FSCA

Financial Sector
Conduct Authority

SOUTH AFRICAN RESERVE BANK
Prudential Authority

Statement* of the need for, expected impact and intended operation of draft Joint Standard [-] of 202[-] – Requirements Pertaining to Beneficial Owners

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[Draft for public consultation]

* This statement is prepared and published in accordance with and in fulfilment of the requirements under section 98(1)(a)(ii) and (iii) of the Financial Sector Regulation Act, No. 9 of 2017

Contents

1. PURPOSE

1.1 In terms of section 98 of the Financial Sector Regulation Act, 2017 (Act No. 9 of 2017) (FSR Act), a financial sector regulator may not make a regulatory instrument unless it has published the following documents:

(a) a draft of the regulatory instrument;
(b) a statement explaining the need for and the intended operation of the regulatory instrument;
(c) a statement of the expected impact of the regulatory instrument; and
(d) a notice inviting submissions in relation to the regulatory instrument, stating where, how and by when submissions are to be made.

1.2 In fulfilment of paragraph 1.1(b) and (c), the Financial Sector Conduct Authority (FSCA) and Prudential Authority (PA) (hereafter jointly referred to as 'the Authorities') have prepared the below *Statement of the need for, intended operation and expected impact of the draft Joint Standard – Requirements Pertaining to Beneficial Owners*.

1.3 This Statement is intended to communicate to relevant stakeholders the policy context, impact and intended application of the draft Joint Standard – Requirements Pertaining to Beneficial Owners (draft Joint Standard), and to assist beneficial owners and financial institutions in complying with the draft Joint Standard.

2. STATEMENT OF NEED FOR THE JOINT STANDARD

2.1 **Introduction – Financial crime and beneficial ownership**

2.1.1 Financial crime is not just a law enforcement problem; it is a systemic problem that directly threatens the integrity, stability and credibility of the financial system.

2.1.2 A financial system can only function if stakeholders, including (but not limited to) customers, investors and global counterparts trust it. Money laundering, terrorist financing and proliferation financing erode this trust by creating opacity, facilitating corruption and enabling illicit flows. Financial sector regulators are uniquely positioned to enforce standards that protect the system from abuse and preserve confidence.

2.1.3 Illicit financial activity can distort markets, allow high-risk institutions to operate undetected, and expose the financial system to sudden instability. Financial institutions with criminal linkages may carry heightened operational and liquidity risks, which can spill over into and undermine the stability of the broader financial system.

2.1.4 Both the FSCA and PA are responsible for licensing financial institutions and therefore perform a critical gatekeeper function. Because the proceeds of crime predominantly flow through financial institutions (e.g. banks, insurers, intermediaries), the Authorities are situated as critical gatekeepers where illegal money can be prevented from onward transmission. Without regulatory oversight of anti-money laundering, countering the financing of terrorism and counter-proliferation financing (AML/CFT/CPF) controls, criminals would exploit these access points freely.

2.1.5 Beneficial ownership structures may be used to obscure the true identity of the natural persons who ultimately control a financial institution or influence its actions and decisions, whether directly or indirectly. This opacity can be exploited by criminals to raise, move, store and disguise illicit funds.

2.1.6 Criminals frequently use shell companies, trusts, front companies or complex corporate chains to hide their identify. When the real owner is concealed, assets or transactions cannot be linked to the criminal behind the illicit activity.

2.1.7 Obscured ownership also allows illicit funds to be integrated into the financial system without detection. By layering ownership in complex structures and across multiple jurisdictions, criminals can make it extremely difficult for Authorities (e.g. regulators) to trace the proceeds of corruption, tax evasion, fraud or other crimes.

2.1.8 Terrorist financiers and sanctioned individuals often rely on hidden beneficial ownership structures to access financial services or move money without detection. If institutions cannot identify the true owner, they cannot properly screen for sanctions or high-risk individuals.

2.1.9 Politically exposed persons or corrupt officials may also use opaque ownership vehicles to hide kickbacks, corruption or assets purchased with stolen money. Hidden ownership makes it difficult to identify conflicts of interest, bribery schemes or misuse of assets.

2.1.10 Where the beneficial owner of a financial institution is a criminal or the associate of a criminal, the risk to the financial system become significantly more severe than ordinary customer-level risk because, in this instance, the criminal is not just part of the system – they control a part of it and have the potential to impact the functions and decisions taken in respect of the activities of the financial institution.

2.1.11 A beneficial owner who is a criminal or is an associate of a criminal of a financial institution can utilise their beneficial ownership to control a financial institution, or the actions or decisions of a financial institution, in various ways. For example:

- *Abuse of financial institution to launder money*: Such person can directly influence internal processes to approve suspicious transactions, weaken controls, bypass monitoring systems, and allow illicit funds to flow through the institution undetected. They may also have the power to hire compromised staff, block investigations, alter risk assessments, reduce know-your-customer standards and disable alerts.
- *Regulatory capture and deception*: Criminals can direct the financial institution to mislead regulators, falsify documents, hide ownership information, and structure transactions so that they appear to be compliant. In addition, owners and directors of financial institutions are usually subjected to fit-and-proper requirements. It is important that persons filling the role of a beneficial owner or their associates are not criminals serving in these positions. Failure to detect this can undermine governance integrity, ethical leadership and risk culture.
- *Sanctions evasion and terrorist financing*: If the beneficial owner is a sanctioned person, they may use the financial institution to access the financial system, move funds through the system and mask beneficial ownership.

- *Facilitation of predicate schemes*: Beyond money laundering, the financial institution can be used to support fraudulent schemes, corruption networks, tax evasion, organised crime and illegal cross-border payments.

2.1.12 Financial sector regulators therefore have a critical role to play in combating financial crime. In addition, preventing financial crime is more effective and cost-efficient than enforcement. It is therefore important that measures to address financial crime are preventative in nature, and that regulators utilise their gatekeeping function to ensure that criminals do not enter the financial sector.

2.1.13 A robust framework regulating beneficial ownership can be an effective way of preventing criminals or their associates from owning or controlling financial institutions.

2.1.14 Fit-and-proper requirements, such as honesty and integrity, could enable regulators to prevent high-risk or criminal individuals and their associates from acquiring ownership or control in a financial institution. For example, if such individuals are identified, regulators can refuse to grant a licence, revoke a licence, require disinvestment, or impose conditions on ownership. As a result, criminals would not be able to embed themselves in the system.

2.1.15 Further, screening beneficial owners of financial institutions against sanction lists, criminal databases, politically exposed persons registers and adverse media could help regulators stop financial institutions from being controlled by individuals involved in corruption, terrorism, organised crime or sanctions evasion.

2.1.16 Measures that improve ownership transparency, including disclosure and verification of beneficial owners and the identification of controlling interests, help prevent opaque structures from concealing criminal control. Increased transparency also acts as a deterrent, as criminals avoid structures that expose their identities to regulators.

2.1.17 To address any potential remaining gaps, the Authorities are also in the process of assessing the extent to which legislative amendments to the FSR Act is necessary to regulate aspects relating to associates of beneficial owners. The Authorities have also been engaging with National Treasury in this regard.

2.1.18 In summary, a robust framework regulating beneficial ownership can ensure that only transparent, fit-and-proper, law-abiding individuals own or control financial institutions.

2.2 Objects of the FSR Act and financial sector Authorities

2.2.1 The FSR Act was promulgated with the purpose of establishing a robust system of financial regulation. The FSR Act, among other things, established the PA and FSCA (jointly referred to as the Authorities) and conferred a broad scope of powers on the Authorities, including the power to make joint standards (see section 107), which is a form of subordinate/delegated legislation.

2.2.2 One of the objects of the FSR Act is to prevent financial crime. In addition, sections 105(2)(b) and 106(2)(d) of the FSR Act empowers the FSCA and PA (Authorities) to make conduct and prudential standards that are aimed at reducing the risk that financial institutions, representatives, key persons and contractors engage in conduct that amounts to, or contributes to, financial crime.

2.3 The Financial Intelligence Centre Act

2.3.1 The purpose of the Financial Intelligence Centre Act, 2001 (Act No. 38 of 2001) (FIC Act) (as amended) is to establish a framework and approach to combat money laundering, terrorist financing, proliferation financing and other financial crimes in South Africa.

2.3.2 Although the FIC Act establishes the Financial Intelligence Centre (FIC) to, among other things, supervise and enforce compliance with the FIC Act, Schedule 2 of the FIC Act assigns supervisory responsibility of various accountable institutions (as listed in Schedule 1) to the Authorities, as follows:

Schedule 1: Accountable institutions		**Supervisory responsibility**
Item	**Accountable institution**	
4	An authorised user of an exchange as defined in the Financial Markets Act, 2012 (Act No. 19 of 2012).	FSCA
5.	A manager registered in terms of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002), but excludes managers who only conduct business in Part VI of that Act.	FSCA
6.	A person who carries on the 'business of a bank' as defined in the Banks Act, 1990 (Act No. 94 of 1990).	PA
7.	A mutual bank as defined in the Mutual Banks Act, 1993 (Act No. 124 of 1993).	PA
7A.	A co-operative bank as defined in the Co-operative Banks Act, 2007 (Act No. 40 of 2007).	PA
8.	A person who carries on a 'life insurance business' as defined in the Insurance Act, 2017 (Act No. 18 of 2017), but excludes reinsurance business as defined in that Act.	PA
12.	A person who carries on the business of a financial services provider requiring authorisation in terms of the Financial Advisory and Intermediary Services Act, 2002 (Act No. 37 of 2002), to provide advice or intermediary services in respect of the investment of any financial product (but excluding a non-life insurance policy, reinsurance business as defined in the Insurance Act, 2017 (Act No. 18 of 2017) and the business of a medical scheme as defined in section 1(1) of the Medical Schemes Act, 1998 (Act No. 131 of 1998.)).	FSCA
19.	A person who carries on the business of a money or value transfer provider.	PA
23.	A clearing system participant as defined in section 1 of the National Payment System Act, 1998 (Act No. 78 of 1998) that facilitates or enables the origination or receipt of any electronic funds transfer and/or acts as an intermediary in receiving or transmitting the electronic funds transfer.	PA

2.3.3 Therefore, the Authorities serve an important role in assisting the FIC to combat money laundering, terrorist financing, proliferation financing and other financial crimes in South Africa.

2.4 Financial Action Task Force and South Africa's Mutual Evaluation Report and amendments to the FSR Act

2.4.1 The Financial Action Task Force (FATF) is an independent inter-governmental body that sets international standards to combat money laundering, terrorist financing and the financing of weapons of mass destruction.

2.4.2 South Africa has been a member of FATF since 2003 – a status that requires it to implement global standards for combating money laundering, terrorist financing and proliferation financing. In April 2019 and June 2021, South Africa was subjected to a mutual evaluation which entailed a peer review of South Africa's AML/CFT financing system. The mutual evaluation led to the issuing of a final report – in the form of a Mutual Evaluation Report (MER) – in October 2021.

2.4.3 The outcome of the MER, based on an overall assessment of the level of compliance and effectiveness, resulted in South Africa being greylisted. The MER contained various findings, including findings relating to beneficial owners, from both a customer due diligence perspective and a financial institution market entry perspective.

2.4.4 With regard to beneficial ownership from a financial institution market entry perspective, the MER highlighted that, while fit-and-proper criteria are in place for many sectors, they often do not cover beneficial owners. The latter issue was anchored in FATF Recommendation 26, which states the following: "*Competent authorities or financial supervisors should take the necessary legal or regulatory measures to prevent criminals or their associates from holding, or being the beneficial owner of, a significant or controlling interest, or holding a management function in, a financial institution*."

2.4.5 Put differently, one deficiency highlighted by the MER was that financial sector regulators had not implemented sufficient measures to prevent criminals or their associates from holding, or being the beneficial owner of, a significant or controlling interest, or holding a management function in, a financial institution.

2.4.6 Following the MER, the General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act, 2022 (Act No. 22 of 2022) (Amendment Act) was assented to on 22 December 2022, and commenced on 31 December 2022. The Amendment Act aimed to address various shortcomings highlighted in the MER.

2.4.7 The Amendment Act, among other amendments, amended the FSR Act by inserting a new chapter into the FSR Act that deals with beneficial owners (Chapter 11A). Chapter 11A provides a definition of 'beneficial owner' and empowers standards to be made in relation to beneficial ownership. More specifically, in terms of section 159B of the FSR Act, the Authorities may make standards applicable to beneficial owners and financial institutions, insofar as it relates to its beneficial owners, dealing with the following:

Beneficial owners:
(a) fit-and-proper requirements, in particular honesty and integrity; and
(b) reporting of relevant information regarding the beneficial owner to the financial sector regulator;

Financial institutions:
(a) identification and verification of beneficial owners; and

(b) reporting relevant information in respect of beneficial owners to the financial sector regulator.

2.4.8 The insertion of Chapter 11A into the FSR Act was specifically aimed at addressing the shortcoming explained in paragraph 2.4.5.

2.5 The Co-operative Financial Institutions (CFIs) have been included within the scope of application of the draft Joint Standard as a CFI carries similar characteristics of a bank and is susceptible to money laundering risks within the provision of its financial services. Furthermore, the business model of a CFI is similar to that of a co-operative bank, with some CFIs being larger than co-operative banks and posing bigger risks.

2.6 The exclusion of CFIs from a deposit-taking perspective as an accountable institution within the FIC Act was further raised as a deficiency in the MER.

2.7 Therefore, the rationale for the inclusion is to:
- promote consistent beneficial ownership, honesty and integrity requirements across comparable financial institutions;
- promote alignment with international AML/CFT/CPF standards; and
- address the identified deficiency from the MER.

2.8 **Conclusion**

2.8.1 The rationale for regulating beneficial ownership of financial institutions is set out in paragraph 2.1.

2.8.2 The objectives of the FSR Act, specifically the objective that is focused on the ‘prevention of financial crime’, and the fact that the Authorities are empowered to make Standards aimed at reducing the risk that financial institutions, representatives, key persons and contractors engage in conduct that amounts to, or contributes to, financial crime, clarifies the Authorities’ mandate in respect of financial crime.

2.8.3 Deficiencies highlighted in the MER surrounding the regulation of beneficial ownership, especially in the context of financial institution market entry, re-emphasised the importance of regulating beneficial owners of financial institutions.

2.8.4 The introduction of Chapter 11A into the FSR Act, which specifically and clearly empowers the Authorities to prescribe a Joint Standard dealing with specific aspects related to beneficial ownership, is an enabler for beneficial owner regulation.

2.8.5 The matters outlined above, when considered collectively, informed the development of the draft Joint Standard. At a high level, the draft Joint Standard aims to –
- subject beneficial owners to fit-and-proper (honesty and integrity) requirements;
- ensure that financial institutions establish sound and robust governance policies, processes and procedures for managing risks with regard to beneficial owners;
- ensure financial institutions take reasonable steps to identify, verify and record its beneficial owners;

- ensure that financial institutions undertake regular review and assurance regarding the status of their beneficial owners;
- ensure that financial institutions report beneficial owner information to the Authorities;
- clarify what ‘ultimate ownership’ and ‘effective control’ mean; and
- clarify which persons are excluded from the definition of beneficial owner as contemplated in section 159A(1) of the FSR Act.

3. STATEMENT OF THE EXPECTED IMPACT OF THE JOINT STANDARD

3.1 The expected positive impact of the proposed Joint Standard is significant. It is envisaged that the draft Joint Standard will contribute to combating financial crime in a substantial manner, to the benefit of South Africa as a whole. As a result, the draft Joint Standard has the potential of building trust in the financial system, both from a local and an international perspective, thereby mitigating systemic issues and aligning South Africa to international standards, which is critically important considering the recent MER and greylisting, and to protect consumers from harmful financial crime.

3.2 Despite these advantages, the proposed Joint Standard will likely result in various impacts for beneficial owners and financial institutions. For example, it will increase the compliance burden for financial institutions as well as lead to administrative burdens and additional costs, especially the requirements focused on the continued identification and verification of beneficial owners.

3.3 The exact nature of the impact is difficult to quantify at this stage, and the Authorities specifically request financial institutions to provide input – both qualitative and quantitative – to the expected impacts through the public consultation process, to the extent possible.

3.4 As much as the Authorities are aware of the potential impacts, and the fact that it is critical to ensure that regulatory requirements do not place an undue regulatory burden and/or barriers to entry, it is equally critical to ensure that regulatory requirements mitigate the relevant risks. An appropriate balance in this regard must therefore be achieved.

3.5 After further inputs have been received as part of the public consultation process, the Authorities will consider these inputs and re-assess whether the approach reflected in the draft Joint Standard strikes an appropriate balance between costs and benefits.

4. STATEMENT ON THE INTENDED OPERATION OF THE JOINT STANDARD

4.1 The draft Joint Standard will apply to financial institutions, as defined in section 1 of the FSR Act, and beneficial owners, as defined in section 159A of the FSR Act but-

(a) excludes financial institutions that are not an accountable institution as defined in section 1 of the Financial Intelligence Centre Act, 2001 (Act No. 38 2001); and

(b) notwithstanding paragraph (a), includes a co-operative financial institution as defined in section 1 of the Co-operative Banks Act, 2007 (Act No. 40 of 2007).

4.2 The draft Joint Standard proposes to exclude the following persons from the definition of a beneficial owner, as defined in section 159A(1) of the FSR Act:

4.2.1 a person that acquired an ownership interest in a financial institution through listed securities as defined in section 1 of the Financial Markets Act;

4.2.2 a person that directly or indirectly acquired an ownership interest in a financial institution as -

(i) a member of a pension fund as defined in section 1(1) of the Pension Funds Act; or

(ii) an investor as defined in section 1(1) of the Collective Investment Schemes Control Act; and

4.2.3 a person that acquired an ownership interest in a financial institution through an employee share scheme as defined in section 95(1)(c) of the Companies Act.

4.3 Financial institutions are expected to implement appropriate governance policies, processes and procedures to ensure compliance with the requirements of the Joint Standard which reflects how the financial institutions will comply with the Standard.

4.4 It is the responsibility of the governing body of a financial institution to ensure that the financial institution meets the requirements set out in the proposed Joint Standard.

4.5 The Authorities will, in future, as part of their supervisory programmes, review and assess the adequacy of financial institutions' policies, processes and practices related to beneficial owners.

4.6 Appropriate and proportionate regulatory instruments and/or additional guidance on what constitutes *direct effective control* and *indirect effective control* will be provided to ensure the effectiveness of the Joint Standard.

4.7 Additionally, the Authorities will continually assess and evaluate the effectiveness of the Joint Standard to ensure that any unintended consequences of the draft Joint Standard to the industry are adequately addressed.