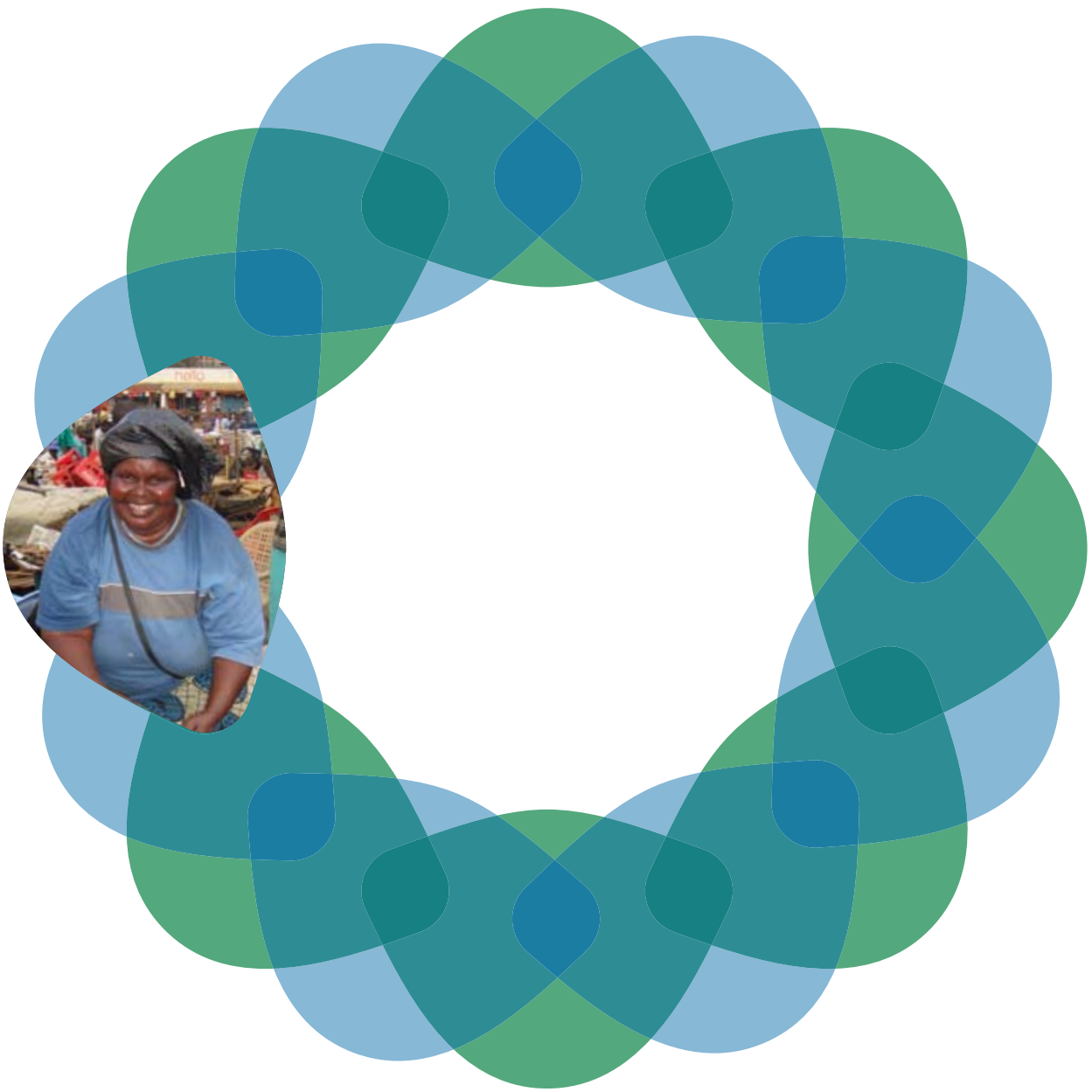




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Global Partnership
for Financial Inclusion

South Africa's engagement with the standard setting bodies and the implications for financial inclusion



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Disclaimer:

Suggestions made in this document do not represent the official views of any of the regulatory authorities consulted. All errors and omissions are those of the authors.



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About this case study

This case study highlights the experience of South Africa in implementing international standards in the financial sector and the interaction, where relevant, with the topic of financial inclusion – a topic that is of particular relevance in South Africa. It draws on a questionnaire completed by the relevant regulatory authorities.

The case study aims to tell the story of South Africa’s engagement with each of the standard setting bodies and to highlight areas where further engagement of the Standard Setting Bodies (SSBs) on the topic of financial inclusion will be welcomed. The South African authorities recognize the important role played by each SSB and would like to contribute to the dialogue process as each SSB engages with the topic of financial inclusion. *However, the case study does not present the official position of any of the supervisory authorities consulted and should in no way be construed as making demands on the SSBs.* Rather, suggestions made illustrate potential needs at the country level for SSB dialogue, information and guidance.

1. Financial inclusion context

As a result of South Africa's discriminatory history, the country is characterized by a two-tiered economy

For many years the inward-orientated development strategy of the Apartheid government, combined with the economic oppression of the majority of the population, contributed to the economic stagnation of the South African economy. In the early 1990s, the state started recognizing that policy reform was necessary in order to catalyze sufficient economic growth for development. South Africa re-entered the international arena with the ending of Apartheid and its first democratic elections in 1994¹. Ever since, economic growth has picked up significantly and the country has been classified as an upper-middle income economy².

In contrast to this positive change, high levels of unemployment, poverty and income inequality remain some of the country's biggest challenges. Unemployment affects a quarter of the workforce³ and the country's Gini coefficient for 2008 was 0.666⁴- one of the highest in the world. The country is also characterized by a large informal sector, with more than one third (35.8 percent) of the economically active population being employed in the informal sector in 2008⁵.

A developed country financial sector in a developing country

South Africa has a sophisticated banking sector based on well-developed financial infrastructure and extensive use of technology⁶. In 2010, there were about 52 automated teller machines (ATMs) per 100,000 adults and approximately 700 point-of-sale (POS) terminals per 100,000 adults (see Table 1). By way of comparison, fellow BRICS country India had respectively 7.29 ATMs and 67.06 POS terminals per 100,000 adults⁷.

The banking sector is, however, highly concentrated, with the so-called Big Four (First Rand, Standard Bank, ABSA and Nedbank) and Investec accounting for 90 percent of total bank sector assets⁹.

Table 1: Physical outreach: ATMs and POS terminals per 100,000 adults⁸

	Automated Teller Machines	Point of Sale Terminals
Botswana	21.5	288.7
India	7.3	67.1
Mauritius	39.1	763.8
Mexico	44.8	592.1
South Africa	52.4	700.0

More than three quarters of population financially included

In 2010, 77 percent of South African adults were financially served by either the formal or informal financial sector. The proportion of banked adults in South Africa has grown significantly from 46 percent in 2004 (13.2 million adults) to 63 percent in 2010 (20.9 million adults)¹⁰. Increased banking levels can be partly ascribed to the Mzansi (basic) bank account initiative (see below); since its launch in 2004, more than 4 million accounts have been opened¹¹. Insurance penetration has, likewise, increased at pace, particularly in the formal market. According to the latest FinScope figures (2010), just short of half of all South Africans have some kind of insurance cover.

Financial inclusion track record built up only recently

The picture has not always been this rosy: prior to 1994, the exclusionary effects of Apartheid locked many poor South Africans out of the formal financial system. The result was that more than 60 percent of the adult population did not have access to any formal financial services (instead meeting their financial services needs through informal means such as stokvels¹² for saving and burial societies for insurance, and transacting largely in cash).

¹ Bester, H., Chamberlain, D., de Koker, L., Hougaard, C., Short, R., Smith, A. & Walker, R. 2008. *Implementing FATF standards in developing countries and financial inclusion: Findings and guidelines*. May. Genesis Analytics: Johannesburg

² World Bank, 2011. [Online]. Available: <http://data.worldbank.org/country/south-africa>

³ Statistics South Africa, 2011. *Mid-year population estimates*. Statistical release P0302. Statistics South Africa: Pretoria

⁴ The Presidency, 2009. *Development Indicators: 2009*. The Presidency: Pretoria

⁵ Statistics South Africa, 2008. *Quarterly Labor Force Survey*. Statistical release P0211.1. Statistics South Africa: Pretoria.

⁶ Financial Action Task Force (FATF)/ Eastern and South African Anti Money Laundering Group (ESAAMLG), 2009. *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism*. FATF/OECD and ESAAMLG: Paris

⁷ Consultative Group to Assist the Poor (CGAP), 2010. *Financial Access 2010. The State of Financial Inclusion through the Crisis*. CGAP/The World Bank Group: Washington DC

⁸ *Ibid.*

⁹ Bester et al., 2008.

¹⁰ Finmark Trust, 2010. *Survey Highlights: Finscope South Africa 2010*. Finmark Trust: Johannesburg

¹¹ The Banking Association South Africa, 2010. *Mzansi account summary: June 2010*. [Online]. Available: www.banking.co.za

¹² A stokvel is a type of savings club, "where members enter into an agreement to contribute a fixed amount of money to a common pool weekly, fortnightly or monthly, to be drawn in rotation according to the rules of the particular stokvel".

Furthermore, mainstream financial institutions have traditionally not been geared to servicing the poor. Post-1994, there have been three key trends that shaped the evolution and current state of the financial sector, as well as South Africa's interaction with the SSBs and the emphasis on financial inclusion:

- *Strong emphasis on international compliance.* After democratization, the new African National Congress (ANC) government placed strong emphasis on complying with international laws, standards and conventions. As a resistance party in exile, the ANC received significant assistance from various international bodies such as the United Nations. After re-joining the international community and leaving its status as pariah state behind, the new government placed much value on compliance with international standards. This new position was backed by strong political will to ensure compliance with relevant standards that matter for the country's development. The newfound commitment to engagement with international standard-setters was evident to these bodies, with the Financial Action Task Force (FATF) noting in 2009 that "particularly since 1994, the Government has worked to enhance consumer protection and streamline regulation of the financial sector in line with Basel I and II, the FATF Recommendations and the International Organization of Securities Commission (IOSCO) standards"¹³.
- *Strong international ambitions for South African financial institutions.* In the same way that the South African government re-joined the international political community after 1994, South African financial institutions branched outwards and started to establish strong international linkages. The cross-border operations of these institutions raised significant regulatory issues: since many of the SSBs principles focused on supporting safety and stability of cross-border investments, the stakes for compliance were significantly increased.
- *State driven financial inclusion attempts to rectify past inequalities.* Post-1994, following the advent of democracy and as part of a broader movement to empower black South Africans, the new government sought to make the financial sector more accessible. Negotiations within the financial sector resulted in the creation of the Financial Sector Charter (the Charter) in 2003 in which major financial institutions committed to a set of

service provision and empowerment targets¹⁴. The banking industry committed to provide access to basic banking services to 80 percent of lower income consumers by 2008. Since these targets impact directly on the ability of banks to secure government and other contracts, they were, until recently, actively pursued by formal financial institutions. The government also committed to amend any regulations that inhibit compliance with the Charter¹⁵. From this commitment to access was born the Mzansi bank account, a savings account with basic transaction capability aimed at the low-income market, launched in collaboration by the big four banks and Postbank in October 2005¹⁶.

Financial inclusion is now an explicit financial sector policy priority

For many years, National Treasury has implicitly pursued financial inclusion as a policy goal¹⁷. The South African government has now taken one step further to institutionalize the focus on financial inclusion beyond the Charter. In its latest draft financial sector policy document, published in February 2011 and titled "Creating a better financial sector for all South Africans," National Treasury included financial inclusion as one of its four official policy priorities¹⁸ for the financial sector. The policymaker is undertaking a number of initiatives that will 'contribute to developing a financial sector that provides access to the poor and thereby contributes to economic growth, job creation and poverty alleviation'. These include developing the role of Co-operative and Dedicated Banks, strengthening the Postbank and the introduction of a regulatory framework for microinsurance¹⁹.

Mutual reinforcement – and a balancing act

Government's emphasis on financial inclusion over the years has triggered and reinforced industry's interest in the low-income market to the extent that financial inclusion has now become a mainstream topic for financial institutions. At the same time, government has had to balance its need for openness and adherence to international standards with the Black Economic Empowerment (BEE) goals that it has actively been pursuing.

These objectives create certain conflicts. One of the challenges has been around targets for the ownership of banks by Black South African individuals. Direct shareholders in banks may be required to assist the

¹³ FATF/ESAAMLG, 2009. *Mutual evaluation report*.

¹⁴ FATF/ESAAMLG, 2009. *Mutual evaluation report*.

¹⁵ Bester et al., 2008

¹⁶ Bester et al., 2008

¹⁷ This was evident in, among other things, the name of the "Banking Development and Financial Access" division. After restructuring at National Treasury, financial inclusion is now dealt with by the "Financial Inclusion and Market Conduct" division.

¹⁸ The other policy priorities as identified in the document include: financial stability, consumer protection and market conduct and the combating of financial crime.

¹⁹ National Treasury, 2011. *A safer financial sector to serve South Africa better*. A National Treasury Policy Document. National Treasury: Pretoria

bank during times of distress; they will require access to significant financial resources and not merely a one-off amount to purchase a significant ownership stake in the bank. However, the way BEE ownership transactions are structured often implies a one-off purchase transaction, without further significant capital being available for investment in the bank. This does not sit comfortably with the principles of the Basel Committee on Banking Supervision (BCBS) that are, ultimately, aimed at ensuring the stability of the banking sector.

At the intersection between these two objectives, South Africa has used its membership in the various SSBs to push the financial inclusion and other agendas internationally. It has sought to impact either the standards, or guidance provided under the standards, in a way that would assist in furthering its domestic political agenda. In doing so, it has become one of a small group of countries that have played an active role in progressing the financial inclusion agenda in their interaction with the SSBs.

2. Standard setting body membership

2.1. Basel Committee on Banking Supervision (BCBS)

Though the South African Reserve Bank (SARB) has been a full member of the BCBS only since 2009, its Banking Supervision Department (BSD) has since the 1990s continuously followed and closely aligned its policies and procedures with guidance and principles issued by the BCBS. It has also become involved in various working sub-groups of the BCBS, such as the Validation Sub-group, Operational Risk Sub-group and the Trading Book Sub-group. Its membership status came with the global expansion of membership of the BCBS beyond the OECD countries after the financial crisis.

2.2. Committee on Payment and Settlement Systems (CPSS)

The SARB was invited to join the CPSS in 2009 when the Bank of International Settlements (BIS) extended membership from the G7 countries to include the G20 countries. Before officially becoming a member of the CPSS, the SARB was invited to participate in various CPSS workgroups and has always provided input when invited to do so by the BIS. Furthermore, the National Payment System Department (NPSD) has always had a very good relationship with the BIS and has invited members of the CPSS to participate in various conferences in and around South Africa.

2.3. Financial Action Task Force (FATF)

The history of anti-money laundering/combating the financing of terrorism (AML/CFT) in SA

South Africa criminalized drug-related money laundering in 1992 and laundering from any type of offence in 1996. The money laundering control law (the Financial Intelligence Centre Act or FICA) was passed in 2001 and the regulations supporting

implementation of the law came into force on 30 June 2003. From that date, registered financial institutions were required, amongst other things, to identify and verify the identity of all new clients.

The current AML/CFT framework was completed when South Africa criminalized terrorist financing as part of the Protection of Constitutional Democracy against Terrorist and Related Activities (POCDATARA) Act of 2004. Together with the FIC Act, this act ensures that South African law complies with the core FATF 40+9 recommendations on terrorist financing and money laundering.

South Africa is the only African representative in FATF

South Africa has been a member of FATF since 2003 and has since then played an active role as the only representative from Africa, and hence the Eastern and South African Anti Money Laundering Group (ESAAMLG), the FATF-Style Regional Body (FSRB) which it belongs to. It held the presidency of FATF in 2005/6. Over time, South Africa has come to be a respected participant in FATF activities, well-known for actively pursuing government policies on financial inclusion.

South Africa participates in all FATF's working and review groups as well as on various projects. The Financial Intelligence Centre (FIC), the country's financial intelligence unit, regularly submits information towards FATF questionnaires. The FIC also communicates FATF public statements, the outcomes of FATF Plenaries, as well as the findings of mutual evaluations, to the public and stakeholders on an on-going basis through announcements on their website, as well as through correspondence with relevant stakeholders. Furthermore, South Africa was an active participant in the drafting of the FATF's draft guidance paper "Anti-money laundering and terrorist financing measures and Financial Inclusion" that was released during June 2011.

Mutual evaluations steer policy developments

South Africa has furthermore volunteered trained evaluators and experts to participate in the mutual evaluations of amongst others the UK, Canada,

Norway, Australia, India and, within ESAAMLG, Mauritius and Mozambique. This has assisted the FIC in better understanding the evaluation criteria for its own mutual evaluations, the latest which was published early 2009²⁰.

Section 3.1 considers the interplay between adherence to FATF standards and financial inclusion in more detail.

2.4. International Association of Deposit Insurers (IADI)

South Africa is not yet a full member of IADI

South Africa, represented by National Treasury (Ministry of Finance), is an associate member of IADI. IADI defines associate members as “entities that do not fulfill all the criteria to be a Member, but are considering the establishment of a deposit insurance system, or are part of a financial safety net and have a direct interest in the effectiveness of a deposit insurance system”²¹.

A deposit insurance policy is under consideration

At the moment, South Africa does not have an official deposit insurance scheme or legislation mandating the existence of such a scheme. However, policy papers on deposit insurance for respectively commercial banks and cooperative banks are currently being developed by National Treasury. The papers rely on the IADI principles as a reference point. At the end of 2010, the detailed IMF assessment of South Africa’s compliance with the Basel Core Principles for Effective Banking Supervision identified the absence of deposit insurance regulation as potentially having “adverse effects” on South African

banks, especially in the light of “recent draft liquidity proposals issued by the Basel Committee on Banking Supervision in December 2009”²².

The planned deposit insurance schemes will be limited to bank financial institutions, including commercial and cooperative banks. It is not foreseen that deposit insurance will cover non-bank deposit-taking financial institutions such as savings and credit cooperatives.

2.5. International Association of Insurance Supervisors (IAIS)

South Africa, through the Financial Services Board (FSB) as a non-bank financial regulator, was one of the seven co-founders of the International Association of Insurance Supervisors (IAIS), which was established in 1994. The FSB chairs the Standards Observance Sub-committee and furthermore actively engages in the IAIS Solvency and Actuarial Issues Sub-committee, the Joint Working Group on Microinsurance (JWGMII), the Market Conduct Sub-committee and the Governance and Compliance Sub-committee. It has also played an important role as a member of the IAIS executive committee over the years.

In the financial inclusion sphere, South Africa has been an active participant in the IAIS discussions around microinsurance. This has partly shaped South Africa’s approach to microinsurance regulation over the years, a process that culminated in the publication of a detailed proposed microinsurance regulatory framework for South Africa at the end of July 2011. Section 3.4 considers the relevance for financial inclusion of the FSB’s engagement with the IAIS principles.

3. Key SSB engagement stories

Although South African financial sector regulators are engaging with all of the five SSBs in one way or another, the stories that have the greatest depth with regards to financial inclusion emerge around two of them, namely FATF and the IAIS. We also provide a short overview of financial inclusion issues arising (or not arising) in engaging with the CPSS and BCBS.

3.1. Basel Committee on Banking Supervision (BCBS)

Below we provide some context on the environment within which the South African Reserve Bank’s BSD

²⁰ The first mutual evaluation was conducted in 2003. The 2009 mutual evaluation report acknowledges that, “Since 2003, South Africa has taken numerous steps to address many of the recommendations that were made in its first FATF mutual evaluation report”.

²¹ <http://www.iadi.org/aboutIADI.aspx?id=48>

²² International Monetary Fund (IMF), 2010. South Africa: Detailed Assessment of Compliance on Basel Core Principles for Effective Banking Supervision. IMF Country Report No. 10/353. IMF: Washington DC. [Online]. Available: <http://www.imf.org/external/pubs/ft/scr/2010/cr10353.pdf>

exercises its regulatory function, as well as recent challenges posed by compliance with the principles and standards of the BCBS.

A tiered banking structure embraces proportionality principle

All South African banks are required to be licensed under the Banks Act of 1990, and adhere to the regulations issued under the Act, unless specifically excluded in terms of the Act. In line with proportionality principles, South African banking regulators have implemented a second tier for co-operative financial institutions (including financial services co-operatives, savings and credit co-

Although implementing the BCPs is sometimes challenging, the BSD is unable to identify BCPs that require revision to facilitate financial inclusion. The BSD therefore states that it has focused and will continue to focus on full implementation of the BCP.

3.2. Committee on Payment and Settlement Systems (CPSS)

The financial inclusion domain within the influence of the SARB's NPSD is characterized by certain landscape features and recent policy actions. These are briefly described below.

Box 1. The interplay between the SA framework and the BCBS standards

The BSD has commenced a formal process to amend the regulatory framework in accordance with the latest international regulatory and supervisory best practices and standards. Some of the challenges presented by the implementation of the standards include:

- *Global liquidity standards in terms of the new Basel III framework:* South African banks currently do not comply with the newly introduced Liquid Coverage Ratio and Net Stable Funding Ratio, and compliance with the standards will require structural changes to the South African financial system. A Structural Funding and Liquidity Risk Task Team was established to consider issues relating to the lack of retail savings, the disintermediation of banks due to the increase in money market funds and the disparate regulatory treatment of banks and money-market funds. The South African financial sector faces structural funding challenges which may affect the way in which banks fund their businesses. However, the changes emanating from this task team's work are expected to have a positive impact from a financial inclusion perspective.
- *Pursuing both BEE and BCBS standards may conflict:* The Broad-Based Black Economic Empowerment (BBBEE) Codes (and proposed Financial Sector Charter) seek to address financial inclusion. One of the challenges relating to banks has been the percentage of direct ownership (15 percent) in the proposed charter being lower than that set by the Department of Trade and Industry's (DTI) Codes of Good Practice on BBBEE (25 percent). The challenge is that a significant, direct shareholder in a bank may be required to assist the bank during times of distress and, as a result, requires access to significant financial resources. It is not clear how comfortably this will sit with the BCBS standards and principles.

Basel Core Principles (BCPs) haven't proven to be problematic for financial inclusion.

operatives, community banks, credit unions and village banks). These are required to register under the Co-operatives Banks Act 2007²³. These institutions are subject to lower capital requirements than first-tier banks.

Steps are now being taken to develop a Dedicated Banks Act for smaller banks. Similar to cooperative banks, these institutions will also be subject to lower capital requirements aligned with the risk posed by their activities. If passed, this will be a groundbreaking piece of legislation that allows the likes of mobile network operators to obtain a license for dedicated financial services provision related to their line of business.

Only banks have access to the direct payment system

Under the National Payment Systems Act, access to the national payments and settlement system is reserved for banks (including cooperative banks); non-bank financial institutions can only access the system through joint ventures or "sponsorships" with banks that are members of the payment system.

The category of 'alternative payment system providers' has been established

Although the deposit-taking and settlement system remains the domain of banks, a new category of 'payment provider' is systematically being allowed

²³ Banks are also able to register in terms of the Mutual Banks Act, no. 124 of 1993 (Mutual Banks Act).

into the system. There are a large number of so-called bill payment providers in the South African payments space. The SARB is responsible for their supervision under Directive 2/2007 to the National Payment System Act (No.78 of 1998). The directive defines bill payment providers or 'system operators' as entities which provide services to "any two or more persons in respect of payment instructions". System operators are not allowed to take deposits. The supervision and oversight function of the SARB includes on-site visit to these entities²⁴.

The goal is to establish interoperability as the policy priority for payment systems

The NPSD published a position paper on interoperability in January 2011²⁵. The goal is to encourage (but not mandate) a move to interoperability, leading to more affordable services for South Africans while encouraging innovation. The paper clearly establishes interoperability as a 'principle' to be "sought and maintained wherever feasible in the sphere of the payment system". It furthermore states that the SARB will not encourage the development of separate closed-loop systems.

CPPS principles have not proved problematic for financial inclusion

It is within this context that the NPSD has not found any of the CPSS's principles to be particularly problematic with regards to payment system development and financial inclusion. According to the regulator, the need for stability of the payment systems implies adherence to all principles of the CPSS, but since these principles have been set at a very broad level, this has not been a challenge.

3.3. Financial Action Task Force (FATF)

South Africa used its non-membership phase to get to grips with the guidance without the specific risk of sanction

South Africa started engaging with the guidance provided by FATF long before it became an official member in 2003. Its initial engagement with the public principles and guidance started in 1995 when the country was creating its own domestic standards to deal with money laundering. At this time, FATF membership was dominated by developed country members and, to inform the development of its domestic standards, South Africa merely drew on the principles and guidance that it could access publically, without any direct engagement with FATF. Non-membership and the developed country focus meant that South Africa faced limited, if any, penalties for non-compliance.

South Africa was an early mover in proactively managing the financial inclusion-AML/CFT trade-off

South Africa was one of the first countries in the world to implement an exemption for certain Know Your Customer (KYC) requirements in order to foster financial inclusion. This was introduced in 2004 and is generally known in South Africa as "Exemption 17". Exemption 17 was the result of a number of domestic policy objectives and financial inclusion concerns, asking for a pragmatic solution that will be in line with international standards. At the time when Exemption 17 finalized, FATF's own thinking on the risk-based approach and what this means for the implementation of the Recommendations had not evolved far. South Africa was therefore able to benefit from being an early mover in yet unclaimed territory.

Since then, the country has implemented a number of further measures in line with a risk-based approach that were directly motivated by financial inclusion concerns. Apart from these measures, South Africa's commitment to balancing financial inclusion and AML/CFT compliance was strongly signaled by the participation of the policymaker, National Treasury, in the steering committee to a study commissioned by the First Initiative in 2007 to explore the impacts of the FATF 40+9 Recommendations on financial inclusion²⁶.

²⁴ South Africa, 2007. Directive for conduct within the national payment system in respect of system operators, Directive 2 of 2007. Directive to National Payment System Act 78 of 1998, Pretoria.

²⁵ South African Reserve Bank (SARB), 2011. Position Paper on Interoperability. Position paper by the National Payment System Department. SARB: Pretoria.

²⁶ The study, in this document referenced as Bester et al. (2008), was published in 2008.

Box 2. The history of South Africa's risk-based approach to counter AML/CFT related financial inclusion barriers²⁷

Financial inclusion a domestic priority. At the same time that the South African government was putting in place its AML regime around 2003, the cause of promoting financial inclusion (given the fact that less than 50 percent of adults were banked at the time) gained strong momentum, culminating in the Financial Sector Charter and the Mzansi bank account initiative (as discussed in Section 1). This set the scene for a number of smart adjustments (or guidance) to FICA legislation and regulations with the aim of not unduly impacting financial inclusion.

The birth of Exemption 17. The drafters of the AML regulations identified address verification as a potential obstacle for the poor to access financial services. As a result, in 2003, when the regulations to the FICA were first drafted they included a specific exemption which relieved institutions of the obligation to obtain details of and verify residential addresses, as long as the financial product in question met certain stringent criteria. These criteria were drafted in consultation with the banks, but took into account only the realities of existing clients – so in practice proved impractical for the majority of the financially excluded. In particular, the need for documentary verification of physical address proved very difficult for many South Africans as at the time, only approximately 44 percent of the population had a residential address (i.e. did not live in an informal settlement or in rural areas on communal or farm land where it is difficult to attach “an address” to the dwelling²⁸). This amounted to just more than 4m addresses out of 9.1m households.

Growing pains lead to adjustment of Exemption 17. When the Mzansi bank account was first designed around 2004, the AML regime was identified as a major challenge to its roll-out to the South African low-income population. The FICA regulations prescribed that the identity of natural persons must be verified by means of an identity document and by comparing the person's residential address details with documentation that is reasonably practical to obtain and can reasonably be expected to achieve such verification. The banks therefore approached the regulator for relief and guidance. The regulator responded by amending Exemption 17 to make it more appropriate for low-value accounts and transactions, and not simply as a means of assisting in the KYC of existing clients. The amended Exemption 17 dispensed with the need to obtain and verify a client's residential address for accounts in which the balance does not exceed R25,000 (\$3,662²⁹) and in which individual transactions do not exceed R5,000 (\$732). The exemption also applies to single transactions below the threshold and money transfers within the Rand Common Monetary Area (CMA). The amendment of Exemption 17 facilitated the eventual launch of the Mzansi account in October 2004. The regulator also issued guidance notes for banks to address the uncertainty around acceptable documentation and other areas of uncertainty.

Non-face-to-face origination for cellphone banking. The introduction of cellphone banking in South Africa once again tested the flexibility of AML controls. The cellphone based banking products introduced to the market by MTN Banking and Wizzit Bank during the mid-2000s required a response from the AML regulator. By its very nature, cellphone banking relies on paperless and convenient non-face-to-face client origination. How then to originate new clients while complying with KYC requirements? The regulator approved non-face-to-face client registration, provided the bank offering the cellphone product obtains a national identity number from the client and then cross-references this against an acceptable third-party database. However, since this model may introduce higher AML risk, clients who utilize the non-face-to-face registration process cannot transact against their accounts for more than R1,000 (\$146) a day. Given the unknown nature of the risk, rather than simply prohibiting this type of business model, it was decided to limit the functionality of the account and allow a non-face-to-face registration process for accounts that adhere to the set limits. Clients are free to exceed this transaction limit once they have submitted to a face-to-face KYC procedure, but still within the limits of Exemption 17. The FIC experienced this exemption as quite challenging in terms of still staying within the limits set by the FATF Recommendations in terms of client identification.

²⁷ A large part of this discussion draws on Bester et al., 2008.

²⁸ Bester, H., de Koker, P. & Hawthorne, R. 2004. Access to financial services in South Africa: A brief case study on the effect of the implementation of the Financial Action Task Force Recommendations. Genesis Analytics: Johannesburg.

²⁹ Using a three-month average R/US\$ exchange rate as obtained from www.oanda.com

More recently, the FIC was once again confronted with the need to apply a risk-based approach in order to foster financial inclusion – on two fronts. The first instance relates to the growing topic of alternative payment mechanisms, while the second relates to South Africa’s substantial challenge of formalizing cross-border remittances in light of the influx of migrants from the region (most notably Zimbabwe) over recent years.

- *Identification exemption issued for prepaid cards.* The South African government recently issued an exemption to full KYC requirements for pre-paid (stored value) cards. Prepaid instruments are defined as “an instrument that functions as an electronic surrogate for coins and bank notes, representing a claim on the issuer, which is stored on an electronic device such as a chip card or computer memory and which is accepted as means of payment by persons other than the issuer.” These instruments are exempted from full KYC requirements in cases where individual transactions do not exceed R200 (\$29), the available balance does not exceed R1,500 (\$220) and the monthly turnover of transactions on the instrument does not exceed R3,000 (\$439)³⁰. Apart from transaction limits and limits on amounts that can be loaded on the card, the exemption is also conditional on the functionality of the product and geographical use. The other obligations included the need for the issuers of such products to have enhanced procedures in place to monitor the transaction activities of users, with the view of still discharging their obligations to report suspicious transactions.
- *Flexibility for Customer Due Diligence (CCD) of refugees.* In May 2010, the FIC issued a Public Compliance Communication (PCC)³¹, announcing that banks should refrain from using refugee and asylum seeker permits to verify identity for the purpose of opening a bank account, since these permits do not meet the requirements of an identity document³². However, following litigation that challenged that guidance, the Department of Home Affairs agreed that the FIC may alter its guidance on acceptable identity documents. In November 2010, the FIC issued an advisory to banks, announcing that they may use the asylum permit to identify clients after verifying whether it is a genuine permit with Home Affairs³³.

In implementing Exemption 17, as well as subsequent applications of the risk-based approach, the FIC has sought to align itself with international standards as represented by the FATF recommendations and special recommendations.

FATF standards have not unduly impacted financial inclusion in South Africa

The FIC’s experience, thus far, has been that adhering to the FATF standards in themselves (as captured in legislation and then implemented) has not had an undue impact on financial inclusion in South Africa. In recent years, reduced due diligence on the verification of customer identities as contained in Exemption 17 has not presented a problem per se, as this is provided for within the framework of the risk-based approach that FATF recommends. South Africa has been able to argue that the risks that may be introduced by the reduced verification requirements are mitigated by the restrictions placed on the functionality of the bank account or domestic remittance services that can be offered within the

framework of the exemption. Likewise, in the opinion of the FIC, the recent acceptance of an alternative identity document for refugees and asylum seekers (see Box 2) does not present a problem as far as the FATF standards are concerned, since the standards allow flexibility concerning the method used to verify a customer’s identity, requiring only that it be done by using reliable, independent source documents, data or information.

The impact on financial inclusion derives from the evaluation process

Despite the fact that the FATF standards have not impacted directly on the FIC’s ability to create room for financial inclusion through the implementation of legislation, regulation and the provision of market guidance, various aspects of the FIC’s risk-based approach were negatively assessed in the mutual evaluations. The first version of Exemption 17 was finalized in 2003, the same year in which South Africa underwent its first mutual evaluation. At this time, FATF had not yet explicitly embraced the risk-based

³⁰ Republic of South Africa. 2010. R.454, Financial Intelligence Centre Act (38/2001): Exemption in terms of the Act. Government Gazette, 33211:80-83. 28 May.

³¹ The purpose of the Public Compliance Communication (PCC) series is to provide an interpretation of issues arising from the FIC Act.

³² Financial Intelligence Centre (FIC), 2010. Identification and verification matters relating to account opening procedures for asylum seekers and refugees in terms of the Financial Intelligence Centre Act. Public Compliance Communication No.03. Financial Intelligence Centre: Pretoria.

³³ Financial Intelligence Centre (FIC), 2010. Identification and verification matters relating to account opening procedures for asylum seekers and refugees in terms of the Financial Intelligence Centre Act. Public Compliance Communication No.03A. Financial Intelligence Centre: Pretoria.

approach. In the report³⁴ on the 2003 mutual evaluation, it is mentioned that “the Regulations [to the FIC Act] also contain a large number of exemptions from the customer identification and record keeping requirements, some of which seem to unduly limit the effectiveness of the law” (emphasis added). FATF’s assessors thus did not perceive these exemptions as aiding in ensuring the integrity of the financial sector.

Similarly, while South Africa was commended on many aspects in its most recent 2009 mutual evaluation, the resulting report specifically mentioned a number of areas for development to the extent that South Africa received a “PC” (partially compliant) score on a number of recommendations, including Recommendation 5³⁵ on Customer Due Diligence, and a non-compliant score on a number of other recommendations. Under Recommendation 10³⁶ on the need for record keeping (Transaction and Customer Identification Records), Exemption 17 was explicitly mentioned as one of the exemptions eroding South Africa’s ability for effective record keeping³⁷. Following the evaluation, no changes have been made to the exemptions.

What are the implications around FATF?

All in all, the South African FIC does not feel that much further work is required at the level of FATF standards to accommodate financial inclusion, as the risk-based approach already allows enough room for maneuver. Though the two goals of AML/CFT and financial inclusion are reconciled at the principle level, there are however some challenges in practice. The risk lies in making inappropriate decisions in the manner in which the two policy objectives are pursued, that would either exclude sectors of the population unduly or would undermine the integrity of the financial sector. The principles are stated at quite a broad level, but there has not been specific guidance so far in terms of how to implement it while also trying to meet domestic financial inclusion objectives. South Africa has had to think creatively and respond to market needs without the FATF structures necessarily supporting them in the process.

More guidance would therefore be welcomed in terms of a clearer articulation of the details of an acceptable

risk-based approach, particularly as it pertains to low risk. FATF should provide guidance on the best practices and methodologies that may be used to assess and interpret risk indicators, in order to draw appropriate conclusions and provide appropriate information to financial institutions on the classification and treatment of risks relating to money laundering and terror financing. Specifically, guidance or best practices as to what may be considered “reliable, independent source documents, data or information” in the context of e-money, stored value cards, etc., where business relationships are often formed in non-face-to-face circumstances, would be welcome.

The need for greater clarity also extends to the mutual evaluation criteria. The main concern for the FIC as regulator in undergoing a mutual evaluation is that the evaluation should represent a correct and fair reflection of the country’s laws and policies and their implementation. Assessors need to take into account the country’s unique circumstances when assessing the country against the ‘one-size-fits-all’ standards. Furthermore, it is recommended that a jurisdiction’s level of financial inclusion, and initiatives to expand financial inclusion, should be considered as part of contextual information when the effectiveness of the AML/CFT system in that jurisdiction is assessed.

3.4. International Association of Insurance Supervisors (IAIS)

South Africa’s engagement with insurance regulation from a financial inclusion perspective has largely focused on creating an enabling regulatory framework for microinsurance, with two core objectives:

- To formalize informal activities and promote consumer protection;
- To encourage outreach by the commercial insurance market down the income spectrum.

The storyline unfolds around the following key moments:

³⁴ International Monetary Fund, 2004. *South Africa: Report on the Observance of Standards and Codes – FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism*. IMF Country Report No 04/119. April. Washington D.C.: International Monetary Fund.

³⁵ “Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names. Financial institutions should undertake customer due diligence measures, including identifying and verifying the identity of their customers...” Financial Action Task Force (FATF), 2003. *FATF 40 Recommendations*. [Online]. Available: <http://www.fatf-gafi.org/dataoecd/7/40/34849567.PDF> (accessed August 2011)

³⁶ “Financial institutions should maintain, for at least five years, all necessary records on transactions, both domestic or international, to enable them to comply swiftly with information requests from the competent authorities. Such records must be sufficient to permit reconstruction of individual transactions (including the amounts and types of currency involved if any) so as to provide, if necessary, evidence for prosecution of criminal activity...” *Ibid*.

³⁷ FATF/ESAAMLG, 2009. Mutual evaluation report: Anti-money laundering and combating the financing of terrorism: South Africa. 26 February. Available at: <http://www.fatf-gafi.org/dataoecd/60/15/42432085.pdf> (accessed July 2011).

Table 2. The South African microinsurance regulatory process timeline³⁸

Date	Milestone
2003	Parliamentary Committee on Finance hearings on abuses in the funeral benefits industry
2004	Financial Sector Charter concluded
2005	FinMark Trust investigative study into funeral assistance business Joint National Treasury/FSB task team set up to direct the assistance business reform process (Parliamentary Committee updated to these developments)
2006	Project extended beyond funeral assistance business to consider all microinsurance
2007	Inter-department forum to ensure alignment across government
2008	Joint National Treasury/FSB discussion paper released for public comment
2009-2010	Public consultations and refining of regulatory proposals
2011	Final policy document with proposed regulatory framework published in July
2012-2014	Planned drafting and passing of legislation; implementation likely to follow 2013/2014

Insurance regulation has its origins in funeral insurance consumer protection concerns

As early as 2003, allegations of consumer abuse in the funeral undertaker industry, where it is common practice to informally provide insurance, came to the attention of the regulator. It led to a diagnostic study, commissioned by FinMark Trust, to better understand the landscape and regulatory challenges for funeral insurance in South Africa, including the large informal market. This formed the basis for further studies, with government gradually broadening its focus beyond consumer protection in funeral insurance to financial inclusion more broadly.

In parallel, there was a policy move towards access to financial services as part of government and industry's agreement under South Africa's BEE-driven Financial Sector Charter of 2004. In response, interest in the microinsurance market also grew among commercial insurers.

From funeral insurance to microinsurance

In 2006, the South African National Treasury decided to broaden the focus beyond funeral insurance to create a regulatory framework for microinsurance development. The first step was to develop a detailed, consultative discussion paper to sketch the landscape, highlight the issues to address and develop a first set of regulatory proposals for public comment. The final proposed microinsurance regulatory framework was published at the end of July 2011³⁹. Implementation of the regulatory framework is expected by 2013 and a dedicated microinsurance department will be formed in the FSB to oversee it.

³⁸ South African National Treasury "Roadshow" presentation, 2008; National Treasury, 2011. The South African Microinsurance Regulatory Framework. National Treasury: Pretoria

³⁹ *Ibid.*

Box 3. Proposed South African microinsurance Regulatory Framework in a nutshell

The microinsurance policy framework has the following objectives:

- Extend access to a variety of good value formal insurance products appropriate to the needs of low-income households.
 - Facilitate formalized insurance provision by currently informal providers and in the process encourage the formation of new, well capitalized insurance providers and promote small business development.
 - Ensure suitable protection for consumers of microinsurance.
- To achieve these objectives, the proposal is that a new Microinsurance Act with accompanying subordinate legislation and rules be introduced. The Microinsurance Act will permit the licensing of a new category of insurers to provide microinsurance products and provide for a simpler solvency regime and lighter market conduct requirements (particularly on distribution) for products that meet certain standards in terms of being simple (i.e. not requiring complex actuarial valuation) and appropriate to the needs of low income customers.

The microinsurance regulations are rooted in proportionality

The proposed microinsurance regulatory framework embraces the proportionality principle on both the prudential and market conduct front. It also embodies a unique application of proportionality within the solvency framework.

The FSB acknowledges that proportionality does not eliminate risk. For this reason, a strong supervision, enforcement and consumer protection drive goes hand in hand with its proposed risk-based microinsurance regulatory tier.

Long-standing IAIS interaction has informed the reform agenda

In its microinsurance regulatory process, South Africa has drawn on international learning through the IAIS microinsurance platforms. At the same time, the South African experience has informed the global learning on microinsurance:

- In parallel to National Treasury's regulatory considerations around microinsurance, the FSB became involved in the IAIS-Microinsurance Network (IAIS-MIN) Joint Working Group on Microinsurance⁴⁰. It has since been an active participant. This included contributing to the Joint

Working Group's Issues Paper on the Regulation and Supervision of Microinsurance in 2007 and, more recently, participating in the drafting group of the upcoming IAIS-MIN Joint Working Group Guidance Paper on Regulation and Supervision Supporting Inclusive Insurance Markets. Learning from the Joint Working Group work was explicitly taken on board in developing the microinsurance regulatory proposals.

- In 2009 the Access to Insurance Initiative⁴¹ was launched as a partnership between the IAIS and others to support microinsurance policy, regulation and supervision. The FSB, through its deputy CEO for insurance, was elected as the chair of the Access to Insurance Initiative Governing Board. In this way, the FSB continues to play an important role in the microinsurance policy, regulatory and supervisory debate globally. The Access to Insurance Initiative has provided an important platform.

Once the proposed regulatory framework is passed, the real challenges will lie in implementation. For this, the forthcoming IAIS-MIN Joint Working Group Guidance Paper will be a very relevant guide.

⁴⁰ The IAIS-MIN Joint Working Group on Microinsurance was created in 2006 as a partnership between the IAIS and the Microinsurance Network's Working Group on Regulation, Supervision and Policy in order to exchange knowledge on how regulation and supervision impact microinsurance market development. At the time, the Microinsurance Network was known as the CGAP Working Group on Microinsurance. Since then, the Joint Working Group has developed two Issue Papers on microinsurance policy regulation and supervision, and one on the regulation and supervision of mutual, cooperative and other community-based organisations. It is currently in the process of drafting a Guidance Paper for the Regulation and Supervision of Inclusive Insurance Markets that will be adopted by the IAIS and will lead to the development of self-assessment toolkit for supervisors regarding inclusive insurance markets. In so doing, the Joint Working Group is supported by the Access to Insurance Initiative.

⁴¹ The Joint Working Group (JWG) functions based on loose cooperation between participating entities, each contributing their time at their discretion. As the scope of activities under the mandate of the JWG increased, such contributions were no longer sufficient to carry the JWG programme. In addition to the JWG, a more formalised approach and dedicated funding were required. This led to the creation of the Access to Insurance Initiative (www.access-to-insurance.org) as a partnership between the IAIS and four other organisations in 2009: the German Ministry for International Cooperation (BMZ), CGAP, the ILO and South Africa-based FinMark Trust. In 2010 the UNCDF joined as major sponsor. The Access to Insurance Initiative aims to promote microinsurance policy, regulation and supervision globally. Amongst others, it supports the work of the JWG on an ongoing basis.

Microinsurance platform gives developing countries a voice

The FSB believes that the microinsurance debate has given developing countries the opportunity to voice their specific concerns in the IAIS. For example, South Africa was able to put the issue of informality of microinsurance providers onto the IAIS agenda. The fact that the IAIS has such a wide variety of members (including highly developed, developing, middle-income and low-income countries) means that all could provide input into the microinsurance discussions. Furthermore, the IAIS's participation in the Access to Insurance Initiative has provided official sanction to the topic of financial inclusion in insurance beyond the structures of the IAIS. It is a best practice model on how supervisors, SSBs, donor agencies and practitioners can work together to construct common learnings and implementation guidance on the topic of microinsurance.

The IAIS microinsurance focus has been more limited in committee structures

The FSB has experienced the IAIS as very willing to allow the microinsurance debate internally and on adjacent platforms, including training provided to members and non-members through the Financial Stability Institute. The leadership of the IAIS has also actively embraced the microinsurance discussion. More broadly, the IAIS has accommodated and, to a certain degree, validated the microinsurance discussion, but has not explicitly integrated this topic into the rest of its committee structures. Financial inclusion thinking within the IAIS has, for the most part, been limited to the Joint Working Group.

There is a need for more detailed IAIS guidance

The FSB has not in any way experienced the insurance core principles as restrictive with regard to the extension of insurance to the underserved. The FSB would, however, appreciate better or more specific guidance on how to apply the Insurance Core Principles⁴² (ICPs) in specific contexts. Areas where there is a need for further guidance include:

- *Licensing requirements (ICP 6⁴³)*, capital adequacy and solvency (ICP 23⁴⁴). Minimum regulatory capital requirements may be a barrier to entry for small players wishing to provide microinsurance, particularly in terms of graduating informal players into formal insurance providers. South Africa is therefore moving towards a tiered capital requirement system whereby all microinsurers will be subject to the same minimum upfront capital requirement, set at a substantially lower level than for mainstream insurers, as well as simple formula-based reserving. Once South Africa's Solvency II-like regime, called Solvency Assessment and Management (SAM),⁴⁵ is implemented the proposal is for microinsurance to be exempted as a separate tier, but following similar risk-based principles as entrenched in Solvency II.
- South Africa would welcome confirmation that the above approach is acceptable from an international standards point of view. Though the ICPs in general entrench the principle of proportionality, also in respect of solvency requirements, more guidance is required on how these principles should be applied in practice for relatively small domestic insurers providing simple microinsurance products.
- The same holds for other ICPs relating to licensing such as fit-and-proper requirements (ICP 7⁴⁶). In the same way that the IAIS is developing ComFrame⁴⁷ to provide a practical standard on how to apply the IAIS ICPs to internationally active, complex insurance groups, it would be useful for the IAIS to develop practical standards on how to apply the ICPs for smaller insurers undertaking simple insurance activities.
- *Governance (ICP 9⁴⁸)*. Another area where further IAIS guidance is required with regard to microinsurance is corporate governance. Microinsurance may require simpler governance requirements, while still achieving the core outcome of adequate oversight of risks and operations. For example, for simple insurance

⁴² The Insurance Core Principles are currently being reviewed. Following finalisation of the revised principles, the numbering of the principles is likely to change. Here we use the unrevised numbering.

⁴³ "An insurer must be licensed before it can operate within a jurisdiction. The requirements for licensing are clear, objective and public". International Association of Insurance Supervisors, 2003. Insurance core principles and methodology. [Online]. Available: http://www.iaisweb.org/_temp/Insurance_core_principles_and_methodology.pdf

⁴⁴ "The supervisory authority requires insurers to comply with the prescribed solvency regime. This regime includes capital adequacy requirements and requires suitable forms of capital that enable the insurer to absorb significant unforeseen losses." Ibid

⁴⁵ For an update on the SAM process and the planned timeline, see: <http://www.fsb.co.za/insurance/SAM/Newsletters/SAMNewsletter2.pdf>

⁴⁶ "The significant owners, board members, senior management, auditors and actuaries of an insurer are fit and proper to fulfill their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications." IAIS, 2003

⁴⁷ In July 2009, the IAIS undertook a project and task force to consider the design and practicality of a common assessment framework for insurance group supervision. The project is called the "Common Framework for the Supervision of Internationally Active Insurance Groups" (ComFrame). For more information, see: http://www.iaisweb.org/_temp/First_Outline_of_the_IAIS_ComFrame_Project_February_2010.pdf

⁴⁸ "The corporate governance framework recognizes and protects rights of all interested parties. The supervisory authority requires compliance with all applicable corporate governance standards." IAIS, 2003

activities, it may not be necessary to have enterprise risk management⁴⁹ in place and some internal control functions (ICP 10⁵⁰) may be combined or taken on by management, provided that there are suitable alternative mechanisms in place for independent oversight of operational management.

- *AML/CFT (ICP 28⁵¹)*. AML/CFT regulations should likewise be applied in a proportionate, risk-based manner. The task for the insurance supervisor is complicated by the fact that it cannot only look to the IAIS proportionality principle in this regard, however, but under ICP 28 must also meet FATF recommendations. More specific guidance by the IAIS that is aligned with what level of proportionality would be acceptable under FATF will be welcomed.

- *Market conduct*. Various ICPs are of relevance to market conduct, including ICP 24⁵² on Intermediaries, ICP 25⁵³ on Consumer Protection and ICP 26⁵⁴ on Information, disclosure and transparency towards the market. Under a proportionate approach, products that meet certain standards in terms of reduced

complexity and being appropriate to low-income consumer needs could have less onerous requirements in terms of pre-sales advice. This has been a much debated core tenet of the South African regulatory framework. More IAIS guidance in this regard, that drills down into specifics, would have been very helpful in determining the contents of the regulatory framework.

From guidance to implementation support

The IAIS's ongoing work on developing guidance on how to apply the ICPs in a proportionate way to the supervision of microinsurance (through the forthcoming IAIS-Microinsurance Network Joint Working Group Guidance Paper) will be a very important step towards providing the kind of guidance the FSB would find helpful. The IAIS's microinsurance engagement can however not end there: once the guidance is out, supervisors like the FSB will welcome capacity building and implementation support with regard to microinsurance supervision.

4. Cross-cutting issues and conclusions

This case study has considered the impact of a range of SSBs on financial inclusion in South Africa⁵⁵. The main conclusions summarized below demonstrate the complexities of accommodating financial inclusion while adhering to international standards focused on financial sector stability, integrity and protected clients.

Standards in themselves are flexible and leave room to pursue financial inclusion. None of the South African regulators and supervisors interviewed perceived current SSB standards by themselves to restrict or undermine financial inclusion. The FIC considered their exemptions aimed at facilitating inclusion to be within the margins allowed for by the recommendations and the overall risk-based approach. Similarly, the FSB did not experience any of the ICPs as restrictive and considered these

sufficiently accommodating of financial inclusion. It is important to note, however, that both these supervisors have gained confidence from the prominent roles they have played within their relevant SSBs. South Africa (and, particularly, the late professor Kader Asmal) has served as chair of FATF, while the FSB obtained confidence from their membership (and chairmanship for a period) of the microinsurance committee of the IAIS. The SARB NPS also did not identify any problematic principles in terms of financial inclusion.

The standards assessment process typically has a bigger impact than standards themselves. South Africa's experience with FATF assessment process and its "yes or no" approach to assessment has been that country context is often not taken into account and compliance with the recommendations is

⁴⁹ Enterprise risk management for capital adequacy and solvency. See:

http://www.iaisweb.org/_temp/2_2_6_Guidance_paper_on_enterprise_risk_management_for_capital_adequacy_and_solvency_purposes.pdf

⁵⁰ "The supervisory authority requires insurers to have in place internal controls that are adequate for the nature and scale of the business. The oversight and reporting systems allow the board and management to monitor and control the operations." IAIS, 2003

⁵¹ "The supervisory authority requires insurers and intermediaries, at a minimum those insurers and intermediaries offering life insurance products or other investment related insurance, to take effective measures to deter, detect and report money laundering and the financing of terrorism consistent with the Recommendations of the Financial Action Task Force on Money Laundering (FATF)." IAIS, 2003

⁵² "The supervisory authority sets requirements, directly or through the supervision of insurers, for the conduct of intermediaries." IAIS, 2003

⁵³ "The supervisory authority sets minimum requirements for insurers and intermediaries in dealing with consumers in its jurisdiction, including foreign insurers selling products on a cross-border basis. The requirements include provision of timely, complete and relevant information to consumers both before a contract is entered into through to the point at which all obligations under a contract have been satisfied." IAIS, 2003

⁵⁴ "The supervisory authority requires insurers to disclose relevant information on a timely basis in order to give stakeholders a clear view of their business activities and financial position and to facilitate the understanding of the risks to which they are exposed." IAIS, 2003

⁵⁵ Other case studies focus on Kenya, Brazil, Philippines and Mexico.

assessed in a binary manner. The results of assessments are also not always in line with other feedback on the South African approach. Despite the fact that South Africa's exemption approach to client identification was included as examples of inclusion-friendly compliance with the FATF Recommendations, these same exemptions were noted in assessments as reasons for marking South Africa down in both rounds of mutual evaluations. In the absence of clear and explicit data on the risks posed by a particular financial service provider or product, the assessment process will encourage countries to take more conservative compliance approaches with a potential negative impact on financial inclusion. This dilemma can be resolved in two possible ways:

- *Providing members with more guidance on risk measurement and assessment.* Members and non-members that develop legislation and regulatory guidance to implement the FATF's 40+9 Recommendations require clear direction on how to go about conducting a national risk assessment. This direction could go as far as the issuing of a suggested methodology (complemented by a toolkit) on national risk assessments. This would allow countries to make risk-informed choices when crafting their relevant legislation to also meet financial inclusion objectives. At the same time, it would provide guidance on the supporting evidence required for FATF mutual evaluations.
- *Making financial inclusion context and impact an explicit consideration in assessments.* South Africa's experience has shown that having an explicit financial inclusion objective at Treasury level acted as a balancing factor in the implementation of AML/CFT regulation. With the Guidance note's recognition of financial exclusion as an AML/CFT risk, this position will be strengthened. To translate the guidance note into action will, however, not only require a mindset (and potentially a skillset) change on the part of assessors, but will also require that the explicit recognition of the inclusion landscape and impact is explicitly incorporated as part of the overall assessment methodology.

Clear direction is required from FATF on non-face-to-face account origination. South Africa was able to allow non-face-to-face origination of bank accounts through imposing clear limits on account

functionality for accounts opened in this way. At the time, no national risk assessment had been conducted and the risk associated with these accounts was not fully quantifiable. According to the South African regulator, explicit exemptions for non-face-to-face origination may be getting into grey territory in terms of the FATF Recommendations. It may therefore be appropriate for FATF to provide explicit guidance in terms of acceptable identification requirements and account limits for non-face-to-face account origination.

Open membership and a commitment to direct interaction with members supports financial inclusion discussion. The IAIS has established itself as a standard-setter with broad membership ranging from developed to developing countries and even some very low-income members. Its open approach to membership, as well as its direct and early engagement with financial inclusion through the establishment of the microinsurance working group, provided many members – including South Africa – with the confidence to actively engage with financial inclusion.

Engagement with SSBs is a two-way street. Both the FSB's and the FIC's engagement with their relevant SSBs reflect South Africa's advocacy role in terms of financial inclusion. While the standards and their assessment have certainly not left the South African financial inclusion landscape unchanged, the ability of South Africa to actively engage with the SSBs has allowed the FSB and FIC to take positions on financial inclusion that have been noted as examples of good practice within their relevant SSBs. With the broadening of developing country membership, developing countries have claimed stronger voices for themselves in terms of the topics of financial inclusion and issue of proportionality.

These are only some of the questions that developing country supervisors are grappling with and suggest a handful of areas where the SSB agendas can be more specifically tuned to their realities in terms of more explicit guidance. As long as the international guidance is vague, risk-averse supervisors will also be vague in their own guidance to industry. Company compliance officers are then left with the same incentive to apply overly conservative approaches to compliance, even if the SSB principles and guidance grant flexibility on paper.



Global Partnership for Financial Inclusion

www.gpi.org

The Global Partnership for Financial Inclusion (GPI) is the main platform for implementation of the G20 Financial Inclusion Action Plan. The group engages partners from G20 and non-G20 countries, private sector, civil society, and others. It is chaired by the G20 troika countries, currently Korea, France, and Mexico. The GPI is supported by three implementing partners: the Alliance for Financial Inclusion (AFI), the Consultative Group to Assist the Poor (CGAP), and the International Finance Corporation (IFC).



Alliance for Financial Inclusion (AFI)

www.afi-global.org

AFI is a global network of central banks and other financial inclusion policymaking bodies in developing countries. AFI has been given the mandate to foster the participation of non-G20 developing countries in the G20's Global Partnership for Financial Inclusion as an implementing partner.

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