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DISPUTE RESOLUTION **ALERT**

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Financial Intelligence: Will the 2019 FATF Mutual Evaluation reflect the 2018 Basel AML Index?

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In the last two decades countries across the globe have become aware of their obligations to combat money laundering (ML) and terrorist financing (TF).

The Financial Action Task Force, the inter-governmental regulating body, is expected to complete its assessment of South Africa's compliance with international Anti-Money Laundering (AML) standards in the last quarter of this year. This is done by means of a mutual evaluation conducted by representatives from the FATF, the International Monetary Fund (IMF) and the Eastern & Southern Africa Anti-Money Laundering Group (ESAAMLG). Such a mutual evaluation report (MER) will provide an in-depth descriptive analysis of South Africa's system for preventing criminal abuse of the financial system. In preparation for such assessment a workshop was hosted by the Financial Intelligence Centre (FIC) in March to prepare the different private sector institutions in respect of the nature and extent of information required to demonstrate South Africa's compliance with FATF standards. The FIC facilitated the pre-assessment training with assistance from an IMF team.

This mutual evaluation is very important, the process extremely thorough and the scrutiny and analysis intensive, taking fourteen months for completion. The FATF assesses over 40 jurisdictions while the remaining global jurisdictions are assessed by the FATF Regional Bodies in conjunction with the World Bank and IMF. The FATF Plenary considers and adopts only two mutual evaluation reports at each of its three annual Plenary meetings; each assessment cycle therefore comprising eight years.

The question is whether South Africa will be found to be compliant with global AML and CTF standards or whether the chickens of corruption and state capture will come home to roost.

In 2008, the FIC Act has already been amended to proactively align South Africa with the FATF's evolving standard, which explains why the 2009 Mutual Evaluation Report, applying the 2004 FATF AML/CTF Methodology, praised South Africa's financial sector as "highly developed" and observed that "South African authorities have established effective mechanisms to cooperate on operational matters to combat ML and FT" and that the "(FIC), law enforcement agencies, and supervisors are able to provide a wide range of international co-operation to foreign counterparts, and generally do so in a rapid, constructive, and effective manner." It also observed that the FIC "is a well-structured, funded Financial Intelligence Unit (FIU)".

The Report however observed that corruption represents a problem and raised a few cautionary recommendations, namely that keeping of statistics need improvement and "Finally, South Africa should review the effectiveness of its systems for combating money laundering and terrorist financing on a regular basis." The Report clearly recorded that the South African Police statistics show a low rate of money laundering investigations and convictions.

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Financial Intelligence: Will the 2019 FATF Mutual Evaluation reflect the 2018 Basel AML Index?*...continued*

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Throughout the Report effectiveness was an issue of concern. The result of the 2009 MER was that South Africa was deemed "Compliant" for 9 and "Largely Compliant" for 14 of the FATF's 40+9 Recommendations. It was however "Partially Compliant or Non-Compliant" for 2 of the 6 Core Recommendations.

Under a targeted follow-up process, South Africa had to report to the FATF Plenary on the progress made in addressing the deficiencies in the 2009 MER. This sword kept hanging over SA's head until November 2017 when, as a result of the Financial Centre Amendment Act which came into operation in October 2017 and which inter alia addressed deficiencies relating to customer due diligence (CDD) and record keeping, the FATF at its Plenary meeting in November 2017 decided to remove South Africa from its targeted follow-up process. The heat was off, at least for a while.

Meanwhile, in 2013 the FATF adopted a new Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT systems, updated in 2019, a universal standard applicable to all countries. It makes provision for four levels of Technical Compliance:

- Compliant (no shortcomings),
- Largely Compliant (minor shortcomings),
- Partially Compliant (major shortcomings) and
- Non-compliant (major shortcomings).

If a requirement does not apply, due to structural, legal or institutional features of a country, it is rated Not Applicable.

Effectiveness is defined as "The extent to which the defined outcomes are achieved". The methodology to assess effectiveness is fundamentally different to the methodology to assess technical compliance. The assessment relies on the judgment of assessors analysing and evaluating the evidence of effectiveness provided by the assessed country.

Immediate Outcomes are, *inter alia*:

- Effective prosecution and proportionate and dissuasive subsequent sanctions;
- Confiscation of proceeds and instrumentalities of crime;
- Terrorist financing offences prosecuted and followed by effective, proportionate and dissuasive sanctions.

The assessors' conclusions will be descriptive and not a mere statistical exercise. The country's technical compliance will serve as a point of departure but conclusions regarding effectiveness will be based on an overall understanding of the degree to which a country achieves the listed outcomes. The approach will be qualitative, rather than quantitative. Effectiveness ratings will be as follows:

- High level: Immediate outcome achieved to a very large extent though minor improvements may be needed

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- Substantial level: Immediate outcome is achieved to a large extent though moderate improvements needed
- Moderate level: Immediate outcome achieved to some extent though major improvements needed
- Low level: Immediate outcome not achieved (or negligible) and fundamental improvements needed.

It is therefore very clear that South Africa's 2019 MER is going to be a thorough and objective test. Fortunately significant progress has been made to improve the AML/CFT legal and institutional framework since the 2009 MER.

The link between corruption and money laundering has long been recognised by the FATF and, for evaluation of effectiveness becomes a very relevant issue: "Effectively implemented AML/CFT measures create an environment in which it is more difficult for corruption to thrive and go undetected." The FATF Reference Guide and Information Note on Corruption is consistent with the revised FATF Recommendations and already in the third round of Mutual Evaluations the FATF included corruption and bribery as part of the predicate offences when considering the number of investigations, prosecutions and convictions for money laundering and the property confiscated during the process.

The heat is on again and it is clear that the South African Government is very aware of its shortcomings, risk and exposure. In the Media Statement (published in the Government Gazette No 42267 of 28 February 2019) accompanying the invitation for public comments on draft regulations on international financial transactions (s31 of FIC Act) and amendment of regulations on cash transaction reporting and aggregation (sec 28, FIC Act), the National Treasury acknowledges that "Failure to implement an **effective** (our emphasis) Anti-Money Laundering and Combating of the Financing of Terrorism (AML/CFT) system weakens the credibility of the South African financial system, undermines the ability to accelerate economic growth and job creation, and compromises the security of the country and its people". The Treasury refers to South Africa's current Programme of Action (specifically priorities to intensify efforts to combat crime "including corruption") and Government's Medium-Term Strategic Framework Outcomes and indicates that the proposed regulations and amendments "seek to improve the generation of quality financial intelligence information so as to assist investigating and prosecuting authorities, and to increase the chances of securing convictions.

Will South Africa's recent efforts however pass muster? Or is it "too little, too late"? Recent global reports have not provided any comfort.

In September 2018, Transparency International published its annual report on enforcement of the OECD Anti-Bribery Convention, referred to above, and labelled South Africa as a country with "limited enforcement of foreign bribery" – a country where foreign bribery goes

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largely unchecked and whose OECD obligations remain unfulfilled, the same rating accorded in 2015 when the report recorded that safeguards to protect the Central Anti-Corruption Bureau from politicisation were insufficient. The 2012 TI report categorised South Africa as a country with "no enforcement", recording no cases or investigations. In March 2016 the OECD Working Group on Bribery raised concerns about South Africa's lack of enforcement actions and it also noted that few steps have been taken to address concerns that political considerations may influence investigation and prosecution of bribery.

Another globally recognised report, the Corruption Perceptions Index, published annually by Transparency International, gave South Africa a score of 43 in 2017, a score below 50 indicative of a country struggling with corruption issues. In 2016, the score was 45.

The 2018 Basel AML Index could provide some insight for purposes of predictive crystal ball gazing. This index is an independent annual ranking that assesses the ML/TF risk around the world. The FATF MER's feeds into the Basel AML Index: like the FATF, it focuses on AML and CFT plus related factors such as corruption, transparency and the rule of law. It is a research-led composite index based on public sources and third party assessments. Just like the FATF effectiveness plays a very important role with the Basel AML Index. In the latest Basel AML Index of 2018 South Africa is listed as one of the "top 10 decliners" under the list of countries which have significantly worsened their scores. South Africa's score has declined from 4.59 in 2017 to 5.34 in 2018, a negative change in score of 0.75.

South Africa has one of the most efficient and modern financial sectors in the world and a robust economy. Technical compliance should not present a problem, even when considering the country's legislative framework. However, one just needs to consider the evidence presented at the current Commissions of Inquiry to realize that effectiveness is going to be a huge problem when South Africa's legal system is assessed for effectiveness.

If corruption has become the country's biggest obstacle to effective AML/CFT, the FATF will not hesitate in critically pointing out what needs to be done to become compliant.

Willem Janse van Rensburg

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Would an arbitration clause embedded in a fraud-tainted agreement also be invalid in South Africa?

The legal instruments referred to appear to assume that the substantive validity of arbitration agreements may be challenged in certain instances.

Arbitration agreements/clauses in South Africa for domestic or international commercial arbitrations are generally valid and enforceable. However parties are entitled to challenge the validity of an arbitration agreement/clause contained in a commercial transaction. In that regard for international arbitration agreements/clauses, the International Arbitration Act, 2017 which incorporates the UNCITRAL Model Law on International Commercial Arbitration (Model Law) and provisions of the New York Convention, entitles a party against whom an arbitral award was rendered to challenge the enforcement of such an award on, amongst others, the basis that the arbitration agreement is invalid under the law to which the parties have subjected it, or where the parties have not subjected it to any law or that the arbitration agreement is invalid under the law of the country in which the award was made. There are no similar provisions found in the Arbitration Act, 1965 in relation to challenges to the validity of domestic arbitration agreement/clause, however a party would be entitled to approach a court to challenge the binding effect of a domestic arbitration agreement/clause on good cause shown.

The basis for challenging the validity of an arbitration agreement/clause is generally found under the law of contract in South Africa. Thus, the legal grounds for challenging the validity of a commercial agreement (ie such as mistake, fraud, misrepresentation etc.) also find application to arbitration agreements or arbitration clauses that form part of a main agreement. South African courts accept that if an agreement is void from the outset then all of the consequential clauses thereto, including exemption and reference to arbitration clauses, fail with it. This principle was most authoritatively enunciated by the Supreme Court of Appeal in North West Provincial Government & another v Tswaing Consulting & Others 2007 (4) SA 452 (SCA) where Cameron JA, as he then was, said that an arbitration clause "embedded in a fraud-tainted agreement" could not stand.

The judgment by the Supreme Court of Appeal is binding when interpreting the separability of arbitration clauses contained in domestic commercial agreements. However, the judgment is a departure from the internationally accepted principle, that an arbitration clause that is contained in a so-called "fraud-tainted agreement" is deemed to be separable from the main agreement (so-called separability presumption). Stripped to its bare bones, the principle of separability means that:

- the invalidity or rescission of the main agreement does not necessarily entail the validity or rescission of the arbitration agreement.
- The arbitration agreement must be treated as a 'distinct agreement' and can be void or voidable only on grounds which relate directly to the arbitration agreement.

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Would an arbitration clause embedded in a fraud-tainted agreement also be invalid in South Africa?*...continued*

As a consequence, only mistake, fraud, misrepresentation etc. directed at the arbitration agreement to arbitrate will, as a substantive matter, invalidate that arbitration agreement.

The logic here is as follows: the fact that one party may have fraudulently misrepresented the quality of its goods, services, or balance sheet generally does nothing to invalidate the parties' agreed dispute resolution mechanism, ie arbitration. As a consequence, only mistake, fraud, misrepresentation etc. directed at the arbitration agreement to arbitrate will, as a substantive matter, invalidate that arbitration agreement.

With the recent promulgation of the International Arbitration Act, the separability presumption is now part and parcel of South African law, at least insofar as international arbitrations are concerned. S6 of the International Arbitration Act read article 16(1) of the Model Law, provides that the arbitral tribunal may rule on its own jurisdiction, including any objections with respect to the existence or validity of the arbitration agreement. For that purpose, an arbitration clause/ agreement which forms part of a main agreement is deemed to be an agreement independent of the other terms of the main agreement. Thus, the fact that the main agreement is invalid does not entail that the arbitration/clause agreement is also consequentially invalid.

As the International Arbitration Act only applies to international commercial disputes, it is important that harmonisation be achieved of South Africa's arbitration laws, specifically when it deals with underlying fundamental principles, such as the principle of separability of arbitration clauses. There appears to be no basis for our law not to recognise that domestic arbitration clauses that form part of a so-called fraud-taunted main agreement survive such a challenge in order to allow an appointed arbitrator to decide whether such main agreement was in fact the product of fraud. South African courts will need to take the lead to ensure that the position enunciated in Tswaing Consulting is corrected, until such time as we wait for a new domestic arbitration Act to harmonise the basic fundamental legal principles of domestic and international arbitration in South Africa.

Jackwell Feris and Vincent Manko

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR

Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 BBBEE verification under the new BBBEE Codes of Good Practice. Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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