Financial Intelligence Centre

Assessment of the inherent money laundering and terrorist financing risks

MOTOR VEHICLE DEALERS' SECTOR

March 2022

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1. INTRODUCTION

Money laundering can be described as the process whereby criminals attempt to conceal the proceeds of their criminal activities from the actual crime thereby giving the funds derived from criminal activities an appearance of legitimacy. This may be done by investing in different immovable and movable assets. Dealers in high-value goods, which include motor vehicle dealers, have been identified by the international anti-money laundering community as being potentially vulnerable for money laundering. Terrorist financing is the process by which individual terrorists and terrorist organisations obtain funds to commit acts of terrorism.

In 2019, the Financial Intelligence Centre (FIC) conducted a preliminary risk assessment of the inherent ML and TF risks affecting the automotive sector in South Africa. Motor vehicle dealers were surveyed to ascertain their views on the sector's vulnerability to money laundering and terrorist financing. This report captures the feedback provided as well as open-source information on national and international money laundering risks in the automotive sector. In addition, the FIC's regulatory knowledge of the sector and the analysis of the regulatory reports submitted by the automotive sector to the FIC were also considered.

The survey offers valuable insights for motor vehicle dealers, the relevant industry bodies and the FIC. While it is understood that the ML and TF environment may change from time to time, the risks identified from this survey feedback and from other sources are significant observations.

2. SCOPE, LIMITATIONS AND METHODOLOGY OF THE RISK ASSESSMENT

This sector risk assessment report addresses the inherent money laundering risks that face the automotive sector pertaining to products, services, clients, transactions, delivery channels, and geographical location. Although it is recognised that these risks could be mitigated by introducing processes and procedures in accordance with the requirements and obligations of the Financial Intelligence Centre Act, 2001 (Act 38 of 2001) (FIC Act), such mitigation factors were not included in this report.

3. OVERVIEW OF THE MOTOR VEHICLE DEALERS' SECTOR

3.1. Nature and regulation of the sector

3.1.1. The South African automotive industry consists of a wide range of companies and organisations involved in the design, development, manufacturing, marketing, importing, exporting and selling of motor vehicles. According to the Automotive Business Council (*National Association of Automobile Manufacturers of South Africa* - NAAMSA), the broader automotive industry's contribution to the gross domestic product (GDP) in 2020, stood at 4.9 percent (2.8 percent manufacturing and 2.1 percent retail). The figure is down from 6.4 percent in 2019, reflecting the severe impact of COVID-19 on automotive manufacturing and retail due to the countrywide lockdown restrictions during the year. As the largest manufacturing sector in the country's economy, a substantial 18.7 percent of value addition within the domestic manufacturing output was derived from vehicle and automotive component manufacturing activities. This continues to position the industry and its broader value chain as a key player within South Africa's industrialisation landscape. The automotive sector remained one of the most visible sectors receiving foreign direct investments, with the seven vehicle original equipment manufacturers investing a record R9.2 billion and the component sector R2.4 billion in 2020.

3.1.2. The National Automobile Dealers' Association which is a constituent association of the Retail Motor Industry organisation – the majority employer party to the Motor Industry Bargaining Council – confirmed that as of 31 March 2021, 29 925 people were employed in the South African new vehicle manufacturing industry. The industry comprised the major new vehicle manufacturers and specialist commercial vehicle and bus manufacturers. The independent vehicle importers structures employed 5 624 people. The retail and aftermarket sector employed 282 096 people which included 56 528 by motor vehicle dealerships.

3.1.3. The FIC issued revised public compliance communication 7 (PCC 7) in March 2016 which defined a motor vehicle dealer as "a person who is engaged in the business of buying, selling, or exchanging any self-propelled vehicle, including a vehicle having pedals and an engine, or an electric motor as an integral part thereof or attached thereto and which is designed or adapted to be propelled by these means on land, as well as any trailer and caravan." This includes persons dealing in new and second-hand vehicles.

3.1.4. In 2010, the Financial Action Task Force (FATF[1]) identified vehicles as part of "movable goods" that could be used for storing criminal funds. In addition, it also referred to the possible use of vehicles to provide logistical support for criminal activities.

3.1.5. The motor vehicle dealers' sector is not subject to a licensing requirement. Accordingly, there is no market entry requirement in force and there is no designated supervisory body (as envisaged in Schedule 2 of the FIC Act) for motor vehicle dealers. The FIC supervises motor vehicle dealers in terms of the FIC Act.

3.1.6. There are strict market entry requirements for persons or business entities wishing to enter and operate a new franchise motor vehicle dealership. These operating standards are imposed by the original equipment manufacturers and importers of the various motor vehicle brands which are governed via franchise agreements. These standards are also evident within pre-owned vehicle dealerships which are linked to new-vehicle dealerships. In this sector of the market, more than 80 percent of all motor vehicles purchased are financed through a financial institution.

[1] The Financial Action Task Force is the international standard setting body for combating money laundering and the financing of terrorism and proliferation. South Africa is a member of FATF and has to comply with its Standards.

4. MONEY LAUNDERING RISKS ASSOCIATED WITH THE MOTOR VEHICLE DEALERS' SECTOR

4.1. Supported by information contained in the regulatory reports submitted by motor vehicle dealers, it is apparent that often the proceeds of crime are used to purchase motor vehicles. In addition, criminals often view owning an expensive vehicle as a status symbol. This observation has been supported by information obtained from criminal cases and regulatory reports submitted by motor vehicle dealers and other institutions. The ease of purchasing a vehicle, the extensive and prevalent use of cash and the fact that motor vehicle dealers are not subject to all FIC Act compliance obligations, contribute to the sector being at a high risk for money laundering.

4.2. Although most dealers and importers of new vehicles are subject to operating standards and entry level requirements imposed by their franchisors, they are not subject to statutory licensing requirements. In addition, there is a large independent pre-owned dealership environment where standards are largely dictated by the owner operators themselves. In this sector of the market there is often a high penetration of cash purchases which raises the risk for money laundering. There are many private transactions regarding pre-owned vehicle taking place on a daily basis without effective monitoring as private individuals are not compelled to report cash transactions.

4.3. Additional information on activities in the sector was obtained from inspections the FIC conducted on motor vehicle dealers. Inspection reports reveal that some of the clients are foreigners making cash payments to motor vehicle dealers. Although the nationalities of clients are not always recorded, client identities are often not verified nor verifiable, in some instances a surname or a country of birth indicate the involvement of foreigners. Foreign clients of motor vehicle dealers increase the money laundering risk.

5. REPORTING BY MOTOR VEHICLE DEALERS UNDER THE FIC ACT

5.1. The volume of reports received from motor vehicle dealers

Between April 2016 to March 2021, motor vehicle dealers filed a total of 153 145 cash threshold reports (CTRs[2]) at an average of 30 629 per year. During the same period, the sector filed a total of 58 535 suspicious and unusual transaction reports (STRs[3]) at an average of 11 707 per year.

The number of regulatory reports filed by motor vehicle dealers with the FIC in each financial year from 2016 to 2021 is depicted in Table 1 below.

Table 1: Regulatory reports filed by motor vehicle dealers

Reports filed by industry	2016/17	2017/18	2018/19	2019/20	2020/21	Average number of reports
CTRs	27 983	37 536	31 071	34 701	21 854	30 629
STRs	5 271	9 118	10 274	19 376	14 496	11 707
Total reports	33 254	46 654	41 345	54 077	36 350	42 336
Registered number of institutions	3 578	3 809	3 891	4 028	3 788	3 818
Average number of reports per institution per year	33 254/ 3 578 = 9.2	46 654 / 3 809 = 12.2	41 345 / 3 891 = 10.6	54 077 / 4 028 = 13.4	36 350 / 3 788 = 9.6	42 336 / 3 818 = 11.1

5.2. Types of regulatory reports filed

[2] Reports on cash transactions exceeding R24 999.99

[3] Reports on transactions that are regarded as unusual and suspicious, as explained in section 29(1) of the FIC Act

Although the FIC received a large number of reports from the sector, the number of motor vehicle dealers that are actively reporting in comparison with the total number registered entities may be considered as low. The relatively low number of reports in the 2020/21 financial year may be attributed to a possible reduction in the number of transactions as a result of the COVID-19 pandemic.

The majority of the regulatory reports filed with the FIC over the last five years, have been CTRs. The FIC has learned, during its engagements with the sector, that large numbers of dealers are no longer receiving cash on their premises due to safety concerns. However, the high number of CTRs received over the last five years, as indicated in Table 1 above, points to the fact that cash is still to a large extent used in the sector– possibly in the form of bank deposits. The money laundering risks associated with the use of cash is therefore still present and motor vehicle dealers need to be aware of such risks and need to apply mitigating measures.

6. RISK BASED ON THE SECTOR SURVEY AND RESEARCH

The risk factors used in this report align with those used in Guidance Note 7, issued by the FIC which is available www.fic.gov.za, and also includes a short reference to risks of terrorist financing.

The risk factors below were taken into consideration when the inputs on the survey were analysed. Motor vehicle dealers need to consider these factors when conducting their daily business.

6.1. Products and services risks

6.1.1. Certain products and services are regarded as posing a higher risk for money laundering purposes. Products and services in the sector include the selling of several types of vehicles such as passenger, industrial and commercial vehicles as well as motorcycles. In addition, some dealers service vehicles and also sell parts and insurance.

6.1.2. The price and types of the vehicles sold also impacts on the money laundering risks faced by the sector. Vehicle types include conventional passenger, sports, off-road, vintage and collectible vehicles.

6.1.3. Although the average deal value of a high percentage of respondents' points to the sale of conventional passenger vehicles, a significant proportion indicated they also dealt in expensive vehicles valued at more than R800 000. In the South African context, high-value vehicles pose a higher ML risk as criminals including money launderers and their close associates often buy expensive vehicles to flaunt their wealth or to launder their illicit funds. A motor vehicle dealer needs to establish whether the product or services that is being provided is consistent with its knowledge about the customer's profile and needs, whether the purchase of such a vehicle makes economic sense for the customer. In addition, they need to establish the origin of the funds in order to make an informed decision about the ML and TF risks associated with the transaction.

6.2. Client risks

6.2.1. To be able to match a product or service to the nature and the needs of a client, a motor vehicle dealer should also have information about the client and the client's needs. Different client types pose different risks. Legal entities such as trusts, companies and partnerships are generally regarded as being of higher risk due to the potential to conceal the identity of the beneficial owner of such a legal entity. Foreign clients also potentially pose a higher risk, as they may find it easier to hide information or not provide adequate identifying information to the motor vehicle dealer.

6.2.2. Some clients, such as foreign prominent public officials (FPPOs), domestic prominent influential persons (DPIPs), complex legal structures or foreigners potentially pose a higher risk for money laundering, depending on the identified circumstances. The establishment of complex structures, involving legal persons (companies) and legal arrangements such as trusts and partnerships – including where such structures are named as beneficiaries of a trust – could possibly be aimed at concealing the ultimate beneficial owners of such legal persons and arrangements.

Motor vehicle dealers indicated in their responses that, although low in volume, they conducted business with these higher risk clients. This increases the ML risks associated with these clients. Establishing the identity of the ultimate beneficial owner where purchases or sales involve a legal person, trust or partnership are complicated by different factors. These factors include business dealings with corporate and foreign clients, although client identification and verification requirements in the FIC Act do not apply to motor vehicle dealers. This increases the risk of the sector being abused for money laundering purposes.

6.3. Transaction risks

6.3.1. Cash is still, to a large extent, used and is prevalent in the sector. Although most deals involved a deposit with partial financing, close to half of respondents indicated that they sold vehicles for cash without any financing arrangement. A large majority revealed they received deposits as cash payments or as full payment, and a small percentage of respondents indicated that some deals were done without the involvement of financial arrangements from other sources. The sector still received funds, including cash, from third parties not regarded as clients, although the number of such instances were small. This represents a high risk for ML given the high value of some of these vehicles.

6.3.2. In addition to the use of cash, motor vehicle dealers should also consider factors such as whether a specific transaction makes sense in relation to the client’s needs and profile. Their willingness to pay above market value or sell below market value, whether there is a request for a transaction to be “reversed” after a deposit is paid and whether a third party is somehow involved in a transaction. These practices may be an indication of possible money laundering.

6.4. Risks associated with distribution channels

6.4.1. As is the case with other products, the advertising and selling of vehicles online and on social media platforms is a general practice in the modern era. More than half of respondents to the FIC questionnaire sold vehicles online. A small percentage also indicated they offered online auctioneering services, which they operated themselves or outsourced to a third party. The use of online sales platforms and auctioneering services could potentially make the process of identifying the client more difficult, resulting in an increase in the ML and TF risks associated with the sector. Motor vehicle dealers must make sure that they have proper and correct knowledge of who their clients are, as well as their needs and the reason for entering into a transaction – also if such transaction is concluded by using non-face-to-face communication and advertising methods.

6.4.2. A majority of respondents indicated that they performed background checks on their agents and sales staff. Background checks are a good industry practice that may lower the risk of motor vehicle dealer employees assisting criminals to launder illicit funds.

6.5. Geographical areas

6.5.1. The geographic location of an institution is important as some locations are subject to higher levels of criminal activities, such as those close to national borders, or bond warehouses. The FIC received responses to the survey from institutions throughout the country, although a larger number were from areas where economic activities were concentrated. These areas are also more disposed to criminal activities. In South Africa, motor vehicle dealers that are closer to borders with neighbouring countries may be exposed to greater risk for ML. These institutions may have more customers from neighbouring countries, and it may be easier for criminals to move vehicles obtained with illicit funds across the border.

6.5.2. Conducting business with a client outside the motor vehicle dealer's geographical location, which is likely to be non-face-to-face business, further increases the risk of the client's identity being obscured. A large majority of respondents indicated that they conducted business across provincial borders while they also conducted business outside South Africa's borders. A significant percentage of respondents indicated they received funds from outside South Africa's borders, thereby increasing the ML risks associated with the sector.

6.5.3. In addition, clients from certain countries also pose a higher risk for ML or TF purposes. High-risk areas include countries identified by the FATF as having low levels of compliance, tax havens, countries regarded as jurisdictions with high levels of secrecy, countries where citizens are subject to a travel ban and countries known to have high levels of organised crime, corruption or from which terrorist organisations are known to operate.

6.6 Terrorist financing risks

The respondents have not submitted any terrorist property reports during the review period and business with clients in sanctioned jurisdiction were limited.

7. INDICATORS OF MONEY LAUNDERING ACTIVITIES AND TERRORIST FINANCING ACTIVITY FOR THE SECTOR

The FIC has compiled a list of risk indicators based on information from the FATF, regional anti-money laundering and combating of terrorist financing bodies and analysis of regulatory reports the motor vehicle dealer sector has submitted to the FIC.

The following can be regarded as ML risk scenarios associated with the motor vehicle dealer sector:

- Purchase does not match customer profile (age, income, nature of client, nature of vehicle)
- Customer hesitant to provide information (e.g., source of funds, beneficial owner)
- Customer due diligence information appears to be false
- Customer buys various vehicles in quick succession
- Last-minute cancellation with subsequent request for repayment of deposit
- Registration of vehicle in the name of a different person or entity
- Cash deposits below reportable amounts
- Customer appears to have good knowledge of FIC Act reporting obligations and ask questions relating to this
- Third-party payments and delivery requests, including to neighbouring countries
- Insurance in the name of a third party.

8. CONCLUSIONS

It is evident from regulatory reports submitted to the FIC, responses to the survey and general sector information that criminals in South Africa often buy expensive vehicles with the proceeds of crime, either as a way to hide criminal funds or to use the vehicle as a status symbol. Cash is widely used in the sector and motor vehicle dealers also conduct business online which aggravates the risk of them being for ML or TF purposes. As reporting institutions, motor vehicle dealers do not have to comply with all the compliance obligations in terms of the FIC Act and are only required to register with and file reports to the FIC.

In conclusion, the inherent ML risks in the motor vehicle dealers sector is therefore high while the terrorist financing risks are considered low.

Money laundering risk factors for motor vehicle dealers

Money laundering risk factor	Likelihood	Consequence	Overall risk rating	Priority
Compliance: Lack of mitigating circumstances through compliance – e.g., CDD, training, record-keeping	4	4	21	1
Products and services /delivery channels – Use of cash, online platforms, transaction size	4	5	24	1
Risk/threats associated with clients – PEPS, source of funds, complex structures	4	4	21	1
Risk/threat associated with geographical area – sales to clients outside geographic area, sales to clients in restricted area	5	3	20	1

Overall money laundering risk of motor vehicle dealers – Rating heat map

LIKELIHOOD SCALE (PROBABILITY)	5 Almost certain likelihood/ probability	11	16	20 Low market level entry requirements	23	25
	4 Highly probable likelihood	7	12	17 Geographic risk	21 Compliance risks, Client risks	24 Products/ Use of cash
	3 Possible likelihood	4	8	13	18	22
	2 Unlikely probability	3	5	9	14	19
	1 Improbable likelihood	1	2	6	10	15
		1 Low impact	2 Minor impact	3 Moderate impact	4 Major impact significant	5 Severe impact
	CONSEQUENCE SCALE (IMPACT)					

The above risk factors and heat map were derived from the responses motor vehicle dealers provided on the risk assessment survey.