

MONEY LAUNDERING AND COUNTERMEASURES:
A COMPARATIVE SECURITY ANALYSIS OF SELECTED
CASE STUDIES WITH SPECIFIC REFERENCE TO
SOUTH AFRICA

by

MAIENDRA SADANANDAN MOODLEY

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Study Leader: Professor M. Hough

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CHAPTER 1. INTRODUCTION

1. IDENTIFICATION OF THE RESEARCH THEME

Common to most criminal and terrorist activities is the need to disguise the source and the utilisation of funds that are obtained in the course of these illicit activities. The disguising of these funds is referred to as money laundering. According to the International Compliance Association (2002), money laundering consists of three phases, namely placement, layering and integration. Placement is the initial entry point of the funds into the economy. Layering refers to the process through which attempts are made to obscure the source of the funds. Integration is the final stage in which the “cleaned” funds are returned to the formal legitimate economy.

Previous efforts to control money laundering have been aimed at curbing the trafficking in narcotics, which has been seen to be intrinsically linked to the fuelling of criminal activities. By confiscating the proceeds of criminal activities, legislators were able to target any profit that criminals derived from their activities. With the war on terrorism, legislators have attempted to target the funding of terrorism in a bid to identify both the financiers and to prevent the funding of future attacks.

Legislators, both locally and globally, have realised that tracking terrorist activities may be easier if the issue of the need to be able to gain access to funding can be controlled and curtailed. These attempts have been complicated by a plethora of underground and alternate banking options that have historically been used by a number of communities, notably the Indian Hawala system and Chinese Chit.

Tracing the source of money laundering may have an impact on intelligence operations in countries that subscribe to the FATF (Financial Action Task Force) guidelines. The FATF was established in 1989, by the Group of Seven (G7/8) industrial countries, and is responsible for spearheading the development of money laundering countermeasures. The renewed focus on money laundering inherently makes it more difficult for the funding of these intelligence operations, given the need to often maintain plausible deniability. This introduces an interesting paradox: Countries have to cooperate to prevent money laundering, but cooperation may undermine their own intelligence efforts. This may potentially result in an effective stalemate as countries limit their cooperation on money laundering unless the benefits or consequences are in

their own mutual self interests despite a public commitment to counter money laundering.

The security implications of money laundering illustrate how the symbiotic nature of the relationship that was once exclusively related to the trafficking in narcotics has been transformed into the funding of terrorism to the promoting of corruption. Sourcing funds has become essential to providing terrorists with a way to pay for the necessary means to pursue their goals with money laundering acting as the mechanism to shield these funds from confiscation and the sources from prosecution as accomplices. In terms of corruption, high profiles cases relating to both narcotics and criminal syndicates have included the Cali cocaine cartel that were alleged to have engaged in laundering funding to political candidates during the 1996 Colombian elections.

2. STUDY OBJECTIVES

This research examined the security implications of money laundering threats and responses drawing on the international experiences, but with specific reference to South Africa. The purpose of this study was to establish how South Africa compares with the international community and to see how effective the current approach to addressing these threats in South Africa has been. The differences between the threats and countermeasures associated with money laundering in theory, and how these threats have materialised based on reported cases, have been identified.

The main objective of this research was to establish the extent of money laundering in South Africa, and whether or not South Africa has from 1994 up until the end of 2006 been able to effectively implement money laundering countermeasures when compared to other selected case studies. These case studies were limited to the joint collective efforts of the G7/8 countries.

The secondary objectives were to:

- a) Identify what improvements could be made to the current countermeasures that South Africa had adopted;
- b) identify how the failure in money laundering countermeasures in neighbouring states has affected South Africa; and
- c) analyse the security implications of money laundering.

3. LITERATURE OVERVIEW

Research in the financial sector and position papers by organisations such as the FATF have suggested that money laundering threats can be mitigated against. However, much of the research and strategic approaches to reducing the threats of money laundering have avoided looking at the underground/ alternate banking stream and online means to achieve this.

In the South African context, limited research has been conducted on the extent and effects of money laundering. Shevel (2002) estimated that the extent of money laundering in South Africa was between R 70 billion and R 80 billion a year. Mdluli-Sedibe (1999) and Goredma (2002 : 8-37) observed that the funds that are laundered in South Africa were mainly the proceeds of crimes and included both non-violent crime (such as smuggling and trafficking) as well as violent crimes such as robbery and hijacking. Methods of money laundering used, according to de Koker (2002 : 14-23), included the use of illegal casinos and the informal sector.

Despite these studies, and the contributions that this had made to the understanding of money laundering in South Africa, certain questions still remained. These related to a lack of research into how South Africa could leverage the experiences of the G7/8 countries to improve its own money laundering regime. Answers also needed to be sought on how money laundering in neighbouring states affected South Africa. This is important as the effectiveness of South Africa's implementation of the FATF principles may be compromised by potential shortcomings in the money laundering countermeasures in neighbouring states.

4. RESEARCH PROBLEM

In reviewing the threats and experiences of both South Africa and the G7/8 countries, this study sought to incorporate a holistic approach that included the threats from the underground and/ or alternate banking systems. These are unregulated and informal banking channels that are susceptible to abuse from money launderers who are likely to use these alternatives to transfer funds as a way of avoiding being exposed through the more stringent money laundering countermeasures that have been adopted in the formal banking sector. This included an examination of the placement, layering and integration phases. The review of the countermeasures examined a broad scope of measures relating to the application of the FATF

principles and an overview of the resultant initiatives that had been implemented by South Africa and the G7/8 countries to comply with this. This study was therefore limited to addressing the money laundering threats from a broad based perspective including the underground/ alternate banking streams and online means in the G7/8 countries and South Africa.

The need to conduct this research was justified by a wide range of factors. As attempts to address money laundering have gained momentum, it has become more apparent that any effort that is not globally synchronised and coordinated would become susceptible to manipulation. Criminals could (and most likely would) shift the scope of their money laundering activities to jurisdictions that were less policed. Similarly, there was a need to understand whether or not the underground and secondary banking systems could be used to commit and perpetuate money laundering.

This research sought to answer the following questions:

- a) What is the extent of, and what are the security implications of money laundering in South Africa ?
- b) Did the money laundering countermeasures in South Africa that were implemented from 1994 up to the end of 2006, effectively address the associated threats ?
- c) How could South Africa implement better money laundering controls when compared to the G7/8 countries?
- d) What factors influenced money laundering in South Africa, and how do these compare to the G7/8 countries?

A response to this required an integrated analysis of the threats, as well as an identification and assessment of the current money laundering countermeasures, and a subsequent gap analysis. This research also attempted to establish whether this was indicative of failures in the countermeasures or due to the poor implementation of these measures. Through identifying the gaps between the measures and their practical application, recommendations have been suggested that would address these shortcomings.

In this study, the core argument that was presented was that South Africa has made considerable inroads into addressing money laundering in the formal banking sector but that there are considerable opportunities for improvement.

This study was based on the following assumptions, namely:

- a) There are still shortcomings in the practical application of money laundering countermeasures in South Africa, despite these countermeasures being based on the legislative measures adopted by the G7/8 countries; and
- b) money laundering promotes crime and corruption in South Africa.

5. METHODOLOGY

The study uses description, analysis and comparison regarding the money laundering countermeasures in South Africa and the G7/8 countries. The research was based on the use of intergovernmental, governmental and secondary sources.

Description is used to indicate the money laundering threats and countermeasures in the global environment, with specific reference to South Africa. The official South African response, as deduced from legislation and other sources (such as speeches) is used to examine how money laundering countermeasures are addressed in South Africa. Subsequently, through the use of comparative analysis, the differences between the global best practices and the South African response, allowed opportunities for improvement to be identified.

As far as the theoretical framework was concerned, the concept of money laundering and its various manifestations served as a basis for subsequent chapters. The case studies, namely South Africa and the G7/8 countries, were chosen to allow the money laundering countermeasures that were adopted by South Africa to be compared to the best practices established by the G7/8 countries.

6. STRUCTURE OF THE STUDY

The following chapter divisions were used in the study:

Chapter 1. Introduction

The Introduction set out the basis upon which this research was conducted. This covered the background to this study, the objectives, problem statement, the research methodology and an overview of the structure of the research.

Chapter 2. Money laundering: A Conceptual Framework

This chapter provided the conceptual framework that was used to conduct this research. In this chapter, key concepts such as defining money laundering, and understanding the process, were covered. The chapter also focused on identifying the centres for money laundering, outlined the extent of the problem, discussed money laundering and underground banking, and the security threats and effects of money laundering.

Chapter 3. Money laundering as a global security issue with specific to the G7/8

An overview of money laundering as a global problem was briefly undertaken, by considering the wider initiatives launched by the United Nations (UN) and European Union (EU). Against this background, this analysis subsequently examined money laundering in the G7/8 countries and the countermeasures that have been adopted.

The purpose of this chapter was to explore and contextualise the issues surrounding money laundering in the countries that were considered to be at the leading edge in terms of implementing effective countermeasures. The chapter also served as a point of reference in terms of the subsequent discussions on money laundering in South Africa.

Chapter 4. The extent and security implications of money laundering in South Africa

This chapter focused on the extent of, and concerns regarding, money laundering in South Africa. The chapter examined the security implications that money laundering has for the South African business, political and social landscape. This provided a basis for contextualising the official government/ legislative response to money laundering.

Chapter 5. Money laundering countermeasures in South Africa

This chapter focused on the legislative/ government response by the South African government to money laundering, and concluded by establishing whether or not this response was sufficient to address the threat. It also identified cooperation with other countries to counter money laundering.

Chapter 6. Evaluation

This chapter summarised the key issues in the research, and examined whether or not the assumptions that the research was based on, can be validated. It provided some recommendations and reforms that should be considered to improve the current money laundering countermeasures that have been implemented in South Africa.

CHAPTER 2. MONEY LAUNDERING: A CONCEPTUAL FRAMEWORK

1. INTRODUCTION

In this chapter, money laundering will be examined from a conceptual perspective. This will include an identification of the centres for money laundering, the extent of the money laundering problem, the relationship between money laundering and underground banking, and the security threats and effects of money laundering.

2. THE CONCEPT OF MONEY LAUNDERING

Money laundering is both a means of concealing the proceeds of crime and to fund terrorist activity. This presents legislators and law enforcement officials with a diverse challenge that ranges from the establishing of a link between criminal activity and the proceeds derived from this activity, to having to trace the source of funds in order to identify the sponsors of terrorism. In the absence of being able to successfully achieve this objective, the masterminds behind either criminal activity or terrorism are unlikely to be easily identified and captured.

2.1 DEFINITIONS OF MONEY LAUNDERING

Money that cannot be associated with criminal activity can be freely spent without any fear of incriminating the spender or the recipient as being party to any criminal misdeeds. With the possible exception of relatively small crimes where criminals steal for sustenance or instances in which collectors of rarities purchase stolen antiquities for their own private collections, it remains inherent in any criminal undertaking that the proceeds of the criminal activity will have to be carefully disguised. The process of meticulously applying this disguise provides the basis of money laundering.

The International Monetary Fund (IMF) (2001 : 7-8) defined money laundering as being the “transferring (of) illegally obtained money or investments through an outside party to conceal the true source”. In South Africa, the Public Accountants and Auditors Board (2003 : 7-8), suggested

that money laundering is more broadly defined in local legislation as being “virtually every act or transaction that involves the proceeds of crimes, including the spending of funds that were obtained illegally”. The Asian Development Bank (2003 : 272) takes a similar viewpoint and endorses the South African approach. This implies that the definition of involvement in money laundering can be extended to include participation in suspicious transactions, to the failure to implement money laundering countermeasures.

The variations that do exist in the definitions or interpretations of money laundering, pertain not to the actual meaning of the term “money laundering” itself, but rather what transactions would be considered to be indicative of money laundering. In practice, this is normally defined as stipulated in the relevant legislation which varies across different jurisdictions. For example, Morris-Cotterill (2001) mentions the Bahamas or the Cayman Islands, that are “usually cited as money laundering havens” because of their “tax regimes that are structured differently.” This implies that money laundering becomes easier, when poorly structured legislation creates loopholes that can be exploited by criminal syndicates and sponsors of terrorism to disguise the sources of funding these illegal activities.

2.2 THE PROCESS OF MONEY LAUNDERING

The International Compliance Association (2002) described the process of money laundering in term of the following unique stages:

- Placement;
- layering; and
- re-integration

Placement, according to Lyman (1999), is the initial stage in the money laundering cycle in which the funds obtained from illegal activities are introduced into the legitimate financial market. Temple (2002) outlined some of the more common ways in which placement could be achieved, such as exchanging currency for smaller denominations that will make it easier to utilise, transport or conceal to methods involving the use of multiple deposits entailing small amounts in different bank accounts. Nixon (2000) refers to the practice of utilising multiple deposits being placed in many accounts by different individuals as “smurfing”. Moulette (1995) identified other strategies such as use of representative offices of foreign banks, international

“houses” or “sub accounts” that may be maintained by banks on behalf of their clients for the funnelling of funds through casino’s or unregulated Asian games such as Pai-Gow.

According to Banerjee (2003), layering serves to hide the source and ownership of the funds. Methods used to achieve layering, that were suggested by Moulette (2000), include the use of offset accounts by dealers, online electronic fund transfers between certain tax havens, and suspicious gold transactions in which “large purchases of gold (are undertaken) in countries with low VAT rates and then (there is an) exporting (of) the bullion back to the country of origin”.

Suter (2003) pointed out that there are other methods that can be adopted to allow, layering to take place that involve the over-invoicing and false invoicing of imports and exports. Krushelnycky (2000) sketched a more complex scenario. In this scenario, a “shell” company or bank would be established in a tax haven. These types of companies are also commonly known as either a “suitcase bank” or a “brass plate bank” because they do not have any employees and exist only as a post office box or nameplate on a building. An account is then opened at a legitimate financial centre such as London or New York. This type of account is referred to as a correspondent account. Money can then be transferred to and from this account to a front company, and then lent to the money launderer. This creates the impression that the money that has been lent out was sourced from a legitimate foreign loan.

The final stage in laundering money, according to Myers (1998 : 1-12), involves Integration. Integration, according to the Irish Bankers Federation (2003 : 1-2), involves re-introducing and integrating the property or money that was laundered into the legitimate financial system. Schroeder (2001 : 3) pointed out that the techniques adopted to successfully integrate funds from a criminal enterprise would very often be similar to that of practices adopted by legitimate business. This would make it more difficult to isolate a *modus operandi* that was unique to money laundering.

For example, Wells (2003) illustrates how Antar who was the founder of a large retail chain of electronic stores in the United State had used “integration” techniques to mix the laundered funds with legitimate sales, so that this could be “disguised as legitimate income.” This practice, according to Savona (1998 : 5) is referred to as “commingling”. Antar’s use of a wide range of money laundering schemes was motivated by a desire to cover up declining revenues and inflate sales in a bid to try and maintain the share prices. Other money laundering methods that were

adopted included depositing money in Israeli banks, and wiring this to banks in Panama. Using fictitious identities, payments were then made back to the stores owned by the Antars.

From an historical perspective, there was nothing new in any of these money laundering techniques. The commingling technique that was used by Antar was similar to the approach used by Mayer Lansky in the United States in 1932 except that the bank was based in Switzerland and the illegal proceeds were sourced from the operating of gambling machines. (Shehu, 2000 : 5).

2.3 THE EXTENT OF, AND CENTRES FOR MONEY LAUNDERING

Money laundering is a global phenomenon, with no country unscathed. Certain countries have gained a dubious reputation for having poor legislation which hampers attempts to mitigate against money laundering. To effectively combat money laundering, global initiatives have focused on a combination of different strategies ranging from enforcing financial sanctions to naming countries with a poor track of implementing money laundering countermeasures.

2.3.1 EXTENT OF MONEY LAUNDERING

PricewaterhouseCoopers (2002) cite an estimate that money laundering globally is estimated to be in the region of six thousand billion US Dollars a year, while the amount seized by law enforcement is around two percent. The two percent seized or estimated to be seized, is based on the “two percent rule” according to Castle (1999 : 11-12), which was proposed by the IMF for estimating the extent of money laundering.

However, the different definitions of what specific offences would constitute money laundering as opposed to prudently arranging ones’ affairs, makes it difficult to gain an accurate estimate of money laundering. A successful money laundering scheme may mimic the practice of legitimate business and this further compounds the difficulty of establishing a reasonable estimate.

The US Department of Treasury (2002 : 1) discusses how during 2001, they had seized criminal assets valued at over a billion US Dollars and were able to attribute at least three hundred million US Dollars of the funds seized, to money laundering. Notwithstanding the effectiveness of the US law enforcement agencies, the amount seized would imply that if the “two percent rule” were applied, the estimated value of money laundering in the United States for 2001, would be

USD 15 billion. To put this into perspective, the United States House of Representatives approved this same amount to be spent over a five period to address HIV/AIDS in fourteen African and Caribbean nations (Lobe, 2003).

2.3.2 CENTRES OF MONEY LAUNDERING

Membership of the FATF (2003a) extends beyond the G7/8 countries and incorporates thirty-three countries including South Africa, which results in it having considerable support. The FATF (2000 : 1-13) aims at curbing money laundering by blacklisting countries that do not comply with international standards. These countries are referred to as non-cooperative countries and territories (NCCTs’).

According to the FATF (2003b : 2), there were nine countries that were listed as NCCTs in 2003. These were the Cook Islands, Egypt, Guatemala, Indonesia, Myanmar, Nauru, Nigeria, Philippines and the Ukraine. By 2006, the FATF (2006 : 5) reported that only Myanmar still remained on this list. The reason why there are so few NCCTs’ was due to the ‘scramble for respectability’, according to James and Peel (2001). Peel (2000) also cited the views of various banks who may not want to transact with clients who are based in NCCTs’, have accounts that are established in NCCTs’ or operate branches in these countries, as they want ensure that their “reputation not be sullied” and would “clearly prefer to be in a location which is not targeted by the FATF or anyone else.” The move towards enforcing these international standards by the various countries may thus be prompted primarily by commercial self-interest as both banks and clients want to preserve their reputations and do not want to be associated with the negative public relations implications of dealing with or operating out of a NCCT.

This view seems to be supported by Ignatius (2000) who observed that the FATF’s policy of “naming and shaming” these countries, exerts financial pressure on them to address any shortcomings. Denny (2001) also supported this viewpoint, by observing that “egregious offenders face financial sanctions from the FATF’s 30 members if they do not amend their laws”. The threat of sanctions and the financial implications thereof combined with reputational loss, may prove to be a strong means of maintaining compliance with money laundering standards amongst both FATF and non FATF members.

Similarly, the focus on addressing money laundering by financial centres could also be attributed to the move to curtail funding to terrorist organisations in the wake of the World Trade Centre

bombing, according to the US House Committee on Financial Services (2003). Fields (2002) expressed the same view and pointed out that this has even influenced the way in which correspondent banking is being undertaken in the US.

2.4 MONEY LAUNDERING AND UNDERGROUND BANKING

A number of alternative remittance systems, according to Carroll (2003) can be tainted with the residue of money laundering or become conduits for laundered money. According to the US Bureau for International Narcotics and Law Enforcement Affairs (2003), this is due to these alternative remittance or underground banking systems functioning through unregulated non-banking channels.

Some of these alternative remittance systems include the Pakistani Hundi, the Indian Hawala systems and the Chinese Chit. While these systems continue to exist and operate as alternatives to the legitimate financial system, they are not always correctly referred to as underground banking. According to Jost and Sandhu (2000), this is because these systems “often operate in the open with complete legitimacy, and these services are often heavily and effectively advertised.” Schodolski (2001) similarly argued that the Hawala system is “thousands of years old” and “is widely and openly used as a legitimate business practice”.

The nature of the Pakistani Hundi and the Indian Hawala systems allows for low transactions costs, and more rapid transfer and availability of funds with often little or no questions asked, which leaves these systems open to exploitation by money launderers. In comparison, an underground banking system such as the Black Market Peso Exchange (BMPE) was conceptually established and operated to thwart financial exchange and reporting controls.

2.4.1 THE PAKISTANI HUNDI AND THE INDIAN HAWALA SYSTEMS

The Pakistani Hundi and the Indian Hawala systems operate in a similar manner to the Chinese Chit, with the variations occurring due to the geographic and cultural practices and the translation value of currency. Unlike the Chinese Chit, the Hawala system is characterised by offering better foreign exchange rates than those available from formal financial institutions (El-Qorchi, 2002). Strictly speaking, according to Mateen (2002), the term “Hundi” refers to the “bill of exchange”, while “Hawala” refers to “trust” or “exchange”. However as the UN Office

on Drugs and Crime (UNODC) (2003) explained, the terms “Hundi” and “Hawala” are often used interchangeably.

Rizvi (2001) found perhaps ironically, that there was strong support for the Hawala system from the Bank of Credit and Commerce International (BCCI) in Pakistan, which was used by Western countries to “channel billion of dollars in covert aid to Afghan rebels fighting Soviet occupation”. Cox (2001) observes that as a result of the secrecy associated with the Hawala system and because these accounts are balanced in Dubai, this system “may foil investigators” who are investigating how laundered money is used to finance terrorist operations. The use of the Hawala system by governments was also noted by the Taipei Times (2001) who pointed out that even the State Bank of Pakistan is alleged to have maintained its foreign reserves by repurchasing currency from persons involved in the Hawala system.

It remains however a contentious issue as to whether or not the whole practice which consists of reconciling the flow of funds from one dealer to another dealer who participates in the Hawala system, is legal or not. Economists such as Wilson (2002 : 1-18) argue that the system and even the method of ensuring that the reconciliation of accounts between dealers can exist legally. However others such as Chatterjee (2002) contend that the practice of reaching a settlement in the Hawala system is based on fraudulently over or under-invoicing goods. The money laundering occurs because the methods used to reconcile accounts between dealers, consist of fraudulent practices involving the over and under-invoicing of goods to facilitate the transfer of funds.

2.4.2 THE CHINESE CHIT

Tucci (1998) explained that the Chinese Chit is a receipt or voucher that is used for “fie chen” or flying money, and that this approach is rooted in “trust, family ties, local social structures, and the threat of ostracism for any breach of good faith.” According to Williams (1997), a depositor would deposit money in exchange for a “chit” or “chop”, which is a seal or token. The money can then be claimed in another country upon presentation of this seal or token. The Chinese Chit operates along the same principles as the Pakistani Hundi and the Indian Hawala systems, and is susceptible to money laundering because the methods used to transfer funds are also similar. The only difference relates to the demographics or ethnicity of the persons who may utilise the Chinese Chit as opposed to the Pakistani Hundi and the Indian Hawala systems.

2.4.3 THE BLACK MARKET PESO EXCHANGE

The Black Market Peso Exchange (BMPE) refers to a money laundering system, which was used by the Colombian drug cartels to launder and exchange pesos in Colombia with US dollars, according to Zill and Bergman (2000). Laundering of proceeds from drugs sales was (previously) achieved through depositing funds in US banks, according to de Granados (2003) and then transferring these funds to Colombia by means of a wire transfer. When the use of this money laundering avenue was curtailed as a result of investigations by the authorities, the drug cartels began to use the BMPE, which consists of informal Peso brokers who exchange pesos for US dollars and *vice versa*. These peso brokers offered better exchange rates and did not ask any questions about the source or the purpose for which the funds were required. (Reason, 2001)

Gordon (1999) explained that the scheme required that the peso brokers pay for any goods using US dollars which were obtained from the proceeds of drug sales. When these goods were sold in Colombia, for pesos, the peso broker would pay over the funds received for these goods to the drug cartels after having taken a share.

2.4.4 MONEY SERVICE BUSINESSES

Guillen (2000) discusses how Money Service Businesses (MSBs) that also provide wire transfer services, could be used to transfer funds into any banking system worldwide. These companies, which operate in certain countries as part of the parallel banking system, also exchange currency and are used by both legitimate businesses and (typically) migrant workers who wish to remit funds to their families.

In South Africa, these services were typically provided by Western Union and are still provided subject to certain conditions set by the South African Post Office. However, as the US National Drug Intelligence Center (2003) points out, money launderers also make use of these services.

The methods of engaging money laundering range from the abuse of legitimate trade channels and money transfer mechanisms to blatant fraudulent transactions involving over and under-invoicing. While the methods may differ, they share a common purpose, namely the promotion of the laundering of money. The effects of money laundering, while significant, can be difficult to identify as other external economic factors may have a similar impact on the economy.

3. THE EFFECTS OF MONEY LAUNDERING

McDowell and Novis (2001) identified the key effects of money laundering as follows:

- Undermining of the legitimate private sector;
- undermining of the integrity of financial markets;
- loss of control of economic policy;
- economic distortion and instability;
- loss of revenue;
- security threats to privatisation efforts;
- reputation risk; and
- social costs.

3.1 UNDERMINING OF THE LEGITIMATE PRIVATE SECTOR

The use of front companies by money launderers undermines the legitimate private sector, according to Quirk (1997 : 7-9) as the motive of money launderers is not necessarily to make a profit out of operations of the front company. As the motive is to launder funds, and increase cash flow, money launderers can easily cross-subsidise the services or products that are being provided through front companies.

3.2 UNDERMINING THE INTEGRITY OF FINANCIAL MARKETS

The Asian Development Bank (2003 : 3-6) examined how money laundering impacts on the establishment and development of financial institutions and found that there is a link between the level of money laundering and the level of “fraudulent activities undertaken by employees”. The subsequent reputational loss by financial institutions may lead to a loss of confidence by consumers in these affected financial institutions who may be perceived to be involved in fraudulent activities. This could also affect the reputation of a country and force investors to invest in economies that are perceived to be less exposed to the risk of money laundering. Money laundering can negatively impact on the integrity of financial markets, and also undermine the reputation of a country.

Money laundering can also impact on the financial sustainability and integrity of the banking system in a country which may have significant security implications. The basis of ensuring sufficient capital adequacy to cover any drawings is premised on the rational behaviour of investors. In money laundering, where a launderer would need to stay ahead of law enforcement officials, it would become harder to predict when such an investor would want to withdraw the investments. A bank would therefore have to maintain a higher degree of liquidity to be able to respond to such a request or risk a financial crisis. Since the cost of money not invested by the bank would need to be recouped as this is the opportunity cost for maintaining a higher degree of liquidity, this may also present additional financial security threats. A notable case, according to Kerry and Brown (1992), where this occurred, involved the collapse of the BCCI in 1998.

Herring (1993 : 76-86) has suggested that although BCCI was involved in money laundering, the cause of its collapse was also due to large-scale fraud. This view may be open to debate since a money launderer would want access to the laundered funds, but not necessarily desire a higher rate of return. This is because the money launderer is more interested in hiding the source of the funds than necessarily receiving a higher rate of return. Money launderers may be willing to accept lower rates of returns, which would allow banks to still be able to accept such funds and to invest these funds in short term investments. However, even if there was fraud involved, it would still imply that the fraudsters had to engage in money laundering to benefit from the proceeds of their criminal activities.

3.3 LOSS OF CONTROL OF ECONOMIC POLICY

The size of the funds being laundered, and the fact that money launderers would want to launder their funds through developing economies to reduce possible detection of their schemes, can affect the inflow and outflow of funds in these countries, according to the IMF (2003). The FATF (1999 : 2-3) observed that the result of these distortions could lead to policy decisions being made that may negatively affect the stability of these economies. Changes in money supply and the exchange rate for a currency may vary significantly depending on whether or not funds are being laundered into or out of a country. Without being able to identify the true causes for these financial transactions, poor economic policy decisions may be made to minimise the potential balance of payments problems due to decreasing foreign reserves.

Similarly if funds are flowing into a country, this may create the illusion that an industry is flourishing, causing government growth projections to be higher. Based on this perception, a government may incur debt or increase its borrowing without being able to repay these debts as the potential tax revenues from these artificially inflated industries, are not sustainable. Thus when money launderers decide to shift these funds out of the country; the affected industries fail to achieve projected growth targets; and the tax collected is therefore lower, the possibility of a country defaulting on its debts increases significantly.

A related challenge is how to differentiate between the behaviour of legitimate currency speculators compared to money launderers since their activities may appear similar and lead to vast cash flows into and out of a country. Depending on what exchange control regime is in place, the impact on economic policy would vary accordingly but this would not necessarily be as a result of money laundering.

While poor policy decisions may occur due to money laundering which led to errors in the interpretation of macroeconomic data, this does not necessarily imply that a simple causal relationship exists between money laundering and poor economic decision making. Money laundering may distort the economic data, but this would also be an argument for better econometric models as opposed to arguing that money laundering leads to a loss of control of economic policy.

3.4 ECONOMIC DISTORTION AND INSTABILITY

Money laundering may also distort capital flows, and thus undermine the effective functioning of the global economy. Castle and Lee (1999) argued that money launderers would not look at where to best invest their money based on economic principles, but rather at where it would be easier to avoid being caught or based on where the cost of avoidance was lower. Taking this view to an extreme, it could be suggested that criminal syndicates could introduce geopolitical and economic instability simply through manipulating the flow of capital from their criminal endeavours particularly if there was a coordinated large-scale transfer of assets across national borders.

In order to protect and obscure the proceeds of crime, money launderers could support cash industries, according to the Organisation for Economic Cooperation and Development (1992 : 2).

Foong (1999 : 12) and Mweetwa (2003) pointed out that this could affect the sustainability of these industries in an economy, as legitimate businesses are forced out since they cannot compete with these front companies. The problem here does not lie in the competition from business funded by money laundering, but rather that the cross-subsidisation creates unfair competition for the legitimate business.

3.5 LOSS OF REVENUE

Money laundering reduces the tax funds available for collection in the economy and by implication government's revenues, according to Kovacevic (2002) and Fundanga (2003 : 2). As a result of this, governments may have to levy higher taxes in order to obtain the funds necessary to fulfil their responsibilities towards their citizens. There are however other viewpoints that are diametrically opposed to this. According to Alldridge (2002 : 279-319), money laundering may also be viewed as a way to allow more funds to be introduced into the economy. The potential benefits of this short term capital inflow may be outweighed by the long term corruption and crime that would possibly follow as criminal syndicates establish centres of operations within these countries.

3.6 RISK TO PRIVATISATION EFFORTS

Chossudovsky (1999) observed that money launderers who are able to purchase previous government entities that are being privatised, can attempt to establish a legitimate front to launder funds. This can undermine economic reforms as money launders are not interested in operating these entities as going concerns, but rather as a conduit for laundering money.

3.7 REPUTATIONAL RISKS

Countries that are competing as destinations for legitimate investments may find it difficult to do so, according to Van Fossen (2003 : 237-275) , if there is a perception that the country has a poor track record of dealing with money laundering or is seen to be a centre for money laundering. This is because legitimate investors are wary of being associated with any country that has a negative reputation. Another explanation may be that these investors fear that their own dealings, even though these may be legitimate, may attract more scrutiny from the

regulators in their own country and that any additional compliance that may be deemed necessary, may introduce further costs that would affect the profitability of any venture.

3.8 SOCIAL COSTS

Bartlett (2002 : 18-23) discusses how despite the difficulties in quantifying the effect of money laundering, the laundering of the proceeds of crime contributes to increases in the level of crime. Similarly Thompson (2003), illustrated this point in reporting on how thefts in the diamond industry have increased due to the anonymity with which diamonds can be traded and used to launder money, which makes this industry a target for money launderers. This may also act as a means of spreading insecurity, particularly when considering the potential trafficking in conflict diamonds that may be used as currency in the money laundering circuit to exchange diamonds for narcotics or munitions.

Petras (2001) notes that money laundering also allows criminal syndicates to expand the scale and scope of their criminal activities. This leads to governments having to spend more on both law enforcement as well as any social and health rehabilitation programmes that may be necessary to address the consequences of the criminal activity, such as drug rehabilitation centres.

3.9 FUNDING OF TERRORISM

Terrorism and money laundering share a symbiotic relationship. Excluding the scenario where terrorism may be undertaken to allow economic profiteering to take place, terrorists utilise money laundering as another weapon in their arsenal to support their terror activities. Law enforcement agencies have a distinct aim to unravel these links as it allows individuals involved in these activities to be prosecuted or publicly exposed, seeing that the war on terror is unlikely to be won as long as there are potential terrorists who have access to funds.

Funds laundered illicitly to terrorists allow the sponsors of terrorism to maintain plausible deniability, provided that these funds are effectively laundered. Cabraal (2007) illustrated the extent to which financial crimes and money laundering are interlinked by relating how the Liberation Tigers of Tamil Eelam (LTTE) engaged in an approximately UK£ 100 million credit card fraud through utilising funds obtained *via* the use of cloned credit cards to fund their activities.

3.10 MONEY LAUNDERING AND PREDICATE OFFENCES

Money laundering has traditionally been linked with the predicate criminal offences from which it receives its source of funding such as trafficking in narcotics. Arguably where it is possible to link a crime causally with money laundering, this may be valid but this is not always possible. In complex money laundering situations which are transnational, the source of the funding and the associated knowledge of the criminal activity may be unknown to the person undertaking the money laundering. Assuming that criminal organisations utilised standard operational practices associated with maintaining the security of their activities, such knowledge would be compartmentalised to prevent any leaks to law enforcement.

Similarly, arguing that criminal complicity arises from money laundering and extends to all predicate activities is also problematic. This would create a situation in which a money launderer would by default be accountable for all actions that were committed to obtain the criminal proceeds as well as the laundering of the funds. In practice, it would be difficult to associate the proceeds of the crime with the crime itself if these were separated by time, distance and a commingling of funds from different criminal activities that had already occurred prior to the funds being handed over for laundering.

Targeting money laundering, according to Lahey (2005 : 699-720), aims to strike at the criminals who may be masterminding these criminal activities as opposed to only the prosecution of those involved with carrying out the criminal deeds. This argument, which is often the subject of crime thrillers, is valid only so as far as the funds derived from criminal activities can be traced back to a criminal act and a beneficiary identified.

4. ADDRESSING THE MONEY LAUNDERING THREAT

Attempts to counter money laundering have typically been driven through the use of legislation. An early example of an international attempt to combat money laundering and its predicate crime was in 1989, when the *UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* (Vienna Convention) was signed. In terms of Article Three, the countries that agreed to this convention had to pass certain legislation that was aimed at enforcing the prevention of drug trafficking and minimising the use of international banking

arrangements to obscure the flows of funds. By ensuring that bank secrecy did not undermine transnational cross border law enforcement initiatives, it created a platform for the subsequent efforts to reduce the abuse of the formal banking system. This use of the Convention and other legislation as money laundering countermeasures, are discussed further in Chapter Three.

4.1 CREATION OF FINANCIAL INTELLIGENCE UNITS

A number of countries have addressed money laundering through legislation which has made provisions for the creation of “Financial Intelligence Units” (“FIUs”). The FIUs collate, assess, analyse, and disseminate details of suspicious financial transactions to the relevant authorities, according to the Egmont Group (2001a : 2). As these FIU’s became more widely established, and international efforts to curtail money laundering increased, an informal grouping was formed known as the Egmont Group. The purpose of this Group (2001b : 3) is to “develop among participants a more effective and practical cooperation, especially in the areas of information exchange and sharing of expertise.”

However, the issue of money laundering has also been addressed by a number of leading financial institutions, according to Pieth (2001). Conyngham (2002 : 8) explained how these institutions agreed in October 2000, to common guidelines for dealing with their customers and to “endeavour to accept only those clients whose source of wealth and funds can be reasonably established to be legitimate”. These common guidelines are referred to as the *Wolfsberg Principles*. Arenstein (2001) reports on how Transparency International representatives from Botswana, Cameroon, Ethiopia, Ghana, Kenya, Malawi, Nigeria, South Africa, Uganda, Zambia and Zimbabwe supported a similar declaration, which is known as the *Nyanga Declaration*. However it remains to be seen how effectively this support translates into tangible results that are based on effective legislation and enforcement. The money laundering initiatives by the Egmont Group and the *Wolfsberg Principles* are discussed in detail in Chapter Three.

4.2 CONFISCATION AND FORFEITURE

In addition to the above, popular strategies that have been widely adopted can be broadly classified as forfeiture and confiscation. Confiscation, according to Fisher (2003 : 409-456), involves seizing the proceeds of crime and thereby mitigating against a criminal profiting from

an unlawful activity. Cassella (2004 : 583-660) stated that forfeiture involved seizing the “instruments” of the crime.

A rational criminal would consider the prospect that a percentage of the gains from criminal activities may be confiscated if the money laundering scheme was unearthed by law enforcement. This would be an inherent cost of operating a criminal enterprise. Forfeiture may have more far reaching consequences. While confiscation, according to Garoupa (2003) is limited to the extent of the benefit that can be linked to criminal activity, this does not apply to forfeiture.

Where forfeiture is involved, the value of the item seized may exceed the known benefit of the criminal activity. The application of this deterrent is not without costs, as the government still needs to maintain the property that was seized until the finalisation of the judicial proceedings. Furthermore the sale and execution of this property may also be subject to counter claims that would need to be addressed in respect of any other third party claims (for instance financial institutions) that exist.

5. CONCLUSION

The complexity of the financial schemes used by money launderers and their tendency to choose developing economies that have a weak regulatory framework combined with poor enforcement, makes money laundering a global challenge. The value of the recommendations proposed by the FATF or the application of the *Wolfsberg Principles*, are only as effective as the support and inducements that developing countries receive to address money laundering as a priority.

Does confiscation and forfeiture serve as an effective deterrent of money laundering ? If it is assumed that either of these strategies or any other money laundering countermeasures were to be strengthened and rigorously enforced, it would not necessarily mean a decrease in the predicated offences from which the proceeds of the criminal activity arose. If a criminal is unlikely to be deterred by the prospect of prosecution and imprisonment for committing the predicate offence, it is unlikely that the possibility of forfeiture and confiscation would instil an adherence to the law. A more likely outcome is that the attempts to launder money would become creative and/ or that there would be an increase in the attempts to corrupt the law enforcement authorities.

In the absence of a coordinated global effort, a short term perspective of treating money laundering inflows as being a valuable source of foreign capital and ignoring the subsequent security threats, is likely. The security threats associated with money laundering can thus only be addressed by a collaborative effort that sees a unified partnership formed by both developing and developed countries, which may be negatively affected in different ways by money laundering. Money laundering countermeasures, including the formation of the FATF by the G7/8 countries; the development of model legislation by the UN; as well as the EU statements on countering money laundering, will be explored further in Chapter Three.

CHAPTER 3. GLOBAL ANALYSIS OF MONEY LAUNDERING WITH SPECIFIC REFERENCE TO THE G7/8

1. INTRODUCTION

In this chapter, the initiatives that have been undertaken by both the UN and the EU to curb money laundering will be discussed. The money laundering countermeasures that have been adopted by the G7/8 will subsequently be examined against this background. The purpose of this analysis is to establish a foundation to assess money laundering in South Africa in the subsequent chapters.

2. THE UNITED NATIONS

The UN has played a pivotal role in promoting multilateral agreements aimed at combating the money laundering associated with the trafficking in drugs, transnational organised crime and terrorism. These agreements provide a minimum baseline against which countries can benchmark and assess their own anti-money laundering initiatives.

2.1 CONVENTION AGAINST ILLICIT TRAFFIC IN NARCOTIC DRUGS AND PSYCHOTROPIC SUBSTANCES

The *UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances* of 1988, built on the 1961 *Single Convention on Narcotic Drugs* and the 1971 *Convention on Psychotropic Substances*, and is commonly referred to as the Vienna Convention. By 2005, there were 170 countries that had acceded to the *Vienna Convention*, although certain countries indicated reservations to certain clauses. The purpose of the convention was to target the illegal trafficking of drugs, and the negative impact that this had on the legitimate economy.

To support the war against drugs, the *Vienna Convention* focused heavily on identifying and seizing the proceeds (Article Five) and assets related to drug offences. Leacock (2001 : 263-280)

noted that countries were expected to allow for bank records to be shared, and that bank secrecy could not be used to prevent access to these records.

The *Vienna Convention* (1971 : 6) establishes a basis for extradition even amongst countries that were not otherwise obligated to support extradition in terms of any other treaties. It also provided for mutual assistance upon request, to aid with the search and seizure requirements. The *Vienna Convention* represented a shift in how the war on drugs was being waged, because it required in terms of Article Three, both the producing countries drugs and the consumer countries to act. Previously, attempts to stem the tide of illegal drugs, tended to direct efforts towards the producer countries. However, Sinha (2001) observed that despite the implementation of the *Vienna Convention*, the usage of drugs has continued to grow and that this is unlikely to decrease.

Despite these criticisms, the *Vienna Convention* serves as a reference point for agreement amongst its signatories regarding the search and seizure of drug related assets. By implication, the convention includes any money laundering activities that may be undertaken to hide the sources of the funds being laundered. A practical problem that does arise when attempting to apply the convention, relates to the exemptions that certain countries made when signing the agreement. Many of the clauses within the convention are limited as these clauses are "subject to its constitutional principles and the basic concepts of its legal system of the signatories". (Vienna Convention, 1971 : 3) This creates easily exploitable loopholes.

For example Colombia, stated that it was not bound by Article Three, paragraphs Six and Nine, or Article Six of the *Vienna Convention* as the *Political Constitution of Colombia* (1991) prevented the extradition of any person who is a Colombian citizen by virtue of birth from 1991 when the new constitution was enacted, until a constitutional amendment in 1997. During this period, it meant that in cases of any worldwide money laundering operations that were run out of Colombia by a Colombian, the person could not be extradited to face trial outside Colombia, if he/ she had been born in Colombia and had retained his/ her citizenship. Without the ability to prosecute the individual, it would be difficult for law enforcement in other jurisdictions to investigate drug smuggling when a Colombian link is suspected. (Acevedo-Holguín : 2003)

2.2 POLITICAL DECLARATION AND ACTION PLAN AGAINST MONEY LAUNDERING

The *Political Declaration and Action Plan against Money Laundering* was made by the General Assembly (Resolution A/RES/S-20/2 of 10 June 1998) and re-affirmed the UN commitment to addressing the threats of money laundering that were related to drug smuggling and to encourage more cooperation amongst members in addressing this threat. The declaration also called on countries that had not signed the *Vienna Convention*, to do so by 2003.

In conjunction with the other resolution that the General Assembly adopted in 1998 on *International Cooperation against the World Drug Problem* (A/RES/53/115, of 9 December 1998), concern was expressed over the increase in criminal syndicates and terrorist organisations that were involved in both drug smuggling and money laundering. The purpose of these declarations was to build an integrated international response to these threats that would leverage and strengthen individual countries legislative systems while creating a framework for improved cooperation. The UN also undertook to provide training and technical assistance to facilitate the responses that would be required in terms of these declarations.

These declarations were effectively precursors to the realisation that the spread of transnational criminal syndicates and terrorist organisations were being fuelled by money laundering that was occurring on a global scale.

2.3 CONVENTION AGAINST TRANSNATIONAL ORGANISED CRIME

This UN *Convention on Transnational Organised Crime* (TOC Convention) was signed in Palermo, Sicily on the 15th December 2000. The *TOC Convention* introduced specific anti-money laundering measures, notably Article Four which criminalised “participation, association, conspiracy, and accessory” in any of the money laundering processes relating to the conversion, concealment and/ or the transfer of property. While this was very similar to the *Vienna Convention*, the *TOC Convention* went further by expanding the scope of the predicate offences to beyond drug smuggling and included the proceeds of crime in the context of the search and seizure enforcement mechanisms. (TOC Convention, 2000)

The *TOC Convention* reinforced the need for a united approach to tackling the threats of transnational crime. Thony (2002) observed that it created a mesh of criminal offences that countries signing the *TOC Convention* would also incorporate domestically. This was necessary to ensure that any gaps that could previously be exploited due to differences in legislation were effectively minimised. Similarly, the congruence of similar legislation amongst countries meant that it would be easier to investigate and prosecute criminal syndicates. A key benefit of the *TOC Convention* was that it included a *Protocol against the Smuggling of Migrants* and a *Protocol against the Trafficking in Persons*. These protocols were important as they introduced certain controls relating to travel documentation, and attempted to prevent vulnerable illegal migrants from being exploited. Human trafficking creates opportunities for criminal syndicates to exploit high risk migrants by forcing them to become involved in criminal activity. According to Wechsler (2001 : 40-57), the income from these criminal activities are subsequently laundered into legitimate enterprises or used to further other criminal activities.

2.4 INTERNATIONAL CONVENTION FOR THE SUPPRESSION OF THE FINANCING OF TERRORISM

The *International Convention for the Suppression of the Financing of Terrorism* was proposed in 1999 and entered into force in 2002, obligated countries signing the declaration to make the funding of terrorist activity a criminal offence. The *International Convention for the Suppression of the Financing of Terrorism* allows for the extradition of any person who engages in the provision or collection of funds knowing that these would be used to support terrorism. Additional measures imposed by the *International Convention for the Suppression of the Financing of Terrorism* in terms of Article Eight, include seizure and confiscation of funds used to further terrorism to holding persons who may be involved with funding terrorism accountable both criminally and civilly. (International Convention for the Suppression of the Financing of Terrorism, 1999)

The *International Convention for the Suppression of the Financing of Terrorism* effectively recognised the possibility of reverse money laundering, although in an indirect manner. While money laundering involves laundering of funds that were illegally obtained, McCulloch and Pickering (2005 : 470-486) explained that reverse money laundering is when legitimate funds are laundered to support illegal activities. Simon and Martini (2005 : 131-146) pointed out that while these funds are often raised for charitable, cultural or social purposes, they are instead used to support terrorism.

2.5 SECURITY COUNCIL RESOLUTIONS

The UN Security Council adopted *Resolution 1373* on 28 September 2001, in the aftermath of the September 11 terrorist attacks that were launched against the US. The purpose of the resolution was to limit the funding of terrorism and to prevent the spread of international terrorism. Besides calling on member states to ratify the other UN conventions on terrorism, *Resolution 1373* established the Counter Terrorism Committee (CTC) which was required to monitor the members compliance with this resolution.

To promote mutual assistance and more effective cooperation to support law enforcement initiatives, the UN also released additional model legislation to support *Resolution 1373*. This included the *Model Mutual Assistance in Criminal Matters Bill* (2000) and the *Model Foreign Evidence Bill* (2000). Collectively this model legislation created a broad based framework that would allow law enforcement to effectively overcome any jurisdictional limitations when dealing with money laundering while ensuring the admissibility of evidence.

Dubois (2002 : 317-335) observed that *Resolution 1373* was undermined because it did not properly define terrorism and the only terror organisations that were initially listed were Al-Qaeda and the Taliban. Human Rights Watch (2003 : 8) pointed out that besides leaving out other groups involved in terrorist activity, this resolution meant that a government could label its opponents as terrorists and act accordingly. This risk, Rosand (2003 : 333-341) suggested, was addressed when *Resolution 1456* was adopted in 2003, that required states to ensure that while attempting to combat terrorism, this was not done at the expense of violating human rights.

The UN Security Council adopted *Resolution 1566* on the 8th October 2004, addressing some of the shortcomings of *Resolution 1373*. As part of this resolution, the UN Security Council established a working group that would identify terrorist groups, recommend appropriate measures to be taken, and to establish procedures to aid with the identification and confiscation of assets.

3. EUROPEAN INITIATIVES

In Europe, the Council of Europe and the European Communities/ Union have spearheaded initiatives aimed at targeting money laundering. Due to the shared borders in Europe and the common currency, money laundering can spread more easily beyond national borders. The ability to engage in money laundering without being restricted by national boundaries, can lead to increased opportunities for those engaged in illicitly funding terrorism.

3.1 COUNCIL OF EUROPE

The Council of Europe (CoE) tabled the *Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime (CoE Convention)* in 1990, with the requirements to be implemented by its members by September 1993. Kilchling (2001 : 264-280) noted that the aim of the *CoE Convention* was to create a seamless process for handling investigations into money laundering from the identification to the prosecution to the confiscation phases. The convention was designed to be both flexible and adaptable to the different legislative frameworks within member states.

The *CoE Convention* expanded the definitions of money laundering that were originally outlined in the *Vienna Convention* to include the proceeds of crime, and removed the limitation that drug smuggling was the only predicate crime involving money laundering. Shelley (2000 : 35-50) noted that this more inclusive approach was widely supported by the FATF. It is also likely that support from the FATF was in part due to the *CoE Convention* addressing the controversial issue of jurisdiction where the predicate offence and the money laundering occurred in different jurisdictions.

The convention establishes the basis of cooperating across jurisdictions on money laundering cases and the removal of the barriers formed by bank secrecy as the basis of non compliance. The strength lay more in the way that it attempts to improve cooperation through utilising and leveraging pre-existing international mechanisms that had already been introduced to combat money laundering as opposed to only introducing new procedures to achieve the same outcomes. (CoE Convention, 1990 : Ch 2)

A key benefit of the *CoE Convention* was that it overcame the limitations associated with the *Vienna Convention* relating to confiscation. According to Helleiner (2000), the *Vienna Convention* did not prescribe a single approach on how to address confiscation. The *CoE Convention* addresses this shortcoming by recognising both the property and value approaches to confiscation, and member states need to be able to provide for either method in terms of approving the relevant domestic legislation.

The *1990 CoE Convention* has been widely regarded as being critical to the debate on money laundering from a policy perspective. The EU endorsed the *CoE Convention* as being vital to addressing the transnational nature of money laundering. However, despite this endorsement, there have been criticisms levelled at the *CoE Convention*. McDonnell (1998) noted that this was due to the lack of liability that would be ascribed to a juristic person involved in money laundering. This potentially creates a loophole that would allow criminal syndicates to create front companies to engage in money laundering.

The CoE in 2003 started a process to revise the *1990 CoE Convention*. This was motivated by the need to incorporate more measures to address terrorist financing. Due to the impact of the changes that were made, a new *Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism* (2005 CoE Convention) was developed. The purpose of the *2005 CoE Convention* was to incorporate the FATF recommendations as well as the *1999 UN Convention* that aimed to prevent financing to terrorists.

The *2005 CoE Convention* also included a more holistic integration with the legislation of the EU. This notably included provisions relating to the establishment of financial intelligence units (Articles 1(f) and 12). Other key clauses included Article Two, that related to the power of confiscation of property used for terrorist funding, Article Seven that effectively removes bank secrecy as a way of obscuring funding and the provision for the access to relevant information by the financial intelligence units in terms of Articles 12 to 15. The *2005 CoE Convention* however only suggests that member states should look at removing any non-disclosure or secrecy provisions that may be applicable to non-financial institutions. This may allow money laundering to still be undertaken, particularly where this is done using rare stamps or other rarities that are traded or exchanged *via* private dealers.

EU Council Directive (91/308/EEC of 10 June 1991) aimed to prevent abuse of the financial system (as revised in *EU Council Directive* 2001/97/EC) and the *EU Council Decision* 2000/642/JHA of 17 October 2000 that covers the sharing of information between financial intelligence units were also included in the *2005 CoE Convention*. This harmonised the different legislation that would apply to member states that belonged to both the CoE and the EU. The *2005 CoE Convention*, also allows members to apply the European Community (EC) or the EU rules in the place of the requirements of the convention. (2005 CoE Convention, 2005 : Article 52, Para. 4) The close similarities in legislation between these various organisations mean that it is unlikely that selective adoption by member states would create significant legislative gaps that can be exploited.

3.2 EUROPEAN COMMUNITIES/ EUROPEAN UNION

The EC was established on 25th March 1957 by the *Treaty of Rome*. Originally it was known as the European Economic Community, but this was amended by the *Maastricht Treaty* in 1992 that saw the amendment of the name of this organisation through the removal of the word “Economic”. The EC also became one of three pillars of the EU and is often referred to as the Community (or Communities) Pillar.

In terms of money laundering, the EC has been actively involved at the forefront of legislative developments by being involved within the *Vienna Convention*, ratifying the *1990 CoE Convention*, and participating in the FATF. The *EC Council Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering* (1991 EC Directive) focused more on preventing money laundering by imposing obligations on financial institutions at the point of funds entering the financial markets. It is likely that this was motivated by the move towards a single market in the EU at the time, and a desire to keep laundered money from entering this market due to the ripple effect that it would have across different countries.

The *1991 EC Directive* was based on the FATF recommendations that were released in 1990, and is similar to the *1990 CoE Convention*, in that it acknowledges that the predicate offences related to money laundering extend beyond drug offences. Despite these similarities, Harding (2000 : 128-147) observed that the penalties for money laundering varied across different member states. Although the penalties may have varied, the blanket coverage of the directive and its focus on financial institutions ensured that the threat of money laundering was not shifted

across jurisdictions in a bid to avoid tougher penalties. Chaikin (1991 : 467-510) suggested that instead the result was that money launderers were forced to utilise other means and depend on other industries such as gaming or property investment trusts.

A key aspect of the *1991 EC Directive*, was the requirement that financial institutions adopt measures that would allow for suspicious transactions to be identified. Malkin and Elizur (2002 : 60-70) noted that this is commonly referred to as the “know your customer” principle. However, the *1991 EC Directive* does not stipulate a mandatory approach to addressing this. This allows member states significant flexibility in determining how the “know your customer” principle is applied when financial transactions are conducted electronically. (1991 EC Directive, 1991 : Article 3, Para 8) While emphasis is placed on reporting suspicious transactions, cooperating with the relevant authorities, the *1991 EC Directive* does not give examples of suspicious transactions and leaves it to member states to define these parameters. This undermines the effectiveness of the *1991 EC Directive* since different member states may classify similar transactions differently. As opposed to highlighting money laundering, this practice may obscure the trail as authorities across different jurisdictions are unable to effectively coordinate their efforts due to the differences in definition of what transactions are considered suspicious.

The *Second Commission Report to the European Parliament and the Council on the Implementation of the Money Laundering Directive* (1998) identified weaknesses in both the *1991 EC Directive* and its implementation. These weaknesses related to the problems with extending the coverage of predicate offences involving money laundering beyond drug related offences, the lack of integrated financial market supervision and the information sharing abilities between financial intelligence units. These weaknesses in the reporting regimes were most likely symptomatic representations of the problems associated with the differing definitions of suspicious transactions.

In 2005, the EU adopted a new directive namely the *Prevention of the Use of the Financial System for the Purpose of Money Laundering and Terrorist Financing*. The *EU Directive* set a transactional value of EUR 15 000 or more to either single or multiple similar transactions that need to be reported on to the relevant financial intelligence unit within each member state. The member states were required to implement this directive, which replaces the *1991 EC Directive*, by 2007. The *2005 EU Directive* effectively aims to implement the revised FATF recommendations. The EU in 2005 also adopted a resolution that requires a person to declare any amount of cash at EUR 10 000 and above that is being transported across borders. (Resolution

A6-0167, 2005) When the *2005 EU Directive* is read in conjunction with this currency declaration, the potential for cash based money laundering is addressed across both natural and juristic persons.

Building on the initiatives that have been undertaken by both the UN and the EC/EU, model legislation has been developed by the UN to act as a means of fast tracking the implementation of the necessary legislation.

4. INTERNATIONAL MODEL LEGISLATION DESIGNED TO PREVENT MONEY LAUNDERING

The purpose of model legislation is to provide countries with an example of how legislation can be drafted to address a particular international resolution or specific convention. Model legislation works by minimising the opportunities for any potential legislative weakness within any countries' jurisprudence to be exploited. In practice, the need to ensure that model legislation is synchronised with the legal system of the country adopting such a model, may give rise to loopholes between the proposed legislation and the existing legislation that is being enforced.

4.1 UNITED NATIONS

The difference between the model legislation and resolutions drafted by the UN, relates to the extent to which these bind member states. Resolutions adopted by the UN Security Council are binding upon member states, while the model legislation serves as a non-compulsory guideline for how states can implement this resolution where legislation may be required.

4.1.1 LAUNDERING, CONFISCATION AND INTERNATIONAL COOPERATION IN RELATION TO THE PROCEEDS OF CRIME

The UN published its model legislation on *Laundering, Confiscation and International Cooperation in Relation to the Proceeds of Crime* in 1999 (1999 Model Law). This model legislation was designed to attempt to create uniformity amongst member states that had to introduce legislation to prohibit money laundering.

The *1999 Model Law* was based on amalgamating the best practices from the money laundering countermeasures that had been outlined by the FATF, the Basel Committee on Banking Regulations and Supervisory Practices, and the EC/EU. Adopting this approach meant that it would be easier to implement the *1999 Model Law* in practice, as it also introduced additional legislative avenues for creating international cooperation. In order to ensure comprehensive coverage while remaining flexible, the *1999 Model Law* included both optional and mandatory components that could be customised to suit particular states requirements. While the *1999 Model Law* provides a legislative means to address money laundering, implementing the *1999 Model Law* in itself will not necessarily ensure domestic commitment or international cooperation. This will depend on the will and commitment of individual countries regarding the combating of money laundering. (UN, 1999 Model Law)

4.1.2 MONEY LAUNDERING, PROCEEDS OF CRIME AND FINANCING OF TERRORISM BILL

The UN Office on Drugs and Crime released the model law on *Laundering and Proceeds of Crime* in 2000. This was subsequently replaced by the model law on *Money Laundering, Proceeds of Crime and Financing of Terrorism Bill* (Model Law) in 2003. The *Model Law* was developed for use with states that have a legal system that utilises the common law tradition, and was designed to authorise the confiscation of funds and/ or property used for terrorist financing. For the *Model Law* to be successfully implemented, it has to be applied in conjunction with the other model legislation that has been developed by the UN in order to create a seamless regulatory net that is capable of trapping terrorist funds.

4.2 ALTERNATIVE MODEL LEGISLATION

Both the Commonwealth Secretariat (CS) and the Organisation of American States (OAS) have also created model laws that address money laundering to a certain extent. The CS (1996) released the *Model Law for the Prohibition of Money Laundering* that was non-binding, but provided an example of how to address money laundering. The Inter-American Drug Abuse Control Commission (CICAD) (2003) which is part of the OAS, has regularly updated its *Model Regulations concerning Laundering Offences connected to Illicit Drug Trafficking and other serious crimes* (OAS Model) in response to changing patterns and methods of money laundering.

The *1996 Model Law for the Prohibition of Money Laundering* and the *OAS Model* are more detailed than the FATF recommendations.

However, in the absence of any compliance measurement being undertaken by either the OAS or the CS, the value of these models may not be fully realised since members can voluntarily choose the extent and degree to which they adopt these models.

Beyond the initiatives undertaken on a multilateral basis, financial institutions have engaged in anti-money laundering measures aimed at preventing the misuse of the global financial system. These measures range from implying better identification of customers to improving the regulatory supervision of the banking sector.

5. PREVENTION OF MONEY LAUNDERING BY FINANCIAL INSTITUTIONS

The Basel Committee has been primarily responsible for developing a multilateral framework that aims to minimise the use of the global financial system for the purposes of money laundering. The Egmont Group was founded to provide opportunities for better information sharing and to facilitate learning opportunities between financial intelligence centres.

5.1 BASEL COMMITTEE ON BANKING SUPERVISION

The Basel Committee on Banking Supervision (Basel Committee) is a representative forum run under the auspices of the Bank for International Settlements (BIS). It was originally formed in 1975 by the Governors of the Group of Ten (G10) countries. The BIS, was established in 1930 to provide an international banking service to central banks. (Felsenfeld and Bilali, 2004 : 13). Toniolo (2005) states that the Basel Committee is responsible for setting international standards for effectively supervising the retail and wholesale component of banking services. These standards, when adopted, provide the basis for bank supervision in member countries.

5.1.1 STATEMENT ON PREVENTION OF CRIMINAL USE OF THE BANKING SYSTEM FOR THE PURPOSE OF MONEY LAUNDERING

The *Statement on Prevention of Criminal Use of the Banking System for the Purpose of Money Laundering* was issued by the Basel Committee (1998) to provide guidance on how financial institutions can ensure that money laundering is not committed through the use of the global banking system. Scott (1995 : 1-4) observed that while the statement did not impose a mandatory duty upon financial institutions to act in a particular way, it did create an expectation of ethical conduct. The basis of the statement was that financial institutions should implement more prudent measures when applying the “know your customer” principle; that suspicious transactions should not be processed; and that financial institutions should cooperate with law enforcement.

5.1.2 CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

The Basel Committee (1997) issued the *Core Principles for Effective Banking Supervision*, which consisted of twenty principles that established the minimum basis for ensuring that the banking supervisory system was effective. Folkerts-Landau and Lindgren (1998) noted that certain of these provisions were distinctly designed to counter money laundering. These provisions related to the implementation of prudential regulations that would ensure that the “know-your-customer” principle was adopted.

The Basel Committee (2006) issued a revised *Core Principles for Effective Banking Supervision*. The updated principles were designed to achieve better consistency with other regulations governing financial institutions and to ensure that the security threats of money laundering were more holistically addressed by supporting the recommendations that had been issued by the FATF.

5.2 GLOBAL ANTI-MONEY LAUNDERING GUIDELINES FOR PRIVATE BANKING (WOLFSBERG PRINCIPLES)

In 2000, twelve global banks in conjunction with the representatives of Transparency International and the University of Basel released anti-money laundering guidelines that were designed for private banking. The Wolfsberg Group (2000) released guidelines that were referred

to as the *Wolfsberg Principles*. The forum is named after Château Wolfsberg in north-eastern Switzerland where the meetings to draft these guidelines were held.

Private banking, as Balmer and Stotvig (1997 : 169-184) noted, involved a unique relationship with clients in which banks tended to focus very strongly on maintaining the confidentiality of clients banking details. This has the potential to undermine attempts to investigate money laundering particularly where numbered, unnamed accounts are utilised. The purpose of the *Wolfsberg Principles* was to prevent private banking being used to finance either terrorism and/or to launder money.

The *Wolfsberg Principles* were revised in 2002, along with the release of a *Statement on the Financing of Terrorism* and the *Wolfsberg Anti-Money Laundering Principles for Correspondent Banking* in the same year. In 2003, the *Statement on Monitoring Screening and Searching* was published. The combination of these statements with the *Wolfsberg Principles* created a *de facto* standard for the prevention of money laundering in the private banking sector. (Wolfsberg Group, 2002, 2003) However, since these principles are not universally applied by all other private banks, potential shortcomings may still exist. This, to a large extent, is addressed by the banking supervisors utilising the Basel Committee principles for supervision to minimise the misuse of financial markets for money laundering. Through this approach, even private banks that did not comply with the *Wolfsberg Principles* would still be reviewed against the criterion outlined by the Basel Committee (2006).

The *Wolfsberg Principles*, and the *Guidance on a Risk Based Approach for Managing Money Laundering Risks* that was released by the Wolfsberg Group in March 2006, are notable as they represented an industry attempt to voluntarily develop and comply with a standard to preventing money laundering. Arguably, this may have been motivated by commercial self-interest as none of these financial institutions would have wanted to be implicated in money laundering. Through participation in such an initiative, these institutions were able to ensure that they had proactively addressed the perception that private banking was being used to launder criminal proceeds or fund terrorism.

5.3 EGMONT GROUP

The Egmont Group (2004a), which was formed in 1995, is an informal grouping of the financial intelligence units from a hundred countries. The purpose of the Egmont Group is to create networking opportunities that foster better international cooperation amongst the financial intelligence units. Winer and Roule (2002 : 87-104) noted that this was vital to ensure that information can be exchanged more seamlessly, and experiences with countering money laundering can be effectively shared amongst the other participants.

To promote these objectives the Egmont Group has five working groups. The Legal Working Group reviews applications from financial intelligence units that are interested in joining the Egmont Group, and addresses any legal issues surrounding money laundering that may affect the broader membership. The Training Working Group is responsible for developing and expanding on the training curriculum for staff within the participating financial intelligence units. The Outreach Working Group assists financial intelligence units with meeting the necessary standards for membership. The Operational Working Group provides operational coordination between financial intelligence units. The responsibility of identifying how technology can be shared to identify potential money laundering activities and trends, is undertaken by the Information Technology Group. (Egmont Group, 2004b)

The Egmont Group has released two significant documents on facilitating information exchange between financial intelligence units, namely the *Principles for Information Exchange* (2001) and the *Best Practices for the Exchange of Information* (2004c). These documents define the basis upon which information can be requested and utilised by financial intelligence units across different jurisdictions, taking into consideration the legislative requirements to protect privacy.

6. PREVENTION OF MONEY LAUNDERING BY THE G7/8

The actions of the G7/8 in dealing with money laundering have been primarily linked to the war on terrorism, in terms of denying funding to terrorists. This trend can be demonstrated through reviewing the various Ministerial Declarations and reports that have been issued.

6.1 MONEY LAUNDERING COUNTERMEASURES ADOPTED DURING 1994 AND 2000

The *Ottawa Ministerial Declaration on Countering Terrorism* (Ottawa Declaration), was released by the G7/8 in 1995. It stated that members should address the threat of terrorism by implementing domestic legislation to conform with the international conventions that had been established. Aryasinha (2001 : 25-50) also pointed out that the *Ottawa Declaration* called on members not to support terrorism or allow their countries to be used as staging sites, and endorsed cooperation amongst members to seize and confiscate funds used to further terrorism.

The emphasis on money laundering and terrorism financing was again evident at the Ministerial Conference on Terrorism held in 1996 in Paris. At this meeting, the G7/8 (1996) adopted an *Agreement on Twenty Five Measures* to prevent terrorist financing. Three of these measures were aimed at stemming the funding of terrorism including through the use of reverse money laundering, improving the exchange of information relating to the movement of funds and reinforcing the need for a strong regulatory environment. (G7/8, 1996, Agreement on Twenty Five Measures : Articles 19, 20, 21)

The G7/8 Justice and Interior Ministers held the G8 Justice and Interior Ministers' Virtual Meeting on Organised Crime and Terrorist Funding in 1998. At this meeting, the ministers agreed that there needed to be an internationally acceptable approach to confiscating the proceeds of crime and the assets used to commit these crimes. (G7/8, 1998) The G7/8 (1999) issued similar calls in the *G8 Köln Summit Statement* that it released after its meeting in Cologne, Germany that reiterated what had been said previously in Ottawa about the need for member states to accept the international conventions on terrorism and prevent the funding of terrorist activity. (G7/8, 1999)

The G7/8 issued the *Action against Abuse of the Global Financial System* report at the Okinawa Summit in 2000. (G7/8, 2000) In this report, the G7/8 clearly identified money laundering as a vehicle for funding criminal and terrorist activity and stated that only an internationally coordinated effort with the full participation of its members would be effective. The G7/8 (2000) also acknowledged in this report the efforts made by the FATF, which operated under its auspices, towards developing recommendations to prevent money laundering and identifying countries that that did not comply with these recommendations.

Most notably, FitzGerald (2002) observed that the G7/8 indicated that it would act against countries that were unwilling to implement suitable reforms by implementing a financial blacklisting if necessary. The G7/8 (2006a) issued the *Action against Abuse of the Global Financial System* report which highlighted the need for the creation of financial intelligence units and recommended that the FATF look at the roles of certain professionals relating to money laundering. These professionals included lawyers and accountants who were considered to be integral to the creation of schemes to aid with the laundering of money.

6.2 MONEY LAUNDERING COUNTERMEASURES ADOPTED DURING 2001 AND 2006

The G7/8 (2001) issued a subsequent report entitled *Fighting the Abuses of the Global Financial System* that examined the extent to which the international financial markets could be misused to launder money. This was followed by the *G7/8 Statement by the leaders of the G8 over last week's terrorist attacks in New York and Washington* on 19 September 2001 in the aftermath of the terrorist attacks on the World Trade Centre in which the G7/8 leadership endorsed the UN convention on terrorism and indicated the measures in their countries to curb terrorist financing and to cooperate on addressing this threat. In October 2001, the G7/8 (2001) finance ministers held a meeting to discuss how to combat terrorist financing, and released an *Action Plan to Combat the financing of Terrorism*. This plan essentially outlined money laundering countermeasure that were aimed at implementing *UN Security Council Resolutions 1333 and 1373*. At this meeting, the G7/8 finance ministers released the *G7 Finance Ministers and Central Bank Governors Statement* that endorsed the role of the FATF in preventing the financing of terrorism through money laundering and all member states would join the Egmont Group. (G7/8, 2001)

To emphasise how strongly the commitment amongst the G7/8 was to address this threat, the *Action Plan: Progress Report on Combating the Financing of Terrorism* was released in 2002. According to this report, all of the G7/8 countries had ratified the *UN Security Council Resolutions 1373* and more than USD 100 million had been frozen. The G7/8 countries indicated in this report that by June 2002 the specific recommendations being developed by the FATF would be implemented within their countries. (G7/8, 2002)

By June 2002, the G7/8 (2002) foreign ministers had also issued *G8 Recommendations on Counter-Terrorism*. In these recommendations, the ministers reiterated the call that measures to prevent money laundering should be implemented, and that measures should be implemented to ensure that terrorist funds could be traced and that bank secrecy was not to be used as a basis for preventing the sharing of information.

The *Combating the Financing of Terrorism: First Year Report* was released in September by the G7/8 (2002). This report examined the link between money laundering and the financing of terrorist activities. In terms of the progress that was achieved, the report noted that more than USD 112 million had been frozen, and strong international cooperation was identified as being the basis for these successes.

At the Evian Summit in 2003, the G7/8 released a report entitled, *Building International Political Will and Capacity to Combat Terrorism: A G8 Action Plan*. In this document, while the need for international cooperation was reiterated, emphasis was also placed on supporting and complying with the recommendations of the FATF. (G7/8, 2003) The G7/8 subsequently issued the *Joint Statement on Combating Terrorist Financing*. This statement identified other means of money laundering particularly through the use of cash-based schemes and the misuse of charities to launder money on behalf of terrorist organisations. (G7/8, 2004) The *G7/8 Statement on Actions to Combat Money Laundering and Terrorist Finance* identified the need for closer working relationship between law enforcement and financial regulators was emphasised as part of a concerted effort to minimise the possible access to funding by terrorists. (G7/8, 2005)

In assessing the approach of the G7/8, it appears as if money laundering has primarily been seen in the context of its use by terrorists to fund their activities. Although there were some initial links to viewing this as a subset of drug related offences, the perspective has changed. The major contribution that the G7/8 made towards countering money laundering is through the formation of the FATF as an inter-governmental body. The ability of the FATF to make recommendations which are synchronised with other international standards and ‘enforced’ by the G7/8, creates a powerful mechanism for combating money laundering regardless of whether the purpose is to prevent terrorist financing or the spread of transnational crime.

6.3 FINANCIAL ACTION TASK FORCE

The FATF, as mentioned previously, was formed by members of the G7/8 countries. This decision was reached at their Paris Summit in 1989, and the FATF is based at the Paris headquarters of the Organisation for Economic Cooperation and Development (OECD). According to Quirk (1997 : 7-9), its main purpose is to develop policies targeted at reducing money laundering and the financing of terrorism. To achieve this objective, the FATF utilises a combination of annual self-assessments and evaluations undertaken by specialist teams to evaluate compliance with the FATF guidelines and recommendations. (Norgren, 2004 : 201-206)

While the FATF does not have the ability to enforce its guidelines, it can suspend members that fail to implement the guidelines. The effects of the FATF blacklisting cannot be underestimated. (Drezner, 2001). This threat has probably proven to be more effective because of the international peer pressure and financial pressure that a blacklisting imposes on a country. Financial transactions that are considered to be suspicious need to be reported to the relevant regulator or law enforcement agency, and this would lead to all transactions involving blacklisted countries being flagged by banks in other FATF countries as being suspicious. In effect, this would effectively impose additional transaction costs as these transactions would be subject to more intense scrutiny. Financial institutions in the FATF member states may therefore be less willing to do business with their counterparts in blacklisted countries because of this additional burden, and this may prove to be a major motivator in getting countries to comply with the FATF recommendations.

The original mandate of the FATF when it was established in 1989 was to review and identify the trends and approaches that money launderers were engaging in. As part of this process, the FATF released a series of *Forty Recommendations* which were geared towards fighting the threat of money laundering. The FATF (2003) subsequently revised these *Forty Recommendations* to target terrorist financing as well.

However, the revised recommendations were not the only efforts that the FATF made to attempt to curb the use of money laundering to fund terrorism. In October 2001, the FATF released eight Special Recommendations that were aimed at turning any funding of terrorism into a criminal activity and called upon its members to ratify the *UN International Convention for the*

Suppression of the Financing of Terrorism and UN Security Council Resolutions 1373. (FATF, 2002) A ninth recommendation was subsequently issued by the FATF in 2004 to deal with the use of cash couriers to smuggle money or negotiable instruments across borders, where this can subsequently be laundered. These recommendations also included provisions relating to the searching and seizure of funds used by terrorist organisations and reinforcing cooperation between member's law enforcement agencies. (FATF, 2004a)

In 2004, the FATF revised its mandate to cooperate more with the IMF and the World Bank to address money laundering, increasing its membership to building strong relationships between the FATF and regional stakeholders. The desire by the FATF to work more closely with the IMF and the World Bank may well arise from the pilot studies that these organisations participated in, to measure money laundering and terrorist financing using the FATF methodology. (FATF, 2004b)

The IMF and the World Bank also adopted the FATF methodology in 2004 for any assessments that they undertake. The Forty Recommendations were again revised in 2004 and a new methodology was also introduced. (World Bank, 2004) The FATF decided in 2006 that it would not undertake any further self assessment exercise and would instead base its actions on the results of the mutual evaluations that were undertaken. This may also have been motivated by the desire to avoid the inherent duplication of efforts where the IMF and World Bank decided to undertake a similar assessment of a country. (FATF, 2006)

The major challenge that the FATF faces is achieving real time information sharing and analysis across national boundaries, particularly where legislation and/ or business practices hinder the sharing of information that may allow transnational money laundering activities and terrorist financing from being identified.

7. CONCLUSION

Developing comprehensive legislation that is designed to address money laundering is an ongoing process. As soon as legislation is approved, money launderers will attempt to identify any weaknesses that can be exploited. Similarly, even if the legislation was sound and no apparent loopholes could be detected, a skilful money launderer would turn his/ her attention to

attempting to corrupt the officials involved with enforcing this legislation. Thus efficient legislation, without effective enforcement, is unlikely to mitigate against money laundering.

Equally problematic, is the partial and/or conditional acceptance of certain international protocols and legislation aimed at prosecuting money laundering and its predicate crimes by some countries. This invariably leads to situations in which the prosecution of crimes becomes dependent on jurisdictional boundaries, and criminals are able to manoeuvre their base of operations to minimise the chances of successful prosecution. Transnational criminal syndicates may also attempt to avoid prosecution through engaging in corruption and bribery to ensure that money laundering associated with their criminal activities continues unabated. This would contribute to undermining the public reputation of a state, and affects its relations with neighbouring states and potential investors/ donors. Addressing this challenge requires a united global effort that is strategically coordinated and operationally efficient to significantly reduce money laundering as opposed to encouraging criminal syndicates to shift money laundering activities between different countries.

Having explored the nature of money laundering in Chapter Two, and international legislation and initiatives in this chapter, the focus in Chapter Four will be to analyse the extent and effect of money laundering in South Africa.

CHAPTER 4. THE EXTENT AND SECURITY IMPLICATIONS OF MONEY LAUNDERING IN SOUTH AFRICA

1. INTRODUCTION

Based on the conceptual framework that was established in Chapter Two, the extent and effects of money laundering in South Africa will be analysed. Through examining how South Africa is affected by money laundering, it will be possible to subsequently focus in Chapter Five on the legislative responses, institutional responses and some of the cases that have involved money laundering. A critical challenge in trying to understand the impact of money laundering is that its clandestine nature makes it difficult to observe. This requires in certain instances that the consequences of money laundering or its relationship with the factors being discussed, be identified by means of inference.

2. EXTENT OF MONEY LAUNDERING IN SOUTH AFRICA

The clandestine nature of money laundering makes it difficult to obtain an accurate estimate of the extent of the problem in South Africa. Estimates that have been published vary significantly. The Star (2007) reported that Moloi's estimate that white collar crime in South Africa is approximately R 150 billion a year. Since the proceeds of these white collar crimes would need to be laundered, it could be argued that money laundering should exceed this estimate if the value of the proceeds of other crimes (such as narcotics smuggling and cash-in-transit robberies) were included. Other quantitative estimates cited by Smit (2001) placed money laundering within the Southern African region at a total of USD 22 billion in 1998. Assuming that this estimate is reasonably accurate and that money laundering increased by the maximum inflation target set by the South African Reserve Bank of six percent per year, on a compounded growth basis, money laundering in South Africa would be approximately USD 35 billion in 2006. Based on an exchange rate of R 6,50 to the USD, this would be approximately R 228 billion.

Goredma (2006 : 6), however utilised a survey by Price Waterhouse to show how money laundering in 2005 that was estimated at approximately R 40 billion, had since doubled in 2006. In comparison, a joint study by Walker, Australian Transaction Reports and Analysis Centre and the RMIT University (2004 : 19) cited Trevor Manuel's statement in 2005 that despite a lack of official studies, money laundering in South Africa was estimated to be between two and eight billion USD per year and that the SA Institute of Chartered Accountant had similarly in 2004 estimated that money laundering in South Africa could be up to R80 billion per year.

3. ANALYSIS OF THE EFFECT OF MONEY LAUNDERING IN SOUTH AFRICA

To analyse the effects of money laundering in South Africa, the extent to which it undermines the legitimate economy and creates opportunities for criminal syndicates to mask the proceeds of their criminal activities will be focused upon. The security implications associated with the funding of terrorism through money laundering that occurs within South Africa will also be briefly examined as well as the broader implications of how this would affect the proposed common African currency.

3.1 UNDERMINING OF THE LEGITIMATE PRIVATE SECTOR

Wannenburg (2003 : 77-90) observed that that there is a tendency to utilise front companies to launder money. Notwithstanding the use of these front companies, the large informal economy estimated to be around 20.6 percent of the total economy by Ligthelm (2006), also provides a fertile environment for money laundering in South Africa. The private sector can be undermined since crowding out may occur where criminal syndicates are able to integrate the need to launder money with protection rackets thus forcing informal businesses out of the market, as these businesses would have to absorb both higher capital costs and the protection costs charged by the criminal syndicates. Since similar businesses, which were being funded by laundered funds do not have these costs and do not have to operate at a profit, if the aim is to hide the funds, this could squeeze legitimate businesses out of the market.

Certain business such as cash loan businesses and shebeens are likely to be targeted, according to de Koker (2003a : 91). In both cases, since these businesses are cash orientated and there is a

high volume of transactions that occur, this provides the ideal opportunity for money laundering. Other opportunities may exist in the transportation sector to informal hawking. In the case of hawking, the sale of counterfeit goods and pirated Digital Video Disks (DVDs) may also contribute to money laundering according to Goredma (2006 : 10-11). A criminal syndicate could either sell counterfeit goods or pirate DVDs and then launder the proceeds subsequently, or using laundered funds purchase these goods for sale through the informal market. While the former scenario is more likely, the latter example demonstrates how a syndicate could channel the proceeds of crime into the informal sector.

3.2 UNDERMINING OF THE INTEGRITY OF FINANCIAL MARKETS

Depending on the extent of money laundering, financial markets may be susceptible to being radically altered when criminal syndicates withdraw or invest funds. The US Bureau for International Narcotics and Law Enforcement Affairs (2006) cites South African government estimates that between two to eight billion USD are laundered through the formal banking sector. However, the problem may be compounded by the ease with which Minnaar (1999), noted it is possible to obtain a legitimate identity document illegally through bribing corrupt officials. The basis of opening a bank account in South Africa, requires that the account holder submit both proof of identity and residence in terms of the *Financial Intelligence Centre Act*. If identity documents can be illicitly obtained and proof of residence forged, it follows that requiring this documentation to be submitted may prove more of a “nuisance” than a mitigating control against money laundering for a criminal syndicate. (Financial Intelligence Centre Act, 2001)

Similarly, the *Financial Intelligence Centre Act* requires that financial institutions report transactions above a stipulated threshold. It is unlikely that the use of this threshold may reduce money laundering since a money launderer could quite easily transact below the threshold to avoid deterrence. The converse may also be true. Since the *Financial Intelligence Centre Act* requires that “suspicious transactions” be reported, a money launderer could create a legitimate front company whose transactions are always above the threshold. After the financial institution has monitored the initial transaction flow for a period, and regards the “value” of the transactions as “normal”, the money launderer could engage in laundering funds knowing that the financial institution would not deem this as being suspicious.

An interesting twist in reviewing money laundering in South Africa can be observed in considering the amnesty process that was initiated in terms of the *Exchange Control Amnesty and Amendment of Taxation Laws Act*. In terms of this process, South Africans who had violated exchange control regulations and either obtained or were holding assets or funds offshore were required to make a full disclosure to an Amnesty Unit. Based on this disclosure, and subject to certain penalties, these individuals would potentially qualify for amnesty in respect of these contraventions. (Exchange Control Amnesty and Amendment of Taxation Laws Act, 2003)

According to Rossouw (2006), the value of the 42 672 amnesty applications that were submitted amounted to R 47.6 billion and that using the population figure in South Africa in 2004 of 46.6 million people, this implied that an application was submitted by one out of every 1000 people. This statistic may be somewhat misleading as it may have been more prudent to have expressed this as a measure of the number of people employed in both the formal and informal sector. Statistics South Africa (2005) estimated the number of people employed in the formal non-agricultural businesses as at the end of December 2004 at approximately 7 075 000. Using this as a basis of measurement, this would mean that a more accurate reflection is that an application was received for every six out a 1000 people employed.

If these applicants illegally held foreign assets or funds, this could only have been achieved through money laundering regardless of whether this also included currency/ negotiable instruments abroad. The full extent or degree to which this disclosure may represent the true value of money laundered will most likely never be known. Assuming that the money launderers wanted to access these funds, and prior to amnesty repatriate these funds, money laundering would also be necessary in order to avoid the original contravention being uncovered. This would also imply that due to the large amount of funds involved, any significant movements to and from South Africa would directly impact on the exchange rate, depending on the mode of laundering these funds.

3.3 LOSS OF CONTROL OF ECONOMIC POLICY

The extent to which economic policy may be influenced by money laundering in South Africa is difficult to quantify. The more successful a money launderer is, the more the mode of laundering funds will resemble legitimate business activity. Since money laundering in South Africa is largely cash based, this would imply that where cross-border laundering occurred, there is likely

to be some volatility between the exchange rate of the South African Rand and the currencies of neighbouring states. Madakufamba (2005) observed that there are plans to implement a single currency within the Southern African Development Community (SADC). If a single currency is implemented, it would make it easier to launder funds without having to factor into account any losses due to exchange rates fluctuating. More problematic though, would be the impact of money laundering in other countries that shared this currency, on fellow participating countries.

The economic effects of money laundering are also harder to identify, as Mackrell (1996 : 29-35) noted it is difficult to distinguish between the fruits of honest labour versus benefits derived as proceeds of crime. It could be argued that the other effects of money laundering, such as its use in supporting an extravagant criminal lifestyle may be indistinguishable from a consumer spending perspective, and thus the difference may not be that significant where spending is concerned. This viewpoint, while valid, ignores the associated supply and demand implications. If both legitimate consumers and criminal syndicates in South Africa are consumers of the same goods, it implies that the total demand for these goods are higher, which would lead to higher prices. In extreme cases, Ait-Sahalia, Parker, and Yogo (2004 : 2959-3004) have noted that these higher prices may force legitimate consumers out of these markets, particularly if the goods are seen to be luxury items. In these situations, the local market for these goods could possibly be more dependent on the purchasing power of criminal syndicates than on legitimate consumers.

Another economic effect that would follow is that since criminal syndicates are able to spend more, by virtue of not having to pay income tax, and through laundering have to engage in certain purchases, this could distort the signaling mechanism within the economy. For example, Goredma (2002) suggested that money launderers prefer to invest in property in South Africa. This would imply that money launderers could spend more in purchasing property thus leading to an increase in prices, and also if their purchases were concentrated in a single area, it would indicate a growth in property demand in that area. This could incorrectly “signal” property growth in an area to property investors.

3.4 ECONOMIC DISTORTION AND INSTABILITY

The extent, to which economic distortion and instability, if caused by money laundering, would arise in South Africa is due to the unanticipated potential capital outflows that would arise. Rossouw (2006) noted that the value of offshore assets held by South Africans is approximately

seven percent larger than previous estimates. This would mean that if all these funds were repatriated into South Africa, there would suddenly be an increase in the amount of funds available to purchase the same amount of goods being produced. This would effectively increase the prices for these goods and an increase in inflation would also result. To control the rising inflation, an increase in interest rates would most likely follow. Increases in interest rates would have a dampening effect on the economy according to Ball (1999 : 63-83). While this scenario is based on what would happen if funds that were previously laundered were re-introduced into the economy, the same analysis would be valid for any funds being laundered into South Africa.

If funds were being laundered out of South Africa, it would create a distorted impression that the sector from which these funds were being withdrawn was underperforming. Alternatively if these funds were being laundered through the use of over invoicing, it would create the impression that there was a higher demand for certain goods. This could distort the economy according to Bartlett (2002 : 18-23) as it sends out the wrong signals to both local and international suppliers and producers. For example, it could create the artificial impression that there was a higher demand for a particular product, forcing local producers to shift production accordingly. When this demand fails to materialise, these producers would suffer financial losses having misinterpreted the market signals.

3.5 LOSS OF REVENUE

The US Bureau of Economic and Business Affairs noted that income tax is the single most important contributor to the revenue raised by the South African government. Money laundering and its predicate offences are factors that contribute to the tax gap, as these activities decrease the amount of tax collected. (US Bureau of Economic and Business Affairs, 1994) According to the UN Economic Commission for Africa (2005 : 15), the tax gap in Africa is more than 40 percent. While similar information is not available for South Africa, Vanek (2006) reported that this is estimated to be between R 10 billion and R 30 billion. The Department of Home Affairs, provides services to all South Africans and its budget for 2006/ 2007 was R 2,8 billion (Business Day, 2007 : 2). To put the extent of these losses in revenue in perspective, the lost revenue amounts to between three and 10 times the 2006/2007 budget for the Department of Home Affairs. Tax Justice Network for Africa (2006) suggests that the extent of the lost revenue can also be viewed as being up to 7,5 times the foreign aid that South Africa received in 2004, and

three to nine times what was spent on addressing the HIV/AIDS pandemic in South Africa in 2005/ 2006.

Manqele and Radebe (2006) cited the Commissioner of the South African Revenue Services, who stated that between 25 and 35 percent of all businesses did not pay income tax, and that there was also a large number of individuals who were not registered as taxpayers. These businesses and individuals would need to launder the income that they received, and/ or hoard this income to avoid being detected by the South African Revenue Services. The non-payment of taxes means that less revenue is raised by the government, which impedes service delivery. The lack of service delivery, Sims (2001) observed, may have an effect on the stability of a country.

Losses in terms of competitiveness may also occur as money launderers are willing to accept low profit margins in order to operate their front businesses. While it could be argued that the local consumer benefits from having to pay less, this may not be sustainable if the money launderer decides to switch to another laundering scheme. Essop (2005) reported on how the tax gap in South Africa was exacerbated by the under-reporting of the value of textile imports. This form of criminal activity according to de Boyrie, Pak and Zdanowicz (2005 : 217-230) is prevalent as a method of facilitating money laundering schemes involving over and under invoicing. While there is a direct loss in terms of the duties that cannot be collected, there are also long term revenue losses. Local textile businesses may not be able to compete, and as these legitimate businesses earned less, their tax contribution would decline.

3.6 SECURITY THREATS TO PRIVATISATION EFFORTS

As part of the process of transforming the South African economy to being more globally competitive as opposed to being dependent on government subsidies, a number of government corporations have been privatised and other parastatals restructured. This has allowed the government to obtain revenue by selling off certain resources, and achieve further savings as subsidies previously paid to these organisations, have been curtailed or are no longer applicable. The liberalisation of the economy has also led to more opportunities for investment.

Jain (2001 : 71-121) has suggested that privatisation attracts money launderers. This could be attributed to the “legitimacy” that a money launderer is able to acquire by purchasing into a

previous government corporation and/ or possibly being linked with the high volume/ value of transactions that may make utilising government corporations the ideal vehicle for laundering money. Similarly Celarier (1997 : 531-543) has observed that money launderers are able to bid fair higher prices for these corporations which undermine fair and legitimate competition. The US Department of Justice (2005) submitted that legitimate buyers who fear that the bidding process has been compromised would not bid in the future. This would mean that if any of South Africa's current privatisation efforts were tainted by money laundering, future attempts to privatise other government corporations may attract lower prices (even if bids were still being made by money launderers) as there was less competition. However, the finite number of government corporations, which can be privatised, limits the opportunities for money launderers to utilise this *modus operandi* for laundering the proceeds of crime.

More problematic to address would be the potential ease with which organised crime could launder its criminal proceeds through gaining ownership or significant interest in South African businesses. With the use of approaches such as over and under-invoicing and other sham transactions, it would become easier to cloak money laundering activities under the guise of legitimate transactions as the companies conducting the transactions are not only legitimate but would have an established track record. Through carefully placing their own individuals in key positions, it would be possible to subvert the organisation or to have illegal or sham transactions mingled with valid business transactions thus making it harder for authorities to unravel any laundering or tax evasion that may occur.

Ernst and Young (2005) noted that there were 238 transformation orientated transactions in South Africa in 2005, which were valued at R 56.2 billion. While this does not mean that any of these transactions involved criminal syndicates or money launderers, it serves as an indication of the size of transactions involved. The possibility that these transactions can be targeted by money launders to be used as either a vehicle to launder money or to gain a foothold into legitimate businesses to subsequently create a vehicle for laundering money, cannot be underestimated.

3.7 REPUTATION RISK

For South Africa to attract foreign investment and to retain domestic sources of investment, it is important that the country is seen as having a stable economy. Investor sentiment is often driven by perception, particularly where emerging markets such as South Africa are concerned. Thus

any potential scandal that impacts on South Africa's reputation may have financial implications, and perceptions regarding the extent of money laundering in South Africa may negatively influence investment by impeding growth in the economy.

3.7.1 USE OF MONEY LAUNDERING BY TERROR GROUPS WITH TIES TO DONORS IN SOUTH AFRICA

According to Peiris (2001 : 1-38), groups such as the Liberation Tigers of Tamil Eelam (LTTE) have received support and funding from donors within South Africa including being able to obtain arms and ammunition through the underground arms trade within the country. The LTTE, according to Gamage (2006), is regarded by the US as a terrorist organisation. Jayasuriya (2005) noted that a similar view is also shared by India, Malaysia, Canada, UK and Australia which have designated or banned this organisation. In order for the LTTE to receive funding from sources within South Africa, these funds would need to be laundered.

The LTTE is not the only terrorist organisation with ties to South Africa. The US Department of Treasury (2003) stated that Al Aqsa which has been listed as a Specially Designated Global Terrorist (SDGT) entity, has branch offices in South Africa. Al Aqsa, channels the money that it claims to collect for charity to Hamas terrorists, according to Levitt (2005). Interestingly, the mode of soliciting these funds was based on apparently collecting funds for charitable purposes. The emotive nature of charity and the Islamic tradition of *Zakât*, make it difficult to prevent abuses of charities. *Zakât*, according to Bonner (2005 : 391-406), refers to one of the pillars of Islam that requires an obligatory donation to be made on a yearly basis to the poor. An approach like this is difficult to counter since it allows funds to be siphoned off to support terror activity, and for assets to be purchased that could be used for both charitable purpose as well as terrorism. It is also difficult to monitor since funds that are collected in South Africa may be used outside the borders for purposes other than what they were collected for. Rosenberg (2004) submitted that this is why Al Qaeda has been able to successfully obtain money that is collected from charities.

South Africa's reputation is affected as global pressure to prevent the financing of terrorism would require that it act decisively against either the abuse of charities or against donations made to sympathiser groups with links to terrorist organisations. Since the mode of financing these groups would require some form of money laundering, an inability to effectively prevent this funding would impact on South Africa's own reputation.

South Africa accepted the presidency of the FATF from July 2005 to June 2006. (RSA Ministry of Finance, 2005) From a reputational perspective, South Africa may find itself expected to maintain its position as a leader in the fight against money laundering, even in years following its period at the helm of the FATF. It is also likely that having held the presidency of the FATF, any funding of terrorist organisations originating from South Africa, would be seen as tacit support which would have political consequences for South Africa.

3.7.2 IMPLICATIONS FOR THE PROPOSED COMMON CURRENCY

From the perspective of reputational risk, AFX News Limited (2006) reporting on Bulgaria's attempts to join the EU, demonstrates how the lack of strong measures to counter money laundering would impact on the ability of a countries to join a common monetary union. While this was based on experiences relating to the formation of the EU, this would also have implications for South Africa and the SADC region. Alweendo (2004) noted that there are plans to establish an African Central Bank by 2021, and a common African currency by 2018 with SADC having laid the foundations for the SADC Central Bank by 2016.

The creation of a common currency would imply that money laundering legislation would need to operate seamlessly across all SADC members. Similarly, with a common currency under and over invoicing schemes as well as other money laundering schemes would be easier to perpetrate as criminal syndicates would target countries in the region which were less able to prevent money laundering and then use South Africa as a transit point. This appears to be consistent with the views expressed by Shaw (2001 : 115-120) who noted the role criminal syndicates in South Africa played in smuggling, but also as Thompson (2003a) reported, South Africa's role as the fourth largest producer of cannabis in the world. In effect, criminals would be able to utilise the common currency and weaknesses in the money laundering countermeasures to run operations within South Africa from neighbouring countries. This would impact on South Africa's reputation as it would implicated by association, unless a means of effective border intelligence could be leveraged to address this new threat.

3.8 SOCIAL COSTS

The major focus regarding the social costs associated with money laundering in South Africa, is on the associated bribery and corruption that inevitably follows. James (2002 : 199-217)

explained that a bribe is a payment made to an agent to ensure that the agent acted not necessarily in the interests of his/ her principal, but rather upon the instructions of the party giving the bribe. According to the Warren (2006 : 803-807), corruption is generally considered to be the abuse of public office for private gain. The link between money laundering and bribery and corruption occurs as corrupt government officials would need to launder the bribes that were received. From a social cost perspective, bribery and corruption would imply that (for a price) officials would act in the interests of whoever was paying the bribe as opposed to the public good.

The extent of bribery and corruption, like money laundering, in South Africa is difficult to estimate accurately due to the illicit nature of these activities. Through bribery, criminal syndicates are also able to obtain protection from prosecution and this contributes to the growth of crime. Certain cases that have become public have had major ramifications. For example, Evans and Leigh (2003) reported on the bribes in the form of secret commissions that BAE systems had paid to win the tender to supply South Africa with Hawk jets. Should these allegations be true, then it would mean that South Africa's ability to defend itself may be potentially undermined by purchasing armaments that are either inadequate or unsuited to its specific requirements.

Another approach in examining the social costs of money laundering in South Africa, is to look at the extent and the nature of crimes committed, and the increases in crime. Crime which involves either theft, armed robbery, or is of a financial nature, is intrinsically linked to money laundering, as criminals would need to be reasonably confident that the proceeds of the crime could be successfully laundered. In the absence of this, possession of the stolen items would implicate the criminals. The Mercury (2006) reported that between 2000 and 2006, R 810 million had been stolen in cash heists in South Africa. It is however not stated what the value of the cash heists were for each year. According to Hills, Oelofse and Pressley (2006), the number of cash-in-transit heists had increased from April 2005 to March 2006 from 220 to 383, and drug related offences increased by 13.2 percent. This is despite the legislative measures that had been introduced to combat money laundering in South Africa. By implication, this suggests that criminals were still able to commit more crimes because it was possible to launder the proceeds of these crimes. From a social cost perspective, these increases in crime also undermine investor confidence in South Africa and its attractiveness as a tourist destination.

3.9 UNDERGROUND BANKING

In South Africa, de Koker (2003b : 27-41) noted that underground banking is found in the form of the hawala/ hundi systems. This view is not however shared by Pieke, Van Hear and Lindley (2005 : 19) who found very little evidence of such a system in South Africa, and that its use was mainly limited to Somalia. While a clear answer as to whether or not such a system is being used may be difficult to establish with the differing views expressed, the prospects for its use cannot be overlooked.

The use of hawala/ hundi is dependent on a network of connections, and as an alternative payment system allows payment instructions to be transmitted by its operators between countries. The actual transferring of money itself, according to Passas (2003 : 49-59), is achieved through manipulating invoices to settle net positions. From a law enforcement perspective, it becomes difficult to trace these transactions due to the lack of records and the difficulties associated with identifying whether or not goods values are adequately reflected in the supplied invoices.

The use of non-traditional banking systems may also flourish in South Africa, as the use of interest is forbidden under Islamic law. According to Gerrard and Cunningham (1997 : 204-216), Islamic banking requires that losses and profits be shared between the lender and the borrower, and a number of different payment mechanisms can be structured to ensure this without relying upon interest charges. With limited banking opportunities for the Muslim consumer to still be able to borrow money while adhering to his/ her religious requirements, a market will exist for financial products that comply with Islamic law. While this form of banking is legitimate, and is widely found elsewhere in the world, there are limited financial products in South Africa that adhere to these requirements. An aspect of Islamic banking, that may be susceptible to abuse by money launderers, is that it allows for joint ventures to be engaged in. This would allow a money launderer to effectively become a “silent partner” in a legitimate business. While this is a possibility, the extent to which this occurs in South Africa can only be speculated upon.

4. CONCLUSION

Money laundering in South Africa can have significant negative economic consequences to the degree to which it would influence the extent of cash holdings; cause fluctuations in interest and

exchange rates due to cash movements; and impact on the rate of inflation. Although many of these effects can only be speculated upon, there are certain distinctive patterns that can be observed.

The high levels of crime in South Africa imply that relatively high levels of money laundering occur. The amnesty process in South Africa in 2006 that led to funds illegally held offshore being returned to South Africa, necessitated estimates for offshore assets being increased by seven percent. This suggests that South Africa has experienced significant money laundering in the past. Regardless of the motivations for exchange control violations, the extent of the funds laundered out of South Africa points to the existence of a successful underground money laundering ‘pipeline’. To assume that criminal syndicates would not make use of the same *modus operandi* to launder money, would be unrealistic.

South Africa has also attracted attention from terror groups who have been soliciting funds from sympathetic donors. The funding of terrorism originating from South Africa, in conjunction with the possible abuses within the unregulated underground banking in South Africa, requires that South Africa implement a cogent, coherent and practical legislative approach supported by a sound institutional framework to address these threats. Chapter Five will focus on the legislative framework that South Africa has adopted; the institutions that have been established to address the money laundering threat; and a selection of cases that have involved aspects of money laundering. This will allow a comparison to be drawn between the provisions of the legislation and how it is applied in practice and whether or not the institutions that are meant to act in terms of the legislation, have performed adequately.

CHAPTER 5. MONEY LAUNDERING COUNTERMEASURES IN SOUTH AFRICA

1. INTRODUCTION

Chapter Five will focus on official perceptions regarding money laundering in South Africa; existing legislation in this regard; an overview of the organisations that have been specifically tasked with addressing money laundering; and a selection of South African cases which highlight the success of applying this legislation in practice.

2. OFFICIAL PERSPECTIVES ON MONEY LAUNDERING

The South African National Director of Public Prosecutions, stated in 2003 that money laundering was a “serious threat to our democracy”, in an address that he delivered at the National Prosecuting Authority’s Anti-Money Laundering Training Seminar. (Ngcuka, 2003) This perspective was based on the view that money laundering underlined all criminal activities, by allowing criminals to obscure the source of the profits of their criminal activities. Earlier attempts by the South African government to combat money laundering emphasised the strong link between criminal syndicates and money laundering as a mechanism of furthering criminal acts associated with (for example) drug smuggling. Combating these crimes required cooperation amongst law enforcement officials in different countries, which South Africa formally addressed when it introduced the *International Cooperation in Criminal Matters Act*, 1996 and the *Proceeds of Crime Act*, 1996. The *Proceeds of Crime Act* made money laundering an offence and provided mechanisms for the seizure and confiscation of these funds. (Omar, 1997a)

The threat of transnational crime, terrorism and corruption has also been seen to affect the South African governments “broader social and economic transformation agenda”. Combating these threats has necessitated the implementation of legislative reforms aimed at criminalising money laundering and ensuring that South Africa is able to comply with the FATF recommendations. (Nqakula, 2005)

2.1 MONEY LAUNDERING AND ORGANISED CRIME

Money laundering in South Africa has often been associated with the drug trade. Its infrastructure and geographical location makes South Africa an ideal location for criminal syndicates engaged in drug smuggling. Focusing on the drug trade and its transnational implications meant that South Africa had to address threats posed by criminal syndicates that may operate outside its national borders. Ensuring that South Africa was able to combat these threats required cooperation, both regionally and internationally. Failure to address these threats would lead to South Africa continuing to be used as a transit point for drug smuggling by criminal syndicates and potentially prompt vigilante action by dissatisfied citizens. (Omar, 1997b)

Crime is viewed as a threat to the quality of life enjoyed by citizens in South Africa. Laundering the proceeds of criminal activity presents particular challenges, as the ability to transmit these proceeds across national borders may inevitably undermine effective law enforcement unless there is adequate effective regional cooperation. It was suggested that this presents a “source of similar exasperation” to law enforcement officials in neighbouring states who are unable to easily pursue criminals who launder their illicit profits in South Africa. To effectively deal with organised crime, it was also suggested that it is essential to understand how criminal syndicates would adapt their behaviour to deal with regulations that have been implemented in South Africa. (Gillwald, 2002)

The proceeds of crime when confiscated are deposited into the Criminal Assets Recovery Account (CARA). CARA was created as a result of the *Prevention of Organised Crime Act*. These proceeds may include cash, motor vehicles, equipment and property. To boost efforts to fight crime, and to provide support to government departments that are involved with aiding the victims of crime, Cabinet authorised in 2006 the disbursement of cash funds amounting to R73,8 million, and for the distribution of motor vehicles, equipment and property to these departments. Previously, more than R200 million has been paid in compensation to the victims of crime. (RSA Ministry of Justice and Constitutional Development, 2006)

2.2 MONEY LAUNDERING AND CORRUPTION

The link between corruption and money laundering was found to be a critical element associated with the furthering and the fostering of growing criminality and the increase in transnational criminal syndicates. Preventing money laundering from having a destabilising effect on government institutions and the financial system required effective cooperation both within South Africa, and in the region itself. To ensure that South Africa was able to play its role in combating money laundering, the responsibility to promote regulations and mechanisms aimed at preventing money laundering was assigned to the Department of Finance. (Baqwa, 1997)

Corruption may have far-reaching consequences. These include the undermining of the effectiveness of the public service; laundering of money and other assets; and reducing tax revenue which would impede service delivery. Only through ensuring that money laundering is effectively curbed and that illicit funds are returned to their source, would it be possible to aid developing nations in their efforts to recover any “looted funds”. However, for these efforts to be successful, cooperation has to be endorsed globally, and the *UN Convention against Corruption* was an initiative that was posed to support these efforts. (Fraser-Moleketi, 2006)

Another example of corruption related to fraud associated with social security grants that had led to losses of more than R 1,5 billion per annum. Reported cases that have been singled out include an Eastern Cape syndicate that is facing “11 000 charges of laundering R 3,5 million in social assistance grants”, and the arrest of 147 government officials. It was also emphasised that for anti-corruption initiatives to be successful, community participation in reporting incidents of corruption is essential. (Skweyiya, 2004)

South Africa, in conjunction with the African Union Commission has subsequently reiterated its commitment to dealing with corruption on a regional and continent wide level, when it issued the “Ekurhuleni Declaration”. It was acknowledged that corruption was undermining the path of development for Africa. The *Ekurhuleni Declaration* specifically included money laundering as an aspect when defining corruption. The South African government has also implemented communication mechanisms to raise awareness of corruption including the launch of a national Anti-Corruption Hotline and a media campaign. (RSA Department of Public Service and Administration, 2007)

2.3 MONEY LAUNDERING AND TERRORIST FINANCING

The need to prevent the proceeds of crime and terrorism financing entering the South African financial system was due to the reputational impact associated with money laundering and the way in which money laundering negatively effects financial stability. Money laundering can have other consequences ranging from distorting business decisions, increasing the likelihood of banks failing, to lower tax revenues. (Mpahlwa, 2003)

The emphasis on halting the funding of terrorist activities; preventing terrorist funding; and ensuring that organised crime did not profit from criminal activities, has underlined the South African approach to combating money laundering. Money laundering in the context of terrorist financing, was viewed as a threat to the international financial system. For these money laundering countermeasures to be successful, a globally coordinated and integrated approach that emphasised cooperation across boundaries was subscribed to. Similarly, in acknowledging the potential for criminals to utilise loopholes in legislation, it was critical that South Africa align the money laundering countermeasures that it had adopted with international best practices, as provided for by the FATF. (Asmal, 2005)

In response to a question posed in a parliamentary briefing to Cabinet in 1996 on how South Africa should address money laundering, Minister Chris Liebenberg stated that “solution number one” was “to get effective legislation on the Statute book”. The introduction of such legislation would only partially address the threat of money laundering as the common monetary area implied that other countries within the SADC region would also need to implement controls for an effective anti-money laundering regimen to be maintained. Locating these controls in the Reserve Bank as an extension of the role of the Registrar of Banks or extending the ambit of exchange control regulations was suggested. (Liebenberg, 1996) A review of the most important legislation that was subsequently implemented and/ or amended to address money laundering, will be discussed in the next section.

3. MONEY LAUNDERING LEGISLATION IN SOUTH AFRICA

The purpose of money laundering legislation in South Africa is to translate official government policy into practical rules and regulations that can be used as the basis for enforcing compliance. In order to establish which money laundering legislation is applicable in South Africa, the Anti-Money Laundering International Database (AMLID) run by UNODC's International Money Laundering Information Network (IMoLIN) was used as a basis for this study. AMLID is a restricted database which contains information pertaining to legislation aimed at preventing money laundering. While access to AMLID is restricted to selected government officials in participating countries, the list of legislation that is applicable to money laundering in a particular jurisdiction is made public.

During 2001 and subsequently in 2006, assessments of South Africa's money laundering legislation were undertaken by UNODC's IMoLIN. From the legislation that was identified as being applicable to South Africa, the following will be reviewed :

- a) Currency and Exchanges Act (Act 9 of 1933);
- b) Extradition Act (Act 9 of 1962)/ Extradition Amendment Act (Act 77 of 1996);
- c) Criminal Procedure Act (Act 51 of 1977);
- d) Banks Act (Act 94 of 1990)/ Banks Amendment Act (Act 26 of 1994)/Banks Amendment Act (Act 55 of 1996);
- e) Interception and Monitoring Prohibition Act (Act 127 of 1992);
- f) Drugs and Drug Trafficking Act (Act 140 of 1992);
- g) International Cooperation in Criminal Matters Act (Act 75 of 1996);
- h) Long-Term Insurance Act (Act 52 of 1998);
- i) Prevention of Organised Crime Act (Act 121 of 1998);
- j) Financial Intelligence Centre Act (Act 38 of 2001), and
- k) Protection of Constitutional Democracy against Terrorist and Related Activities Act (Act 33 of 2004).

The *Financial Intelligence Centre Act*, is specifically designed to combat money laundering and establishes mechanisms to mitigate the threat of money laundering, while the *Prevention of Organised Crime Act* and the *Protection of Constitutional Democracy against Terrorist and Related Activities Act* make participation in money laundering whether for criminal purpose or to

support terrorist groups an offence. Elements of money laundering associated with the *Long-Term Insurance Act* and the *Short-Term Insurance Act* are not unique to South Africa, and would apply to any similar insurance agreements. The remaining legislation that is discussed incidentally addresses money laundering as being a consequence and/ or a means of fuelling other criminal and/ or terrorist activities.

Early attempts to address money laundering were associated with combating money laundering associated with a particular crime. Thus the *Drugs and Drug Trafficking Act*, which dealt with the illegal trade in narcotics made the associated laundering of proceeds associated with this predicate offence a criminal act. This approach subsequently evolved as South Africa addressed money laundering by approving the *UN Convention against Transnational Organised Crime*, and nine of the *International Instruments on Terrorism*. (Nqakula, 2005) The conventions and International Instruments upon ratification have subsequently been incorporated into legislation. Addressing the threat of transnational organised crime was dealt with by the *Prevention of Organised Crime Act* while money laundering associated with terrorist financing as referred to in the *International Instruments on Terrorism* was dealt with in the *Prevention of Organised Crime Act* and the *Protection of Constitutional Democracy against Terrorist and Related Activities Act*.

3.1 CURRENCY AND EXCHANGES ACT

The *Currency and Exchange Act* deals with “Regulations regarding currency banking or the exchanges”. (Currency and Exchange Act, 1933 : Section 9). This section allows the President to promulgate regulations relating to currency, banking and exchanges. In addition, certain functions and duties have been delegated by the Minister of Finance to Governor/ Deputy Governors and the General Manager of the Exchange Control Department in the South African Reserve Bank. This delegation of power and the manner in which it is exercised is dealt with in terms of *Exchange Control Regulations*. (RSA Government Notice R1111, 1961 and RSA Government Notice No. R.885, 1999).

These *Exchange Control Regulations* target money laundering by limiting the amount of currency that can be transferred out of South Africa, and by allowing these transactions subject to the purpose of the transactions being valid, and the identity of the person conducting the transaction known. The former is achieved by limiting the trading of currency to authorised dealers only. These dealers are appointed by the Exchange Control Department of the South

African Reserve Bank, and any person wanting to purchase or sell any foreign currency has to do this through these authorised dealers. The latter objective, in terms of approved transactions, requires that the purpose of the purchase must be provided when foreign currency is being purchased and that the authorised dealers are obliged to report on each sale of foreign currency made. (RSA Government Notice R1111, 1961 and RSA Government Notice No. R.885, 1999).

The *Exchange Control Regulations* also authorise the searching of any persons entering or leaving South Africa, for possession of currency that has not been declared. With the FATF having drawn attention to the use of currency smuggling as a mode of money laundering, this provision which was adopted to prevent the loss of currency, may prove to be advantageous to authorities in a quest to combat money laundering. A potential weakness, according to the Consultative Group to Assist the Poor (2003) is that in terms of the *Postal Act of 1958*, the South African Post Office may also remit money, but that this does not have to be reported to the South African Reserve Bank. (Postal Act, 1958 : Section 46). This loophole was subsequently closed in 2001 with the introduction of the *Financial Intelligence Centre Act*. (Financial Intelligence Centre Act, 2001).

However, without detailed searches being conducted on every person leaving and/ or entering the country, it would still not be possible to prevent the smuggling of currency. Similarly, with a person having up to thirty days upon returning to South Africa to re-sell any foreign currency in his/ her possession, there is no guarantee that a person will re-sell this currency to an authorised dealer or that a person accurately reflected the foreign currency in his/ her possession when entering the country. This creates potential opportunities for criminal syndicates to be able to gain access to foreign currency if they are able to utilise “touts” outside authorised dealers. Similarly, a criminal syndicate can also utilise “mules” to legitimately carry the maximum currency allowed offshore out of the country. With the relatively low cost of international travel, this option may prove more difficult to counter.

3.2 EXTRADITION ACT/ EXTRADITION AMENDMENT ACT

The *Extradition Act* (1962) was subsequently amended by the *Extradition Amendment Act* (1996). The purpose of this act is to allow South Africa to extradite any person upon a request being submitted by a country with which South Africa has an extradition agreement. The *Extradition Amendment Act* was designed to allow authorities both in South Africa and abroad to

be able to trace, apprehend, and repatriate suspected criminals and thus avoid criminals fleeing to or from South Africa to avoid prosecution. Since money laundering is an offence, this legislation could be used to extend the reach of the law. However, in terms of the *Extradition Amendment Act* which replaced the *Extradition Act*, the Minister does not have to surrender a person to be extradited under certain circumstances. These circumstances, include where a suspected criminal may be subject to violations of his/ her human rights. (Extradition Amendment Act, 1996: Section 11 and Extradition Act, 1962: Section 9)

The challenge with the *Extradition Amendment Act* is whether or not it would be possible in practice to extradite a person who is about to be charged for an offence within South Africa. While the *Extradition Amendment Act* allows the Minister to hand over a person who is already serving a prison sentence, the authorities would most likely insist that the person repay his/ her debt to society in South Africa before being extradited to face prosecution elsewhere. (Extradition Amendment Act, 1996: Section 10)

The problem may be compounded by the growth of transnational crime. With money laundering being a complex activity, it may prove onerous to differentiate between the different jurisdictions that have a claim to prosecution in terms of layering, integration and placement. Likewise, many countries apply the “double jeopardy” principle, as defined in the *Convention for the Protection of Human Rights and Fundamental Freedoms* which protects a person from being charged for a second time for the same offence. (Convention for the Protection of Human Rights and Fundamental Freedoms, 2003: Article 4, 7th Protocol). This would effectively mean that in the absence of international cooperation at a prosecution level, extraditing persons on money laundering offences may prove futile if they have been charged in one jurisdiction, regardless of the sentencing outcome.

3.3 CRIMINAL PROCEDURE ACT

The *Criminal Procedure Act* (1977) provides the basis for criminal investigations in South Africa. While the *Criminal Procedure Act* explains the powers, duties and responsibilities of law enforcement when undertaking investigations, its relationship to countering money laundering can be seen in the way that it predominantly deals with the predicate crimes whose subsequent proceeds are laundered.

The sections that deal with the use of traps and undercover operations were subsequently amended by the *Criminal Procedure Second Amendment Act (1996)*, and allow law enforcement authorities to engage in such activities provided that the setting of a trap does not involve entrapment. Entrapment implies that law enforcement entices or actively encourages the commission of the crime, as opposed to merely providing the opportunity for the crime to be committed. This approach may prove to be advantageous when dealing with money laundering as opposed to focusing solely on the confiscation/ freezing of assets. The approach of confiscation and freezing funds and other assets works ideally when dealing with transnational and local criminal syndicates as it targets the profit motivation of criminals, and if applied properly would reduce the predicate crimes accordingly. (Criminal Procedure Second Amendment Act, 1996: Section 252 and Section 265)

When dealing with money laundering used to finance terrorism, the use of confiscation and forfeiture may yield mixed results. In the same way that terrorists cache arms and ammunition to be used to spread terror, the laundering of money is merely another tool in their arsenal. Targeting money laundering in this situation will temporarily deprive a terrorist group of funds and assets, but not lead to their capture and prosecution. In the case of preventing money laundering being used as a vehicle for terrorist funding, the aim should be to follow the money trail and apprehend the terrorists.

Based on applying this, law enforcement authorities should understand the purpose for which the funds are being laundered before deciding on whether or not to confiscate and freeze these assets or funds or to use this as a bait to lure terrorists. The use of this provision in the act also provides for the admissibility of the evidence obtained in this manner, which would support a successful prosecution. (Criminal Procedure Second Amendment Act, 1996: Section 252)

It is also an offence to knowingly receive stolen property. This would occur at the point of placement within the money laundering cycle, which would therefore be the weakest point which could be exploited by law enforcement. Through prosecuting the persons involved with receiving the stolen property, the market for stolen goods can be attacked which reduces the opportunities that a criminal has to get rid of the stolen property in his/ her possession. (Criminal Procedure Second Amendment Act, 1996: Section 265)

3.4 BANKS ACT/ BANKS AMENDMENT ACT

The *Banks Act* (1990), and the *Banks Amendment Act* (1994, 1996 and 2003) regulate the establishment, control, review and operation of banks in South Africa. An application of the *Banks Act* and its subsequent amendments, is designed to prevent money launderers from being able to establish shell banks or engage in illegal deposit taking.

Shell banks are entities that are created as banks, but which have no real physical presence, beyond a paper operation run by a single agent and consist of little more than a physical address for legal purposes. The purpose of these shell banks is to enable the operators to bypass the more rigorous prudential supervision that is in place to mitigate against money laundering in countries that subscribe to FATF and Basel principles. Shell banks often operate through a correspondent banking agreement with an established financial institution, which allows financial transactions to be processed without the shell banks having to identify its own customers to the financial institution undertaking the transactions on its behalf. Serio (2004 : 435-444) noted that shell banks have been extensively used to launder money, and the connotations of being associated to an established bank also adds to the legitimacy of the funds being transferred as this is being undertaken by a recognised financial institution. In preventing these arrangements, South Africa is able to effectively prevent the undermining of its banking system by eliminating a potential loophole that would allow laundered money to be introduced into the financial business stream.

The problem of preventing illegal deposit taking is more complex. While the *Banks Act* itself explicitly identifies the nature of a bank to include the soliciting of deposits, defining an activity as being illegal does not mean that the activity can easily be prosecuted. The SA Registrar of Banks (2006 : 29-30) stated that there were three new investigations into illegal deposit taking which were undertaken in 2005 and that a further thirty investigations were completed that had been “carried over from 2004”. It may prove to be a Herculean task for any Regulator to try and stamp out illegal deposit taking because of its underground nature and because of willing participants who may be attracted by promises of higher returns. Illegal deposit taking may also lead to an increase in money laundering, since this creates a cash flow cycle which makes it easier to launder money.

3.5 INTERCEPTION AND MONITORING PROHIBITION ACT

The *Interception and Monitoring Prohibition Act* of 1992 was subsequently repealed and replaced with the *Regulation of Interception of Communications and Provision of Communication-related information Act* (2002). Privacy International (2004) noted that the purpose of the *Regulation of Interception of Communications and Provision of Communication-related information Act*, remained similar to its predecessors. The purpose of this legislation was to allow for the monitoring of communications, in an attempt to obtain evidence or leads that could be used to in to support further investigations or to prosecute criminals. The significant differences in the *Regulation of Interception of Communications and Provision of Communication-related information Act* compared to the 1992 Act, related to the inclusion of monitoring of the Internet; the provision of the means for intercepting communications by the telecommunications service provider; and for the creation of interception centres. (Regulation of Interception of Communications and Provision of Communication-related information Act, 2002: Chapters 5 and 6)

The *Regulation of Interception of Communications and Provision of Communication-related information Act* allows for the decryption key to be obtained by law enforcement authorities. (Regulation of Interception of Communications and Provision of Communication-related information Act, 2002: Section 21) The ability to intercept, monitor and decrypt these communications would allow law enforcement to obtain proof of either predicate crimes and/ or money laundering itself. However, the likelihood of being able to obtain the decryption key remains uncertain particularly where the encryption products used by criminals are produced by companies that are not based in South Africa. Given that these companies have a commercial interest in the success of their products, and this is based on the ability of the products to protect the communications that are being encrypted, it is unlikely that they would willingly disclose this key as it would impact on the continued sales of their products. Similarly the multiplicity of encryption products, and the need to negotiate with foreign governments to attempt to obtain access to these keys, may undermine the chances of successfully decrypting a message timeously.

There is also nothing to prevent money launderers and criminals switching products, if a particular encryption product can be unlocked or using techniques such as steganography which involves hiding data in seemingly innocuous graphics files. Besides being innovative, it would be time consuming and extremely costly for law enforcement authorities to attempt to decrypt

communications that were both encrypted and hidden using steganography. While the aim of the *Regulation of Interception of Communications and Provision of Communication-related information Act* is vital in ensuring that communications between criminals can be monitored and intercepted, it would not prevent the use of illegal telecommunication devices that are not capable of being intercepted or the adoption of technology by criminal syndicates and terrorists that are designed to prevent monitoring and interception.

3.6 DRUGS AND DRUG TRAFFICKING ACT

The *Drugs and Drug Trafficking Act* (1992) was an early precursor to legislation aimed at preventing money laundering, and focused specifically around the prevention of laundering associated with the trafficking of narcotics. In terms of the Act, the “acquisition” and “conversion” of the proceeds of these predicate offences were made a crime. (Drugs and Drug Trafficking Act, 1992: Sections 6 and Section 7)

The *Drugs and Drug Trafficking Act* also created an obligation to report suspicious transactions to the police or a designated officer. A designated officer was a commissioned police officer within the South African Narcotics Bureau. (Drugs and Drug Trafficking Act, 1992: Chapter 3). The Act also specifically addresses the proceeds of crime including attempts to simulate or engage in sham transactions to avoid confiscation. (Drugs and Drug Trafficking Act, 1992: Chapter 5)

It could be argued that the emphasis on targeting the proceeds of crime should have been extended beyond this Act to other crimes, such as theft, hijackings and robberies. However, at the time that this legislation was passed, the key focus both in South African and internationally was on targeting drug trafficking as a transnational crime by attacking the profits of drug barons.

3.7 INTERNATIONAL COOPERATION IN CRIMINAL MATTERS ACT

The *International Cooperation in Criminal Matters Act* contributed to the campaign against money laundering by ensuring the admissibility of testimony obtained outside South Africa that is deposed according to certain procedures. A South African court would issue a letter of request in terms the Act that would be submitted through the Director-General of Justice to an appropriate government body in the country where the witness was. The testimony that the

witness would provide, is given the same evidentiary weight as if the testimony had been delivered locally. (International Cooperation in Criminal Matters Act, 1996: Chapter 2)

The *International Cooperation in Criminal Matters Act* allows South African courts to seek compensation from the disposal of assets that may be held outside South Africa. The Director-General of Justice is also required to reciprocate in processing similar requests to obtain compensation from assets held in South Africa where a person has been found guilty in another jurisdiction. (International Cooperation in Criminal Matters Act, 1996: Chapter 3)

Effectively the provisions of the Act allow for the grasp of the law to be extended beyond the borders of South Africa, particularly in targeting the proceeds of crime where these may have been laundered and disposed off outside South Africa to avoid prosecution from local authorities. The admissibility of evidence from witnesses in other countries prevents money launderers escaping prosecution due to a lack of local evidence.

3.8 LONG-TERM INSURANCE ACT

In terms of the definitions in the *Long-Term Insurance Act*, a long-term policy is described as “an assistance policy, a disability policy, fund policy, health policy, life policy or sinking fund policy, or a contract comprising a combination of any of those policies; and includes a contract whereby any such contract is varied.” This Act regulates how long-term insurers ensure the financial viability of their operations when selling these types of policies. (Long-Term Insurance Act, 1998: Part VII) From a money laundering perspective, Moulette (2000) observed that a money launderer could launder funds through premiums and then gain access to these funds by redeeming a long-term policy early. It would also be possible to launder money by creating a “clean” annuity income stream by using laundered funds to pay the premiums.

A more complex, but viable approach, would be to raise a loan against a policy that had been funded using laundered funds. The surrendering/ early redemption of the policy (depending on the agreement) would settle the outstanding loan allowing the money launderer to pay off the loan against the redemption of the policy as a means of laundering money. It would be more innovative to have maintained the loan, and the long-term policy as security with the laundered funds being used to pay the premiums. This would allow the money launderer a semi-permanent

vehicle with which to launder funds, that would be limited only by the terms of the policy itself and which could still be surrendered should the funds be required.

Despite the encompassing nature of the *Long-Term Insurance Act*, it is unlikely that an insurance company is going to be able to prevent early redemption of a policy. Although deterrents such as higher penalties can be implemented, this is unlikely to mitigate against the use of these schemes by money launderers who would regard this as the operating costs associated with laundering the proceeds of criminal activities.

It remains difficult to prevent the abuse of these policies as the mode of abuse mirrors normal transactions, which is why money launderers would be attracted to such a scheme. The early redemption of policies and the use of a policy as security are not necessarily transactions that generate suspicion, and more attention should be focused on the potential loopholes that can be exploited by money launderers.

3.9 PREVENTION OF ORGANISED CRIME ACT

The initial attempts to combat organised crime were rooted in focusing on the proceeds of crime. The *Proceeds of Crime Act* made money laundering a specific offence. It provided the means to confiscate the proceeds derived from criminal activity, and imposed a requirement on businesses to report any suspicious transactions. Only a single report of suspicious activity was filed in terms of the Act, according to Schönteich (1999). This probably contributed to the perception that the *Proceeds of Crime Act* had generally failed to deliver any significant impediment to money laundering activities, and it was subsequently repealed. The *Prevention of Organised Crime Act* replaced the *Proceeds of Crime Act*. (Prevention of Organised Crime Act, 1998 and Proceeds of Crime Act, 1996)

The purpose of the *Prevention of Organised Crime Act* was to counter the planning, involvement or participation in respect of a list of wide ranging criminal activities. These activities included gang related activities and participating in any of the phases of laundering the proceeds of crime. In terms of money laundering, the Act also makes engaging in sham transactions an offence. The Act also provides indemnity against civil/ criminal action for any disclosures made in terms of suspicious transactions. This may prove to be a challenge in practice as it would (in theory) impact on the confidentiality that an attorney and his/ her client has. For example, how would an

attorney ensure that the fees being paid to represent his/ her client were not being paid out of the proceeds of criminal activity ? (Prevention of Organised Crime Act, 1998: Chapter 3)

Since the basis of reporting suspicious activity is based on the person receiving the property having had such a suspicion, Gupta (2002 : 159-183) submitted that this could form the basis of a defence argument. In complex money laundering schemes, the obscuring of the proceeds of crime will include not only transactions that mimic legitimate transactions, but also involves intermediaries who were acting on the basis that this was a legitimate transaction. Piercing the layers of a money laundering scheme, and proving that each of the participants knowingly engaged in the laundering of funds that was known to him/her as being derived from criminal activity, may prove to be time consuming and onerous. Likewise, the confiscation and seizure of these funds and/ or other assets by law enforcement authorities would alert other participants involved in the money laundering scheme and make it difficult to arrest and prosecute these individuals.

The *Prevention of Organised Crime Act* also deals with the proceeds of criminal activity and forfeiture of the proceeds of crime which is investigated by the Asset Forfeiture Unit. The National Director of Public Prosecutions can approach the court to seek a forfeiture order in respect of the proceeds of crime or because the funds/ assets were used in furtherance of criminal activity. These provisions are designed to target the nerve centre of criminal activities by threatening not only the illicitly derived profit, but also by removing the means to commit further criminal activity. (Prevention of Organised Crime Act, 1998: Chapter 5 and 6)

The *Prevention of Organised Crime Act* provides for a Criminal Asset Recovery Account, which is meant to house the proceeds of funds obtained through the application of any forfeiture and confiscation orders and is to be used in the fight against crime and for providing compensation to victims. (Prevention of Organised Crime Act, 1998: Chapter 7) This approach is innovative as it potentially goes beyond providing a self funding means to target criminals but also encourages balancing the costs of pursuing a successful prosecution against the value of the proceeds that are recovered from these criminal activities. Since more funds would be generated by combating larger criminals syndicates as opposed to petty criminals, successful prosecutions lead to criminals ironically funding the fight against their ilk, through the proceeds of illegal activities. While this may be reminiscent of poetic justice, it could also create a situation in which only larger criminal syndicates are targeted because of the effort and cost involved, allowing smaller criminals groups to evade the net. These groups could subsequently evolve to fill the vacuum left

by the prosecution and apprehension of larger syndicates. To avoid this situation from transpiring, it may be prudent to develop operational guidelines that differentiate when and to what extent these duties and responsibilities can be divided between the Asset Forfeiture Unit and the SAPS.

3.10 FINANCIAL INTELLIGENCE CENTRE ACT

The *Financial Intelligence Centre Act* led to the establishment of the Financial Intelligence Centre (FIC) in South Africa which is responsible for countering money laundering. The FIC is responsible for the processing, and analysing of information relating to suspected money laundering activities. To assist the FIC in identifying the best practices and the latest trends, the experiences and knowledge of regulators, certain government departments and accountable institutions are tapped into through the creation of the Money Laundering Advisory Council (MLAC). (Financial Intelligence Centre Act, 2001: Chapter 1)

Beyond providing a forum for representing the interests of the regulators, certain government departments and accountable institutions, the MLAC also provides a platform for the FIC to build relationships and to form cohesive partnerships to combat money laundering through a united front. This approach is also likely to enjoy more support, if applied properly, since it would minimise the potential lack of commitment from organisations represented in the MLAC due to perceived territorial issues or a perception that the FIC is undermining these organisations duties and responsibilities.

The specific control measures necessary to prevent money laundering are described in the Act. These include the requirements in respect of identifying clients, the necessary records to be retained, and the reporting of cash transactions over a particular threshold. The Act also outlines the rationale behind identifying what transactions should be considered suspicious. (Financial Intelligence Centre Act, 2001: Chapter 3) Though this list is well laid out and appears reasonable at first glance, the challenge remains that the determining whether or not a transaction is suspicious requires a subjective evaluation. Applying the standards of a reasonable man to determine this, while a judicial device, may not prevent the initial laundering of the funds itself.

Further provisions in the Act relate to the carrying of currency into or out of South Africa and the use of electronic transfers to achieve this objective. (Financial Intelligence Centre Act,

2001: Chapter 3) Despite these provisions, it is unclear as to how purchases done on a valid credit card either electronically through the use of the Internet or physically outside of South Africa would be prevented, since the payment would still be processed locally. This may create opportunities for money laundering to occur through credit cards.

Other forms of laundering through (for example) the use of collectable postage stamps may occur. A reading of the *Prevention of Organised Crime Act* does not appear to explicitly enforce any reporting requirements on philatelic dealers. Beyond stamp collecting serving as a hobby, it is also a mode of investment. The *Prevention of Organised Crime Act* would have therefore benefited by perhaps listing commodities that may be collected for investment purposes, and requiring that dealers in these rarities also report suspicious transactions.

The *Prevention of Organised Crime Act* also supports the monitoring and freezing of bank accounts that are suspected of being used to launder money and the seizure and forfeiture of the proceeds of crime. The extent to which the FIC will be able to translate the information that it receives into credible intelligence that can be used to guide efforts to counter money laundering may be open to debate.

The FIC, for example, requires that transactions be reported within a prescribed period. However, in practice how would the FIC ask reporting institutions to search for an account of a suspected terrorist or criminal syndicate? The publishing of a list with identification details may not help, since identity documents can be forged and many South Africans have two identity numbers. This was as a result of identity numbers being amended to no longer indicate population groups. With the possibility of identity theft, it is not inconceivable that a criminal and/ or a terrorist could hold an account in another person's name with a smaller financial institution to avoid discovery.

To address this loophole, the FIC should consider releasing a request template and require that all reporting institutions incorporate the requirements for such a template to be processed in any system that stores either client or transaction records. This would then speed up the turnaround time from submitting requests, and improve the prospects that reporting institutions would be able to participate in preventing money laundering, as opposed to grudgingly processing these requests by improving the ability to analyse data more effectively and efficiently due to this standardisation.

3.11 PROTECTION OF CONSTITUTIONAL DEMOCRACY AGAINST TERRORIST AND RELATED ACTIVITIES ACT

The *Protection of Constitutional Democracy against Terrorist and Related Activities Act* is the latest salvo in the bid to develop legislation aimed at combating money laundering and terrorist financing. The purpose of the Act was to incorporate into local legislation, South Africa's support of the UN Counter Terrorism Conventions and Protocols and the *African Union Convention on the Prevention and Combating of Terrorism*. The *Protection of Constitutional Democracy against Terrorist and Related Activities Act* targets money laundering by making the laundering of funds for the purposes of financing of terrorist activities an offence. (Protection of Constitutional Democracy against Terrorist and Related Activities Act, 2004: Section 4)

Addressing money laundering in this way, is an important aspect of ensuring that South Africa's legislation supports the conventions and agreements that the country has endorsed. However, this may mean that legislators will need to decide whether or not future money laundering legislation should be focused on specific predicate offences or consolidated into a single legislative act. The latter approach may be preferable as it would prevent duplication, since the core issues and the nature of money laundering remain the same regardless of whether it is used by a criminal syndicate or a terrorist organisation. The difference lies in money laundering being the means through which a criminal protects the proceeds of criminal activity, while a terrorist utilises money laundering to fund the necessary tools to support the spread of terror.

While effective legislation provides the foundation for countering money laundering, it is necessary to establish institutions that are able to implement this legislation. An examination of the supporting institutional framework, that explores how the authorities who are responsible for fighting money laundering utilise this legislation, will contribute to identifying potential legislative weaknesses that are only visible when this legislation is implemented. It may also indicate gaps between what was required by the legislation and the capacity and capability within these institutions to implement this legislation.

4. INSTITUTIONAL FRAMEWORK FOR COUNTERING MONEY LAUNDERING IN SOUTH AFRICA

Effective measures to counter money laundering require not only sound legislation, but also need to be integrated within a coherent, cogent and well constructed institutional framework that efficiently focuses the efforts of authorities. The pillars within the institutional framework that addresses money laundering in South Africa can be found in reviewing the activities of the FIC, and the Asset Forfeiture Unit. Briefly examining the track record of these institutions will also provide an indication of how successful efforts to counter money laundering have been.

4.1 FINANCIAL INTELLIGENCE CENTRE AND THE MONEY LAUNDERING ADVISORY COMMITTEE

The FIC reported that it had received 7480 reports of suspicious transactions from April 2003 to March 2004, and 161 requests for assistance were received from law enforcement. Only 56 of these 161 requests were received from local law enforcement authorities, with the remaining 105 requests being received from international law enforcement authorities. For the financial year ending 2003, the FIC received only 991 reports. The high volume of reports submitted for the financial year ending 2004, was probably due to institutions applying the “know your customer” principles, since there were deadlines for completing this activity. (Financial Intelligence Centre, 2004 and Financial Intelligence Centre, 2005)

A review of the financial statements for the FIC indicated that there was a net surplus of unspent funds from 2002 of R 32 169 000, and that for 2003, this amounted to a further R 33 807 000. This created a combined net surplus as at 31 March 2004, of R 65 976 000. (Financial Intelligence Centre, 2004 : 36-37) An obvious concern is that despite the sudden rise in the number of suspicious reports being submitted, the FIC was still able to show that it had not managed to spend the funds allocated to it and that this led to a surplus over successive years. It would have been expected that with this rapid increase in the number of suspicious reports being received, that an increase in both capacity and infrastructure would have been necessary. The financial statements for the FIC for April 2003 to March 2004 do not clearly indicate how many of these suspicious transactions that were reported, were indeed indicative of money laundering or were merely reported because the transactions were considered to be suspicious as it had

exceeded a particular threshold and it was mandatory to submit a report. (Financial Intelligence Centre, 2004 : 15-16)

Without such information being provided, it is not possible to establish the efficacy of the reporting regimen. Similarly, with the volume of reports in 2004, it would mean that approximately between 20 and 21 reports would need to be received, scrutinised and a decision made for every day of the year, including weekends and public holidays. Using this basis for 2003, it would have only required that between two and three reports be finalised per day. The difference in manpower and resources is staggering, particularly considering that there does not appear to have been a similar proportional increase in expenditure on personnel and infrastructure.

The FIC's Annual Report for April 2004 to March 2005 indicates that the number of suspicious transaction reports that was submitted was 15757. There were 90 requests that were submitted by local law enforcement, compared to a 107 international requests. The net surplus increased by R 10 825 000 to an accumulated net surplus of R 76 740 000. (Financial Intelligence Centre, 2005) To place the pattern of net surpluses into perspective, the South African government allocated approximately R 105 866 000 to the FIC during 2002 to 2005. This would mean that the combined operations of the FIC over these four years, required only a third of what was budgeted despite an increase in the workload of almost fifteen fold at the end of 2005, from what was initially required.

According to the FIC's Annual Report for April 2005 to March 2006, there were 19793 suspicious transactions reports that were filed. Local law enforcement submitted 185 requests for assistance, with an additional 65 international requests being received. The FIC acknowledged that the majority of the international requests were received from countries that had signed a memorandum of understanding with South Africa. This does not however explain why there was a decrease in the number of international requests received. The net deficit of R 3 898 000 can be attributed to increases in operating costs and staff costs. (Financial Intelligence Centre, 2006)

Despite the minor net deficit reported in 2006, it is likely that the pattern of budget surpluses may continue due to the lack of investment that has occurred. While prudent spending policies are to be commended and have probably resulted in over expenditure and wastage being curtailed, it may be indicative of a short term as opposed to a long term approach to spending on skills development, personnel and infrastructure. Without developing and deploying the

necessary infrastructure and data mining tools, it is likely that the volume of reports will increase and response times will decrease.

4.2 ASSET FORFEITURE UNIT

The Public Service Commission (2001 : 70) reported that the Asset Forfeiture Unit had managed to freeze R 218 million in 2000, with a further R 225 million being frozen in terms of the 81 investigations that were pursued in 2001. However, forfeiture only occurred in 18 out of 38 cases, which amounted to R 7 million. Kempen (2006) reported that the Asset Forfeiture Unit had seized R 700 million during the five year period up to 2006. It was also announced in Cabinet in 2006, that the amount of compensation that was paid out to victims of crime amounted to more than R 200 million, and that an additional R 73,8 million was made available to provide resources to government departments involved in combating crime. (RSA Ministry of Justice and Constitutional Development, 2006) This compensation was paid out of the proceeds of criminal activities that had been seized by the Asset Forfeiture Unit, and provides an indication of the extent of the success of this Unit.

In reviewing these indicators, the assets and funds seized constitute the proceeds of crime or the “instruments” of crime. The proceeds of crime are the financial benefits that criminals derive from engaging in criminal activity, while the “instruments” of crime refer to the assets and funds that are used in the furtherance of criminal activities. In either case, the difference cannot be determined from the information available. It is also difficult to establish whether or not these confiscations and forfeitures were a result of another criminal investigation, or a suspicious activity report that was forwarded on for investigation from the FIC.

With the high number of suspicious transactions reported to the FIC, and the low rate of confiscation and forfeiture by the Asset Forfeiture Unit, a gap clearly exists. Either there are a large number of legitimate transactions that are being incorrectly reported as being suspicious, or valid suspicious activity reports from the FIC are not being translated into arrests and prosecutions. This may well be indicative of the need to develop a more effective means of identifying suspicious transactions to ensure that money laundering activities that are identified by the FIC are vigorously pursued either by the SAPS or the Asset Forfeiture Unit. In the absence of adopting this approach, or forming a specialised enforcement unit to ensure follow

through on all valid suspicious activity reports, the reporting of any potential money laundering will not alleviate the problems experienced.

To assess whether or not the combination of legislation and the supporting institutional framework has been able to successfully address the threats posed by money laundering, an impartial and independent assessment is necessary. The FATF conducted an assessment of the measures that South Africa implemented to counter money laundering in 2004. A review of the assessment conducted by the FATF may indicate areas where the effectiveness and efficiency of the money laundering countermeasures that have been implemented by South Africa, can be improved.

5. ASSESSMENTS OF SOUTH AFRICA BY THE FINANCIAL ACTION TASK FORCE

The FATF (2004 : 6-7) evaluated South Africa's compliance in terms of the original 40 recommendations that it had published and the eight special recommendations relating to the financing of terrorism. The evaluation found that while considerable progress had been made to address money laundering, there were still areas requiring improvement. These related to the need to establish a dedicated unit to prosecute cases upon referral from the FIC; the need to identify originator information on certain electronic transactions; gaps in the application of compliance standards for foreign branches of financial intuitions; and the vetting of staff in financial institutions.

Of these recommendations, vetting employees in financial institutions may prove to be the most difficult recommendation to implement in practice. While it is prudent to ensure that the risk profiles of employees are regularly scrutinised, this is not a panacea to preventing criminal syndicates from obtaining the cooperation of corrupt government officials through bribery and intimidation. A better recommendation would have been to suggest that all financial institutions should implement an effective compliance and governance programme, incorporating incentives for whistle blowing. This would probably pay greater dividends as it would encourage vigilance on the part of all employees and reward the reporting of any suspicious behaviour.

The other recommendations are reasonable and practical. The need to establish why suspicious activity reports from the FIC are not being pursued more actively, should be investigated. The number of different stakeholders who are already involved in administering, regulating or investigating various aspects of either money laundering and/ or its predicate offences, would imply that it should be easier to wage a more successful campaign against money laundering. It would appear that this is not happening in practice, and the activities and performance of the MLAC should be revisited to establish whether this forum is delivering on its mandated purpose.

The concerns relating to the funding of terrorism were addressed in the formulation and passing of the *Protection of Constitutional Democracy against Terrorist and Related Activities Act*. This FATF assessment was undertaken prior to the release of the additional special recommendation which focused on the smuggling of currency. Rather than waiting for a future evaluation to identify this shortcoming, a more proactive approach would be to identify what aspects of the current legislation can be adapted to address this potential threat of terrorist financing.

6. COOPERATION WITH OTHER COUNTRIES

To counter money laundering more effectively, South Africa participates internationally as a member of the FATF, and regionally in the Eastern and Southern African Anti-Money Laundering Group (ESAMLG). The combination of global and regional participation allows South Africa to be able to share global knowledge and experiences that it is able to access with regional stakeholders. This not only strengthens South Africa's reputation within the region, but is also essential to ensuring that opportunities for criminal syndicates and terrorist groups to use neighbouring countries as bases for their money laundering operations, are reduced.

Membership of a regional body such as the ESAMLG, which is aimed at addressing money laundering, is a requirement for membership of the FATF. The ESAMLG enhances the effectiveness of member states in combating money laundering as it creates a strong platform for regional cooperation.

To assess how South African courts address money laundering in practice, two case studies will be briefly examined. These case studies demonstrate how South African legislation is intricately woven together to address both the predicate offences and the combating of money laundering.

7. SELECTED MONEY LAUNDERING CASE STUDIES

The extent to which money laundering is being countered in South Africa can be illustrated by reviewing two cases that have appeared before the courts.

7.1 SIMON PROPHET V NATIONAL DIRECTOR OF PUBLIC PROSECUTIONS

In December 2000, the SAPS executed a search warrant on the basis that Prophet had committed an offence in terms of the *Drugs and Drug Trafficking Act*. While substances and other items indicating possible use for the manufacturing of methamphetamine were found, Prophet was acquitted in the Magistrates Court. When Prophet was arrested, an order was granted by the Cape High Court for the preservation and subsequently the forfeiture of his property in terms of the *Prevention of Organised Crime Act*. (Constitutional Court, *Simon Prophet v National Director of Public Prosecutions*, 2006)

When Prophet was acquitted, and was unable to have the forfeited property returned, he appealed without success the decision of the Cape High Court. The Supreme Court of Appeal granted him leave to apply to the Constitutional Court. In dismissing the appeal, and allowing the forfeiture to stand, the Judge found that the acquittal of criminal charges did not prevent forfeiture, as the *Prevention of Organised Crime Act* required that on a balance of probabilities, the State demonstrate the property was being used to further criminal activity. This was proven, through the submission of evidence on how the house had been adapted to support the manufacturing of methamphetamine. This case was important as it illustrated that while it may be possible to avoid criminal prosecution due to the need to prove guilt beyond reasonable doubt, confiscation and forfeiture could still be achieved if criminal activity can be proven on the balance of probabilities. (Constitutional Court, *Simon Prophet v National Director of Public Prosecutions*, 2006)

7.2 SHAIK V THE STATE

In terms of the civil case that was launched by the State against Schabir Shaik and his companies/ corporations, the court examined whether or not the proceeds of crime could be confiscated in terms of the *Prevention of Organised Crime Act*. The appeal that was heard by the Supreme Court of Appeal revolved around whether an indirect benefit could also be subject to

confiscation. The case demonstrated that any benefits of criminal activity or the proceeds itself, that may be laundered through or to a third party but which is effectively controlled by the same person, can still be attached. The court expressed this view by allowing the forfeiture of the proceeds of these criminal activities to stand, despite the complexity of the laundering attempts that were undertaken. (Shaik v The State (2), 2006)

8. CONCLUSION

The relationship between money laundering and its use by criminal syndicates has been emphasised in official statements by the South African government. Money laundering is seen by the South African government as having the potential to undermine the country and negatively affect the social and transformation goals that have been established. There is also common consensus that the provision of safety and security to South African citizens requires the government to implement effective legislation combined with efficient institutions, to successfully combat money laundering.

An examination of the countermeasures that have been implemented to address money laundering indicates that the legislation that South Africa has introduced is comprehensive. Likewise, the judiciary has also indicated a willingness to address money laundering as it is a means of allowing criminal syndicates to profit from their predicate offences.

The critical challenge appears to be a lack of adequate capacity to meaningfully differentiate between suspicious reports and actual cases of money laundering. This problem is exacerbated by the apparent lack of coordination necessary to translate the reports of money laundering into thorough investigations and subsequent prosecutions. In spite of these weaknesses, it should be borne in mind that compared to international standards, South Africa's results in terms of the independent assessment conducted by the FATF indicate that steady progress has been made in countering money laundering.

In attempting to unravel the potential reasons for investigations not being able to generate results consistent with the volume of suspicious reports being filed, the main reason could lie in the lack of adequate capacity and data mining technology and the failure to utilise the funds that are being earmarked for this purpose completely. Despite the sound intentions of authorities, the lack

of being able to demonstrate concrete action that translates money laundering legislation into practice, will probably lead to criminal syndicates viewing confiscation and forfeiture as being part of the cost of doing business. Confiscation and seizure will be unlikely to reduce criminal activities and money laundering unless these actions by law enforcement authorities are able to significantly and substantially disrupt the *modus operandi* of criminal syndicates and money launderers. In the absence of concerted ongoing efforts by law enforcement authorities, criminal syndicates are more likely to factor the possibility of confiscation and forfeiture into the profit and loss columns of engaging in criminal activity.

CHAPTER 6. EVALUATION

1. INTRODUCTION

Chapter Six summarises this study; tests the assumptions that the study was based on; and presents the main conclusions that were reached in this study.

2. SUMMARY OF THE TEXT

Chapter One formed a basis for conducting the research relating to this study. It provided a brief background relating to the study; the aim of conducting this study; and the problem statement that this study was designed to address. The research methodology and the structure of the research were also presented, in support of the process necessary to reach a critical response to the problem statement.

In Chapter Two, a conceptual framework relating to money laundering was developed as it related to the ambit of this study. The aim of this chapter was to define the key concepts associated with money laundering and to briefly set out the extent of the problem and the security and other threats that money laundering poses.

Exploring the conceptual framework for money laundering led to the observations that money launderers prefer to target countries that have a combination of a weak regulatory framework and poor law enforcement. With the onset of transnational crime and the global scourge of terrorism being a priority on the agenda of law enforcement officials, a global effort is necessary to successfully combat money laundering as opposed to displacing the extent of money laundering from one state to another. International initiatives to mitigate against money laundering, such as the recommendations by the FATF and the *Wolfsberg Principles*, are limited to the extent that they can obtain buy-in from developing countries who may be inclined to focus on the “potential” benefits of funds entering their economies regardless of the illegal source of these funds. This may require that donor countries examine whether or not as part of providing aid/ loans to developing countries, compliance with these money laundering countermeasures is made mandatory.

To examine how money laundering has been combated as a global security issue, Chapter Three drew on the initiatives that were launched by the UN and the EU and focused on what countermeasures the G7/8 countries had adopted. Through this process, it was possible to establish what countermeasures had been adopted by other countries which were leading the fight against money laundering, and to use this as a subsequent basis of comparison against which to analyse the efforts made by South Africa.

Chapter Four analysed the extent and effects of money laundering in South Africa. Money laundering and criminal activity in South Africa were found to be intrinsically intertwined. It was also found that terror groups had been raising funds from sympathetic donors in South Africa. The unregulated underground banking environment in South Africa is likely to provide terror groups with a means to continue covertly raising these funds, despite efforts by authorities to prevent them from openly raising funds.

Sound, practical and clear legislation based on international best practices is essential in addressing the transnational nature of money laundering. Chapter Five presented various official South African government statements made on money laundering and discussed how this had been translated into South African legislation. South Africa had established institutions to address the threats of money laundering and the judiciary was willing to act to prevent criminal syndicates from profiting from their illicit activities through engaging in money laundering.

However, the challenge remains on how to effectively and efficiently separate the reports of suspicious activity from actual incidents of money laundering. Poor coordination appears to be the major reason why despite the large volumes of reports of money laundering, there is not a concomitant volume of successful prosecutions. Despite the inadequacies of translating reports of money laundering into successful prosecutions, the FATF has reported favourably in its assessment of South Africa's progress on implementing measures to counter money laundering.

3. TESTING OF ASSUMPTIONS

This study was based on the following assumptions:

- There are still shortcomings in the practical application of money laundering countermeasures in South Africa, despite these countermeasures being based on the legislative measures adopted by the G7/8 countries; and
- money laundering promotes crime and corruption in South Africa.

Assumption: “There are still shortcomings in the practical application of money laundering countermeasures in South Africa, despite these countermeasures being based on the legislative measures adopted by the G7/8 countries.”

South Africa’s legislative adoption of money laundering controls compares favourably with the G7/8 countries, as both have adopted the FATF recommendations on money laundering. (Asmal, 2005 and FATF, 2004 : 6-7) It is interesting to note that South Africa had implemented controls aimed at preventing the smuggling of currency, prior to these being proposed by the FATF. This can be attributed to exchange control regulations and the era of sanctions during which there was also a strong internal focus in South Africa on preventing currency smuggling.

Money laundering in South Africa can be linked to either criminal syndicates who are laundering their illicit profits, and/or to terrorist financing. (Peiris, 2001 : 1-38) The G7/8 countries are also similarly influenced by these two factors. The major difference however is that it is possibly easier to launder funds through the G7/8 countries that belong to the EU, due to the common currency (Euro) and the ease with which citizens in these countries can travel to other EU member countries.

The common currency makes it easier to launder funds across national boundaries, as the placement, layering and conversion phases of money laundering can be done in different countries making it more difficult for law enforcement authorities to connect the laundering of these funds with a specific predicate offence. (Shelley, 2000 : 35-50) The lack of travel restrictions for citizens belonging to EU members may lend itself to creating an environment that is primed for currency smuggling.

South Africa’s porous borders however also present both criminal syndicates and terrorist financiers with a means to launder currency *via* neighbouring states, and *vice versa*. Although neighbouring states have their own currency, the South African Rand is easily traded for local currency making it more difficult to connect the proceeds of criminal activity to a particular

crime that may have occurred in South Africa. Despite the high volume of suspicious activity reports, there has not been a corresponding number of successful prosecutions. (Public Service Commission, 2001 : 70) This implies that beyond adopting legislative measures similar to the G7/8 countries, efforts should be focused on ensuring that there is a complementary commitment to enforcement. In the absence of this, the legislation will remain only partially implemented in practice.

The assumption that there are shortcomings in how money laundering countermeasures are applied in South Africa, where these are based on the legislative countermeasures adopted by the G7/8 countries, is valid.

Assumption: “Money laundering promotes crime and corruption in South Africa.”

In South Africa, money laundering, amongst others, has been linked to the drug trade. (Omar, 1997b) If criminal syndicates engaged in either drug smuggling and/ or any other criminal activities are able to profit from their criminal activities, crime in South Africa will increase. Legislative efforts in South Africa have therefore been directed at preventing criminal syndicates from profiting from their crimes through targeting the proceeds of these criminal activities.

Between 2000 and 2006, R810 million was stolen in cash heists. (The Mercury, 2006) There was also an increase in the number of drug offences of 13.2 percent during April 2005 to March 2006, while the number of cash heists during this period increased from 220 to 383. (Hills, Oelofse and Pressley, 2006) Official statistics released by the SAPS indicate that drug related offences have dramatically increased from 52 900 incidents in 2001/2002 to 53810 incidents in 2002/ 2003; 62689 incidents in 2003/ 2004; 84001 incidents in 2004/ 2005 to 95690 incidents in 2005/ 2006. (SAPS, 2006) This suggests that despite the introduction of money laundering legislation that the level of confiscation and seizure by South African authorities is far less than the proceeds of crime that criminals are able to successfully launder, notwithstanding any hoarding of the cash by criminal syndicates. The ability to successfully launder the proceeds of crime by criminal syndicates contributes to the promotion of crime in South Africa.

Corruption implies the abuse of public office for personal financial gain. (Warren, 2006 : 803-807) Money laundering and corruption are intrinsically related, as corrupt government officials would act in the interests of whichever criminal syndicates were willing to pay a bribe which

would need to be laundered. The illicit nature of corruption makes it difficult to accurately estimate how widely spread corruption is in South Africa, beyond drawing on high profile examples that illustrate the causal relationship between money laundering and corruption in South Africa. Evans and Leigh (2003), for example, have cited the allegations that substantial bribes were paid to South African government officials during the South African tender for the supply of Hawk jets.

Corruption and money laundering are also considered to be contributing factors to the increase in criminal activity in South Africa. (Baqwa, 1997) The effects of corruption can undermine the commitment of the South African government to deliver effective services to its citizens. In the Eastern Cape, social security fraud has led to losses exceeding R 1,5 billion per annum. A criminal syndicate implicated in 11 000 charges of laundering R 3,5 million in social assistance grants, has led to the arrest of 147 government officials. (Skweyiya, 2004) When criminal syndicates are able to bribe government officials and reap the proceeds of their criminal activities, it is unlikely that seizure and confiscation will have any effect on reducing money laundering. Instead, crime is likely to increase as criminal syndicates enjoy “protection” from corrupt government officials.

The assumption that money laundering promotes crime and corruption in South Africa, is valid.

4. CONCLUSION

While efforts to address money laundering in South Africa are based on adopting legislation that is consistent with international best practices as expressed by the FATF, and legislation is similar to that adopted by the G7/8 countries, there is a lack of effectively and efficiently translating the legislation into practice. Despite strong political commitment, the lack of capacity and lack of adopting advances in information technology are exacerbated by poor coordination amongst stakeholders. This leads to a large volume of reports being received without a corresponding track record of successful prosecutions.

Instead, reports of suspicious activity are unlikely in the future to realistically point to money laundering activities by syndicates and terrorist financiers, who will adapt their *modus operandi* to avoid being entrapped by money laundering regulations. A more vigorous and aggressive

approach to significantly and substantially disrupting the *modus operandi* adopted by criminal syndicates and money launderers is required. Seizure and confiscation are unlikely to have any significant effect on criminal activity and money laundering, as criminal syndicates are likely to factor the likelihood of potential seizures and confiscations into the costs of engaging in criminal activity. Unless authorities are able to increase the cost of participating in criminal activity to beyond the threshold of perceived benefit, criminal syndicates are unlikely to be discouraged. To raise these costs beyond this threshold, it would paradoxically require that authorities intensify and expand their seizure and confiscation efforts against criminal syndicates combined with sterner prison sentences for criminals.

The reasons why transnational syndicates and terrorist financiers engage in money laundering vary. Transnational criminal syndicates utilise money laundering to ensure that they are able to benefit from their illicit activities, while terrorist financiers regard money laundering as a means of supporting their terror cells. Seizure and confiscation by law enforcement authorities which substantially reduced the profits from criminal activities would to some extent affect transnational criminal syndicates, but is unlikely to have a similar effect on terrorist financiers. Terrorist financiers are likely to regard seizure and confiscation as a temporary setback as their primary objective is not to profit through the use of money laundering, but to use these funds to support their terror activities. It may therefore be more effective to trace the source of terror activities and the terrorist financiers, as opposed to focusing on simply tracing and apprehending operational terror cells. Countering terrorism may also require a more holistic approach, as reducing terrorist funding will not necessarily lead to a decrease in terrorist activity. Reducing terrorist activity also requires interventions that focus on promoting suitable alternatives to fundamental radicalism, and encouraging transparent dialogue between participants in a conflict.

The role of the FIC, and the location of this organisation should be seriously re-evaluated. Both the South African Reserve Bank and the South African Revenue Services may be better suited to performing these functions as they have a motivated interest in addressing money laundering. The South African Reserve Bank, in terms of its mandate to conduct bank supervision and manage exchange controls, may be able to provide a single point of contact to retail banks and foreign exchange dealers for the reporting and investigating of money laundering.

Exchange control investigations could deal with currency smuggling, while bank supervision by the South African Reserve Bank would be able to audit compliance with money laundering regulations amongst banks. Placing the FIC in the South African Reserve Bank would also be

beneficial since money laundering has financial stability implications, and may also affect inflation targeting both representing critical areas that the South African Reserve Bank focuses on. Due to the effect that money laundering has on the tax collected, the South African Revenue Service may similarly be committed to addressing money laundering in practice, and enabling legislation to strengthen their ability to seize and confiscate any funds and resources being laundered may have a more substantive effect on reducing money laundering. Leveraging the investigative abilities of organisations such as the Financial Services Board, to support the South African Reserve Bank and the South African Revenue Service, may also contribute to reducing money laundering.

Regardless of where the FIC is located, designing an effective regime that leverages the self interest of other stakeholders is more likely to yield results as it prevents competition and a silo approach to money laundering, and encourages collaboration. In the absence of correctly locating the FIC within a stakeholder that has a self interest to ensure that reports of suspicious activities are converted into successful prosecutions of money laundering, transnational criminal syndicates and terrorist financiers are unlikely to be deterred by legislation alone.

To address money laundering in South Africa, it is necessary to practically demonstrate that the confiscation of the proceeds of criminal activity renders crime unprofitable. Without rendering criminal activities unprofitable, confiscation and seizure will be unlikely to reduce either criminal activities or money laundering. Criminal syndicates are likely to regard these confiscations and seizures as part of the costs of doing business, and will factor this into their planning. Authorities in South Africa need to continually assess how criminal syndicates and terrorist financiers will respond to confiscation and seizures, and how this will lead to changes in the *modus operandi* used to launder money, to ensure that they are able to proactively adapt enforcement strategies. In the absence of this approach being adopted, criminal syndicates and terrorist financiers are likely to adapt to changes in legislation and reporting requirements. Vigilance in monitoring the modes of money laundering, combined with the technological means, sound processes and the right blend of trained resources, are essential to ensuring that money laundering offences are identified, the perpetrators prosecuted and the funds being laundered seized.

It is recommended that the following measures be considered to improve efforts in South Africa to address the security implications of money laundering:

- a) Adopting an analytical approach to addressing money laundering, by improving the analysis into red flags that serve as indicators of money laundering activity;
- b) development of capacity, and the implementation of processes and technology to be able to better investigate which reports of suspicious activities are actual incidents of money laundering;
- c) developing education programmes to highlight the need for money laundering countermeasures;
- d) undertaking annual qualitative benchmarks of the performance of South Africa's FIC against other international and regional FIC's, as opposed to verifying only compliance with FATF recommendations;
- e) implementing a more proactive approach to money laundering by considering whether the FIC is correctly located;
- f) encouraging more collaboration and communication amongst stakeholders, who are required to address money laundering;
- g) building stronger relationships with international, and regional stakeholders to be able to facilitate and support the seizure and confiscation of funds and resources being laundered by transnational criminal syndicates and terrorists financiers with operations and ties to South Africa; and
- h) engaging in proactive research into the changing money laundering *modus operandi* adopted by transnational crime syndicates and terrorist financiers to be able to ensure that investigative methods and legislation are able to keep pace with these changes.

ABSTRACT

TOPIC: MONEY LAUNDERING AND COUNTERMEASURES:
A COMPARATIVE SECURITY ANALYSIS OF SELECTED
CASE STUDIES WITH SPECIFIC REFERENCE TO SOUTH
AFRICA

BY: MAIENDRA SADANANDAN MOODLEY

STUDY LEADER: PROFESSOR M. HOUGH

DEPARTMENT: POLITICAL SCIENCES

DEGREE: MASTER OF SECURITY STUDIES

This study focuses on examining the security implications of money laundering and countermeasures, with reference to South Africa. The purpose of this study was to establish the following:

- What is the extent, and what are the security implications of money laundering in South Africa;
- whether the current money laundering countermeasures in South Africa were effectively implemented from 1994 up to the end of 2006;
- if South Africa could implement better money laundering controls when compared to the G7/8 countries; and
- what the factors were that influenced money laundering in South Africa, compared to the G7/8 countries.

This study also examined the validity of the following assumptions:

- That there are still shortcomings in the practical application of money laundering countermeasures in South Africa, despite these countermeasures being based on the legislative measures adopted by the G7/8 countries; and
- money laundering promotes crime and corruption in South Africa.

An analysis of the South African anti-money laundering legislation indicated that South Africa had legislatively adopted all of the Financial Action Task Force money laundering recommendations. It was found that despite the strong legislative framework to combat money laundering in South Africa, these efforts were undermined by a lack of capacity; poor coordination that led to a large volume of reports being filed without a corresponding track

record of successful prosecutions; and the failure to adopt advances in information technology. This led to a lack of effectively and efficiently translating the anti-money laundering legislation into practice in South Africa.

KEY WORDS

CORRUPTION

FINANCIAL INTELLIGENCE CENTRE

GROUP 7/8

LEGISLATION

MONEY LAUNDERING

NARCOTICS SMUGGLING

ORGANISED CRIME

PREDICATE OFFENCES

SECURITY THREATS

TERRORIST FINANCING

TRANSNATIONAL CRIME

OPSOMMING

- ONDERWERP:** GELDWASSERY EN MAATREËLS OM DIT TE BEKAMP:
'N VERGELYKENDE VEILIGHEIDSANALISE VAN GESELEKTEERDE
GEVALLESTUDIES MET SPESIFIEKE VERWYSING NA SUID-AFRIKA
- DEUR:** MAIENDRA SADANANDAN MOODLEY
- STUDIELEIER:** PROFESSOR M. HOUGH
- DEPARTEMENT:** POLITIEKE WETENSAPPE
- GRAAD:** MAGISTER IN VEILIGHEIDSTUDIES

Hierdie studie fokus hoofsaaklik op die veiligheidsimplikasies van geldwassery en teenmaatreëls met spesifieke verwysing na Suid-Afrika. Die doel van die studie is om die volgende te bepaal:

- Die veiligheidsimplikasies van geldwassery vir Suid-Afrika;
- of Suid-Afrika effektiewe teenmaatreëls teen geldwassery geïmplementeer het vanaf 1994 tot en met die einde van 2006;
- of Suid-Afrika effektiewe kontrolemaatreëls geïmplementeer het in vergelyking met die G7/8 lidlande; en
- die faktore wat bygedra het tot geldwassery in Suid-Afrika in vergelyking met die G7/8 lidlande.

Die geldigheid van die volgende aannames is ook ondersoek, naamlik:

- Dat daar nog tekortkominge is in die implementering van effektiewe maatreëls om geldwassery in Suid-Afrika te bekamp ten spyte daarvan dat dit op die wetgewing van die G7/8 lidlande gebaseer is; en
- geldwassery bevorder misdaad en korrupsie in Suid-Afrika.

'n Vergelykende ontleding het aangetoon dat Suid-Afrika 'n soortgelyke benadering tot geldwassery aanvaar het as die G7/8 lidlande en dat die benadering om geldwassery te bekamp gunstig vergelyk met dié van die Finansiële Aksie Taakmag se aanbevelings. Daar is ook bevind dat daar tekortkominge bestaan ten opsigte van die effektiewe toepassing van wetgewing in die praktyk. 'n Tekort aan kapasiteit en die versuim om die voordele van inligtingstechnologie behoorlik aan te wend, is vererger deur 'n gebrek aan koördinasie wat gelei het tot groot volumes verslae wat geliasseer is sonder 'n ooreenstemmende rekord van suksesvolle vervolgings.

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