

DRAFT PUBLIC COMPLIANCE COMMUNICATION

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COMMUNICATION**

No. 115

GUIDANCE ON COMPLIANCE MEASURES
AIMED AT COMBATING PROLIFERATION
FINANCING

PCC SUMMARY

This PCC provides guidance on the targeted financial sanctions (TFS) obligations in terms of the FIC Act, and provides recommendations aimed at mitigating the risk of non-compliance with the broader activity-based sanctions obligations that stem from the United Nations Security Council resolutions on non-proliferation of weapons of mass destruction.

In addition, the PCC provides clarity on certain definitions related to non-proliferation financing of weapons of mass destruction and sets out heightened risks scenarios or red-flag indicators.

THE AUTHORITATIVE NATURE OF GUIDANCE

The Financial Intelligence Centre (Centre) provides the guidance contained in this draft PCC 115 in terms of its statutory function as set out in section 4 (c) of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001), as amended, (FIC Act) read together with Regulation 28 of the Money Laundering and Terrorist Financing Control Regulations (Regulations) issued in terms of the FIC Act.

Section 4 (c) of the FIC Act empowers the Centre to provide guidance in relation to a number of matters concerning compliance with the obligations in terms of the FIC Act. Guidance provided by the Centre is the only form of guidance formally recognised in terms of the FIC Act and the Regulations. Accordingly, guidance provided by the Centre is authoritative in nature and must be considered when interpreting the provisions of the FIC Act or assessing compliance of an accountable or reporting institution with its obligations imposed on it by the FIC Act.

It is important to note that enforcement action may emanate as a result of non-compliance with the FIC Act in areas where there has been non-compliance with the guidance provided by the Centre. Where it is found that an accountable or reporting institution has not followed guidance which the Centre has issued, the institution must be able to demonstrate that it has complied with the relevant obligation under the FIC Act in an equivalent manner, nonetheless.

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DISCLAIMER

The publication of a PCC concerning any particular issue, as with other forms of guidance, which the Centre provides, does not relieve the user of the guidance from the responsibility to exercise their own skill and care in relation to the user's legal position. The Centre accepts no liability for any loss suffered as a result of reliance on this publication.

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OBJECTIVE

The PCC provides guidance on TFS, and recommendations regarding activity-based sanctions aimed at combating proliferation financing. The PCC also provides clarity on certain definitions including non-proliferation financing of weapons of mass destruction and sets out heightened risk scenarios or red-flag indicators.

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1. INTRODUCTION

- 1.1. The United Nations Security Council (UNSC) can take action to maintain or restore international peace and security under Chapter VII of the United Nations Charter. Sanctions measures encompass a broad range of enforcement options that do not involve the use of armed force, and is often used as a last resort in addressing human rights violations, extremism groups etc.
- 1.2. Such sanctions measures can include travel bans, asset freezes, arms embargoes, trade and commodity restrictions and bans on items, materials, equipment, goods and technology related to nuclear ballistic missiles and other weapons of mass destruction.
- 1.3. The targeted financial sanctions (TFS) provisions that are regulated through the FIC Act relate to the targeted sanctions in relation to asset freezes. These provisions deal with the financing element of terrorism or proliferation of weapons of mass destruction, and not the act of terrorism or proliferation itself.
- 1.4. South Africa has two TFS regimes based upon the country's obligation as a member of the United Nations (UN). These TFS regimes are in relation to terrorist financing (TF) and proliferation financing (PF). The focus of this draft PCC 115 is on PF.
- 1.5. UNSC resolutions 1718(2006), 2087(2013), 2094(2013) and 2270(2016) relating to the Democratic People's Republic of Korea (DPRK) sets out the specific restrictions that include TFS aimed at PF.
- 1.6. South Africa's legislation includes the TFS obligation relating to PF in sections 26A, 26B and 26C of the FIC Act.
- 1.7. In addition, an accountable institution must apply a risk-based approach to identify, assess, monitor, mitigate and manage the risk of its products and services being

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used for PF. This will reinforce and compliment the rules based TFS controls that the accountable institution has in place for TFS.

1.8. This PCC must be read together with PCC 44 which provides guidance on the different TFS regimes, Guidance Note 6A that provides guidance on the reporting obligation in terms of section 28A of the FIC Act, and the FIC Targeted Financial Sanctions user guide on how to conduct searches on the TFS list as available on the Centre's website.

1.9. This PCC is divided into two parts:

Part A – TFS and risk-based approach obligations in terms of the FIC Act aimed at combating PF

Part B – Activity-based financial sanctions aimed at combating PF.

PART A – TFS and the risk-based approach in terms of the FIC Act aimed at PF

2. The FIC Act does not provide a definition of weapons of mass destruction (WMD), proliferation of WMD or PF.
3. The Financial Sanctions provisions under Part 2A of the FIC Act, namely sections 26A, 26B and 26C of the FIC Act, refer to the UNSC resolutions that specifically deals with the financing of PF.
4. Definitions relating to WMD, proliferation of WMD and PF are therefore drawn from existing South African legislation that deals with WMD and proliferation of WMD, and international standards as determined by the Financial Action Task Force (FATF).

Understanding proliferation financing of weapons of mass destruction

5. The Non-Proliferation of Weapons of Mass Destruction Act, 1993 (Act 87 of 1993) (NPWMD Act) defines a **WMD** as:

“...any weapon designed to kill, harm or infect people, animals or plants through the effects of a nuclear explosion or the toxic properties of a chemical warfare

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agent, or the infectious or toxic properties of a biological warfare agent, and includes a delivery system exclusively designed, adapted or intended to deliver such weapons.”

6. This definition points to different categories of WMD including, but are not limited to:

6.1.1. Chemical

6.1.2. Biological

6.1.3. Space industry or missile delivery systems

6.1.4. Nuclear.

7. According to FATF, the term **proliferation of WMD** refers to the:

“...manufacture, acquisition, possession, development, export, trans-shipment, brokering, transport, transfer, stockpiling or use of nuclear, chemical or biological weapons and their means of delivery and related materials (including both dual-use technologies and dual-use goods used for non-legitimate purposes)”.

8. The broader definition for the risk of **financing of proliferation of WMD** as set out in FATF guidance refers to:

“...the risk of raising, moving, or making available funds, other assets or other economic resources, or financing, in whole or in part, to persons or entities for purposes of WMD proliferation, including the proliferation of their means of delivery or related materials (including both dual-use technologies and dual-use goods for non-legitimate purposes)”.

9. The narrower definition for **proliferation financing risk** as defined in the FATF Recommendations for purposes of application of the standards refers to:

“...the potential breach, non-implementation or evasion of the targeted financial sanctions.”

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10. From the definition as provided in the FATF Recommendations it is clear that PF is confined to instances where funding is made available to a person whose name appears on a TFS list, due to the proliferation of WMD. Understanding FATF's broader definition contributes toward understanding the PF risks and risk-based approach measures which may be implemented.

Targeted financial sanctions measures aimed at PF

11. Accountable institutions must comply with TFS obligations as it applies to designated persons. This includes all instances where the designated person is the client, person acting on behalf of the client, beneficial owner or party to a transaction.
12. A designated person refers to a specifically named person pursuant to a UNSCR sanction, e.g., a person whose name is reflected on the TFS list.
13. The offence as set out in section 26B of the FIC Act applies to **all persons**, not only accountable and reporting institutions. This is especially important for persons who are required to hold a permit in terms of the NPWMD Act.
14. The TFS obligations in terms of the FIC Act include the requirements to scrutinise, freeze and report, which obligations are expanded on below.

Scrutinising client information in terms of section 28A of the FIC Act

15. Section 28A of the FIC Act requires that the accountable institution scrutinises client information to determine whether any persons are listed on TFS lists. The client information that must be subject to scrutiny includes but, is not limited to, the information on the prospective or existing client, the person acting on behalf of the client, beneficial owner and persons who are party to a transaction.
16. The client information must be scrutinised regardless of the risk rating of the business relationship or whether there is a single transaction. Where there is a heightened PF risk, the accountable institution should scrutinise additional information (e.g. determination of the end users of the client's goods and services in a trade finance transaction).

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17. The accountable institution must not establish a new business relationship or conduct a single transaction with designated persons. Where the accountable institution has an existing business relationship with a designated person the accountable institution must freeze all the designated person's property and submit a report to the Centre under section 28A of the FIC Act. Refer to Guidance Note 6A.
18. In addition, the Centre recommends that all persons who are required to have a permit in terms of section 13 of the NPWMD Act, should scrutinise their client information against the TFS lists, as they face a heightened risk of PF of WMD.
19. Accountable institutions must not process transactions where they are unable to determine accurately whether such transactions would breach TFS obligations.

Freezing and prohibiting dealing in funds or other assets of designated persons and entities

20. The accountable institution must have a process in place to ensure the freezing of a designated person's property (property includes all funds, assets etc.) **immediately without delay** where the accountable institution is in possession or control of such property. This applies where the client, person acting on behalf of the client, beneficial owner, party to a transaction, or the end user of the client's goods or services is a designated person on a TFS list. Any form of monetary value or funds, including negotiable instrument (e.g. letters of credit, bills of lading) to or from a designated person must be subject to a freeze.
21. The accountable institution must not wait to first report to the Centre that it has in its possession property of a designated person or receive a communication from the Centre to freeze property. The accountable institution must freeze the designated person's property **as soon as possible without delay**.
22. The accountable institution may not proceed to provide or release any property to the client unless permission for such a release has been obtained from the Centre in terms of section 26C of the FIC Act.

Reporting

23. Refer to Guidance Note 6A regarding terrorist property reports and Guidance Note 4B for guidance on suspicious and unusual transaction reports, as issued by the Centre.
24. In addition, the Centre cautions businesses required to hold a permit for controlled goods and activities, that there is a heightened risk of PF. Therefore, the Centre strongly urges such permit holders to implement controls to monitor transactions to identify suspicious and unusual transactions that relate to PF and report the same to the Centre.

Risk-based approach

25. In addition to the TFS obligations to scrutinise, freeze and report, the accountable institution must adopt a risk-based approach to ensure sufficient resources are focused on heightened risks of PF. This could enhance the accountable institution's ability to apply the broader activity-based financial sanctions.
26. A key risk relating to PF, is the evasion of TFS. Designated persons employ different methods in their attempts to be undetected, or distance themselves from certain transactions. This could be done through the use of shell or front companies to obscure either the identity of the beneficial owner of the goods and services being provided, or the geographic area to which goods or services are destined and other purposes. Consider instances where the client is a legal person but functions as a shell or front company and does not have actual operations in an industry, which may indicate a heightened PF risk. Designated persons often attempt to hide behind legal persons, trusts and partnerships.
27. A second key PF risk relates to the particular industry in which a client operates, and the associated nature of the client's product offerings. This risk can be further heightened given the nature of the accountable institution's product offering in support of the client.
28. When assessing the risk of PF in light of the above key risks, there are additional factors the accountable institution may take into consideration (in addition to guidance set out in Guidance Note 7):

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Client risk factors

29. Any person including the client, the person acting on behalf of the client, beneficial owner, party to a transaction or end user that is a designated person, and would attract TFS obligations, would be a clear indicator that the business relationship or single transaction poses a high PF risk.
30. Where the client, the person acting on behalf of the client, beneficial owner, intermediary or end user is a national of, or based in a geographic area that is subject to TFS PF sanctions.
31. Where the client's beneficial owners are linked or associated with a designated person or a geographic area that is subject to TFS PF sanctions.
32. The client is a foreign prominent influential person, high-risk domestic prominent influential person or government entity dealing in a high-risk sector such as arms and ammunition.
33. The client is represented by a third party in a manner that is not aligned to the client profile or that does not make business sense or seems unnecessary. Where there is an unusual or unexplained third party acting on behalf of the client or are party to a high-risk transaction.
34. The client's legal structure is overly complex.
35. Clients who offer certain products and services that face a heightened risk of being abused for PF. Examples may include import and exports businesses (e.g. freight forwarders, airlines, road couriers, warehouses, vessels, ports of entry, shipping companies, maritime companies, clearing agents, import and export insurance companies, credit and insurance providers, ports of entry and others).
36. The client requires a permit in terms of section 13 of the NPWMD Act, as they are dealing with dual use goods, controlled goods and technologies. Consideration of the conditions of the permit, and whether the client was denied a permit.

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37. The client is dealing in controlled goods and activities without the required permit or is not registered in terms of the NPWMD Act.
38. The nature of the client's business, including the industry the client operates in, the type of products and services the client provides are linked to controlled activities and goods listed in terms of the NPWMD Act. The South African Council for the Non-Proliferation of Weapons of Mass Destruction (Non-Proliferation Council) publishes a list of controlled goods which may serve as a guide to accountable institutions for purposes of determining and assessing the PF risks relating to the client's sector and the goods in which the client deals.

Controlled activities and goods

Accountable institutions are urged to understand the controlled goods and activities lists as published by the Non-Proliferation Council. In South Africa, persons must hold a permit in terms of section 13 of the NPWMD Act to deal in controlled goods and activities. The list can be found **HERE**.

Controlled goods and activities include goods that have “*dual-purpose capabilities*” relating to technology, expertise, service, material, equipment and facilities ‘which’ can contribute to the proliferation of weapons of mass destruction, but which can also be used for other purposes, including conventional military, commercial or educational use” (e.g. include technologies like drones).

Refer to the NPWMD guidance products available on the Non-Proliferation Council's website for further information click [HERE](#).

There are various other lists that may apply, given the parties to a transaction and correspondent banking obligations. In addition, the UNSC publishes a list of prohibited items.

List of sources of controlled goods/activities/dual-use goods

<http://non-proliferation.thedtic.gov.za/>

<https://www.un.org/securitycouncil/sanctions/1718/prohibited-items>

Geographic area factors

39. Consider whether the geographic areas in which either the client, the person acting on behalf of the client, beneficial owner, originator, beneficiary, or intermediary to transactions are based is subject to TFS PF sanctions (e.g. North Korea is specifically listed as being high-risk for PF concerns). Refer to PCC 49 on geographic risks.
40. Consider whether the geographic area in which either the client, the person acting on behalf of the client, beneficial owner, originator, beneficiary or intermediaries to transactions are based, is an area of concern due to diversion risk, or where the country is not listed but supports or aids sanctioned countries.

Diversion risk refers to the diversion of funding or resources to geographic areas that are subject to sanctions for PF.

Product risk factors

There are certain product risk factors that are specific to certain industry activities and associated transactions that could impact on the vulnerability of an accountable institution and could result in heightened PF risks. These may include:

41. **Trade finance** involves the financing of the import and export of goods, which can include controlled goods or activities. Trade finance transactions may be complex and involve the movement of funds to or from geographic areas that present a high PF risk. Lastly, there are various parties to a trade finance transaction, including the client, beneficial owners, persons acting on behalf of the client, parties to the transaction as well as end users of the good or services information.

Example

Bank Y is financing a trade agreement where, following a review of the bill of lading, it is found that the shipping vessel is subject to sanctions. The Bank Y client is not a designated person, however, the agreement will financially benefit a designated person. Therefore, Bank Y decides not to proceed with the payment.

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42. **Correspondent banking** is the provision of banking services by one bank to another bank, which services can include international transactions and cash management. An accountable institution should assess whether their correspondent bank operates in or has any links to geographic areas with heightened PF risks, or links to persons including beneficial owners who are designated persons. Accountable institutions should understand the controls the correspondent bank has in place to combat PF.
43. **Foreign exchange** refers to the conversion of a country's currency into another country's currency. For all foreign exchange payments, the beneficiary, intermediaries, and originator information should be scrutinised to identify designated persons or countries of other PF risk concerns. The transaction should also be scrutinised to identify links to controlled goods and services and countries of diversion risk.
44. **New technologies** including crypto assets are increasingly being used for PF due to the anonymous nature of the crypto assets, the ease of domestic and cross-border transfer, and the fact that crypto transactions are subject to less scrutiny
45. **Cash payments** to or from accounts of clients that pose a high risk from a PF perspective, could indicate possible evasion of PF controls.

Other factors

46. False documentation or documentation that seems unusual could indicate an attempt to evade sanctions. Criminals often attempt to obscure the true nature of goods, destination of goods, beneficiary, the originator, intermediary or vessel used through false documentation.
47. Information on the end user of the client's controlled goods and activities.

Customer due diligence considerations

48. Where a client poses a higher PF risk, an accountable institution must conduct enhanced due diligence, and is strongly encouraged to obtain the following additional information:
 - 48.1. Information on the end users of the client's goods and services
 - 48.2. Information of the permit of the end user, and intermediaries to the transaction.

49. It is critical for an accountable institution to conduct ongoing due diligence and enhanced account monitoring on high-risk business relationships. This includes assessments of transactional information and documentation to be able to identify suspicious and unusual transactions and activity, including possible PF or evasion of PF.
50. As part of ongoing due diligence, an accountable institution should analyse whether transactions processed for clients presenting a heightened PF risk are consistent with any permits issued to that client, and other documentation that forms part of the transactions.
51. Where assessing a high-risk transaction, an accountable institution should request additional client, transaction information and end-user information as is necessary, so as to not breach TFS. The additional information may include but is not limited to the beneficial ownership information of all the parties to the transaction and end users.
52. Where additional information is required to clarify whether or not a transaction poses a PF risk, and such information is not provided, the accountable institution would not be in a position to adequately establish and verify the identity of the client as envisaged in section 21E to the FIC Act and may not continue with the transaction.

De-risking

53. Refer to paragraph 17 which applies where a designated person is identified.
54. In addition to the principles as set out in Guidance Note 7, it is not considered effective or adequate risk management if an accountable institution decides to de-risk a client for the mere fact that the business relationship or single transaction with the client poses a heightened PF risk.
55. It is the Centre's view that where an accountable institution de-risks solely based upon the fact that there is a heightened risk, then that accountable institution has not complied with its obligation to follow a risk-based approach.

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56. Where an accountable institution takes the decision to not onboard a certain class of client, the accountable institution must be able to demonstrate the application of a risk-based approach in terms of which several factors have been considered.
57. Ineffective application of de-risking can cause inadvertent consequences including the loss of valuable information through regulatory reporting due to the Centre.

PART B – ACTIVITY-BASED FINANCIAL SANCTIONS

58. There are broader activity-based financial sanctions apart from TFS, which are relevant to accountable institutions, although not covered within the reporting ambit of the FIC Act.
59. These activity-based financial sanctions may be considered as further PF risk considerations. Accountable institutions are advised to rely on their existing risk-based approach, customer due diligence, account monitoring, scrutinising of client information and reporting controls to adhere to the broader activity-based financial sanctions and where necessary enhance these controls.
60. Accountable institutions as well as all other persons are prohibited from providing financial services, resources, and assistance to any sanctioned persons either directly or indirectly. An accountable institution must implement controls to ensure it does not provide financial services, resources, and assistance which enables the *supply, sale, transfer, manufacture, maintenance, or use* of controlled goods and activities to persons (other than provided for in the permits as issued by the Non-Proliferation Council).
61. Activity-based sanctions include:
- 61.1. Restrictions of activity
 - 61.2. Travel restrictions
 - 61.3. Trade restrictions
 - 61.4. Income prohibitions
62. Where an accountable institution suspects possible non-compliance with activity-based financial sanctions, the accountable institution must file a suspicious and unusual

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transaction report to the Centre in terms of section 29 of the FIC Act. Refer to Guidance Note 4B.

63. UNSC Resolution 1540 paragraph 2 indicates that:

“...all Member States, in accordance with their national procedures, shall adopt and enforce appropriate effective laws which prohibit any non-State actor to manufacture, acquire, possess, transport, transfer or use nuclear, chemical or biological weapons and their means of delivery, in particular for terrorist purposes, as well as attempts to engage in any of the foregoing activities, participate in them as an accomplice, assist or finance them”.

64. Further paragraph 3(d) indicates:

“...all States shall...Establish, develop, review and maintain appropriate effective national export and trans-shipment controls over such items, including appropriate laws and regulations to control export, transit, trans-shipment and re-export and controls on providing funds and services related to such export and trans-shipment such as financing, and transporting that would contribute to proliferation, as well as establishing end-user controls; and establishing and enforcing appropriate criminal or civil penalties for violations of such export control laws and regulations”.

CONSULTATION

65. Before issuing guidance to accountable institutions, supervisory bodies and other persons regarding their performance, duties and obligations in terms of the FIC Act or any directive made in terms of the FIC Act, the Centre must in accordance with section 42B of the FIC Act—

65.1. Publish a draft of the guidance by appropriate means of publication and invite submissions

65.2. Consider submissions received.

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66. Commentators are invited to comment on the draft guidance by submitting written comments via the online comments submission link only, [CLICK HERE](#). Any questions or requests relating to this draft PCC 115 may be sent to the Centre only at consult@fic.gov.za. Submissions will be received until **Friday, 22 July 2022**, by close of business.

COMMUNICATION WITH THE CENTRE

67. The Centre has a dedicated compliance contact centre geared to assist accountable institutions to understand their registration obligations in terms of the FIC Act. Please call the compliance contact centre on 012 641 6000 and select option 1.

68. Compliance queries may also be submitted online by clicking on: <http://www.fic.gov.za/ContactUs/Pages/ComplianceQueries.aspx> or visiting the Centre's website and submitting an online compliance query.

Issued By:

The Director

Financial Intelligence Centre

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