NAMFISA
NAMIBIA FINANCIAL INSTITUTIONS SUPERVISORY AUTHORITY

NaSIA
Namibia Savings & Investment Association

A TYPOLOGY STUDY ON THIRD-PARTY PAYMENTS CONDUCTED BY NAMFISA IN COLLABORATION WITH THE NAMIBIA SAVINGS AND INVESTMENT ASSOCIATION

MAY 2023

TABLE OF CONTENTS

1. DEFINITIONS AND ACRONYMS

AI	Accountable Institution as described under Schedule 1 of FIA.
AML	Anti-Money Laundering.
AUM	Assets Under Management.
Business relationship	An arrangement between a client and an accountable or reporting institution for the purpose of concluding transactions on a regular basis.
CEO	Chief Executive Officer appointed in terms of the Namibia Financial Institutions Supervisory Authority Act, 2001 (Act No. 3 of 2001).
CFT	Combating the Financing of Terrorism.
CIS	Collective Investment Scheme.
Client	A person (Natural or legal) who has entered into a business relationship or a single transaction with an AI. The words “customer” and “investor” have a corresponding meaning.
COVID-19	Corona virus disease 2019 which is an infectious disease caused by the SARS-CoV-2 virus.
CPF	Combating Proliferation Financing.
CDD	Customer Due Diligence

EDD	Enhanced Due Diligence
FIA	Financial Intelligence Act, 2012 (Act No.13 of 2012).
FIC	Financial Intelligence Centre established in terms of the FIA.
LISP	Linked Investment Service Provider
MANCO	Management Company, means a unit trust management company.
ML	Money Laundering.
NAMFISA	Namibia Financial Institutions Supervisory Authority established in terms of the Namibia Financial Institutions Supervisory Authority Act, 2001 (Act No. 3 of 2001).
NaSIA	Namibia Savings and Investment Association
NBFI	Non-Banking Financial Institution
PF	Proliferation Financing.
Single transaction	A transaction other than a transaction concluded in the course of a business relationship.
Transaction	A transaction concluded between a client and an AI in accordance with the type of business carried on by that AI, and includes attempted transactions.
Third-party	A third party is any natural or legal person other than the client.

Third-party payment	Third-party payment is a payment of investment funds by an AI to a natural or legal person other than the client.
TF	Terrorism Financing.
UNSC	United Nations Security Council.

2. EXECUTIVE SUMMARY

2.1 NAMFISA in collaboration with the Namibia Savings and Investments Association (NaSIA) conducted a study to understand the trends and typologies of third-party payments in the securities sector and the magnitude of ML/TF/PF risks emerging from third-party payments.

2.2 The collaboration between NAMFISA and NaSIA in this study is anchored on NAMFISA's overarching strategic theme "customer and stakeholder engagement" to maintain a purposeful relationship with customers and stakeholders while executing its supervisory mandate to ensure prudent delivery of financial services and effective mitigation of ML/TF/PF risks.

2.3 NaSIA volunteered to jointly conduct a typology study with NAMFISA on the ground that its members are the custodians of the bulk of the assets under management in the Non-banking Financial Institutions (NBFIs) sector, accounting for more than 71% of the market share as of 31 December 2021.

2.4 NaSIA's members are Asset Managers, Collective Investment Scheme (CIS), management companies, Linked Investment Service Providers (LISPs) and long-term insurance companies. Some of the members are affected by the subject of the study and deemed it necessary to contribute to the study.

2.5 The study follows a Directive on third-party payments issued by NAMFISA on 05 July 2022 to the securities sector to apply the necessary AML/CFT/CPF measures to mitigate ML/TF/PF risks associated with third-party payments[1].

[1] https://www.namfisa.com.na/wp-content/uploads/2022/07/Directive-on-Third-Party-Payments_20220705_1700.pdf

2.6 The study uncovered cases illustrating a continuation of the practice of third-party payments, posing eminent threats of ML/TF/PF and possible abuse of the securities sector for ML/TF/PF activities.

3. INTRODUCTION

3.1 Third-party payment involves payment of redeemed investments to parties other than investors of such investments. In this regard, redeemed investments are paid into third-party bank accounts that are different from investors' initial nominated bank accounts.

3.2 Although a third-party payment offers payment convenience to investors with exigency to settle debts or acquire commodities using their redeemed investments, it also renders the delivery channel susceptible to abuse for ML/TF/PF activities.

3.3 Nominating a bank account by investors at the on-boarding stage has been a common industry practice to mitigate the potential risk of fraud and, ultimately, ML/TF/PF activities. The said practice is characterized by a requirement to nominate bank accounts held in the names of the investors at the on-boarding stage. In other words, the nominated account cannot be an account held in the name of a party other than the investor.

3.4 In this regard, AIs in the securities sector who facilitate third-party payments are exposed to the risk of cyber-attack particularly smurfing. The perpetrators therefore send redemption instructions to unsuspecting AIs, coupled with third-party payment instructions for redeemed investments to be paid into third party bank accounts.

4. PURPOSE AND OBJECTIVE

4.1 This typology study:

4.1.1 outlines the trend of third-party payments in the securities sector and the magnitude of ML/TF/PF risks associated with third-party payments.

4.1.2 purport to promote a common understanding of the risks of ML/TF/PF emerging from third-party payments.

4.1.3 serves as an educational tool for AIs and their employees when processing third-party payments to avert ML/TF/PF risks.

5. LIMITATION

This typology study is limited to the case studies developed by NAMFISA as a result of complaints lodged with NAMFISA by investors who fell prey to fraudsters, as well as data and case studies availed by NaSIA.

6. THE TREND

6.1 The manifestation of third-party payment in some segments of the securities sector involves payment of redeemed investments into third parties' bank accounts by AIs at the instructions of investors. These bank accounts are –

6.1.1 different from investors' bank accounts that were nominated at the on-boarding stage; and

6.1.2 held in the names of third parties to whom redeemed investments should be paid as per instructions by investors.

6.2 This trend brought a paradigm shift from the conventional investment method where investors receive their redeemed investments directly from the AIs into their own bank accounts. The face-to-face contact is also fading away due to the introduction of, and increased reliance and preference for non-face-to-face platforms.

6.3 Today, in most instances, online platforms are being used when investors (clients) are on-boarded and they are also used as means of communication between investors and AIs in the course of business relationships.

6.4 At on-boarding, investors use online platforms to open accounts with AIs. Similarly, investors use the same platform to channel redemption instructions to AIs, including instructions for redeemed investments to be paid to third-party bank accounts.

6.5 A prospective investor can obtain an investment application form from the website of the AI and complete such application form. After completing such application form, the prospective investor may submit his/her or its application online. The prospective investor can also transfer the initial investment amount or deposit cash into the bank account of the AI. This process is entirely non-face-to-face.

6.6 Disinvestments/redemptions can be made swiftly depending on the nature of investment, this can be within 48 hours for products with high liquidity features. The following are the common grounds for investors to request AIs to pay redeemed investments into third-party bank accounts:

6.6.1 Debt settlement; and

6.6.2 Payment of commodities.

6.7 Under rare circumstances, third-party payments may also include redemptions that occur in the form of transfer of funds between different client investment accounts such as, but not limited to:

6.7.1 Where an investor manages two or more separate investment accounts and makes transfers between such accounts, for example, an individual investment account and a Family Trust or Close Corporation investment account;

6.7.2 Where transfers occur between investment accounts of spouses or related persons, for example as gifts;

6.7.3 Where parents manage their children's investment accounts and make transfers to/from their children's investment accounts; and

6.7.4 Where groups of companies make intercompany transfers between subsidiaries or related parties' investment accounts.

6.8 According to data collected by NaSIA, most of its members indicated that no third-party payments are allowed, with investment managers and long-term insurers both recording zero transactions on third-party payments for the 5-year period (1st January 2017- 31st December 2021). Third-party payment transactions were therefore only detected among LISPs and Unit Trusts, which accounted for about 0,005% of the total number of outgoing payments made in the 5-year period.

6.9 However, there were exceptional cases where third party payments were allowed. These cases related to:

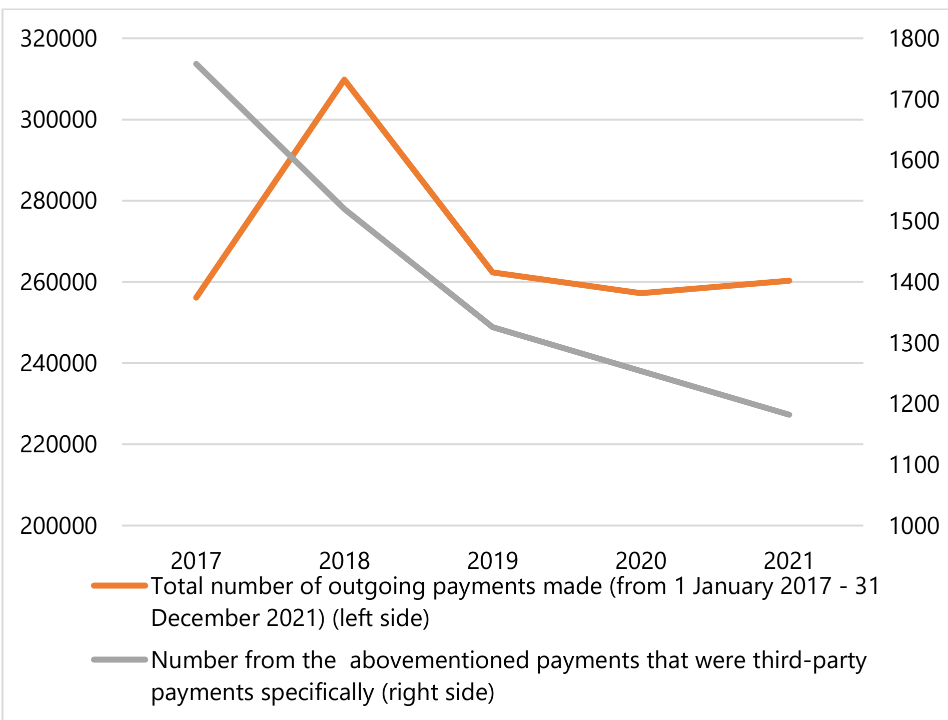
6.9.1 withdrawals made from unit trust portfolios when clients transferred their funds from the unit trust to another unit trust fund;

6.9.2 when clients ceded their unit trusts investments to an external party and their units were transferred to the cessionary; and

6.9.3 when clients transferred their funds from one class of a unit trust to a different class (switches) as well as transactions from a minor's account into the account of a parent.

Scenario: *Client A withdraws her funds from her account and transfers it to another asset manager/ external party. Client D cedes his unit trust account to a third-party cessionary. A transfer of Client D's units is made to the cessionary. Client B withdraws funds from Class C to Class D of the same portfolio. Client B withdraws funds from the account of her 5-year-old son into her account.*

Figure 1: Outgoing payments and third-party payments by NaSIA members

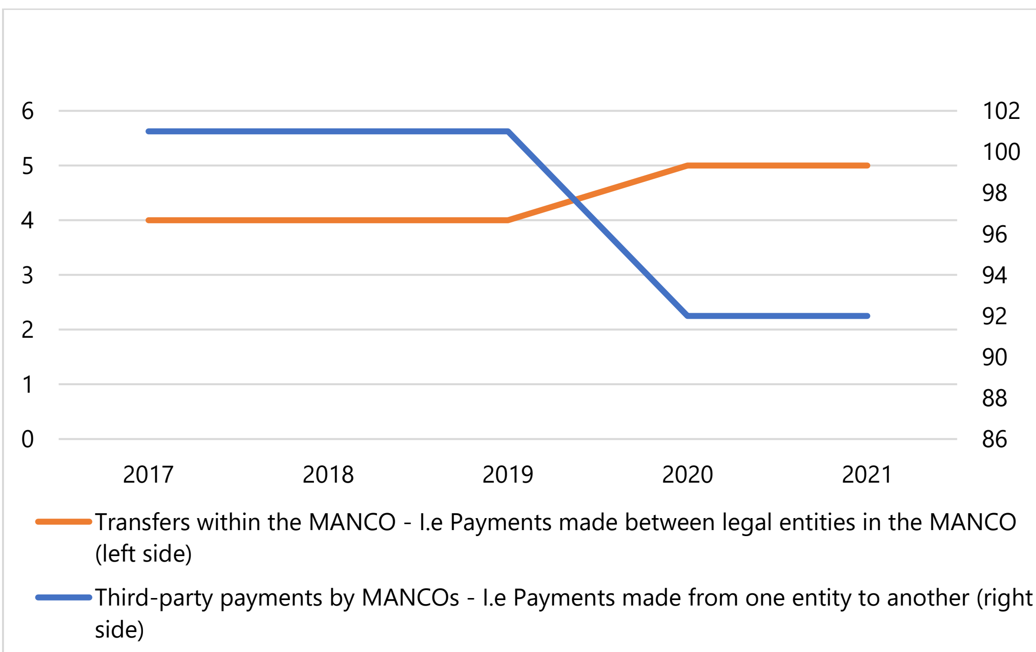


Source: NaSIA

6.10 The chart above shows that there was a sharp decrease in outbound third-party payments from 2017 to 2019 and started to stable towards 2021. The decrease towards 2021, as indicated by NaSIA was due to the discontinuation of third-party indemnity forms which were previously used to process third-party payment instructions.

6.11 During the 5-year period reviewed, LISPs and Unit Trust Management Companies (MANCOs) are the only industries that made third-party payments. The figure below shows that there were 4 to 5 of these transactions that occurred annually between 1st January 2017 and 31st December 2021.

Figure 2: Transfers between accounts within MANCOs and other third-party payments by MANCOs



Source: NaSIA

6.12 Despite the downward trend observed in the number of third-party payments in the securities sector, it is important to highlight that there are still cases that illustrate the manifestation of ML/TF/PF risks or indicate vulnerabilities and threats of ML/TF/PF as expounded under paragraphs 8 and 9 of this typology study.

7 MANIFESTATION OF ML/TF/PF RISKS

7.1 The eminence of the threat of cyber-attack is emphasized in the World Economic Forum Global risks report of 2022[2], citing the surging of cybercrime since the outbreak of the COVID-19 pandemic. Similarly, the FIC has issued various forewarning reports alerting the public of various scams after observing a worrying increase in scams linked to money transfers, change of bank details and other related scams. The FIC's efforts were necessary to help contribute to efforts geared towards combatting such activities.[3].

7.2 In terms of the NAMFISA 2021 ML/TF/PF Sectoral Risk Assessment, the following factors were found to be heightening the ML/TF/PF risks in the securities sector:

7.2.1 The non-face-to-face on-boarding of clients (investors) due to the use of online platforms renders identification and verification of clients' information difficult, thus heightening the potential risks of ML/TF/PF.

7.2.2 Account servicing, including investment instructions, may be given via non-face-to-face mediums such as emails, which render the distribution channel vulnerable to abuse for ML/TF/PF activities.

7.2.3 ML/TF/PF risks increase significantly if the investor holds or designates a foreign bank account or demands that disinvestments be

[2] https://www.weforum.org/reports/global-risks-report-2022
[3] https://www.fic.na/index.php?page=forewarning-reports

paid to a designated foreign bank account in a high-risk or non-cooperative jurisdiction.

7.2.4 Entities/individuals involved directly or indirectly in proliferation activities may, upon redemption of investments, instruct AIs that redeemed investments be paid into third-party bank accounts.

All these are indicators of possible emergence of ML/TF/PF risks from third-party payments.

8 TYPOLOGIES/CASE STUDIES

8.1 Type 1 (Case # 1)

ABC Trust was onboarded and invested funds with XYZ stockbroker. ABC Trust usually receives investment statements and sends withdrawal instructions via email. During 2020, two separate email instructions for the withdrawal of X-amounts from a money market account were received by XYZ stockbroker. According to XYZ stockbroker, the email instructions were received from ABC Trust's email address as recorded on the client's CDD file. XYZ stockbroker also indicated that the necessary verification (confirmation of email address) was done.

The email instructions specified that the withdrawal or disinvested funds are to be paid into a third-party's bank account (a bank account other than the one nominated/designated by the client at onboarding stage) which is a foreign bank account held with a South African Bank. After receipt of the email instructions, XYZ stockbroker responded via the same channel requesting ABC Trust to complete a third-party payment instruction form after which payment can be processed as requested. No further verification was performed on the assumption that the email instructions and subsequent correspondence originated from the confirmed email address (the email address of the client – ABC Trust).

Several months later, ABC Trust attempted to effect a withdrawal from its money market account but, surprisingly, was informed by XYZ stockbroker that the investment balance is not sufficient to honor the request for the withdrawal of such an amount. ABC Trust challenged the feedback received from XYZ stockbroker and raised the matter with NAMFISA. Consequently, XYZ stockbroker initiated its own investigation into the matter and furnished ABC Trust with an account statement reflecting the withdrawals in question, and evidence of such withdrawal instructions.

Following completion of the investigation, it became apparent that this was a scam and the funds were not recoverable. ABC Trust suspected that its own email account (which is recorded on its client file with XYZ stockbroker and through which all withdrawal instructions and investment related correspondences are sent) may have possibly been compromised or hacked and hackers may have used the opportunity to withdraw funds from the said money market account. ABC Trust upon scrutiny of the supporting documents used in this scam noted negligence on the side of XYZ stockbroker because had XYZ stockbroker conducted appropriate verification prior to honoring withdrawal instructions the financial loss would have been avoided. Further, XYZ stockbroker ought to have detected that the documents used to process the third-party withdrawal instruction did not look authentic.

ABC Trust lodged a formal complaint with NAMFISA through the NAMFISA Complaints Department for recourse. NAMFISA, after considering the merits of the complaint instructed XYZ stockbroker to refund ABC Trust for the financial loss suffered.

8.2 Type 2 (Case # 2)

Mr. X opened a money market account with WXY Wealth Management. As part of the CDD process, Mr. X disclosed that his occupation is a legal practitioner and that funds invested are derived (source) from his law firm/practice. In a period of 2 years, Mr. X deposited more than N$ 73 million into his money market account through numerous or frequent high value deposits which were not in line or consistent with the expected financial profile of such a client. Therefore, the transactions appeared suspicious. Despite the apparent suspicious behavior and transactions, CDD and EDD measures applied by WXY Wealth Management failed to detect any suspicious behavior or transactions by Mr. X.

Mr. X also frequently made withdrawals or disinvestments by sending written instructions to WXY Wealth Management to process third-party payments (payments into a bank account other than the one nominated/designated by Mr. X at onboarding stage).

A year later, Mr. X was implicated in a multimillion-dollar corruption case in which Mr. X is alleged to have abused his law firm and is considered to have abused the third-party payment service to move proceeds of unlawful activities (i.e. corruption) to intended destinations under the disguise of debt settlement.

8.3 Type 3 (Case # 3)

Two NaSIA member institutions indicated that the majority of third-party payments happen when a payment is made from a minor's investment account into a parent/guardian's transactional bank account. This happens because a minor would generally not have a transactional bank account.

8.4 Type 4 (Case # 4)

A beneficial owner requested a unit trust management company (a NaSIA member) through an intermediary, to redeem units and that payment should be made to their LISP instead of the customer's (company) bank account. The request was for the funds to be split and invested in the LISP in the names of the two shareholders of the company. The unit trust management company assessed the request. Thereafter the general rule was applied which requires that the unit trust management company only pays the redemption to the customer's bank account.

8.5 Type 5 (Case # 5)

A NaSIA member institution indicated that a third-party payment was processed. In this case, a transfer from a discretionary trust's investment account was processed to a bank account in the name of one of the trustees.

This was done due to the absence of a transactional bank account in the name of the trust. This transfer was approved by all the trustees.

8.6 Type 6 (Case # 6)

Some NaSIA member institutions indicated that some third-party payments they processed related to administration of deceased estates.

This included processing payments from estate late accounts into testamentary / discretionary trust accounts created and payments actioned in terms of a last will and testament.

Other payments related to payment to third-parties as a result of a cession agreement.

9 CONCLUSION

This typology study serves as an educational tool to AIs in the securities sector to promote the understanding of the types of third-party payments and the associated risks of ML/TF/PF to enable AIs in the securities sector to guard against ML/TF/PF risks associated with third-party payments.

pp	31 May 2023		14 June 2023
KENNETH S. MATOMOLA	DATE	JASON HAILONGA	DATE
CEO: NAMFISA		CEO: NASIA	

HOW TO CONTACT NAMFISA:

The CEO
NAMFISA
P.O. Box 21250
51-55 Werner List Street,
Gutenberg Plaza,
Windhoek,
Republic of Namibia

Tel: +264 (61) 290 5000
Fax: +264 (61) 290 5194
amlinspections@namfisa.com.na
or info@namfisa.com.na.

HOW TO CONTACT NASIA:

The CEO
NASIA
P.O. Box 253, Windhoek
6 Feld Street,
Bonsec Heights,
Windhoek,
Republic of Namibia

Tel: +264 (61) 250 315
info@nasia.org.na