Seychelles Financial Intelligence Unit

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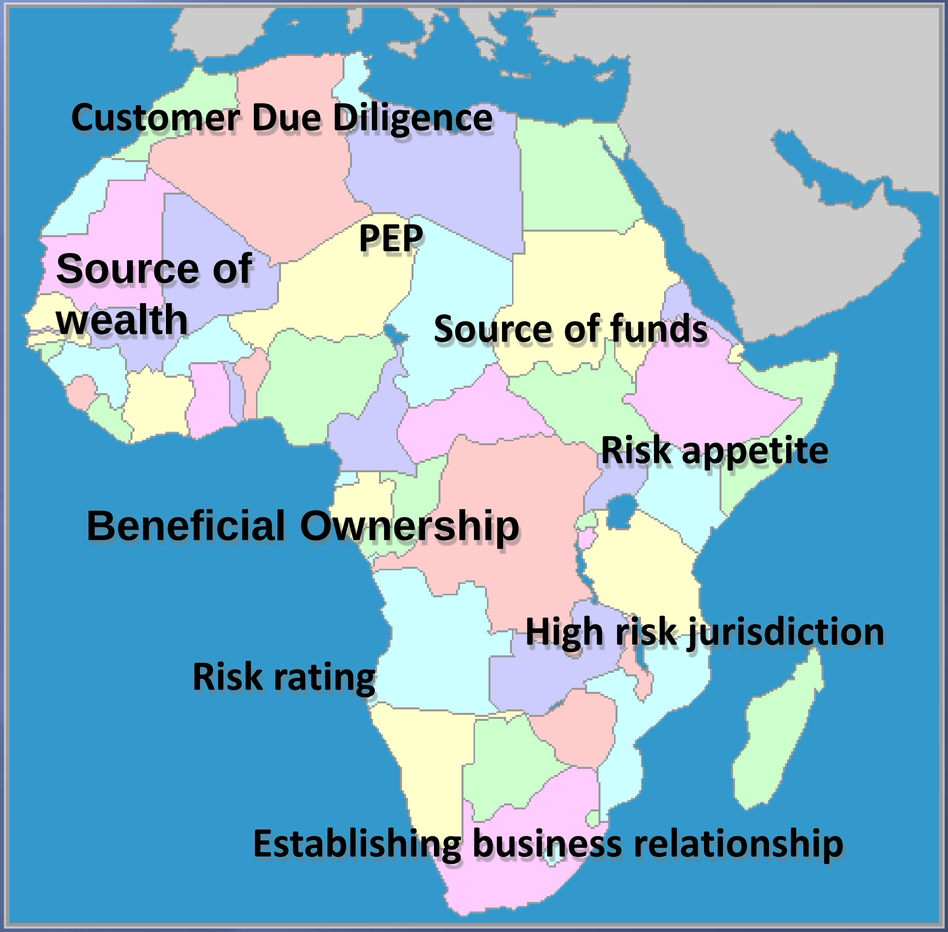
Emerging Architecture of African Due Diligence



Content

- Background on some emerging trends in the financial sector on the African continent
- Characteristics of African financial institutions
- New regulatory requirements and international norms
- Problem question – How should the African continent respond?
- Emerging trends in CDD practices on the African continent

Background

Some emerging trends on the African continent

- ✓ Growth of Pan-African financial institutions
- ✓ Rise in banking champions across the continent
- ✓ Boom in private equity due to improvement in perception of risks of the African continent and movement of capital from depressed developed market
- ✓ Innovative strategies and approaches being adopted to access under developed markets
- ✓ Use of innovative technology to extend reach of financial products and services

Underlying contributors

Banking sector

- Demography - Emerging and growing middle class base of the African population
- Sharp increase in urbanisation
- Consumer demand for banking products and services has increased
- Reforms of financial sector in some countries
- Significant investment in infrastructure project

Characteristics of African Financial Institution

<u>Emergence of Pan- African financial institutions</u>

- Large financial institution
- Retail banking and more sophisticated products to corporate entities
- Expansion and diversification of financial services businesses beyond traditional borders
- Expansion strategy focus both on organic growth and acquisitions
- Growth across different sectors – Systemic financial institutions ?

Characteristics of African Financial Institutions

<u>Country specific financial institutions </u>–

- More traditional products and services
- Can be large or smaller
- Banks, Credit unions, Post Offices' type financial institution
- Business strategy and approach less aggressive

Characteristics of financial institutions

- CDD arrangements – Group wide for pan-African financial institutions with minimum standards adopted of most stringent country of operation
- CDD decision making and governance function centralised
- Compliance Cost saving
- Group wide policies and procedures
- Risk assessments completed and updated
- Other financial institutions and non-financial bodies – understanding of requirements and key concepts vary

Environmental challenges

Financial Institutions operate in an environment where they have to be compliant with regulatory requirements. For them to be compliant the overarching legislative and implementation framework has to be at par with international standards and norms. Because of the development needs of the continent, complying with international standards is not necessarily a top priority and resources may not be allocated to meet those requirements.

Development context for the African continent

" Africa made great strides towards the eight [Millennium Development Goals](). In many areas, especially related to health and education, the advance registered by Sub-Saharan Africa was the fastest among all developing regions. At the same time, the Northern part of the continent met many of the targets, including those on poverty and hunger reduction, universal primary education, children and mothers' health, as well as sanitation."

MDG Report 2015

Development goals and targets to be achieved

- Child mortality rate in Sub- Saharan Africa declined five times faster during 2005-2013 than it was 1990-1995, the region still detains the highest rate

- 70% of its population still suffers from lack of access to improved sanitation facility, 41% of its inhabitants still live, in 2015, with less than $1.25 a day and out of the 57 million of global out-of-school children of primary school age in 2015, 33 million are in Sub-Saharan Africa

- Over last two decades, Northern Africa has not registered any improvements in women's access to paid employment, with women still holding less than one out of five paid jobs in the non-agricultural sector

Solution

World Bank – Making Finance Work for Africa (2011)

“ Economic growth is the surest way to a substantial and sustained reduction in poverty in Africa; policy for long-term growth requires focusing on the larger and more formal parts of the financial system. But while even growth-enhancing policies are beginning to have their effect, improving the access of low-income households and micro entrepreneurs to financial services should become an additional central focus of financial sector policy”

Problem Statement

- Should complying with international standards be a top priority for countries on the African continent?
- How should resources be allocated to ensure compliance, at least compliance with key and core standards?

Why is non-compliance an issue?

Seychelles' example

Seychelles was rated as non-compliant on a number of essential elements under the OECD current methodology, which included the availability and accessibility of information, including accounting information. The primary focus of this assessment was the offshore financial services.

Example

Case example – Seychelles

- A financial services centre perceived as high risk not because of the banking and transactions risk that arise from carrying out banking in the Seychelles, but largely due to the inherent risks of the attributed to the types of legal entities that can be registered in Seychelles
- Seychelles has over 70,000 active international business companies ("IBCs") on its register

DIRECT AND INDIRECT IMPACT OF NEGATIVE RATING

Impact of negative rating on the economy not assessed fully, however during the period of the non-compliant rating the following was observed:-

- Financial institutions having difficulty with their correspondent banking relationships and in one case, the financial institution lost its correspondent banking relationship for all currencies completely.
- Enhanced scrutiny and additional compliance costs on transactions emanating from and destined for Seychelles
- Negative rating by commercial rating companies where country risk rating for Seychelles was elevated
- Refusal by foreign banks to open accounts with of Seychelles registered entities
- Seychelles has requested for a supplementary review and only last month was deemed to have done sufficiently to obtain a more favourable rating against the OEC standards.

Environmental challenges

Emerging regulatory landscape

- Changes to international obligations governing CDD for financial institutions and country- FATF
- Changes to how countries are assessed against international standards through peer reviews
- Changes to impose additional CDD requirements through multi-lateral and bi-lateral agreements – OECD and FATCA
- Higher expectations on supervisors and regulators – enforcement requirement

Rationale

(1) Financial institutions will have sufficient information at hand to make a determination about whether to proceed or not with the transaction. Where it decides to proceed it will be fully informed of the risk surrounding the customer such that it can take additional measures to ensure that the risks of carrying out the transaction or offering its services to the customer is mitigated

Rationale

(2) Where the financial transactions are not being conducted in the country where the entity or individual operates, the expectation is that the relevant information is available and readily accessible in the country where the entity or individual is registered, resident or domiciled for tax purposes or otherwise

Environmental challenges

<u>Problem Question for Afrexim - ACDIRP</u>

- Legislative framework – a maze to navigate
- Availability and accessibility of information to inform the CDD and risk processes
- Evidence of regulatory action and enforcement
- What risk assessment methodology should be used?
- How to guarantee validity and reliability of CDD information obtained?

Example

Case study – Politically Exposed Person

Case study 1

A company is incorporated in Country Africa 1. Shareholder and director is disclosed to financial institution as an individual from Country Africa 2, Director is corporate entity who is controlled by Individual 1. The Company wants to make significant investment in Country Africa 2, and approaches FI to act as intermediary. Individual 1 owns a number of other companies in Country Africa 1, but his source of funding for setting up the companies are unclear. From newspaper articles, it can be seen that individual 1 is closely related to individual 2, who is a high ranking government official (PEP) in Country Africa 1 and who has oversight responsibility of the sector in which the companies purports to be trading. The PEP relationship, although requested as part of the CDD requirements, was not disclosed. Other newspaper articles, alleges that individual 1 is a proxy for the government official in Country Africa 1.

Example

Case study 2 -

Company A is operating in Country Africa 1 discloses to be trading in vehicle parts and that its suppliers are from China. Company A claims to sell the goods onwards to a separate company who is operating from the Free Port Zone of Country Africa 2. The operating bank account is in Country Africa 3 where a subsidiary of Company A is registered. Transactions on bank account show funds being transferred to the suppliers in China. Supporting documents provided such as bills of lading etc. All are issued in the name of Company A and not the subsidiary. However all inward funds into the account are from non-related foreign companies incorporated in high jurisdictions. Controlling and ownership structures are non-transparent. The turnover on the operating account is over USD 30 million over a 3 year period. It is very difficult to obtain information on the counter parties and it is suspected that all the companies making the inwards payments are shell companies.

Example

Case study 3

Company A set up to trade building equipment from Country Africa 1 to Country Africa 2. On company registers the shareholder of company A is another Company incorporated in a different jurisdiction. This company was set up under a 3rd party reliance agreement and the related documents of the company are kept by the 3rd party in a foreign jurisdiction.

Emerging compliance trends

Compliance with CDD international standards

- Financial Action Task Force (FATF) – 40 Recommendations on anti-money laundering and prevention of terrorist financing
- OECD – Standard for Exchange of information for tax purposes (new Compliance Reporting Standards
- FATCA – standard for country to exchange due diligence and financial information on US and related citizens and entities

Emerging compliance trends

- CDD approach on a risk sensitive basis
- Risk assessment of all customers at the point of establishing business relationship or carrying out one-off transaction or service
- Risk assessment of all products and services, delivery method
- On-going monitoring and remediation also on a risk sensitive basis

What requiments to adopt?

- International norms – not complying with international norms means rated as non compliant

- Non-compliant rating = high risk rating notwithstanding reasons for non-compliant rating

CDD Opportunities

- Each African country can shape its CDD architecture based on its needs and specificities
- Respecting the minimum standards set by international community
- But the CDD international standard is designed to allow flexibility at industry level and at country level
- To consider its specificities in light of its development needs and legislate and implement accordingly

Solution – Country level

- African countries adopt an African (or regional) strategy for setting minimum standards for CDD and compliance requirements across the continent
- Standard definition of key concepts eg. Beneficial owners, certification standard
- Makes it easy for lower capacity countries to adopt a CDD common standard
- Sharing of risk modalities, high risk indicators across countries, and assessment methodology

Solution – Afrexim Bank

A distributed solution for Africa, based on national jurisdictions, may be more feasible. In this model, each State would host a single office (based in the CBS?) linked to the Afrexim Secretariat. To conduct a CDD for a customer in a given jurisdiction, the Secretariat polls the jurisdiction which operates under its own domestic framework to provide a risk assessment and respond.

Thank you

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