transacting processes.

Appendix a: Stakeholder consultation list

Category	Organisation	Stakeholders
Authorised Dealers with Limited Authority	Mama Money	Candice Smith (Head of Compliance), Irfaan Imamdin. (Head of Product), Tsitsi Ngoshi (AML Reporting Officer)
	Mukuru	Diane van Eeden (Head of Financial Crimes)
	Hello Paisa	Sayjil Megan (Managing Director)
Regulators	The South African Reserve Bank	Nkululeko Nkosi (Associate Analyst in Policy and Regulation for NPS), Peter Makgetsi (Senior Analyst in Policy and Regulation for NPS), Sameera Dawood-Bhagwan (Head of AML specialists)
	The Financial Sector Conduct Authority	Charl Geel (Senior specialist: AML/CTF Advisory Unit), Katherine Gibson (Regulatory Policy), Kedibone Dikokwe (Divisional Executive: Business Supervision Conduct), Kgomotso Molefe (AML/CTF Specialist), Michele Fourie (FICA and AML/CTF Supervision)
	The Financial Intelligence Centre	Christopher Malan (Executive Manager Compliance & Prevention), Kamla Govender (Legal and Policy), Peter Sekgothe (Compliance Monitoring Manager), Pieter Smit (Legal and Policy)
Commercial Banks	Finbond Bank	Hannes Cloete (Head of Compliance), Noni Mahlangu (Compliance Manager)
	Absa	Nicolas Swingler (Head of Financial Crimes)
	Standard Bank	Ntombi Ngema (Previously part of the AML/CTF oversight team; currently supporting in the Group-wide role), Sean Stander (Chief Operating Officer: Group Anti Financial Crime)
	Tyme Bank	Johan Hetzel (Money Laundering Control Officer)

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Commercial Banks	FNB	Megan Brown (Payments Executive)
FinTech	Paycode	Ralph Pecker (CEO and Board Member)
Associations	The South African Insurance Association	Pamela Ramagaga (Acting General Manager: Insurance Risks)
	The Banking Association of South Africa	Adri Grobler (Manager: Legislation & Regulatory Oversight Market Conduct), Khulekani Mathe (SGM: Head of Financial Inclusion), Thabo Tlaba-Mokoena (GM: Financial Inclusion)

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Thank You