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MONEY LAUNDERING AND RELATED MATTERS

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INTRODUCTION

The South African Law Commission was established by the South African Law Commission Act, 1973 (Act 19 of 1973).

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PREFACE

This issue paper (which reflects information gathered up to the end of March 1996), was prepared by the research staff of the Commission to elicit responses and with those responses, to serve as a basis for the Commission's deliberations. The views, conclusions and recommendations contained herein should not, at this stage, be regarded as the Commission's final views. The issue paper is published in full so as to provide persons and bodies wishing to comment or make suggestions for the reform of this particular branch of the law with sufficient background information to enable them to place focussed submissions before the Commission.

The Commission will assume that respondents agree to the Commission's quoting from or referring to comments and attributing comments to respondents, unless representations are marked confidential. Respondents should be aware that the Commission may have to release information contained in representations under the Constitution of the Republic of South Africa, Act 200 of 1993.

Respondents are requested to submit written comments, representations or requests to the Commission by 24 May 1996 at the address appearing on the previous page.

The project leader responsible for this project is Adv JJ Gauntlett SC and the researcher, who may be contacted for further information, is Mr P K Smit.

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SOURCES AND CITATION

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Cinelli C, Dallorso P, Sensini M **Dossier / The fight against money laundering: Itally's experience** Radiocor Telerate Economic and Financial News Agency Rome: 1994

Rider

Rider BAK The practical and legal aspects of interdicting the flow of dirty money1996 **Journal of financial crime** vol 3 number 3 234

Toms

Toms A N D **Banks's concerns regarding measures in South Africa to combat money laundering.** Paper read at the Money Laundering Seminar held by the South African Reserve Bank on 28 July 1995 in Pretoria.

SELECT LEGISLATION

Australia

1988 Financial Transactions Reports Act, 1988

South africa

1992 Drugs and Drug Trafficking Act, No.140 of 1992

United kingdom

1988 Criminal Justice Act, 1988

1993 Money Laundering Regulations, SI 1933/1993

United States of America

Bank Secrecy Act 31 USC

CHAPTER 1

ORIGIN OF THE INVESTIGATION AND INTRODUCTION

1.1. The Commission has previously proposed that the courts be empowered to confiscate the proceeds of crime in general. Together with this, the Commission also proposed the creation of a number of offences to criminalise money laundering and certain related acts.[1] Following this the Commission decided to undertake an investigation focusing specifically on regulatory measures to combat money laundering.

1.2. This issue paper was compiled in consultation with a group of diverse experts whose assistance is greatly acknowledged. It is aimed at focussing the attention on money laundering with specific reference to the development and implementation of a framework of regulatory measures. The purpose of this paper is to provide a basis for discussion of the topic among all interested parties. To achieve this objective, the issues involved are first identified and thereafter various options for reform in this respect are put forward. For this reason this paper does not contain clearly defined recommendations for reform coupled with proposed draft legislation. Respondents are invited to comment on the issues and options discussed in this paper and to indicate whether there are other issues or options that should also be investigated.

1.3. Following this issue paper it is contemplated that draft legislation will be prepared and published for general knowledge and comment.

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1 Chapter five of the proposed Proceeds of Crime Bill in Annexure B of The Report on International Co-operation in Criminal Matters.

CHAPTER 2

THE PROBLEM

2. 1. Money laundering can be described as the manipulation of illegally acquired wealth in order to obscure its true source or nature.[2] This is achieved by performing a number of transactions with the proceeds of criminal activities that, if successful, will leave the illegally derived proceeds appearing as the product of legitimate investments or transactions.

2.2. The money-laundering process can generally be divided in at least three discernible stages namely the placement stage, the layering stage and the integration stage. During the placement stage the proceeds of criminal conduct, usually in the form of cash, are moved away from the location where it was obtained and placed in the financial system. Entry into the financial system is usually gained through financial institutions.

2.3. In the second stage the money, which is now in the form of electronic funds, is distributed through the financial system. This done by layering one transaction involving these funds on top of another by means of electronic transfers, shell companies, false invoices, etc. The result of these transactions is that the laundered money becomes indistinguishable from "legitimate" money.

2.4. In the integration stage the money that was diffused into the commercial sphere is collected and made available to the offender under the guise of being legitimate earnings. This description of the money-laundering process illustrates the vital importance of the financial system to the money launderer. It is used as a device to transfer his or her proceeds of crime and to alter the appearance of such proceeds.

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2 Rider 1996 **Journal of financial crime** 238.

2.5. South African law does at present not recognise this manipulation of the proceeds of crime as an offence save for the offence of "conversion of the proceeds of drug trafficking" under the Drugs and Drug Trafficking Act, 1992, (hereinafter referred to as the "Drugs Act").[3] In cases where the Drugs Act does not apply, no offence will be committed unless the methods used to bring about the misrepresentation constitute another offence such as fraud.

2.6. In respect of regulatory measures the Drugs Act creates a statutory obligation to report certain information relating to the proceeds of drug trafficking.[4] This obligation applies to any director, manager or executive officer of a financial institution, and compels such persons to report any suspicion that property acquired by the institution in the normal course of business is the proceeds of a crime to an officer of the Narcotics Bureau. The Drugs Act places a similar obligation on stock brokers and traders in financial instruments.[5] A failure to report such information is punishable by imprisonment for up to 15 years, or any fine that the court deems fit, or both such imprisonment and fine.[6]

2.7. As regards obligations of secrecy the Drugs Act provides that no such obligation will affect a person's obligation under the Act to report his or her suspicion.[7]

2.8. Apart from these provisions, our law does not contain any measures by which money laundering can be controlled and combatted.

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3 Section 14(b) read with section 1(1) and section 7 of the Drugs Act.

4 Section 10(2) read with section 1(1) of the Drugs Act.

5 Section 10(3) of the Drugs Act.

6 Section 17(d) read with section 15(1) and section 10(2) and (3) of the Drugs Act.

7 Section 10(4) of the Drugs Act.

CHAPTER 3

IDENTIFYING ISSUES

3.1. If the principle that laundering of all proceeds of crime should give rise to criminal liability is accepted, it follows that administrative measures to combat money laundering should not only apply in respect of certain offences. The problem in our law is, however, that a comprehensive legislative scheme comprising regulatory measures to combat money laundering is lacking. The issues that have to be discussed here are therefore whether such a legislative scheme should be introduced in our law and if so what components it should comprise. This chapter is restricted to the identification of the apparent issues. In the next chapter the options in relation to each issue are considered.

Introduction of regulatory measures

3.2. The brief description of the stages in a typical money-laundering scheme given earlier shows the importance of the institutions of the business community to the money launderer. These institutions are used to gain access to the financial system and to move the illegally derived proceeds through the system. The point of entry into the financial system is often referred to as the "splash down zone" because it is at this point where large amounts of cash enter the financial system that a money-laundering scheme is most noticeable.[8] Further along the route there are other instances where a scheme may also be detected, such as international funds transfers. Another important factor in this respect is that most, if not all, activities performed within the financial system can potentially leave a so-called audit trail to be followed.

8 Rider 1996 **Journal of financial crime** 239.

3.3. The mere criminalisation of money laundering will not provide an effective measure with which to combat this phenomenon. In order to benefit from the fact that a money-laundering scheme needs to involve the financial system to accomplish its objective,[9] certain administrative measures that will apply to the institutions of the business community must be introduced. Such measures should facilitate the prevention, identification, investigation and prosecution of money-laundering activities. To accomplish this, a legislative framework comprising regulatory measures must be introduced.

3.4. The regulatory instruments that apply to the various institutions of the financial sector such as the Banks Act, 1990, the Stock Exchanges Control Act, 1985, the Insurance Act, 1943, the Companies Act, 1973, and the Currencies and Exchanges Act, 1933, were not designed with a view to combatting money laundering and can therefore not be relied upon for this purpose.

3.5. Examples of regulatory measures that are applied in jurisdictions where regulatory schemes are in place, are the reporting of information on certain transactions, record keeping of particulars of clients and transactions, the conducting of business in accordance with guidelines aimed at minimising the opportunity for money laundering, the establishment of a body that can record and manage the information obtained through the reporting system and the laying down of criteria for participation in the financial sector that will ensure the integrity of intermediaries.

3.6. If one is to combat money laundering effectively, an anti money-laundering policy should be developed. Such a policy should not only be aimed at punishing offenders, but should include mechanisms that are directed at the persons who are in a position to identify and prevent money-laundering practises.

Scope of a regulatory framework

3.7. The first issue to be considered in respect of a regulatory framework is to determine **to which institutions** it should apply. Although banking institutions are traditionally used by money launderers to penetrate the financial system, other institutions can also be used for this purpose. It is therefore suggested that, in the interest of maximum effectiveness, the scope of a regulatory framework should not be limited to the mainstream banking sector.

Reporting information

3.8. In respect of the reporting of information there are several issues to be discussed. The first is **what should be reported**. If it is accepted that the aim of money-laundering schemes is to conceal the illegal origin of the proceeds of crime, it follows that such schemes will make use of transactions involving such proceeds. This means

9 Namely to cause the proceeds of crime appear as legitimate earnings.

that the reporting of information on such transactions can be an effective weapon in detecting, not only the money-laundering scheme, but also the primary offence from which the proceeds had originated. A regulatory framework must therefore include the reporting of information on transactions that involve the proceeds of crime.

3.9. Another important issue is the **protection** of the person or body reporting the required information. The statutory obligation to report the relevant information under the Drugs Act overrides a financial institution's obligation to treat the client's affairs as confidential.[10] Compliance with the statutory obligation will therefore serve as a defence against a claim based on a breach of the confidential relationship between a financial institution and its client.

3.10. The scope of the protection under the Drugs Act is restricted by the phrase "any obligation incurred by virtue of the provisions of subsections (2) or (3)". Subsections (2) and (3) refer to the proceeds of a "defined crime"[11] which means that it is only in cases of suspicions that property is the proceeds of a "defined crime" that section 10(4) will offer protection against a breach of confidentiality towards a client. In the majority of cases, however, an official of a financial institution may form a suspicion that property has a criminal origin but will not be in a position to identify the specific offence. Financial institutions, therefore, follow a cautious approach and do not report suspicions unless it is absolutely clear that the property forms the proceeds of a drug offence. This is shown by figures for 1994 given at a money-laundering seminar in July 1995:

Bank a reported 2 cases under the Drugs Act;

Bank B - nil;

Bank C - 64 of which 54 were proven to be drug-related; and

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10 Section 10(4) of the Drugs Act.

11 Under section 1(1) read with section 13 and section 5 of the Drugs Act a defined crime includes dealing in dangerous and undesirable dependence producing substances and conversion of the proceeds of such dealing.

Bank D - 6.[12]

3.11. One of the problems with the current legislation on reporting information seems therefore to be that it does not offer adequate protection to the body making the report.

3.12. Other issues in respect of a reporting requirement are how to **identify** the transactions to be reported, the **types** of transactions that should be reported and what information in respect of a transaction should be reported.

Record keeping

3.13. Once a transaction has occurred through which the proceeds of an offence have been laundered, the only effective way of identifying the transaction and those involved in it is to follow the so-called audit trail. This means that by identifying the nature of the transaction and the true participants in that transaction, not merely their agents, the money-laundering scheme can be exposed. This will only be possible if sufficient records have been kept by the institution at which the transaction had occurred. Mechanisms ensuring effective record keeping must therefore be an essential part of a regulatory scheme.

Business conduct

3.14. Responsible business conduct aimed at diminishing the risk of money laundering will require all institutions concerned to formulate **internal policies** to guard against being abused for the purpose of money laundering. Such policies should be based on sound business practice. They can, on the one hand, be employed to protect institutions from being infiltrated with the proceeds of illegal activities, and on the other hand to enable institutions to co-operate with law enforcement agencies in the detection and investigation of money-laundering schemes.

Financial intelligence units

3.15. The tendency in other jurisdictions has been to set up a central institution to which all reports are made. Such an institution is referred to as a financial intelligence unit as its task is to gather intelligence for investigating authorities to base their investigations on. It receives and analyses reported information through the reporting structure and disseminates it to the investigating authorities concerned. A financial intelligence unit is an important

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12 Toms **Banks's concerns regarding measures in South Africa to combat money laundering** at 5.

part of a regulatory scheme as it enhances the communication between the persons or institutions reporting certain information and the authority whose responsibility it is to use that information in the course of the investigation of money laundering and other criminal activities.

3.16. An important issue to consider in this respect is the question of where the **responsibility** for the functioning of a financial intelligence unit should lie. The form and function of a financial intelligence unit will be the determining factor in deciding where its place in the reporting structure should be. The main concern in respect of the positioning of a financial intelligence unit should be its effectiveness, both in receiving reported information and in communicating the relevant information to the investigating authorities concerned.

Criteria for establishing and carrying on certain business forms

3.17. Criteria to determine who may establish and carry on the types of businesses that will fall within the scope of a regulatory framework should be laid down. The objective of such criteria must be to prevent the institutions of the business community from falling under the control of persons whose aim is to abuse those institutions for the purpose of money laundering. These measures are therefore aimed at protecting the integrity of the financial system.

Enforcement

3.18. A regulatory system must be enforced. This means that **offences and administrative sanctions** for the failure to comply with the provisions of the system will have to be introduced. The **responsibility** for applying these enforcement measures must also be determined.

3.19 Apart from this, a **compliance culture** must also be established among the persons and institutions to which the regulatory framework will apply. International experience has shown that the higher the level of co-operation between the relevant authorities and the institutions of the business community the less need there is for strong enforcement measures.

Cost

3.20. Implementing a regulatory framework can be expected to be costly, both to the state and to the institutions of the financial community. The point of departure in this respect should be that the financial burden on the business community should be kept at a minimum. It must be accepted that combatting money laundering is in the national interest of the Republic as it is one of the measures that can be implemented to combat large scale crime, and should therefore be one of the government's responsibilities. However, making the South African financial system as unattractive as possible to criminals as a mechanism to process their ill-gotten gains is also in the interest of protecting the integrity of the business community.

Public awareness

3.21. The success of a regulatory framework is dependent on the co-operation of all interested parties at all levels. Ignorance of the risk of money laundering will cause apathy towards the implementation of an administrative framework. Therefore **general awareness** of money laundering and all that is associated with it is important to the success of such a framework. Public awareness must also be promoted in order to justify spending state revenue on any effort to combat money laundering. The issue as to **responsibility** for the creation of such an awareness will have to be considered

CHAPTER 4

OPTIONS FOR REFORM

4.1. Against the background of the identification of apparent issues in the preceding chapter it is now necessary to consider possible options in relation to each such issue. The same order is followed.

Scope of a regulatory framework

4.2. For a regulatory framework to have as wide a scope as possible consideration should be given to the inclusion of institutions that fall outside the mainstream banking sector. The inclusion of the following must be considered: financial institutions (i.e. banks and building societies), insurers and insurance intermediaries or brokers, securities dealers or brokers, futures dealers or brokers, managers of unit trusts, dealers in bullion, dealers in travellers cheques, dealers in money orders and similar instruments, persons collecting and transporting currency, persons owning or operating casinos and totalisator agency boards, estate agents or property brokers and certain retailers such as dealers in gold, gems, art, vehicles, etc.

4.3. A contentious issue in this regard is whether legal practitioners should be included in the scope of application of a regulatory framework. In the United Kingdom legal practitioners are not included in the regulatory framework as set out in the Money Laundering Regulations.[13] However, the scope of the offences of "Assisting another to retain the benefit of criminal conduct"[14] and "Acquisition, possession or use of proceeds of criminal conduct"[15], to which disclosure of a suspicion that a transaction involves the proceeds of crime is a defence, is broadly structured and includes legal practitioners.

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13 Statutory Instrument 1933 of 1993.

14 Section 93A of the Criminal Justice Act, 1988.

15 Section 93B of the Criminal Justice Act, 1988.

4.4. In Australia the legal profession is not included in the scope of the regulatory framework introduced by the Financial Transactions Reports Act, 1988 (hereinafter referred to as the Financial Transactions Reports Act). However, the Australian Government is considering a proposal to impose a limited reporting obligation upon solicitors.[16]

4.5. The rationale behind the obligation upon legal practitioners to report certain transactions is that trust accounts can be used to facilitate money laundering, thereby involving the lawyer, albeit unwittingly, in some form of criminal enterprise. The same goes for other professionals who operate accounts similar to attorneys trust accounts such as chartered accountants for instance. Consideration should therefore be given to the inclusion of all such professionals in a regulatory framework, at least as far as reporting the movement of cash into and out of their trust accounts is concerned. An exception should, however, be made where an attorney is approached to defend a person charged with a money-laundering offence or involved in proceedings aimed at the issue of a restraint order.[17] In such a case disclosure of any information that may have a bearing on that specific case in which he or she is to represent the client, will be in conflict with the client's best interest which the attorney must promote, as well as the public interest in ensuring unfettered legal advice to accused persons.

Reporting information

4.6. The aim of a reporting system should be to identify transactions involving the proceeds of crime. Such transactions will probably, upon further investigation, appear to be part of a money-laundering scheme. It is therefore not the money-laundering scheme itself that has to be identified and reported, but any transaction that involves illegally derived assets or at least the suspicion that particular assets have an illegal origin.

4.7. Various options exist for criteria to base the identification of transactions to be reported on. The reporting requirement can be suspicion-based, or an amount can be set as a threshold together with certain other criteria. A combination of these methods can also be used as the reporting criterium.

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16 This will require Australian solicitors to report cash transactions exceeding Australian $10 000.

17 The introduction of which was proposed in Working Paper 56.

4.8. In Australia the Financial Transaction Reports Act introduced a range of provisions that relate to the reporting of information in connection with various types of financial activities. The first of these activities is that of cash transactions involving the transfer of amounts of Australian $10 000 or more.[18] Another instance of mandatory reporting is where an electronic fund transfer is made out of, or into Australia.[19] In this case no threshold is set, which means that all international fund transfers must be reported.

4.9. The Australian Act also makes provision for suspicion-based reporting.[20] Where reasonable grounds exist to suspect that information regarding a transaction is relevant to an investigation or prosecution of any offence, or may be of assistance in the enforcement of the Proceeds of Crime Act, 1987,[21] the transaction must be reported. The obligation to report under these provisions applies to so-called cash dealers which include financial institutions, insurers and insurance intermediaries, securities dealers, futures brokers, certain Registrars, trustees or managers of unit trusts, persons dealing with travellers cheques, dealers in bullion, persons collecting and delivering currency, persons operating casinos and bookmakers.[22]

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18 Section 7 read with section 3 of the Financial Transaction Reports Act.

19 Section 17B of the Financial Transaction Reports Act.

20 Section 16 of the Financial Transactions Report Act.

21 Which deals with the confiscation of the proceeds of crime and criminalises money laundering.

22 Section 3 of the Financial Transaction Reports Act.

4.10. The Australian statute furthermore makes it an offence to transfer Australian or foreign currency to the value of Australian $5 000 or more into, or out of Australia, unless the person making the transfer has made a report on it.[23] This provision applies to all persons except a bank, where the currency is transferred on behalf of the bank by a commercial carrier.

4.11. The information that must be reported generally includes the identity of the person making the report, the identity of the person conducting the transaction, the identity of the person on whose behalf the transaction is conducted, the identity of the payee or beneficiary, the nature of the transaction, the amounts involved and the type and identifying number of the accounts that are affected by the transaction.[24]

4.12. The United States of America have a number of provisions dealing with the reporting of information on certain transactions. These are prescribed by Title II of the Bank Secrecy Act as codified under Title 31 of the United States Code. The US provisions are mainly based on threshold reporting. This applies to domestic cash transactions,[25] transactions in respect of the importing or exporting of monetary instruments[26] and transactions with a foreign financial agency.[27] The Secretary of the Treasury is entitled to set the threshold in respect of domestic

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23 Section 15 of the Financial Transaction Reports Act; proposals were made to raise this threshold to Australian $10 000.

24 Schedules 1 to 4 of the Financial Transaction Reports Act.

25 Section 5313 (a) USC 31.

26 Section 5316 (a) USC 31.

27 Section 5314 (a) USC 31.

transactions and transactions with a foreign financial agency. This threshold is set at US$10 000. The threshold for importing and exporting of monetary instruments is set by the Bank Secrecy Act at US$10 000.[28]

28 Section 5316 (a) USC 31.

4.13. The Bank Secrecy Act also makes provision for suspicion-based reporting. Any financial institution and any person associated with a financial institution must report any suspicious transaction.[29] Institutions or persons making a report under this provision are protected from liability under any law.[30]

4.14. The system for reporting in the United Kingdom is purely suspicion-based. The Criminal Justice Act, 1988, creates *inter alia* the offences of assisting a person to benefit from crime[31] and acquiring another's proceeds of crime.[32] In both cases the disclosure of a suspicion that the money involved is derived from criminal conduct excludes liability for the offences.[33]

4.15. It can be accepted that the amount of information reported by means of a threshold-based system will by far exceed the amount of information reported by means of a suspicion-based system. The success of a threshold-based reporting system is therefore absolutely dependant on the existence of a body or bodies that can manage the reported information effectively, either by analysing and distributing such information or by investigating it. The setting of a threshold should be coupled with other criteria such as the transaction being a cash transaction or a foreign exchange transaction. If this is not done the burden on both the reporting body and the body to whom reports must be made, will become intolerable. The overburdening of the available resources is indeed the main disadvantage of a threshold-based system of reporting.

4.16. Suspicion-based reporting requires a certain level of training and insight of the persons to whom it applies. Otherwise they will not be able to notice irregular characteristics that should trigger their suspicion about a

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29 Section 5318 (g)(1) USC 31.

30 Section 5318 (g)(3) USC 31.

31 Section 93A of the Criminal Justice Act, 1988.

32 Section 93B of the Criminal Justice Act, 1988.

33 Sections 93A(3) and 93B(5) of the Criminal Justice Act, 1988.

transaction. It is doubtful whether the South African society in general, and the personnel in financial institutions especially, have the knowledge or the inclination to be on the lookout for transactions involving the proceeds of crime. Responsible managers should therefore acquaint themselves of the fact of money laundering and how it affects the type of institution in which they are engaged. They should also make sure that their staff, especially the frontline staff who deal with the customers, are acquainted with the sort of circumstance that ought to appear suspicious and their legal obligations in this regard. The development of guidelines and training material specifically aimed at each type of organisation required to make reports on suspicious transactions will also go a long way in eliminating this problem.

4.17. Ideally a combination of threshold and suspicion-based reporting should be implemented. Where a threshold is introduced one can expect money launderers to structure their transactions to avoid exceeding the threshold. A threshold should therefore be set at a low amount so that the money launderer will find it too frustrating and time consuming to structure a large number of small transactions in order to effect a money-laundering scheme without drawing the attention of a reporting body. At the same time the threshold should not be so low that the reporting system becomes clogged with reports of insignificant transactions. An important factor that must be kept in mind when a cash threshold for reporting in South Africa is considered is that the bulk of South African users of the financial system make use of cash transactions. It can therefore be said that the South African financial system is largely cash driven. It is suggested that the amount of R30 000 could be a realistic cash threshold for South Africa to start with.

4.18. One of the expected consequences of the introduction a threshold is that it tends to alter the behavioural pattern of criminals who want to launder their illegally derived proceeds. Such criminals will usually attempt to structure the transactions by means of which their criminal proceeds are placed in the financial system in order to avoid the threshold. In doing so they may perform transactions that do not make any economic sense at all and will therefore immediately appear suspicious. The persons upon whom the obligation to report rests, should be made aware of the possibility of structured transactions and should be obliged to report any suspicion of such transactions. Other suspicious transactions which may not fall within the category for which reporting is mandatory, are transactions that appear unnecessarily complex, unusual transactions or periodic transactions that form a peculiar pattern. In connection with such transactions suspicion-based reporting will have to compliment the mandatory reporting of certain types of transactions above a certain threshold. With regard to a reporting requirement in general, the responsibility of financial intermediaries will be to set up internal policies and procedures to enable them to comply with the legal requirements.

4.19. The types of transactions that should be reported are all transactions where amounts of cash exceeding the proposed threshold are transferred, all transactions where funds of any amount are electronically transferred across our borders, all transactions involving the import or export of amounts of cash exceeding the proposed threshold, all currency exchanges exceeding the proposed threshold and any transaction that appear suspicious regardless of the type of transaction.

4.20. The information that should be reported should be sufficient to enable investigating authorities to identify the person(s) involved in the transaction, the beneficiaries of the transaction and the nature of the transaction. Details of account numbers, the true holders of accounts (not their agents or nominees), the payee or beneficiary, the form of payments or transfers as well as the origin and destination of funds should be reported.

4.21. The persons or institutions making reports, either voluntarily or under the regulatory requirements should be protected from any liability for breach of confidential relationships. This protection should override any privilege or obligation to secrecy or confidentiality irrespective of the basis for its existence.

4.22. The protection for persons reporting information, especially in respect of suspect transactions, should go further than protection against liability for a breach of confidentiality though. The identity of such a person and the fact that he or she has made such a report should be kept absolutely confidential. One possibility to accomplish this is to render the fact that a report has been made as well as the basis for the report inadmissible as evidence. This will mean that the investigating and prosecuting authorities will not be able to base their case on the fact that a report was made or that the person who made the report was suspicious of the relevant transaction. As such, the reporting of the relevant transaction will only serve as intelligence to identify an occurrence that should be investigated and will not in itself provide evidence of any criminal conduct. It will then be up to the investigating and prosecuting authorities to build their case upon the relevant bank records and other evidence they may find.

4.23. Another possibility is to provide for the submission of an affidavit by an official of the body to which a report is made[34] stating that such a report was received without identifying the source of the report. Such an affidavit may then provide conclusive proof of the fact that a report was made in a certain instance. It will, however, not serve to provide evidence of the facts that gave rise to the forming of a suspicion by the person who made the report. The investigating and prosecuting authorities will still have to build their case without relying upon the facts which formed the basis of the suspicion. It is suggested that affording this type of protection to a person making a report will be necessary in order to ensure the co-operation of the persons to whom this requirement will apply. Such protective measures will therefore be in the interest of the success of the regulatory framework as a whole.

Record keeping

4.24. The Australian Financial Transactions Reports Act requires that records be kept of all information in respect of an account and a signatory to an account.[35] This includes all documents provided to the institution in question. These records must be kept for a period of at least seven years after the business relationship has ended.[36]

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34 Such a body is referred to as a financial intelligence unit and is discussed in paragraph 54 *infra*.

35 Section 23 of the Financial Transactions Reports Act.

36 *Ibid.*

4.25. In the United Kingdom records of information on the identity of customers as well as on all transactions must be kept for at least five years after the account has been closed or the transaction has been finalised.[37]

37 Regulation 12 of the Money Laundering Regulations SI 1933/1993.

4.26. The basis of an effective record keeping system is information that identifies the clients of the institution concerned. Records containing such information should therefore be kept by the relevant institutions. The type of information that should be kept in such records will be discussed later in this document.[38]

4.27. Records should also be kept of information on specific transactions. This information will include the identity of the person undertaking the transaction, the nature of the transaction, the account details from which funds were paid or the form in which funds were transferred, the form of the instruction or authority and information on post transaction contact with the customer. In respect of electronic transfers of funds it is of particular importance to keep a record of the location from where the funds are transferred and the destination of the funds.

4.28. It is suggested that records in respect of customer identification should be kept for a period of five years after the business relationship with the customer has ended. Records in respect of transactions should be kept for a period of five years after the transaction was completed.

Business conduct

4.29. This component of a regulatory scheme entails that all institutions must be required to formulate and implement certain internal policies that are based on responsible business conduct. Care should be taken in any legislation on this topic not to be too prescriptive of the contents of the internal policies which these institutions are required to adopt. The contents of internal policies cannot necessarily be the same for all the types of institutions to which this requirement will apply. These policies will therefore have to be developed in conjunction with the various organisations to which they will apply.

Know your customer

4.30. The most important of such policies is a so-called know your customer policy. A know your customer policy means in the first place to be able to identify the customer effectively. This means that anonymous accounts, accounts held under a false name or pseudonym and accounts held by nominees as well as transactions done through agents where the beneficial owners or principals are unknown to the institution should not be allowed.

38 See paragraphs 45 to 50 *infra*.

4.31. The Australian Financial Transactions Reports Act provides that information identifying the account and account holder must be obtained when an account with a so-called cash dealer (which includes all types of financial institutions) is opened. If the required information is not received by the institution, such an account is blocked as soon as the balance in the account reaches a certain level for the first time after the opening of the account.[39] Verification of the required information is done by the financial institution under the Financial Transactions Reports Regulations.

4.32. The British Money Laundering Regulations also require that information identifying a prospective customer is obtained.[40] This only applies to new and one-off transactions and business relationships. The information should be obtained as soon as possible and if it has not been obtained within a reasonable time the business relationship or transaction may not proceed.[41] The institution concerned must furthermore verify the information obtained from the customer.[42]

4.33. The information that may be needed to identify a customer includes his or her name and identity number, if he or she is a natural person, or the registered name and registration number if it is a corporate body, and a physical address. In the case of a corporate body the persons authorised to act on the behalf of the corporate body as well as the directors thereof should be identified. Where an account is held, or a transaction done, by a business entity that is not a corporate body, the identity of the person conducting the business should be established. This information should be obtained at the time when the prospective client applies to enter into business with the institution.

4.34. Verification of a person's identity, including the physical address given, must be done by the institution in question. In the case of the identity of a customer this can be obtained by production of an identity document or the constitution of a corporate body. The address of a customer can be more difficult to verify, but should nevertheless be required. This may be done by checking the Voters Roll, checking a telephone directory, requesting sight of a

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39 Section 18 of the Financial Transactions Reports Act.

40 Regulations 7 and 9 of the Money Laundering Regulations SI 1933/1993.

41 Regulation 7 of the Money Laundering Regulations SI 1933/1993.

42 Regulation 11 of the Money Laundering Regulations SI 1933/1993.

municipal bill or by a personal visit. Copies of all documents presented to the institution as means of verification should be made and kept with the other records.

4.35. If the customer is unable to provide satisfactory information in respect of his or her identity or such information cannot be verified, the business relationship should be suspended until the information can be given or verified

Identification and reporting information

4.36. A regulatory system should prescribe the minimum criteria with which a policy for the identification and reporting of transactions should comply. Rigid provisions should not be prescribed so that each institution can model such a policy to fit in with its organisational structure. One aspect that should be prescribed though is the appointment of a central office or official in the institution who will be charged with making the reports to the relevant body or bodies. Such an office or official may be referred to as a reporting office / official.

Record keeping

4.37. An organisation should implement a policy on procedures for effective record keeping. Particular attention should be given to procedures to capture the relevant information in a form that will render it easily accessible and useful to law enforcement agencies, but will at the same time protect the privacy of the persons concerned, to unauthorised use of the stored information. Such a policy could be incorporated with a policy on the reporting structure within the organisation.

Education and training

4.38. Another important policy that financial institutions should adopt is one of education and training. Under the British Money Laundering Regulations all institutions are required to set up an official education and training policy to make employees aware of money laundering, the importance of identification, record keeping and reporting as well as the legal requirements in this respect.[43]

4.39. The formulating and the effective implementation of an education and training policy in South African institutions should be required as part of the regulatory system. This should be aimed at making members of staff at all levels aware of the phenomenon of money laundering and the effects thereof. Staff should also be informed of the relationship between money laundering and the proceeds of crime and should be guided as to the circumstances which should raise suspicion.

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43 Regulation 5 of the Money Laundering Regulations SI 1933/1993.

Financial Intelligence Units

4.40. Various options exist in respect of both the form and function of an institution that is concerned with gathering and disseminating information reported through a reporting structure. In Australia the financial intelligence unit is named Australian Transaction Reports and Analysis Centre (AUSTRAC) and it was instituted by the Financial Transactions Reports Act.[44] The American version of such an institution is the Financial Crimes Enforcement Network (FINCEN) and its equivalent in the United Kingdom is the National Criminal Intelligence Service (NCIS). In Italy information is reported to the Bank of Italy where it is placed on a national database. This information is collected and analysed by the Italian Exchange Office (UIC) which is a satellite of the Bank of Italy.[45]

4.41. The financial intelligence unit can be attached to a government department or to the central bank, or it can function independently from a specific organisation. Each of these scenarios has certain advantages and disadvantages. AUSTRAC is attached to the Office of the Attorney General but functions virtually independently. FINCEN is attached to the US Treasury which has very strong law enforcement branches. NCIS functions as an independent organisation. These multi-disciplined institutions all incorporate sections of their respective law enforcement communities which are represented in the financial intelligence units. The Italian financial intelligence unit is, however, connected to the central bank and provides its information to the so-called tax police who carry out the money-laundering investigations.

4.42. The functions and powers of the financial intelligence unit will have to be carefully considered when the placement of the financial intelligence unit is decided upon. If the task of the financial intelligence unit is to include the policing of the enforcement of the regulatory system it should be attached to a government department. This will have the advantage of the availability of the necessary human and other resources in the relevant department. However, in the South African context we are faced with the problem of a multitude of regulating authorities for the various branches of the financial system. A separate division within the financial intelligence unit that will be able to liaise closely with the various financial regulators can perhaps be considered.

4.43. Another alternative is to attach the financial intelligence unit to the central bank as there already exists a channel for communication between the banking sector and the central bank. A major problem that may, however,

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44 Section 35 of the Financial Transactions Reports Act.

45 Cinelli *et al* at 7.

be experienced in this respect is that it may exclude financial intermediaries outside the banking sector, who have little or no contact with the central bank, from the reporting structure. Communicating the relevant information to the various investigating authorities, such as the different specialist branches of the South African Police Service or the Office for Serious Economic Offences may also suffer as there are no established links to promote co-operation between the central bank and the law enforcement community.

4.44. The main benefit to be gained from the information provided by a financial intelligence unit is that it can facilitate money trail investigations of offences as an alternative to the traditional investigation of the primary criminal conduct itself. The worth of a financial intelligence unit will therefore lie in its ability to promote the idea that money trail investigation is a sound law enforcement approach. A financial intelligence unit that functions independently may be in a better position to distribute the relevant information among the different authorities whose task it will be to investigate the information with a view to instituting criminal proceedings. This will serve to enhance the credibility of the financial intelligence unit within the law enforcement community and to have the unit accepted as part of that community. Such an independent financial intelligence unit will not be charged with policing the enforcement of the anti-money-laundering policy.

4.45. The information distributed by the financial intelligence unit can relate to any number of offences and will not necessarily be limited to money laundering. To cope with this variety of information effectively a section consisting of representatives from the interested parties in the law enforcement community may be set up as part of the financial intelligence unit.

4.46. A feature of all the financial intelligence units that operate in the various countries is the sophisticated software systems they utilise for analysing the reported information. The Italian system is a good example.[46] It is named Generator of indices of anomalies in suspect operations (Gianos) and it enables the identification of atypical or unexpected transactions by clients. This is done by analysing the processed information stored in a database. The types of transaction that may be classified as anomalous or unexpected are transactions involving disproportionately high amounts, economically unjustifiable transactions, numerous transactions by one client that appear similar, frequent transactions on the behalf of third parties who never appear in person, cash transactions, short term transfers of funds between accounts and currency exchanges. There are various other software packages developed for this type of analysing of reported information and drawing the necessary conclusions about transactions and links between various accounts at different institutions and persons operating such accounts. It must, however, be remembered that this is an aid to identify transactions that are sufficiently suspicious to warrant investigation, and is not aimed at replacing the investigating authority.

Criteria for establishing and carrying on certain business forms

46 Cinelli *et al* at 32 and 33.

4.47. The last component of a regulatory system is the laying down of criteria to determine who may establish and carry on a business in the financial sector. These criteria will of course not be the same for each type of business. What such criteria should be will therefore have to be determined in conjunction with the various types of businesses that will fall within the scope of the regulatory framework. An example is to lay down requirements for ownership structures of, and share holdings by financial institutions. These types of requirements are set by the Italian regulatory system in terms of which all financial intermediaries must be enrolled in a register kept by the central bank.

Enforcement

4.48. To provide for the enforcement of a regulatory framework offences and penalties will have to be introduced. The use of the criminal law in this respect may, however, not be sufficiently effective to ensure the enforcement of the types of measures discussed in the previous paragraphs. For this reason administrative sanctions will probably have to be relied upon. Possible options in this respect are the revoking or suspension of licences or removal from the relevant registers.

4.49. A practical problem is the extent to which those contemplated for inclusion in a regulatory framework are themselves regulated through registration or some other system by which their existence and scope of operations are recorded. In respect of those institutions that are overseen by regulators or supervisors the enforcement of the regulatory system can be readily facilitated. A suitable government authority could be commissioned with the policing of these measures in respect of the institutions that are not regulated or supervised. In the absence of such an authority the normal law enforcement authorities will have to see to the enforcement of the regulatory system through the medium of the criminal law.

4.50. Emphasis should, however, be placed on fostering a culture of co-operation between the business community, the financial intelligence unit and the various law enforcement agencies. Experiences in other jurisdictions have shown that promoting such a spirit of co-operation is far more effective than strong handed enforcement in ensuring compliance with a regulatory framework.

4.51. Financial rewards and incentives for co-operation with investigating authorities that lead to successful investigations of money laundering and other offences may also be considered. This will, however, have to be balanced with the interests of other interested parties such as persons who suffered loss as a consequence of the offence in question.

4.52. The successful implementation of a regulatory scheme will also require self-regulation by the business world and its determination to prevent its institutions from becoming associated with criminals or being used as a channel for money laundering.

Cost

4.53. The financial burden of implementing and maintaining a regulatory scheme must as far as possible be borne by the State. An option which has been implemented in the United States of America is to create an "asset forfeiture fund". Such a fund is then financed with the confiscated proceeds of crime, which include the proceeds of money laundering itself. The confiscation of the proceeds of crime has already been proposed by the Commission[47] and consideration should be given to channelling such proceeds into an "asset forfeiture fund". The funds accumulated in such a fund can be applied to defray the cost of implementing and maintaining an administrative framework as well as to facilitate investigations, prosecutions and compensation for victims of money-laundering schemes.

Public awareness

4.54. Awareness of money laundering can be promoted in a number of ways such as the use of the printed and electronic media and the launching of campaigns in the form of seminars or similar conventions to expand the general awareness of money laundering and its dangers. The options in respect of the responsibility for creating such an awareness tie in with the options for the place of a financial intelligence unit in the reporting structure and the enforcement of the regulatory framework. This responsibility could be part of the function of a financial intelligence unit especially if such a unit will also be responsible for policing the enforcement of the administrative framework. Where the financial intelligence unit functions independently the responsibility for creating public awareness can rest with either the financial intelligence unit or the authority that will enforce the administrative framework.

47 Chapter five of the proposed Proceeds of Crime Bill in Annexure B of The Report on International Co-operation in Criminal Matters.

CHAPTER 5

THE WAY AHEAD

5.1. It is suggested that the issues and options outlined above ought to be debated thoroughly before any particular direction is embarked upon. Based on the outcome of such discussions legislation in respect of a regulatory framework to combat money laundering will be proposed. The comments of all parties who feel that they have an interest in this topic or may be affected by the type of measures discussed in this paper are therefore of vital importance to the Commission. All respondents are invited to indicate their preferences in respect of the options examined and to indicate whether there are other issues and/or options that must be explored. All the relevant role players and institutions that are likely to be affected by regulatory measures should participate in this debate.

5.2. To facilitate a focussed debate, respondents are requested to formulate crisp submissions with the following in mind:

is there a need for regulatory mechanisms to meet the problem of money laundering;

is it agreed that the principal issues are those set out in this paper, and

what, specifically, is proposed in relation to those issues (or any further issues) as an effective basis for reformatory legislation?

5.3. The Minister of Justice has recently indicated that the matter is regarded as one of some urgency. The surge of foreign investment in recent months in South Africa, and its return to full participation in the international community underscores this fact. Interested parties are accordingly requested to consider this paper and to respond before 24 May 1996.