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2024 BUDGET REVIEW

FINANCIAL SECTOR UPDATE

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

This annexure reports on steps to strengthen South Africa's framework to combat money laundering, the financing of terrorism and other financial crimes; reforms to support greater financial inclusion; measures to enhance climate-resilient investment; and other initiatives.

BUILDING CAPABILITY TO FIGHT FINANCIAL CRIMES AND EXIT GREY LISTING

In February 2023, the Financial Action Task Force (FATF) put South Africa on its "grey list" due to deficiencies in technical compliance and effectiveness of the country's system to combat money laundering and the financing of terrorism. This grey listing followed publication of the 2021 mutual evaluation report, in which the FATF identified compliance with 20 of the 40 FATF recommendations and deficiencies in all 11 measures of the effectiveness of the system. In response, government developed a strategy to build a financial system that is less vulnerable to abuse and where abuses are effectively prosecuted. This involves both legislative and regulatory changes, as well as improvements in the implementation and application of these laws and regulations.

Progress on technical compliance

In late 2022, government enacted two key legislative amendments to address the identified problem areas: the General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act (2022) and the Protection of Constitutional Democracy Against Terrorist and Related Activities Amendment Act (2022). These amendments address most of the legislative deficiencies identified.

At its October 2023 plenary, the FATF formally re-rated 15 of the 20 deficiencies as no longer deficient, with 14 recommendations now fully or largely compliant, and one recommendation not applicable. Accordingly, South Africa needs to address five outstanding technical deficiencies in which the country is partially compliant. Government intends to address these by the end of October 2024.

Progress on effectiveness

Following the 2021 mutual evaluation report, South Africa agreed to implement an action plan with the FATF. Government is working closely with the FATF to implement the 22 items in the plan. These include improvements in government's capability to deal with financial crimes, including corruption, and the better use of beneficial ownership, digital and other information to assist investigations, asset recoveries and prosecutions. Once all items are implemented and the improvements are deemed sustainable, the FATF will reconsider the country's grey listing. South Africa provides the FATF with a progress report every four months.

The October 2023 FATF plenary noted that South Africa is making progress, including largely addressing two action plan items. Additional feedback will be received in the February 2024 FATF plenary. Addressing all the remaining actions and demonstrating that improvements are sustainable by February 2025 will require a significant effort from all the relevant South African authorities.

FINANCIAL INNOVATION TO IMPROVE COMPETITION AND INCLUSION

Government is taking steps to promote the adoption of digital payments, which will help to improve the lives and livelihoods of marginalised groups. Collaboration between the public and private sectors will be key to successful implementation.

Crypto asset policy

The Intergovernmental Fintech Working Group published a position paper on regulating crypto assets in June 2021. In 2024, the group will publish additions to include "stablecoins" as a particular type of crypto asset. It will conduct analytical work to understand the applicable use cases of stablecoins and to recommend an appropriate policy and regulatory response. The group will also finalise a diagnostic of the domestic stablecoin landscape and regulatory recommendations in line with relevant international standards and recommendations.

In 2023, the Financial Sector Conduct Authority (FSCA) and the Financial Intelligence Centre (FIC) began registering the service providers of crypto assets. This follows amendments made to the schedules of the FIC Act (2001) in late 2022 in line with FATF recommendations. In November 2023, the FSCA declared crypto assets to be a financial product, thereby requiring providers of financial services relating to crypto assets to be licensed by the FSCA. Licensing requirements include adherence to standards on fitness, propriety and reporting. In 2024, the FIC and FSCA will jointly increase enforcement of unlicensed service providers of crypto assets.

The FIC Act requires accountable institutions to report all cash transactions exceeding R49 999 to the FIC, as this information may be valuable during criminal investigations. The authorities will consider measures to extend this requirement to transactions concluded with crypto assets.

Tokenisation

Tokenisation is the representation of assets such as securities and payment instruments on distributed ledger technology, commonly known as blockchain. The Intergovernmental Fintech Working Group is considering the impact of tokenisation on domestic financial markets. By June 2024, a paper providing an overview of tokenisation will be published. By December 2024, a discussion paper will be published that outlines the policy and regulatory implications of tokenisation and blockchain-based financial market infrastructure.

Supporting small and informal businesses through payments innovation

The National Treasury and the Reserve Bank, in collaboration with Switzerland's State Secretariat for Economic Affairs and FinMark Trust, have developed practical interventions that will contribute to an inclusive payments digitalisation programme. The interventions will be implemented from 2024 to 2027. Partners will include financial service providers involved in specific markets and target a combination of new entrants or smaller providers and larger, more established service providers to ensure scalability. The initiative is made up of four digital payments pilot projects.

Project 1: Community digitalisation

Consumers in townships and rural areas primarily use bank accounts as mailbox accounts, withdrawing all money paid into the account instead of using it as a payments tool, while remaining reliant on cash. This tendency is compounded by small enterprises in these areas that deal almost exclusively in cash. This project will enable local merchants to establish the infrastructure needed for digital payments, such as internet connectivity and point-of-sale devices. The project will be piloted in Gauteng. Once the financial services and digital infrastructure footprint is mapped, interventions will be implemented to promote the use of digital payments and infrastructure. The aim is to increase acceptance and use of digital payments by merchants and consumers.

Project 2: Digitising informal and low-income worker payments

This project aims to digitise tips and other payment transactions for informal and low-income workers. About 2 million employees derive between 20 and 50 per cent of their total earnings from tips, and many others depend on tips to supplement their income. The pilot will test various digital tipping solutions in several sites where low-wage and informal workers are concentrated such as shopping centres, petrol stations and restaurants. This pilot will provide information allowing solutions to be adapted and improved. If successful, digital tipping approaches will be scaled up.

Project 3: Cross-border remittances

This project aims to combat money laundering and the financing of terrorism risks in cross-border remittances. At present, many cross-border traders use high-risk channels to send money across borders because of the high cost of formal transactions. On average, these payments attract a transaction fee of 7.6 per cent of the payment value relative to the G20 target of 3 per cent. The majority of these remittance transactions begin with cash, which has high handling costs for operators transferring the remittances. Digitising the initiation of such transactions is expected to reduce these costs. The pilot will focus on the main corridors for sending remittances to Lesotho, Malawi, Mozambique and Zimbabwe. In addition, the pilot will enable retailers and fintechs in South Africa to provide a digital store of value, such as digital deposit accounts or wallets, for migrants to transfer money digitally across borders. This will reduce the cost of these services and reliance on agents.

Project 4: Cross-border trade

This project aims to formalise access to finance for micro, small and medium-sized enterprises engaged in regional trade, with an initial focus on payments before expanding to include other financial needs. It targets the poor and specifically women, who make up a substantial proportion of cross-border traders in the Southern African Development Community region. It will facilitate low-value cross-border trade payments using existing regional infrastructure for remittance payments, and gather data needed to provide additional financial services. The pilot will encourage the use of new and innovative payments technologies for low-value cross-border trade, guided by the outcome of research on digital payment solutions.

RESPONDING TO CLIMATE RISKS AND WORKING TOWARDS NET ZERO

Economy-wide transition strategies and finance are required for South Africa to reach net zero carbon emissions by 2050. This includes financing support for high-emitting businesses and sectors to adopt cleaner technologies, increase energy efficiency and become greener over time. This transition finance will be met in part through the amounts committed by entities such as the International Partners Group, composed of countries that have endorsed South Africa's Just Energy Transition Investment Plan, such as France, Germany, the United Kingdom and the United States. In addition, regulatory frameworks such as the green finance taxonomy, published in 2023, will help incentivise the private sector to provide financing and prepare industry for climate risks.

A critical part of transition finance is transition planning, which sets out the steps individual firms need to take to ensure they can operate sustainably and in a manner that protects investor and stakeholder interests. In 2024, the National Treasury, working with the Sustainable Finance Initiative (previously the Climate Risk Forum), will publish principles for effective transition planning. These principles will be aligned with emerging international best practice.

RETIREMENT REFORM

Early access to retirement funds

Chapter 4 outlines the upcoming reforms as the two-pot retirement system is implemented. The two-pot retirement system will allow retirement fund members to make withdrawals from their retirement funds while they are still active members, so members need not resign to access part of their retirement benefits. Parliament recommended that early access to retirement funds be set earlier than 2025, as originally suggested. This reform is proposed to come into effect on 1 September 2024. The National Treasury aims to finalise the legislative process rapidly in the next few months to ensure that industry and regulators can prepare for implementation. Policy research and engagement continues on the outstanding auto-enrolment, mandatory enrolment and consolidation retirement reforms.

Unclaimed assets

At the end of 2022, the FSCA published a discussion paper, entitled *A Framework for Unclaimed Financial Assets in South Africa*, with recommendations to address high levels of unclaimed assets – assets for which the owner is unknown or cannot be contacted – in the financial system. The FSCA has considered stakeholder feedback on the discussion paper and will release a comprehensive response in early 2024. This feedback will inform the development of a framework for the identification, monitoring, management and reporting of unclaimed assets, including tracing of beneficial owners.

FINANCIAL INCLUSION AND DEPOSIT INSURANCE

The National Treasury will develop a national strategy on financial inclusion in 2024 based on the policy paper, approved by Cabinet in 2023, entitled *An Inclusive Financial Sector for All*. The strategy's goals will include deepening financial inclusion for individuals; improving access to financial services for small, micro and medium-sized enterprises; and enabling diversification, competition and innovation in financial services.

In March 2023, the Corporation for Deposit Insurance was established to provide a framework to ensure depositors' funds are protected in the event of a bank failure. The establishment of this institution is one of the key amendments contained in the Financial Sector Laws Amendment Act (2021). The remaining provisions, including the provisions to enable the Corporation for Deposit Insurance to begin collecting premiums and other financial contributions, will be effective from 1 April 2024.

MEASURES TO BOOST LONG-TERM INVESTMENT

Capital flows management framework

The 2020 *Budget Review* outlined reforms to modernise the foreign-exchange system to maximise trade and investment benefits in a globalised capital environment and complement the African Continental Free Trade Agreement, to which South Africa is a signatory. The reforms were aligned to the Organisation for Economic Co-operation and Development (OECD) best-practice *Code of Liberalisation of Capital Movements*. The National Treasury, alongside the Reserve Bank, Prudential Authority and the FSCA, will evaluate the impact of these reforms on the prudential, fiscal and monetary policy frameworks. This research is intended to generate adjustments to improve alignment of the frameworks and may affect the pace at which these reforms continue to be implemented.

The following capital flows management reforms are proposed to foster the growth of high-potential and innovative businesses, promote trade and reduce trade-related red tape.

Fostering business growth

Authorised dealers – banks that are authorised to trade in foreign exchange – will be permitted to process requests by certain unlisted companies to establish an offshore company and/or have their primary listing offshore in order to raise foreign loans and capital for their operations up to a limit of R5 billion, in line with the foreign direct investment policy. Provided these companies operate in the fields of technology, media, telecommunications, exploration and other research and development, they will not require prior approval from the Reserve Bank. Investments exceeding R5 billion per company per calendar year require approval from the Reserve Bank's Financial Surveillance Department. The transfer of intellectual property offshore as well as the use of the share-swap mechanism will still require prior approval.

Promoting investment in the region

Authorised dealers will be permitted to allow South African private equity funds that are licensed with the FSCA to invest offshore up to a limit of R5 billion, in line with the foreign direct investment policy, without prior approval. Investments exceeding R5 billion per applicant company per calendar year require approval from the Financial Surveillance Department.

Promoting trade

To support greater trade, authorised dealers will be given greater discretion over certain payment arrangements for customer foreign currency accounts, provided they are satisfied that the relevant transactions are legitimate and have viewed suitable documentary evidence, subject to the relevant reporting to the Financial Surveillance Department.

- Settlement of transactions: Authorised dealers will be permitted to process transactions for customer foreign currency accounts for all current account payments.
- Export proceeds: Local agents of exporters of goods from South Africa will now be able to settle export proceeds due to the local exporters through the customer foreign currency accounts without prior approval from the Financial Surveillance Department.
- Import payments: Authorised dealers may allow resident entities purchasing goods via a local subsidiary of an offshore supplier (that has to import components from abroad) and/or agents to settle only the cost of the imported components in foreign currency through the respective customer foreign currency accounts without prior approval from the Financial Surveillance Department.
- Related party agreements: Authorised dealers will be permitted to process all related party agreements relating to current account payments if applicants provide suitable documentary evidence confirming that the agreements are in accordance with transfer pricing rules contained in section 31 of the Income Tax Act (1962), in line with the OECD Guidelines and subject to normal reporting requirements of the Financial Surveillance Department.