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Grey list: What are the implications for SA going forward?

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South Africa's grey listing by the Financial Action Task Force (FATF) has significant implications for its economic growth and global competitiveness, but moves are already being taken to satisfy the FATF.

Image source: Sergey_Nivens – 123RF.com

The main implication of grey listing is that members of the international community are "warned" that conducting business with the impugned country could facilitate terrorism financing and money laundering.

South Africa has taken certain measures to address FATF concerns

1. In April 2022, the Investigating Directorate (ID) was established within the National Prosecuting Authority to prosecute individuals and entities that were involved in state capture. Besides, South Africa submitted several reports to the FATF, prosecuted several money laundering offenders, and utilised extraditions to get fugitive offenders. The National Treasury also moved quickly to enact necessary legislation.

2. On 22 December 2022, the General Laws (Anti-Money Laundering and Combating Terrorism Financing) Amendment Act commenced after being signed by the President. The Act amends five pieces of legislation including the: 1) Companies Act, 2008; 2) Financial Intelligence Centre Act; 3) Financial Sector Regulation Act, 2017; 4) Nonprofit Organisations Act, 1997; and 5) Trust Property Control Act, 1988. For more details on the amendments made to the aforementioned legislation and when the relevant sections in the Act are commencing, see here.

3. On 23 December 2022, the Protection of Constitutional Democracy Against Terrorist and Related Activities Amendment Act commenced after being signed by the President. This Act expands the definition of terrorist activities; provides for crimes related to terrorist training, the joining of terrorist organisations, and the possession and distribution of publications with terrorism-related content.

4. In February 2023, South Africa made a high-level political commitment to work with the FATF and ESAAMLG to strengthen the effectiveness of its AML/CFT regime. Since the adoption of the Mutual Evaluation Report (MER) in June 2021, South Africa has made significant progress on many of the MER’s recommended actions to improve its system, including by developing national AML/CFT policies to address higher risks and newly amending the legal framework for TF and TFS, among others.

Financial crime watchdog adds South Africa, Nigeria to "grey list"
Tassilo Hummel, Alexander Winning and Bhargav Acharya 24 Feb 2023

What are the implications for the country moving forward?

The implications of grey listing for South Africa are two-fold: reputational and economic. South Africa now has a negative reputation in the global economy. It may also be downgraded by credit rating agencies, which would affect the country's ability to borrow on the international capital markets.

Economic consequences of grey listing can be summarized as follows:

1. ***Less capital flows into South Africa:*** According to a report by the International Monetary Fund (IMF), grey listing leads to a significant decrease in capital inflows. For vulnerable countries, this could result in a balance of payments crisis. This is because grey listing entails that all transactions of South African companies and individuals will be seen as high-risk transactions, resulting in complicated compliance and administrative duties, and likely disincentivising investment into and trade with South Africa.

2. ***Economic penalties might be imposed on South Africa:*** FATF member states and other international bodies might impose economic penalties and similar measures against South Africa. International finance flows to and from SA will entail higher compliance obligations and transaction costs.

   Regulators in the US, EU, and the UK might place restrictions on their banks regarding transacting with South African banks. Some international financial institutions have policies that prevent them from doing business with grey listed countries or at least, limit the scope of business that can be conducted. Such restrictions will further impede business and foreign investment.

3. ***Less foreign direct investment (FDI):*** grey listing will discourage FDI in South Africa and reduce capital inflows. It will raise the cost of doing business in South Africa, making foreign investors reluctant to invest in the economy. This is because international counterparts will have to undertake increased due diligence when dealing with South African entities. As transaction costs rise, there is a disincentive to do business with South African firms. South Africa will be viewed as a high-risk jurisdiction for business, so some foreign investors might take out their investments.

4. ***Decrease in South Africa's external reserves:*** if there are lower capital inflows and FDI into South Africa, this could reduce external reserves as there will be less tax revenue.

5. ***Difficulty obtaining financing on the international market:*** given the implications of grey listing, South African companies will find it harder to obtain financing from foreign lenders on the international capital markets, and from multilateral lenders such as the World Bank.

6. ***Decreased competitiveness of South African companies in the global economy:*** South African companies, due to enhanced monitoring, will face more requirements to prove sources of funding, leading to higher transaction costs and delayed execution of transactions. This will ultimately harm the competitiveness of South African companies and South Africa as a whole in the global market.

   Financial institutions that rely heavily on global trade in their treasury departments will be heavily impacted. Trading offshore will come with higher due diligence hoops to jump through and more red tape. Trading revenue is therefore going to decline. The South African insurance industry will particularly be impacted.

7. ***Climate adaptation will be impacted:*** South Africa urgently needs to adapt to climate change, and financing from international partners is needed. At COP 26, the US, EU, UK, France, and Germany pledged to give $8.5bn to South Africa to finance its transition to a lower carbon economy. After grey listing, international finance flows to and from South Africa will be riddled with higher compliance obligations and transaction costs. Even if South Africa does receive the funding, it is likely to need the support of other foreign investors and companies to successfully transition to a lower carbon economy. Grey listing will make it harder for the country to achieve its ESG goals.

What does South Africa need to focus on?

The FATF has identified eight areas that South Africa needs to focus on, which include improving South Africa's risk-based supervision of identified risks. South Africa is also required to improve their investigation and prosecution of serious and complex money laundering and terrorist financing activities. Competent authorities are also required to ensure that they have accurate and up-to-date beneficial ownership information.

Conclusion

It is important to note that, as Mauritius has shown, South Africa can come off the grey list within as little as two years if government and the private sector co-operate to take decisive actions to address the FATF’s concerns. Government is clearly committed to these actions. Finance Minister Enoch Godongwana, in his Budget speech on 22 February, said the outstanding deficiencies would be addressed through regulations and the eight actions summarised above. South Africa has a plan of action, it is now about implementation.