



No Shades of Grey

It is highly likely that South Africa will be “grey listed” by the Financial Action Task Force (FATF) in February next year. In short, there are broad concerns around South Africa’s ability to effectively deal with money laundering and terrorist financing. In this article, we explore the detail of what has brought us to this point, what is being done to try to avoid being grey listed along with the impacts on individuals, the economy, and the currency if the grey listing does eventuate.

How did we get here?

In 2019, assessments were undertaken into South Africa’s anti-money laundering (AML) and counter-terrorist financing (CTF) measures. FATF analysed our level of compliance with international best practice on AML and CTF, known as the FATF 40 recommendations. These assessments were led by staff of the International Monetary Fund (IMF) and resulted in the drafting of a 240-page report (the Mutual Evaluation Report (MER)). The MER was then adopted by the FATF in June 2021, with a one-year observation period beginning in October 2021.

Who is the FATF?

The FATF, founded at a G7 summit in 1989, is “an independent inter-governmental body that develops and promotes policies to protect the global financial system against money laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF 40 Recommendations are recognised as the global anti-money laundering (AML) and counter-terrorist financing (CTF) standard.” www.fatf-gafi.org Policies are implemented and monitored at a local level, with over 200 countries globally adhering to the FATF principles.

FATF maintain two lists: a black list and a grey list. Countries on the black list (currently Iran and North Korea) face sanctions by financial institutions as they are considered havens for money laundering and terrorism financing. Countries are added to the grey list if serious deficiencies exist in their AML and CTF policies and systems. There are currently 23 countries on the grey list, including Albania, Burkina Faso, Haiti, Myanmar, Pakistan, South Sudan, Syria, Turkey, Uganda, the UAE and Yemen.

What were the MER’s findings?

FATF considers risks (and then makes recommendations) on a technical level, looking at legislative and regulatory measures that a country has in place to combat ML and TF. FATF importantly also looks at the enforcement of these measures and resultant prosecutions.

The findings in SA’s MER report were concerning. The assessment was not helped by the fact that South Africa was in the middle of facing up to State Capture including the corruption and money laundering that went along with it. The lack of progress on prosecutions following the State Capture Report contributed to the concerns raised by the MER. In short, SA has not been able to demonstrate that we are able to deal with corruption or prosecute where there is evidence of wrongdoing.

The report is very detailed, but the focus was on three core parts:

1. Effectiveness Ratings: FATF rated how effective SA’s AML and CTF measures were against 11 key categories (also known as Immediate Objectives). As per the findings set out in the table below, SA was rated as low or moderate in all 11 categories.



IO.1	IO.2	IO.3	IO.4	IO.5	IO.6
Risk, policy & co-ordination	International co-operation	Supervision	Preventive measures	Legal persons & arrangements	Financial intelligence
Moderate	Moderate	Moderate	Moderate	Low	Moderate

IO.7	IO.8	IO.9	IO.10	IO.11
ML investigation & prosecution	Confiscation	TF investigation & prosecution	TF preventive measures & financial sanctions	TF financial sanctions
Moderate	Moderate	Moderate	Low	Low

Effectiveness ratings

High
Substantial
Moderate
Low

2. Technical Compliance Ratings: The MER tested SA against the FATF’s 40 Recommendations: SA was only fully compliant on 3 of the recommendations, partially compliant with 15, and non-compliant with 5 of the recommendations. There were broad concerns around parts of the legislation, the enforcement of the laws, and the ability to prosecute.

The report discusses the lack of enforcement at length and points to a combination of a lack of understanding and a lack of political will to deal with the complex issues of corruption, ML and TF.

3. Priority Actions: The report ended with 12 priority actions or improvements that SA needed to implement in order to meet the standards for technical compliance and effectiveness. The actions are detailed and specific, including introducing new policies, making changes to legislation, improving the availability of data on beneficiaries, and improving law enforcement across the board.

The report concludes that if SA is not able to improve its ability to detect and prosecute financial crimes, there is a risk of the country being placed on its grey list. Effectively, South Africa was given a year (from October 2021) to demonstrate action to address all the shortcomings.

What progress has been made on the 12 Priority Actions?

Treasury and the Financial Intelligence Centre (FIC) released a media statement following the release of the MER stating that it would take ‘remedial steps within 18 months to address deficiencies identified in the mutual evaluation report’. The statement goes on to say that the government is fully committed to implementing the recommendation of the report.

However, many stakeholders are required to work closely together to make progress on the 12 priority actions: Government (including Cabinet), Treasury, and Law Enforcement Agencies, inter alia. It has therefore taken time to bring everyone together and for any progress to be made, when not much time is available given the one-year observation period. We are left hoping that it is not too little, too late.

Significant progress has been made on the legislative side. Cabinet has in recent weeks urgently approved the submission of a number



of bills aimed at amending legislation to cover areas of concerns raised and to ensure that SA meets international AML standards. Importantly, these amendments empower the Financial Intelligence Centre and other law enforcement agencies in their AML and CTF efforts. The challenge remains in getting all of the bills passed in a very short time frame. Political will is crucial to get it over the line.

There has been progress in other areas as well, including:

- The establishment of an Anti-Corruption Task Team (ACTT): the intention is to foster collaboration between the FIC, NPA (National Prosecuting Authority), SARS, the Hawks and the Department of Justice. This is seen as an important step, but it will need to demonstrate that it operates effectively and makes an impact (as opposed to being for show).
- National Terrorism Financing Risk Assessment: first ever assessment published in March 2022. The “fact finding” report aims to educate on TF risks and mitigation options. Another important piece in the puzzle, but the implementation of actions to mitigate needs to follow.

There are three of the twelve action items that have seen little progress and that are more difficult to solve in the short term:

1. One of the most significant issues raised in the report concerned the information and transparency regarding the beneficial ownership (BO) of companies and trusts. Without this information, it is very difficult to identify the people involved in a specific transaction where a trust or company is involved. The implementation and gathering of data on all existing trusts and companies will take time and significant effort.
2. SA also scored poorly on the monitoring and prosecution of TF. The Hawks have been slow to recruit, especially financial investigators and forensic accountants. This is partly due to a lack of availability of skills and expertise.
3. FATF doesn't only look at financial services businesses but requires AML and CTF measures to be applied in designated non-financial businesses and professions, for example, real estate agents, casinos and attorneys. Progress has been slow on introducing regulation and oversight for these businesses.

In summary, the progress made on the legislative front is offset by the challenges in dealing with the deficiencies concerning the investigation and prosecution of financial crimes. It requires a significant momentum shift regarding the effectiveness of the criminal justice sector. A significant step forward would be to see additional funding into the NPA – basically, we need to demonstrate that SA is building the capacity to fight financial crime.

The observation period ends with the FATF plenary being held on 18-21 October 2022. By then, SA must demonstrate to the FATF that it has become less vulnerable to financial crimes. A FATF subgroup will report on SA's progress in all the recommended actions in December 2022, before the FATF plenary in February 2023 when a decision is likely to be made on whether SA will be added to the grey list.

What is the impact of a Grey Listing?

Grey listing effectively means we are considered to not have enough measures in place to combat money laundering and terrorist financing, so regarded to be a high-risk country to do business with. This obviously results in negative publicity and reputational damage, weakening SA as an investment destination of choice.

On a practical side, this makes it more difficult for entities, individuals, and governments abroad to do business with anyone in SA. This should result in a reduction in SA's GDP - examples of other countries being added to the grey list indicate an initial 1% decline in GDP is likely.

The consequence for South African businesses is that it will become more expensive for them to do offshore business because compliance requirements will need to increase. Offshore entities need to understand the SA counterparty far better initially and then continuously monitor future transactions. In effect, it will become more difficult and more expensive to do cross border transactions.

The other impact on SA is that it could raise the cost of borrowing as investors require an additional risk premium for SA assets because of the increased level of compliance required. However, it does depend on how much of this risk is already allowed for in current rates, the stock market and the exchange rate.



The longer term impact on GDP growth and on other SA assets will depend on how global investors perceive SA's progress on the AML and CTF issues raised by FATF. The Mauritius experience is a good example of a positive outcome. Mauritius only remained on the grey list for around 18 months and implemented a well-structured set of FATF-approved objectives in a short time frame. Offshore investors believed that the risks were being dealt with so the impact on their economy was muted. However there are many examples where countries have been incapable of responding with remedial action post a grey listing, and their economy has suffered materially.

For SA investors, the biggest impact will be the enhanced due diligence that will be required to place new investments offshore or add to existing investments. The due diligence is likely to be more frequent and more invasive, especially where an investment is made through a trust.

While it is very likely that the recent actions taken will be too little, too late, it is crucial that the efforts continue even in the event of SA being grey listed. The impact on our economy and SA risk assets will depend heavily on how we respond, and even more importantly, how foreign investors perceive our response.



MARKET REPORT

30/09/2022

		3m	YTD	1yr	3yr pa	5yr pa	10yr pa	5yr Vol1	10yr Vol1
LOCAL MARKET INDICES									
FTSE/JSE All Share Index (ALSI)	ZAR	-1.9%	-10.1%	3.5%	9.2%	6.5%	9.5%	15.9%	13.6%
FTSE/JSE SA Listed Property	ZAR	-3.5%	-15.8%	-8.7%	-8.7%	-9.0%	1.2%	27.2%	21.5%
SA All Bond Index (ALBI)	ZAR	0.6%	-1.3%	1.5%	5.7%	7.1%	6.7%	8.3%	8.0%
SA Cash Index (SteFI)	ZAR	1.3%	3.6%	4.6%	4.9%	5.8%	6.1%	0.4%	0.4%
Balanced Benchmark	ZAR	-0.5%	-8.8%	1.3%	7.4%	6.6%	9.5%	11.1%	9.2%
SA Inflation (1 month lag)	ZAR	2.8%	6.6%	7.6%	5.3%	5.0%	5.3%	1.4%	1.4%
GLOBAL MARKET INDICES BASED TO USD									
Global Equity (Datastream World)	USD	-6.1%	-25.1%	-19.2%	5.1%	5.8%	8.7%	17.5%	14.2%
Emerging Markets Equity (Datastream EM)	USD	-11.4%	-26.9%	-27.8%	-1.7%	-1.4%	1.4%	17.7%	16.1%
Global Property	USD	-11.5%	-28.7%	-20.8%	-3.5%	1.6%	4.7%	17.6%	15.0%
Global Bonds (Barclays Global Bond Index)	USD	-8.9%	-24.5%	-25.1%	-7.2%	-3.0%	-1.2%	7.5%	6.7%
Global Cash	USD	0.8%	1.2%	1.3%	0.8%	1.4%	1.0%	0.3%	0.3%
MAJOR INDICES BASED TO RANDS									
FTSE/JSE All Share Index (ALSI)	ZAR	-1.9%	-10.1%	3.5%	9.2%	6.5%	9.5%	15.9%	13.6%
Global Equity (Datastream World)	ZAR	3.0%	-15.7%	-3.5%	11.2%	12.1%	17.5%	16.9%	15.3%
Emerging Markets Equity (Datastream EM)	ZAR	-2.8%	-17.7%	-13.8%	4.0%	4.4%	9.6%	14.3%	13.3%
Global Property	ZAR	-2.9%	-19.7%	-5.4%	2.1%	7.6%	13.2%	18.3%	15.6%
SA All Bond Index (ALBI)	ZAR	0.6%	-1.3%	1.5%	5.7%	7.1%	6.7%	8.3%	8.0%
Global Bonds (Barclays Global Bond Index)	ZAR	0.0%	-15.0%	-10.5%	-1.8%	2.7%	6.8%	15.7%	13.7%
COMMODITIES									
Gold (US Dollars)	USD	-7.4%	-8.1%	-4.9%	4.3%	5.5%	-0.6%	12.8%	14.4%
Gold (Rands)	ZAR	1.6%	3.4%	13.6%	10.4%	11.7%	7.5%		
CURRENCIES									
Rand / Dollar	ZAR	-9.7%	-12.6%	-19.5%	-5.8%	-5.9%	-8.1%	16.2%	14.9%
Rand / GBP Pound	ZAR	-0.8%	7.2%	1.1%	-2.4%	-2.1%	-4.2%	14.3%	14.5%
Rand / Euro	ZAR	-2.8%	3.0%	-1.0%	-2.1%	-2.0%	-5.2%	14.2%	13.6%
Spot Rates									
		30-Sep-22	Latest Quarter	1 Year Ago	5 Years Ago	10 Years Ago	20 Years Ago		
CURRENCIES									
Rand/US\$	Rand	17.97	16.38	15.05	13.50	8.25	10.54		
Rand/GBP	Rand	20.07	19.90	20.29	18.11	13.33	16.58		
Rand/EUR	Rand	17.61	17.13	17.44	15.96	10.62	10.42		
RATES									
Libor 6m \$	US\$	4.23	2.94	0.16	1.51	0.64	1.71		
Repo Rate	Rand	6.25	4.75	3.50	6.75	5.00	13.50		
Prime	Rand	9.75	8.25	7.00	10.25	8.50	16.00		
All Bond Index Yield	Rand	11.40	11.05	11.64	9.32	7.10	9.74		
COMMODITIES									
Gold (\$/oz)	US\$	1 674.06	1 806.87	1 760.95	1 283.83	1 774.45	323.60		
Platinum	US\$	864.00	907.00	963.00	920.00	1 668.00	563.00		
Oil (Brent Crude) \$	US\$	88.18	114.93	78.56	57.57	112.56	28.90		
INFLATION									
SA Inflation	%	7.6	7.4	5.0	5.2	5.5	9.4		

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