IN THE APPEAL BOARD OF THE FINANCIAL INTELLIGENCE CENTRE ACT

Appeal Number: 12/3/1/5-FGLL/SARB(4/21)

In the matter between:

FEDGROUP LIFE LIMITED Appellant

and

PRUDENTIAL AUTHORITY Respondent

(SOUTH AFRICAN RESERVE BANK)

Appeal panel: LTC Harms, Adv Harshila Kooverjie SC and Ms Zama Nkubungu-Shangisa

For the appellant: Mr P Bracher of Norton Rose Fulbright South Africa Inc

For the respondent: Adv F Mathiba instructed by Bowman Gilfillan Inc (Mr Trichardt)

Hearing: 26 August 2021

Contraventions of FIC Act – life insurer - financial penalty – factors - risks

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DECISION

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[1] The appellant, Fedgroup Life Ltd, appeals the imposition of a financial penalty by the Prudential Authority, the South African Reserve Bank, in terms of sec 45C(3)(e) of the Financial Intelligence Centre Act 38 0f 2001 ("*the Act"*).

[2] The appeal is under sec 45D of the Act.

[3] The appellant conceded that it had failed to comply with two sections of the Act, namely secs 43 and 42(A)(2). Its complaint on appeal is about the quantum of the penalties.

[4] We use by way of background the following information from the letter of decision.

[5] The appellant is an accountable institution in terms of Schedule 1 of the Financial Sector Regulation Act 9 of 2017.

[6] The Prudential Authority is a juristic person operating within the administration of the Reserve Bank (sec 32), and it is the responsible authority under the Banks Act in terms of Schedule 2. The role of the Registrar of Banks was assumed by the Chief Executive Officer of the Prudential Authority (the PA) since 1 April 2018).

[7] In July 2018 the PA and the Financial Sector Conduct Authority (FSCA) delegated the FSCA's supervision and regulation of compliance obligations in respect of licensed life insurers to the PA.

[8] It is the duty and responsibility of the appellant to fully comply with the provisions of the FIC Act and it is the responsibility of the PA to supervise and enforce compliance with the FIC Act.

A SECTION 43 TRANSGRESSIONS

[9] Section 43 of the FIC Act provides:

"*An accountable institution must provide ongoing training to its employees to enable them to comply with the provisions of this Act and the Risk Management and Compliance Programme which are applicable to them*."

[10] The PA found the following deficiencies in the training of the appellant's employees:

a) The anti-money laundering and counter terrorist financing ("AML/CFT") training material was not adequate and would not assist the appellant in ensuring that its employees were trained on compliance and its risk management and compliance programme ("RMCP").
b) Its AML/CFT training programme did not adequately cover the requirements outlined in the FIC Act and FIC Guidance Notes to place employees in a position to identify and mitigate AML/CFT risks.
c) The appellant had not provided AML/CFT refresher training to all its employees during 2014 to 2018.
d) The appellant had not provided AML/CFT training to 2 out of 13 of its senior management.

[11] Because of this the PA issued a directive in terms of sec 45C(3)(c) requiring of the appellant to take certain remedial actions. In addition, it imposed a financial penalty of R500 000 in terms of sec 45C(3)(e).

[12] The appellant took the remedial actions to the satisfaction of the PA.

B <u>SECTION 42A TRANSGRESSIONS</u>

[13] Sections 42A(1) and (2) of the FIC Act state:

(1) The board of directors of an accountable institution . . . must ensure compliance by the accountable institution and its employees with the provisions of this Act and its Risk Management and Compliance Programme.

(2) An accountable institution which is a legal person must—

(a) have a compliance function to assist the board of directors . . . in discharging their obligations under subsection (1); and

(b) assign a person with sufficient competence and seniority to ensure the effectiveness of the compliance function contemplated in paragraph (a).

[14] The PA found that the appellant had failed to comply with the governance of AML/CFT compliance requirements in terms of section 42A(2) as follows:

a) It failed to provide documentary evidence that its AML/CFT compliance function had performed adequate oversight and monitoring relating to its FIC obligations in respect of, inter alia, cash threshold reporting - identification, and reporting of cash transactions exceeding R24 999.99.

b) The former internal rules and the RMCP of the appellant were not customised for its specific operations, as the internal rules documented mostly the legislative requirements and not the practical business procedures deployed to ensure compliance therewith.

[15] For these transgressions the PA issued a caution and imposed a financial penalty of R250 000.00.

C ADMINISTRATIVE SANCTIONS

[16] Administrative sanctions are dealt with in sec 45C of the Act. The material provisions are quoted to the extent relevant.

[17] The PA, as supervisory body may impose an administrative sanction on any accountable institution when satisfied on available facts and information that the institution has failed to comply with a provision of the Act or any order, determination or directive made in terms of the Act (sec 45C(1)).

[18] When determining an appropriate administrative sanction, the Centre or the supervisory body must consider the following factors (sec 45C(2)):

(a) The nature, duration, seriousness and extent of the relevant noncompliance;

(b) . . .;

(c) any remedial steps taken by the institution or person to prevent a recurrence of the noncompliance;

(d) . . .; and

(e) any other relevant factor, including mitigating factors.

[19] The PA may impose any one or more of the following administrative sanctions (sec 45C(3)):

(a) A caution not to repeat the conduct which led to the noncompliance ;

(b) a reprimand;

(c) a directive to take remedial action or to make specific arrangements;

(d) the restriction or suspension of certain specified business activities; or

(e) a financial penalty not exceeding R10 million in respect of natural persons and R50 million in respect of any legal person.

[20] After considering any representations and the factors referred to in subsection (2), the PA may impose an administrative sanction the PA considers "*appropriate*" (sec 45C(6)).

D THE FINANCIAL SECTOR REGULATION ACT 9 OF 2017

[21] The PA may impose sanctions, including financial penalties, under the FSR Act. The two Acts are, however, materially different and perform different functions. The reason we quote sec 167 (2) of the FSR Act will become apparent:

(2) In determining an appropriate administrative penalty for particular conduct—
(a) the matters that the responsible authority must have regard to include the following—

(i) The need to deter such conduct;
(ii) the degree to which the person has cooperated with a financial sector regulator in relation to the contravention; and
(iii) any submissions by, or on behalf of, the person that is relevant to the matter, including mitigating factors referred to in those submissions; and

(b) without limiting paragraph (a), the matters that the responsible authority may have regard to include the following—

(i) The nature, duration, seriousness and extent of the contravention;
(ii) any loss or damage suffered by any person as a result of the conduct;

(iii) the extent of any financial or commercial benefit to the person, or a juristic person related to the person, arising from the conduct;

(iv) whether the person has previously contravened a financial sector law;

(v) the effect of the conduct on the financial system and financial stability;

(vi) the effect of the proposed penalty on financial stability;

(vii) the extent to which the conduct was deliberate or reckless.

E THE TEST ON APPEAL

[22] As said, the appeal is about the quantum of the penalties. It is trite that the ordinary rule is that a higher body is not entitled to interfere with the exercise by a lower body of its discretion unless it: failed to bring an unbiased judgment to bear on the issue; did not act for substantial reasons; exercised its discretion capriciously; or exercised its discretion upon a wrong principle.

F REMEDIAL STEPS

[23] The decision letter set out the transgressions and, in relation to the penalty it stated the following:

- The PA has duly considered all remediation attempts by Fedgroup Life following the inspection conducted by the PA in terms of section 45B of the FIC Act. The PA noted that Fedgroup Life has already commenced taking steps to remediate the areas of non-compliance. However, the administrative sanctions are determined with reference to the status quo of Fedgroup Life's anti-money laundering and countering the financing of terrorism (AML/CFT) controls assessed at the time of the inspection.

- The PA would like to assure Fedgroup Life that it has considered all provisions of section 45C of the FIC Act including the representations made by Fedgroup Life in its letter of 22 July 2020 and has determined the appropriate administrative sanctions in line with the non-compliance identified as a result of the AML/CFT inspection that had been conducted.

- After due consideration of the nature of the findings and the level of non-compliance with the FIC Act, the PA hereby confirms its decision to impose administrative sanctions upon Fedgroup Life in terms of section 45C of the FIC Act.

[24] The first bullet point shows that the PA failed to comply with the statutory prescript that it "must" consider "*any remedial steps taken by the institution or person to prevent a recurrence of the noncompliance*" before it imposes a penalty. In this instance the PA prescribed the directive steps and provided a time-line for completion but imposed the penalty while the appellant was busy complying with the directive and before the time had expired.

[25] The PA sought to rectify its approach by stating afterwards that –

> "*though the administrative sanctions are imposed on the non-compliance of the appellant at the time of the inspection, the respondent also took into account the remedial activity undertaken by the appellant to prevent a recurrence of the non-compliance*."

[26] This volte face is not credible and not one expected of an authority with the status of the PA. Furthermore, in *S v Wells* 1990 (1) SA 896 (A) the Appellate Division said that a judicial officer may change, amend or supplement his pronounced judgment

provided that the sense or substance of the judgment is not affected thereby. The same would no doubt apply to an administrator such as the PA.

G DETERRENCE

[27] That brings us to the issue of deterrence, the main justification for the size of the monetary penalties. The PA said in this regard *inter alia*:

- In fact, it would be true to say that the main function of the power given to the respondent to impose administrative sanctions on those regulated accountable institutions that fail to comply with the obligation as stipulated in the FIC Act read with the Regulations, in terms of section 45C of FIC Act, serve as a credible deterrence for an institution's failure to comply with the FIC Act.

- In the respondent's view, the main theoretical justification for the imposition of sanctions on those who violate or do not comply with the FIC Act is deterrence - both to the offending responsible party and to other responsible parties that may consider engaging in the same type of behaviour in future.

- This view is fortified by section 45C(3) of the FIC Act which permits a supervisory body such as the respondent to impose any one or more of the administrative sanctions specified in that section, including a financial penalty of up to R10 million in respect of natural persons and R50 million in respect of a legal person, per contravention.

- Where such large monetary penalties are authorised by the FIC Act and imposed, a strong message is sent to all accountable institutions that non-

compliance with the FIC Act is intolerable. Such large monetary penalties serve as a deterrent, are educative and also have a punitive effect.

[28] These paragraphs contain several misconceptions which indicate that the PA did not understand its function.

[29] First, deterrence is not listed as factor in the FIC Act although it is given prominence in the FSR Act. It appears that the PA confused the two Acts. This does not mean that deterrence is an irrelevant consideration, but it cannot be the prime consideration under the FIC Act. (Deterrence must in the context of the FSR Act be considered in conjunction to the degree to which a person cooperates with the Regulator in relation to the contravention and any submissions made by the person including mitigating factors referred to in those submissions.)

[30] Second, if deterrence were such a powerful factor, South Africa, in the light of the minimum sentence provisions and the sentences imposed daily, would have been crime free. The Financial Services Tribunal dealt with deterrence in the context of the FSR Act and the PA is invited to read its decision because it is relevant to its functions under the FSR Act.[1]

[31] Third, the statement that the size of a penalty should serve as a message/deterrent to "*both to the offending responsible party and to other responsible parties that may consider engaging in the same type of behaviour in future*" bears no relationship to the facts of the case. The public will not know if and why a penalty was imposed, and there is no suggestion that the PA considered the appellant as a possible recidivist.

[1] Decision - MET Collective Investments (RF) (Pty) Ltd v FSCA and another.pdf.

[32] Fourth, the PA read sec 45C(3) myopically. It lists five administrative sanctions and not only the penalty of R50 million. Counsel's submission that "what the Authority is saying is that the fact that the FIC Act authorises a financial penalty of up to R10 million in respect of natural persons and R50 million in respect of legal persons for any non-compliance with the FIC Act demonstrates the seriousness of any non-compliance with the FIC Act" is rejected. So is the attempt to draw a comparison with the way penalties are imposed by the Competition Commission in a different context. The PA should rather have had regard to the application by the FIC of the FIC Act and the decisions of this Appeal Board relating to financial penalties instead of going out on a limb of its own.

[33] Finally, there is this statement by the PA:

It is important to mention here that FATF [Financial Action Task Force] suggested in its 2019 Mutual Evaluation Report of South Africa that the administrative sanctions imposed by supervisors up to the Mutual Evaluation appeared not to be dissuasive.

[34] "*Appeared not to be dissuasive*" presumably means in ordinary English that penalties imposed by supervisors at a certain level may not have a deterrent effect. This tells us nothing. The relevant part of the report its not attached and one cannot assess the value of the "*suggestion*" or its relevance in the present context. The value of an opinion depends on the facts on which the opinion is based – and these are absent.

H THE NATURE, DURATION, SERIOUSNESS AND EXTENT OF THE RELEVANT NONCOMPLIANCE

[35] The first factor the PA had to consider was "*the nature, duration, seriousness and extent of the relevant noncompliance*". Apart from stock statements about the dangers and scope of terrorist financing and money laundering it appears that the PA gave scant attention to this aspect of the case.

[36] Any penalty must be individualised and not be based on generalisations. See the decision of the Board in *Mit Mak Motors v FIC* paras 21 and 22 dealing with a related aspect:

Mr. Latif explained that the FIG aims at being fair and these criteria are workable in respect of all transgressors. It is certainly laudable that the FIG strives to achieve parity in respect of sanctions imposed, but an approach as set out in the previous paragraph has the effect of disregarding the seriousness or not of the particular transgression viewed in terms the provisions of Section 45C(2)6. Moreover it makes it impossible for the FIC to even consider the alternative sanctions prescribed in Section 45C(3)7. It negates the personal circumstances of a particular transgressor.

[37] The following facts, stated in the notice of appeal, are not in dispute.

- The Appellant's clients (*"persons who have entered into a business relationship*" with the Appellant) are either major employers with many employees or registered pension funds with a large number of members.

- There is no probability or even real possibility of anyone setting up such an elaborate structure to provide terrorist financing or as a basis for money laundering. (During argument, counsel for the PA could not suggest otherwise.)

- The PA failed to consider the very low risk of terrorist funding and money laundering arising from the Appellant's non-compliance with the FIC Act.

- The Appellant's Compliance Risk Assessment found that its transactions were low risk in terms of the risk-based approach for the life insurance sector according to the Financial Action Task Force (FATF) Guidance Note.

- During remediation, the Appellant identified 19 different notionally possible suspicious transactions and noted that the Appellant has not had any instances of any such transactions.

- There was no finding of actual non-compliance with customer due diligence, recordkeeping, cash threshold reporting (the Appellant does not accept cash), terrorist property reporting and identification, and reporting suspicious and unusual transactions.

- There is no finding that any non-compliance with the FIC Act led to any adverse consequence (despite the detailed onsite inspection from 18 to 29 March 2019).

- There is no finding that those overseeing client transactions (bound as they are to comply with the Insurance Act, 2017 and the Financial Advisory and Intermediary Services Act, 2002) were not aware of their responsibilities to ensure that no money laundering or terrorist activities were permitted.

- The non-compliance relied by the PA on regarding refresher training of employees between 2014 and 2017 overlooked the fact that the new version of section 42 of the FIC Act was only in force from 2 October 2017.

[38] These facts are not only undisputed but were ignored in determining the sanction or the level of the financial penalty. This means that the PA had failed to consider the prime statutory factors of nature, duration, seriousness, and extent of the relevant noncompliance. Paying lip service by reciting the Act is insufficient. The decision must reflect how the factors were taken into account.

I CONCLUSION

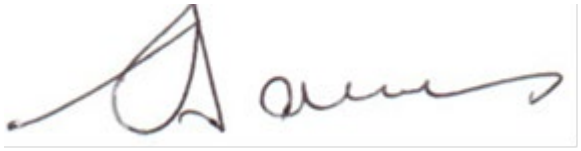
[39] This means that the appeal must be upheld. Although we may refer the matter back to the PA to reconsider, the PA did not ask for such an order and neither did the appellant. The PA, unfortunately, gave us no data (comparative or otherwise) of how it has dealt with other transgressions under the PIC Act. It also does not possess any guidelines such as those designed by the PIC.

[40] The appellant did not submit that the breaches did not justify a financial penalty, which leaves us with the unenviable task of exercising our own value judgment with reference to the factors set out earlier. The breaches were bureaucratic in nature and did not affect any of the purposes of the FIC Act or created any systemic risks. We believe that a penalty of R80 000 and R60 000 for the respective transgressions would be fair, and that the appeal deposit of R10 000 must be deducted from the amount payable.

J ORDER

1. The appeal is upheld.
2. The financial penalty of R500 000 for transgression of sec 43 is set aside and replaced with one of R80 000.
3. The financial penalty of R250 000 for transgression of sec 42A is set aside and replaced with one of R60 000.
4. The fees paid by the appellant in respect of the appeal are to be set off against the said penalties in terms of sec 45D(10)(a).

Signed on behalf of the Tribunal on 31 August 2021



LTC Harms (deputy chair)